

Are truly global standards achievable?

Ian Mackintosh, Vice-Chairman of the IASB, Johannesburg, 13 August 2014

I am pleased to welcome you to the IFRS Foundation conference. It is always a pleasure to return to Johannesburg. It is little more than a year since I was here to attend the July 2013 meeting of our Trustees. I would like to thank Terence Nombembe, CEO of SAICA, the South African Institute of Chartered Accountants, for his opening remarks. The IASB and SAICA have a long track record of extensive co-operation. South Africa was one of the first countries to adopt International Financial Reporting Standards, or IFRS for short, as well as the *IFRS for SMEs*. South Africa has always taken our Standards in full, and without modification. You set a fine example for the rest of the world.

In return, the IASB listens very carefully to South African views throughout the IFRS development life cycle. We are privileged to have Wiseman Nkuhlu, South Africa's first black chartered accountant and an inspirational figure to us all, as one of our Trustees. Darrel Scott serves as a Member of the IASB and Bruce Mackenzie has recently been appointed to the IFRS Interpretations Committee. We have many South Africans serving on the staff and our various advisory bodies. SAICA is also very effective in making sure South Africa's views are communicated effectively on the international stage.

According to the conference programme, I am to set out the future of financial reporting in less than 30 minutes. That is some task. Perhaps I will leave it to others to describe different aspects of that future, such as the IASB's work programme, integrated reporting and the many other important topics that are shaping the future.

Instead, I would like to use my time this morning to discuss a fundamental question that underpins any discussion on the future of financial reporting. That is, whether a single set of global standards is achievable? Is it really possible to create a global language of financial reporting, that can be applied on a globally consistent basis in every country of the world, developed and emerging economies alike?

This may seem a strange question to ask when more than 100 countries already mandate the use of IFRS, including of course South Africa. Yet, despite this progress, there are several large countries that have yet to decide whether and how to commit to IFRS, and decisions by policymakers in those countries are largely shaped by their views on the achievability of global accounting standards.

The case for global standards

Let's start with the demand side of the equation. The recent financial crisis provided a real-world example of the globally interconnected nature of national capital markets. When the crisis began back in 2007, the International Monetary Fund reported that the US sub-prime crisis, as it was known back then, was containable and posed little threat to the global economy¹. At that time, few policymakers realised the extent of interconnectedness and mutual dependence between advanced economies, while decoupling theory between developed and emerging economies was all the rage. Post-crisis, policymakers are all too aware of how every national capital market in the world, even the largest, functions as little more than a satellite of the global financial system.

¹ *Fallout from US subprime market 'limited'*, Chris Giles, April 11, 2007, www.ft.com

None of this is a surprise to multinational companies or investors, who have been well aware of the opportunities presented by the global marketplace for many years. For example, last week² the international law firm Baker & McKenzie reported that the level of cross-border M&A transactions now exceeded pre-crisis levels. The report states that “powerful macroeconomic and political forces continued to provide impetus to globalisation, and companies around the world were driven by their strategies to move into new markets and jurisdictions.” It is worth noting that 40 per cent of these international M&A transactions were originated from North America.

Consistent with this analysis, McKinsey & Co recently published their own research which showed that more than one-third of all financial investments are in fact international transactions. Moreover, they concluded that the total volume of global flows could triple in the next decade, powered by a combination of rising prosperity, the participation of the emerging world and technological progress³.

These reports, and many others like them, paint a picture of ever-increasing global transactions, undertaken by companies operating in a global marketplace, backed by investors seeking global opportunities and diversification. Against this backdrop, it is increasingly difficult to see different and often incompatible national accounting standards as anything other than a legacy of a bygone era. They add cost, complexity and translation risk to companies and investors operating in today’s global marketplace.

Progress towards global accounting standards

Now let’s look at the supply side. Efforts to achieve global accounting standards began in 1973 with the creation of the International Accounting Standards Committee, or IASC—the predecessor body to the IASB. That initiative was led by accounting bodies in nine of the largest economies working together to reduce differences in their national accounting standards against an internationally agreed benchmark. Twenty-five years later, the accounting standards of those countries remained as incompatible as ever, and none required the use of international standards. The problem was this. Each country took only the parts of the international standard that were consistent with the preferences of their own standard-setting body. Different countries had different preferences, so international comparability went out of the window and the quality of the standards used at a national level remained inconsistent.

That is one of the main reasons why the IASC was restructured to become the IASB, and the mission evolved from similar national standards to everyone adopting verbatim the same standard around the world. The old model did not work and we had to change to the new, IASB, model.

The model of a single set of standards, applied on a globally consistent basis, has proved to be a remarkable success. Since the IASB began its work in 2001, we have gone from no major economies requiring the use of IFRS to more than 100 countries having made the transition from national standards to IFRS. The IFRS Foundation recently published the findings of a major research project led by Paul Pacter, a former Member of the IASB. That research, verified by the relevant jurisdictional authority in each of the 130 countries surveyed, showed that more than 100 countries, or 81 per cent of those surveyed, now mandate the use of IFRS for all or most public companies.

² Cross-Border IPO Index (2104), Baker & McKenzie, www.bakermckenzie.com

³ Global flows in a digital age (2014), McKinsey&Company, www.mckinsey.com

Almost all of the remaining countries that have yet to require the use of IFRS for domestic purposes already permit its use in certain circumstances. Both India and Japan have for some time permitted voluntary use of IFRS, while the Japanese government views encouraging greater use of IFRS as a fundamental element of its recently announced growth strategy. Many of China's largest companies report using full IFRS for the purpose of their dual listings in Hong Kong, while the United States has since 2007 allowed non-US companies to report using IFRS as issued by the IASB. Furthermore, investors in these countries are often prolific users of IFRS-based financial statements.

As I have already said, global adoption of IFRS is not yet complete. However, the quality of IFRS has been validated by more than a decade of use by both advanced and developing economies. And IFRS is already used extensively by the remaining jurisdictions that have not yet mandated its use.

This evidence indicates that global standards are both desirable, achievable and in my view, inevitable. As economic globalisation continues apace, so too will the force of the arguments in favour of IFRS adoption within these remaining jurisdictions. That is why I believe that we should not fret too much about the timing by which we get every jurisdiction onto global standards. To quote Paul Volcker, legendary Chairman of the US Federal Reserve and the first Chairman of our Trustees, "Ultimately, this will get done"⁴.

'Adoption' and 'convergence'

It is perhaps worth spending a few minutes discussing what 'getting this done' actually means. I frequently see the terms 'adoption' and 'convergence' used interchangeably, when they are two very different things.

Adoption entails the application by a jurisdiction of IFRS in full. It implies a continuing commitment by all adopters to contribute to the development of IFRS into the future.

Convergence, on the other hand, has been a perfectly valid strategy for bringing different sets of accounting standards into close alignment, but as the 2011 Trustees' Strategy Review made clear, convergence cannot be a substitute for adoption.

The objective of the decade-long convergence programme with the US was to work together to improve US GAAP and IFRS, and in doing so to bring the standards closer together, thereby making an adoption decision easier and more acceptable.

That programme has had some success, and also some failures. In many important areas, the IASB and the US have managed to align disparate requirements, such as in the accounting for business combinations, fair value measurement and most recently, in the all-important Revenue Recognition project. These achievements should not be overlooked, because they have improved the quality and comparability of financial information around the world.

At the same time, we have also seen failures in convergence in other important areas, such as in the Financial Instruments project. In various aspects of this project, including the netting of derivatives, loan loss provisioning and in the classification and measurement of financial instruments, we have seen the boards sit around the table and reach a converged outcome, only to see that agreement melt away.

⁴ IFRS as Global Standards: a Pocket Guide (2014), www.ifrs.org

It's not altogether surprising that this happens when you have two boards with different imperatives—one prioritising the feedback from their national constituents and the other striving to understand and carefully balance feedback from around the world, including the US. Where that feedback is consistent, then convergence follows. Where it is not, then convergence generally fails, as in the Financial Instruments project. This was the structural fault with the old IASC approach to international standard-setting, and it is the same structural fault that exists with convergence today. Independent boards with different imperatives considering finely-balanced questions of judgement have a nasty habit of reaching different, and often incompatible conclusions.

Moreover, much like a football team that always plays the same formation, our critics have learned how to use convergence to play the boards off against each other, and by doing so to delay or derail much-needed improvements to financial reporting. The strategy of 'divide and conquer' pre-dates the Roman Empire, and has become an effective tool for defeating efforts to achieve convergence. Pick off one or other board to deviate from an agreed position, and then argue that a lack of convergence undermines the benefits of the project.

Moreover, there are many dangers in pretending that converged national standards can serve as a substitute for global standards. The devil is always in the detail. Small differences in accounting requirements can have a substantial effect on reported performance. We should not expect investors and other users of financial statements to have to understand differences buried in thousands of pages of accounting literature in order to compare the financial performance of, say, Ford, Hyundai, SAIC, Toyota and Volkswagen.

These are the reasons why full convergence can probably never be achieved, and why adoption of IFRS is the only viable approach to achieving global accounting standards. There really is no shortcut to meeting the challenges of economic globalisation, other than by providing a single set of high quality, global accounting standards. That is what IFRS does.

Working with standard-setters

This quality and global applicability does not come about by chance. The IASB has refined its processes over more than a decade to ensure IFRS is both of high quality and capable of being applied on a globally consistent basis. The nations of the world need to have confidence in the IASB's processes, judgement and outreach to ensure the necessary quality is maintained.

Much of the success of IFRS has come about as a result of the commitment of the global standard-setting community to get behind the IASB and to dedicate resources around the world to the achievement of high quality, global standards. For example, in the days of IASC, the largest national accounting standard-setters would meet separately within a group known as the G4+1. Members of this group, which was made up of the national standard-setting bodies from Australia, Canada, New Zealand, the United Kingdom, and the United States, would meet regularly to discuss efforts within their own jurisdictions and to agree common positions in their dealings with the IASC.

However, the creation of the IASB in 2001 with a mission of creating a single set of global standards provided the G4+1 members with a vehicle to allow them to stop meeting separately, and to throw their collective resources into the IFRS project. The G4+1 disbanded in 2001 because of, to quote the communiqué itself, "the possibility that continuing the activities of the G4+1 might divert resources that otherwise could be used to support the IASB's efforts to achieve convergence of

standards worldwide”⁵. That level of co-operation with jurisdictional authorities has been a vital ingredient in the success of IFRS and its ability to provide all economies with a high quality standard that can be applied on a globally consistent basis.

In the last two years, we have further deepened this co-operation with jurisdictional standard-setters with the creation of the IASB’s Accounting Standards Advisory Forum, or ASAF. Membership of the ASAF includes representatives from national or jurisdictional authorities from around the world, with African membership of the group currently provided by Kim Bromfield from the South African Financial Reporting Standards Council, supported by PAFA, the Pan African Federation of Accountants.

The ASAF provides a platform for national and regional representatives to discuss technical views on important topics with the IASB in an open and transparent manner. The ASAF meets in public, with all papers published and available on the IFRS website. Any ASAF member can present his or her proposals for discussion, with that set of proposals then subject to peer review by other ASAF members. Having attended every ASAF meeting since it was formed, I can testify that these are incredibly useful discussions and really do help to inform the IASB as well as others about the different views around the world and those discussions do have an impact on our decisions.

When the ASAF was established we agreed to conduct a review of all aspects of ASAF and its operations two years after the established of the group. As that review approaches, we will be reaching out globally to seek views on how this important group can be improved, for the benefit of all constituents. As the G4+1 concluded in its final communiqué, it is important that the global standard-setting community continues to focus its limited resources on advancing our work to achieve the long-term vision of a single set of global accounting standards. The upcoming review will provide a mechanism to ensure that this continues to be the case.

Conclusion

Ladies and gentlemen, in these brief opening remarks I have offered my views on how economic globalisation created the need for global accounting standards. How the continued melding of national capital markets into one big, globally interconnected market presents a compelling case for a global language of financial reporting.

I have talked about how using convergence to achieve globally comparable standards cannot provide that language, and how the IASB is working with the entire standard-setting community to advance the quality and use of IFRS around the world.

Global standards are not only achievable, but an inevitable consequence of continued economic globalisation. More than four-fifths of countries now mandate the use of IFRS, while momentum towards IFRS adoption continues in many of the remaining countries, as evidenced by recent developments in India, Japan and Singapore. IFRS has become the de-facto global language of business, and over time, the IFRS map of the world will be complete.

I thank you for your time, and wish you a successful conference.

⁵ G4+1 Communiqué (2001), <http://www.iasplus.com/en/binary/resource/g4final.pdf>