

Korea and IFRS

Michel Prada, International Seminar with Mr. Michel Prada, Chairman of the Trustees of the IFRS Foundation, November 2014

Introduction

Ladies and gentlemen, distinguished guests, it is a great pleasure for me to be with you this morning in Seoul. I am grateful to the Korean Accounting Institute and the Korea Accounting Standards Board, or KASB, for hosting this breakfast meeting. In particular, I would like to acknowledge Jee In Jang and the other members of the KASB for their excellent co-operation. The high quality work of the KASB is admired by accounting standard-setters around the world, but especially by the IASB.

Korea is well represented across the IFRS Foundation and on the IASB. I am honoured to have Duck-Koo Chung, a former Minister for Commerce for Korea, to serve alongside me as a Trustee, while Chungwoo Suh has served as a Member of the IASB since 2012. Je-Yoon Shin, Chairman of the Financial Services Commission of Korea has recently been appointed to our Monitoring Board. We also greatly appreciate Korea's regional leadership through the work of the Asian-Oceanian Standard-Setters Group, as well as its significant contribution to the IASB's Emerging Economies Group.

I understand that I will speak for around 20 minutes, followed by a question and answer session. During that time, I will begin by setting out why the case for a single set of global accounting standards has never been stronger. I will then update you on progress towards that goal. Finally, I will talk a little about our plans during 2015 to review the structure and effectiveness of the IFRS Foundation in order to meet the challenges of being a global accounting standard-setter.

The case for global accounting standards

First, the case for global standards. In many ways, Korea is the perfect place to talk about global accounting standards because Korea has been one of the major beneficiaries of economic globalisation. Successive Korean governments have undertaken the necessary structural reforms to allow your export-led economy to flourish. Today, Korean companies are world leaders in the global economy, while Korea continues to attract significant Foreign Direct Investment from around the world.

An important step on the path to establishing this business-friendly environment has been Korea's decision to switch to International Financial Reporting Standards, or IFRS. As a result of that decision, investors around the world are entirely familiar with the financial statements of Korean companies. Korean multinational conglomerates such as Hyundai, LG, POSCO and Samsung are now able to use the same reporting framework across tens if not hundreds of international subsidiaries and joint ventures.

Indeed, the KASB's recent review of academic literature on the economic consequences of the move to IFRS reached some positive conclusions.¹ The review concluded that the introduction of IFRS has led to an improvement in the quality of earnings, as well as improving comparability between different Korean companies as well as their international peers. Analysts' estimates became more accurate and the cost of capital for Korean companies has decreased. Of course, there have been challenges in the transition to IFRS, but the medium- to long-term benefits of switching to IFRS can be significant.

The findings of this review are consistent with the experience of other jurisdictions that have adopted IFRS. For example, the Institute of Chartered Accountants of England and Wales has just completed its own literature review of 170 academic studies on the use of IFRS in the European Union. The findings of this review were also encouraging.

These reviews show that IFRS-compliant financial statements provide investors and others with very high quality information. But more than that, they point to the benefits that flow from countries around the world speaking the same global language of financial reporting.

And that is important. Because, according to McKinsey & Co, more than one-third of all transactions around the world are cross-border transactions.² 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 progress.

According to the international law firm Baker & McKenzie, the level of cross-border M&A transactions is now back above levels last seen before the financial crisis.³ Their research 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'.⁴ As I said before, Korea is a great example of a country that has been able to harness these powerful economic forces.

As the level of economic globalisation and financial interconnectedness continue to grow, so does the case for a global language of financial reporting. In a world where investor and investee are sitting on opposite sides of the world, it makes little sense to maintain different and often incompatible sets of national accounting standards. National standards add friction and translation risk to the global financial system. They add cost to companies and they impede the efficient allocation of capital. These are some of the reasons why the G20 Leaders, the International Monetary Fund, the World Bank and IOSCO have each

¹ Korea Accounting Standards Board (2014), *Economic Consequences of IFRS Adoption in Korea: A Review of Literature*, www.kasb.or.kr

² McKinsey & Company (2014), *Global flows in a digital age*, www.mckinsey.com.

³ Baker & McKenzie (2014), *Cross-border IPO index*, www.bakermckenzie.com.

⁴ Baker & McKenzie (2014), *Why Cross-Border M&A is Thriving*, www.bakermckenzie.com.

supported the work of the IFRS Foundation and the IASB, and they have also supported our mission of global accounting standards. Indeed, several weeks ago the Financial Stability Board reaffirmed the continued relevance and importance of global accounting standards.

Much of this international support comes from a desire to create a stronger, more resilient financial system in the wake of the global financial crisis. However, our work is also highly relevant to policy-makers around the world who are looking to capital markets to support continued economic growth.

For example, in Europe much of the financing of companies has traditionally come from banks, with a smaller proportion of companies turning to the capital markets. With many European banks now focusing on building up their capital reserves, the European Commission is looking to create a 'Capital Markets Union' and in doing so, to achieve a better balance between bank-based and market-based financing.

Of course, the success of this initiative will depend on whether international investors are prepared to increase their investment allocation in European markets. And that is where IFRS comes in—because in Europe, as in Korea, IFRS provides international investors with a marque of trust in the quality of financial reporting. That trust in financial reporting is essential if investors in capital markets are to be encouraged to step in to promote continued economic growth.

Progress towards global standards

So, if the objective is a single set of high quality, global accounting standards, how are we doing against meeting that objective? Pretty well, against most measures.

The IFRS Foundation recently completed a major research study on the use of IFRS around the world. The study began by surveying national standard-setters such as the KASB about their use of IFRS. We then supplemented the survey results with information from the international accounting firms as well as securities regulators from around the world. Finally, we validated our findings with the relevant public authority from each jurisdiction. As a result of this thorough methodology, we have a high degree of confidence in the quality of the data.

To date we have researched 138 countries that together account for 96 per cent of worldwide Gross Domestic Product. Our research showed that of those 138 countries, 114 already require the use of IFRS for all or most public companies. In other words, four-fifths of countries now mandate the use of IFRS. Most of those countries, including Korea, have adopted IFRS in full and without modification. Because of that, full adopters such as Korea provide an exemplary role model in the region, but also internationally.

As of today, 52 per cent of Fortune Global 500 Companies report using IFRS compared to 29 per cent reporting using US GAAP. IFRS has become the predominant reporting language for most industry sectors. Keep in mind that

little more than 10 years ago, no major jurisdictions required the use of IFRS. This is a remarkable transition in a very short period of time.

Of course, we cannot ignore the fact that some major economies have yet to require the use of IFRS for domestic companies, such as China, India, Japan and the United States. But even here, good progress continues to be made.

China has already completed two major updates to its domestic accounting standards. The first update was in 1992 and the most recent update was in 2006. These updates have resulted in the current versions of Chinese Accounting Standards, which are similar, although not identical, to IFRS. Chinese companies representing more than 30 per cent of total market capitalisation already report using full IFRS for the purpose of their dual listings in Hong Kong. I was in China last week, and during that visit I expressed my desire for China to complete this last step and to complete its transition to full IFRS.

In India, IFRS developments continue to move at pace. The new Indian Government recently announced its intention to make the transition to Indian Accounting Standards based on IFRS, although, as in the case of China, those standards may deviate from IFRS in some areas. We will work with our Indian colleagues to ensure that the differences are kept to a minimum. It is also important to many Indian companies that they should continue to have the option to use full IFRS if they so wish.

Japanese companies have had the option to use IFRS since 2009. It is very encouraging to see the number of companies making use of that option grow rapidly. As of today, 46 domestic Japanese companies with a combined market capitalisation of 63 trillion Yen have adopted or announced plans to adopt full IFRS. According to the annual reports of these companies, the top three reasons for making the transition to full IFRS were comparability with global competitors, the spread of their shareholder base and to improve the efficiency of their management. Use of full IFRS is one of the factors considered for the inclusion of Japanese companies in the recently launched JPX-Nikkei 400 Index—an index that, according to a recent article in the *Financial Times*, is very popular with international investors.⁵

In the US, it is fair to say that progress has been slower than anticipated. However, the use of IFRS in the US is more advanced than many realise. US investors are already prolific users of IFRS financial statements, holding more than eight trillion dollars of foreign holdings, most of which report in IFRS. In addition, the SEC oversees the IFRS-compliant financial statements of almost 500 international companies listed in the US. Those companies have a combined market capitalisation in the trillions of dollars, which represents a significant market for US investors.

⁵ *Financial Times* (15 June 2014), 'Japan groups take a shine to JPX-Nikkei 400 Index', www.ft.com.

The SEC Chairman, Mary Jo White, has indicated in public forums that IFRS is a high-priority item for the SEC and she also acknowledged that there is a need to provide some clarity on the SEC's position about the domestic use of IFRS in the US. We look forward to working with Jim Schnurr, the new SEC Chief Accountant, on this important topic.

In summary, it is true that the IFRS map of the world is not yet complete. However, four-fifths of that map now requires the use of IFRS, while use of IFRS is widespread across the remaining one-fifth of countries.

Becoming the global standard-setter

Finally, I would like to say a few words about the evolution of the IFRS Foundation and the IASB as the global accounting standard-setter. Since the IFRS Foundation began its work in 2001, the Trustees have overseen four separate Strategy- and Constitution Reviews. Each review further enhanced and refined the structure and effectiveness of the IFRS Foundation and the IASB. The cumulative effect of those reviews has been to create an international organisation that is more transparent, more accountable and more consultative in its activities than any other organisation I have observed.

It is important, however, that the Trustees continue to seek further opportunities for improvement. To do that, we must continue to learn from other international organisations and to hear from stakeholders such as you. In this regard, we will begin in the coming months a fifth public consultation on the structure and effectiveness of the IFRS Foundation.

We are keen to hear any further ideas for improvement. However, there are several themes that the Trustees have already identified.

First, we will consult on the optimum size of the IASB. According to our Constitution, the IASB can have up to 16 members with appropriate geographical and professional diversity. One of the main reasons for having such a large Board was to provide sufficient resources for regional stakeholder outreach. However, in recent years other mechanisms have been developed to support this important goal. The Accounting Standards Advisory Forum, or ASAF, has been an excellent innovation for connecting the IASB with important stakeholders from around the world. Furthermore, the advent of regional groups of accounting standard-setters has further enhanced our contacts with important regional- and national stakeholders. Today, we have EFRAG in Europe, the Asian-Oceanian Standard-Setters Group, and the Group of Latin American Standard-Setters. The Pan African Federation of Accountants also does an excellent job of co-ordinating views from across that region. All of these bodies are represented on the ASAF.

So, the question is whether these innovations mean that a smaller, more focused IASB would be appropriate. We will seek feedback on this before determining how to proceed. The Trustees are also planning to seek input on improvements to further enhance the governance and accountability of the IFRS Foundation, as well as to protect the independence of the IASB.

Close

I will now draw to a close, to provide the opportunity for further questions. I have set out the case for global accounting standards, and how the arguments in favour of global standards will only continue to grow, driven by economic globalisation and the desire for capital markets to support continued economic growth. I have provided an update on our work to further reinforce IFRS as the global standard. I have also shared with you our plans to enhance the structure and effectiveness of the IFRS Foundation as the global standard-setter. I thank you for your time, and look forward to your questions.