Safety in numbers

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Introduction

It is a great pleasure to be with you again at this important conference. Let me start by thanking someone who would have normally addressed you yesterday, but who will leave her office soon. IFRS is a very difficult subject for the Securities and Exchange Commission (SEC), but I would like to thank SEC Chair Mary Jo White for the constructive cooperation we have enjoyed over the past four years, and for the considerable time and effort she has devoted to our cause.

Developments around the world

2016 certainly has not been a boring year. Recent events made clear that forecasting political outcomes can be at least as tricky as forecasting company earnings! First we had Brexit and then the surprising outcome of the Presidential elections in this country. Both outcomes have been widely interpreted as a negative reaction to globalisation.

Recently, one of your compatriots asked me whether this alleged retreat from globalisation would have consequences for IFRS as a global standard. Of course it is too early to tell, but for now we see no immediate consequences.

While the UK has decided to leave the EU, it has not yet decided to leave the world. The Brexiteers are indeed very keen to be seen as pro-free trade and pro-globalisation. Britain has already signalled support for continued use of IFRS Standards post Brexit.

However, history never develops in straight, flawless lines, so it is entirely possible that the trend towards growing global investment and trade may be interrupted. But even if the level of cross-border transactions ended up reducing, however unlikely for the long haul, the logic for common accounting standards remains compelling. Multinational corporations will

continue to span the world and investors will continue to seek investment opportunities on a global basis.

Moreover, the framework for global accounting standards is already in place for much of the world, and I can't see why anyone would want to chip away at it. Among the G20, three-quarters of the countries will be on board with domestic use of IFRS Standards when Saudi Arabia adopts next year. In Japan, the number of companies using IFRS Standards continues to rise every month. India has just taken a giant step towards IFRS adoption.

Even though the US does not permit domestic use of IFRS Standards, you have a great deal invested in our success. US investors have more than $7 trillion dollars invested in companies that report using IFRS Standards. Many American companies have subsidiaries that will be producing IFRS-compliant financial statements, while nearly 500 foreign companies listed on US markets report using our Standards.

For these reasons, the IASB is keen to keep IFRS Standards as closely converged as possible to US GAAP. And I promise you, if the Financial Accounting Standards Board (FASB) comes up with good ideas before we do, then we will steal them as quickly as possible. We have no shame, and good accounting ideas cannot be patented!

Completion of the major projects

Moving onto our technical agenda, we are in the process of finalising our *Conceptual Framework*, which we will issue next year. We will also soon issue our new insurance contracts Standard, which we expect to publish in the first half of 2017. We began this project back in 1997, so the new Standard will not come one day too soon.

Should you have forgotten what a world without global accounting standards looks like, just look at the accounting anarchy in the world of insurance. Just about every country in the world does its own thing and it doesn't look pretty.

The table below shows a real-life insurance company that uses one national GAAP as the subsidiary of a group, while using another GAAP for its statutory financial statements. As you can see, the same company shows quite astounding differences–between 25 and 60 per cent in revenue, operating income and equity–depending on the accounting language it uses. Even for those who know that accounting is not a simple matter of adding and subtracting, this divergence in outcomes is simply shocking.

(In millions of USD)	GAAP 1	GAAP 2	Difference	
Revenue	9,010	11,244	(2,234)	-25%
Operating income	1,606	748	858	53%
Total equity	10,375	4,567	5,808	56%

Moreover, some of the accounting practices used for insurance contracts around the world are at odds with what are considered generally accepted (or should I even say acceptable…) accounting practices for all other sectors of the economy.

For example, many insurance premiums contain a deposit component because many insurance products combine insurance protection with investment. More than a few insurance companies recognise all deposits they receive as revenue. Can you imagine a bank or an asset management company doing that? Moreover, premium revenue is often recognised on a cash basis, which is at odds with the general principles of revenue recognition.

A comparison with the IFRS treatment of the pension liability is also illustrative. IAS 19 requires current measurement of the pension liability, so that the pension liability is continually updated to account for–amongst other things–changes in interest rates. In large parts of the world, however, insurers do not fully update the insurance liability. Often they use historical interest rates.

As a result, the devastating impact of the current low-interest-rate environment on long-term obligations is not nearly as visible in the insurance industry as it is in the Defined Benefit pension schemes of many companies. Clearly, discounting an insurance liability that was incurred 15 years ago at a historical interest rate of five-six per cent does not give relevant information in a time when interest rates are close to–or even below–zero.

Our new insurance contracts Standard will put an end to these outdated accounting practices. It will require current valuation of all insurance liabilities, not just life, but also non-life. It will dramatically increase comparability between insurance companies and between insurance and other parts of the financial industry, such as banks and asset management. It will be a huge step forward in accounting and it will bring much needed transparency in this very important part of the economy.

Better Communication

With the completion of the new insurance contracts Standard, the IASB will have filled most (but not all) of the gaps in our suite of Standards.

So that begs the question, what's next? Well, rather than developing, yet again, major cross-cutting Standards, in the next couple of years we will try to focus more on improving what is already there. We feel we can do more to improve the communication effectiveness of the financial statements. For that reason, we have decided to make Better Communication the central theme of our new agenda.

There are a couple of issues that need to be addressed. First of all, investors often tell us that, currently, financial reporting does not depict the performance of a company clearly enough. They notice that we define revenue and profit or loss, but not too much in between. As a result, there is very little comparability above the bottom line.Investors therefore want more disaggregation, additional line items and possibly subtotals that tell more about the performance of a company.

Preparers, on the other hand, tend to look at the financial statements as too much of a compliance exercise. We also see increasing use of non-IFRS alternative performance measures, also known as non-GAAP, which tend to dominate press releases and investor information packs.

Let me make clear that we do not intend to ban alternative performance measures, because some of them clearly have added value. Yet, we share the SEC's concern that non-GAAP generally paints a rosier picture of a company's performance than GAAP. This is not in the interest of investors and I even believe it is not in the interest of preparers themselves. Let me explain why.

While our Standards are designed to help investors understand a company, we should never forget that modern accounting was originally developed as a management tool. I firmly believe that high quality accounting standards should still be part of management's toolkit, helping a company better understand the complexity of its business. Our pensions Standard, for example, made the very complex pension liability visible and, therefore, more manageable. Likewise, I strongly believe that our new leases Standard will help companies make better decisions between leasing or buying an asset.

Alternatively, non-GAAP measures that consistently flatter a company's performance are probably not the best basis for sound business decisions. Audit and remuneration committees should also be concerned about the increasing use of non-GAAP, usually developed by management itself. All involved in managing a company should realise that there is safety in the GAAP numbers. They are rigorous and based on sound economic principles. They should serve as an anchor, not just in reporting, but also in management decisions. At the end of the day, you manage correctly what you measure correctly.

What can the IASB do?

The central part of the Better Communication theme will be to take a fresh look at the Primary Financial Statements–what we call performance reporting. We will have to provide more and better structure to the income statement and the cash flow statement. We will look at additional line-items and possibly sub-totals. We might decide to create more discipline around the presentation of non-recurring items (which have such a nasty habit of recurring time and again!).

The end result should be better-formatted primary statements, which increase comparability and which should make it easier for regulators to enforce discipline around the presentation of non-GAAP measures.

We are continuing our work on disclosures, providing guidance on the application of materiality and developing general principles for disclosure. This should help companies to remove clutter and make their disclosures more meaningful.

In the context of Better Communication we will also look at the changing nature of the consumption of financial information. Increasingly, investors are using electronic means to digest financial information. Data aggregators are developing artificial intelligence that mines disclosures, press releases and big economic data. Some even believe that these new research capabilities are becoming so sophisticated that accounting as it exists might become less relevant.

While I do believe we have entered a new era of information gathering and consumption, I am not yet concerned about my job security. The more information becomes available to data aggregators and investors, the more need there is for adequate formatting along sound underlying economic concepts. Just think back at the schizophrenic accounting numbers of

the insurance company I just presented to you. No artificial intelligence in the world would be able to make heads or tails from information that is so inherently flawed.

Apart from setting high quality Standards, the IASB can do more to improve the quality of electronic financial data. We will continue to work on the IFRS Taxonomy to shore up the reliability of electronic reporting. We also believe that better structuring of the primary financial statements will contribute to the quality and comparability of the information provided by data aggregators. More generally, we will ask ourselves what impact changing patterns of data consumption and provision should have on the way we set Standards.

Close

Ladies and gentlemen, I have come to the end of my presentation in which I have tried to give you some insight into what keeps us awake at night–apart from jetlag! I hope you will continue to follow us closely and invite you to contribute to our work. Thank you for your attention and I wish you a very fruitful conference.