IFRS

IASB Speech

Latest developments and future focus

Date: 24 August 2016

Speaker: Hans Hoogervorst, Chairman, International Accounting Standards Board

Venue: Joint IFRS Foundation, PAFA and ICPAK Conference, Nairobi

Introduction

Ladies and gentlemen, it is a great pleasure to be here in Nairobi. I would like to begin by thanking the Pan-African Federation of Accountants (PAFA) and the Institute of Certified Public Accountants of Kenya (ICPAK), in particular its Chief Executive Dr. Ngumi and Chairman Barasa. Both organisations play an important role representing the views of this region in our work. It is an honour to co-host this conference with them. My thanks also go to Director General Ndung'u of the National Treasury for his thoughtful remarks.

It is truly a great pleasure to be in Kenya. The World Economic Forum has called Kenya one of the growth stars of Africa. Your country is maintaining high rates of growth, not relying on natural resources but based on economic reforms and increased competitiveness. Kenya is one of the faster-growing economies in Africa, a continent that itself has astonished the world by maintaining high rates of growth since 2010.

Africa is increasingly seen as a continent of economic opportunity. Kenya is one of its frontrunners, not just in athletics, but also economically. Today, I will say some words on how IFRS Standards can help Africa in general, and Kenya in particular, to achieve the economic progress which they deserve.

But first, let me begin by talking a little about the mission of the IASB, its importance to the world economy, and in particular the opportunities and challenges here in Africa.

The importance of IFRS Standards

It is difficult to overstate the importance of high quality financial reporting standards to the world economy. If money makes the world go round, then the system can only function when people understand how that money is being used and managed.

Market-based economies are built on financial exchanges between providers and consumers of capital. The system only works when trust exists between investors and the people they entrust their money to.

IFRS Standards help create that trust by providing investors with confidence in the quality, the robustness and the completeness of the financial information provided by companies.

We have put together a short video that better describes how our work serves the public interest. Please take a moment to watch it now.

[PLAY VIDEO]

As the video says, our work brings transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.

Academic research shows that most capital markets benefit from a reduced cost of capital after switching to IFRS reporting. That is because almost every international investor will be familiar with a set of IFRS-based financial statements. This creates huge opportunities for those countries that see the development of capital markets as a way to fund economic development.

Like all regions, Africa is not immune to the economic headwinds facing the global economy. The end of the commodity super-cycle and extraordinary monetary policies in the US and Europe has created huge uncertainty for all countries, but particularly for emerging economies. African economies continue to outgrow most of the rest of the world, albeit at a slower rate than before. Maintaining growth in the face of such economic headwinds will require considerable effort.

The 2016 African Economic Outlook report produced by the ADB, the OECD and the UNDP makes clear the importance of developing African capital markets as a way to unlock latent economic potential and to aid regional integration. African capital markets are still very small relative to the rest of the world. That is not a problem; it is an opportunity. The only way is up!

Here in Kenya, increasing the attractiveness of capital markets has been at the heart of efforts to strengthen the economy, and is a key element of the government’s Kenya Vision 2030. Cross-border investment is an important pillar in developing Nairobi as an international financial centre and as the gateway to Africa’s capital markets.

Kenya has put a lot of effort into improving its markets and systems. Reports by the World Bank and the International Monetary Fund show those efforts are paying off[1]. The World Bank’s Doing Business 2016 report[2] revealed that Kenya is among the countries in the world that improved the most on the previous year in terms of making it easier to do business.

---

[1] Reports on the Observance of Standards and Codes (ROSC), 2001 and 2010

[2] doingbusiness.org

IFRS Standards are recognised by these two organisations as important for strengthening economic and financial stability. Kenya was one of the first countries to require the use of IFRS Standards back in 1999.

So there is no doubt that Africa, and in particular Kenya, is making good progress, putting in place structural reforms and adopting international norms for sound financial systems. IFRS Standards are part of this package, as recommended by the Financial Stability Board, the World Bank and IOSCO.

Progress towards global standards

Let me now tell you a little bit about the progress we have seen towards IFRS adoption in the world. To date, we have researched the financial reporting requirements of 143 countries, with those countries representing more than 98 per cent of total market capitalisation. Nearly 120 of these countries now require the use of IFRS Standards for all or most public companies. And while the IFRS for SMEs Standard only came into effect seven years ago, we already see 80 countries requiring its use, and it is under consideration by a further 11 countries.

In Africa, we have seen very good progress among the Eastern, Central and South African countries, with most of the larger economies now requiring the use of IFRS Standards. Progress elsewhere in Africa is mixed, with a lower level of adoption among the French-speaking African countries. It is not entirely clear to me why this is, but I hope to see them join the IFRS family in the near future.

Almost every country in Europe and South America requires the use of IFRS, while in North America, Canada and Mexico are full IFRS adopters. It seems unlikely that the United States will adopt any time soon. However, more than 500 foreign companies listed on US markets already report using IFRS while most US investors are entirely familiar with IFRS-based financial statements.

In the last couple of years we have seen a lot of progress in Asia and the Middle East. All but one of the Middle Eastern countries now requires the use of IFRS Standards, while in Asia we continue to see positive developments. In the last year both China and Indonesia have reaffirmed their commitment to achieve full convergence with IFRS Standards and India has adopted new standards which are almost full IFRS. In Japan, we are seeing a growing number of major Japanese companies adopt IFRS Standards on a voluntary basis.

It is encouraging to see such progress towards global accounting standards around the world, and also here in Africa. The IFRS map of the world is not yet complete, but we continue to make good progress in most regions.

IASB work plan

Let me now focus on our technical work. Over the past couple of years, we have finished three large and important Standards—financial instruments, leases and revenue. Together with the new insurance contracts Standard, which we expect to issue around the end of this year, these Standards plug the gaps that existed in our existing set. My colleagues Darrel Scott, Wei-Guo Zhang and Hugh Shields will discuss some of these standards in more detail with you, but let me make some general comments.

First, the financial instruments Standard, IFRS 9. This is the IASB's main response to the global financial crisis. The most important change it will bring is the impairment model, which will move from an incurred to an expected credit-loss model. This means that banks will have to recognise inevitable losses at a much earlier stage than currently is the case.

This has two main benefits. First of all, during an economic downturn, banks will have to clean up their balance sheet much quicker than currently is the case. This will prevent credit from getting stuck in companies that are in effect no longer viable. More credit oxygen will become available for companies that do have growth opportunities. Secondly, investors can have more faith in the quality of a bank's balance sheet.

Second, let me touch on the new revenue Standard, IFRS 15. This Standard was developed jointly with the US standard-setter, the Financial Accounting Standards Board (FASB) and we managed to stay almost completely converged with our American friends. That is great news for the investor, because it means that the revenue numbers of almost all companies in the world are completely comparable. I therefore call this standard the jewel in the crown of the convergence efforts between the IASB and the FASB.

IFRS 15 represents a big step forward in when and how to recognise revenue. It addresses the problem of too little guidance detail in the previous IFRS Standard and too much and often conflicting guidance in the US Standard. It also addresses the challenges of accounting for revenue in the modern era.

Later today, Darrel Scott will guide you through our standards on agriculture, which are of particular significance to this region. Recently, we made some significant changes to the accounting treatment of so-called bearer biological assets in IAS 41 Agriculture. This is a good example of how the IASB listened very carefully to concerns raised by emerging economies.

Before the changes, biological bearer assets such as palm oil trees and grape vines had to be measured at fair value. This meant that the fair value fluctuations of a whole plantation would be included in profit or loss, even if the owners had no intention to sell the plantation. Both preparers and investors thought this distorted profit or loss and clamoured for change. Under our new proposals, bearer assets will be treated more like property, plant and equipment and measured at cost. The new standard will be less costly to apply and will reduce artificial volatility in the income statement.

Future priorities

So as we have completed most of the big standards, should we conclude that we are done? I know some of our constituents would like us to come to that conclusion, as they have been struggling to keep up with constant change. Yet I believe there are reasons for us to not become complacent. There is still a lot of work to do. But our focus will not be so much on creating more big new standards as on improving the presentation of the information that we already require.

High quality, IFRS-compliant financial information is 'necessary but not sufficient' for financial reporting to achieve its communications objectives. We must recognise that preparers sometimes experience financial reporting as too much of a compliance exercise. Investors sometimes believe that the financial statements depict performance in an insufficiently clear manner.

Valuable information gets drowned out by 'tick the box' disclosures and voluminous, but poorly organised and presented financial data. Our standards are partly to blame for that. The fact is that IFRS Standards prescribe very little in the way of formatting the income statement. We define revenue, we define profit or loss, but we do not define very much in between.

So companies have considerable freedom in the way they present the components of income that make up profit or loss. As a result, there is little comparability above the bottom line, making it difficult for users to judge performance.

Partly as a result of IFRS prescribing few subtotals in the income statement, preparers increasingly present alternative performance measures to investors, which is basically adjusted IFRS. This information is easier for users to consume, but it almost always paints a rosier picture than reality and can be highly misleading. In addition, many companies present non-financial information on, for example, sustainability issues. For the investor, it is often difficult to see the woods for the multitude of information trees.

Better Communication

So we have decided that we have to focus our work in the coming years on improving the communications effectiveness of IFRS-based financial statements. We are calling this theme 'better communication'. So what will this mean in practical terms?

We will not propose to cut back the information provided, nor to dramatically increase it. But we are going to look at how this information is presented, how it is grouped together, and in what form it is made available. The objective is to make sure that companies can better tell their story through the financial statements, in a way that is clear, objective and consistent.

The central building block of this work will be our Primary Financial Statements project. This project will potentially result in a facelift of what is often called the ‘face of the financial statements’. Its focus will be to improve the organisation of the statements of financial performance (profit or loss and other comprehensive income), the statement of cash flows and the statement of financial position, also called the balance sheet. We might also try to find a better way to present some elements of Other Comprehensive Income, which is currently a conundrum for most investors.

Better communication will also be home to a number of current and future projects–all designed to improve the communications effectiveness of financial statements. These include the disclosure initiative project, the development of a materiality practice statement and our work on digital reporting. The good news is that we believe we can make substantial improvements in this area without introducing wholesale new information requirements.

Better communication will be an overarching theme and a source of inspiration for the coming years. It responds to feedback we received through our various consultations, and it will hopefully deliver material improvements to the communications value of financial statements.

Implementation support

At the end of my presentation, I would like to talk about our efforts to help our constituents to implement our standards. We have given a great deal of thought to how we can improve on what we are already doing in this respect.

First of all, we have brought together into a single function the various parts of our organisation that get involved in supporting and maintaining issued standards. This includes the IFRS Interpretations Committee, the Education Initiative and the Post-Implementation Reviews of recent Standards. The idea is to take more of a cohesive approach to this work, and these changes are already starting to bear fruit.

Second, we are now asking the project teams responsible for new IFRS Standards to develop resources and training materials for use by others in their preparation for applying the new Standards. These teams have a developed a huge amount of knowledge and we are looking at ways to make this expertise available for all concerned. Conferences such as this are one way to share this valuable information, but we are also exploring the use of some new and exciting online services to get the information out far and wide.

Third, it is clear that providing the most effective support involves working in close cooperation with others. At an international level, we are exploring how to deepen our cooperation with the World Bank. And at a regional and a national level, we are keen to work with the accounting institutes and national standard-setters to collaborate on relevant projects.

Although developing and maintaining IFRS Standards will always be the core of what we do, we do see opportunities to play a more active role in helping countries implement our Standards on a globally consistent basis.

Close

I have talked today about the importance of high quality financial reporting, and progress towards the adoption of IFRS Standards around the world. I have also talked about our priorities for the next few years: the overarching theme of better communication, and our work to provide greater support in the application of IFRS Standards. This is all highly relevant to the countries of Africa. I thank you for your continued support and cooperation, and I look forward to a successful conference.

Thank you.