Are we there yet?

Charting the world's progress towards global accounting standards

Hans Hoogervorst, Hong Kong, 5 June 2013

The term 'globalisation' was introduced into the business lexicon by Harvard Professor Theodore Levitt in 1983. He then said that "The Earth is round but, for most purposes, it's sensible to treat it as flat."[1] If Levitt thought that the economic world was flat back in 1983, imagine what he would make of it today, some 30 years later.

Unfortunately, the regulatory system that underpins this global market has failed to keep up. Indeed, the global economic crisis showed how international regulatory arbitrage was rife. Since the crisis broke, many have been working hard to upgrade this global regulatory infrastructure, to make it fit for purpose for the 21st century.

In the area of financial reporting, progress had been made a lot earlier. The shocks of the Asian financial crisis, the Enron and WorldCom scandals, and Europe's creation of a common financial market: all these developments helped build consensus for global accounting standards. Every relevant international organisation has expressed its support for our work to develop a global language for financial reporting.

The G20 Leaders, the IMF, the World Bank, the Financial Stability Board, the IOSCO and the Basel Committee on Banking Supervision: all are on record with their support for this important project.

So, how are we doing? Who is using our standards and how are they being adopted? Thus far, we have formed estimates of progress based on our own knowledge and the experiences of the large accounting firms. Still, up to now, our knowledge has not been very precise. As a result people often doubt whether progress has really been as great as we think. Some believe that many countries have adopted locally modified versions of IFRS. They claim that the use of unmodified IFRS is actually relatively limited.

For these reasons, we felt it necessary to get a clearer understanding of which jurisdictions have adopted our standards and how. So, in 2012 the Trustees strategy review recommended that we come up with a more precise assessment of progress towards IFRS as the global standard.

For the last nine months our staff, led by former IASB Board member Paul Pacter, has been working to compile this information. We began by conducting a survey among the accounting standard-setters around the world. We then supplemented the survey results with information drawn from other sources, including securities regulators and the large accounting firms.

Finally, we asked the relevant authority within each country or jurisdiction to validate our conclusions.

[1] Theodore Levitt, Globalisation of Markets, Harvard Business Review, May 1983

Today, we are publishing the first batch of 66 jurisdictional profiles on the IFRS website. This first batch includes all members of the G20 and a further 46 jurisdictions that responded to our initial survey request. We are beginning work on a further 50 to 60 jurisdictional profiles, including the 13 EU member states that did not respond to our first survey. We hope to end up with a comprehensive picture of the IFRS-world.

These initial results are both fascinating and very encouraging. Although this is a qualitative assessment, there are some obvious conclusions to be drawn.

First of all, there is almost universal support for IFRS as the single set of global accounting standards. 95% of the 66 jurisdictions have made a public commitment of support for a single set of high quality global accounting standards. Furthermore, with the exception of Switzerland, every jurisdiction has made a public commitment to IFRS as the single set of global accounting standards. This includes those jurisdictions that have yet to make a decision on adopting IFRS, such as the United States.

Second, 55 jurisdictions, or more than 80% of the profiles, report IFRS adoption for all (or in five cases almost all) public companies. Most of the remaining 11 non-adopters have made significant progress towards IFRS adoption.

This is a remarkable achievement when you consider that this shift has occurred in little more than 10 years.

Third, those jurisdictions that have adopted IFRS have made very few modifications to IFRS. Most of these modifications have been very limited. For example, the European carve-out from IAS 39 has been used by fewer than two dozen out of 8000 listed companies in the European Union.

Moreover, where such modifications have occurred they are meant to be temporary arrangements in the migration from national GAAP to IFRS or have little effect in practice. In almost all of these cases, we have active projects on our agenda that address these issues, including agriculture, loan-loss provisioning, macro hedge accounting, separate financial statements and revenue recognition. The end result will be that most of these modifications will likely disappear.

The results also show an impressive uptake for the IFRS for Small and Medium-sized Entities, or IFRS for SMEs.

More than half of the 66 jurisdictions have already adopted the IFRS for SMEs or are planning to do so in the near future. This is all the more remarkable when you consider that the SME Standard is less than four years old.

This is only a subset of the information provided by this first batch of profiles and there is no reason to believe the remaining profiles to be published will tell a very different story. I strongly encourage you to take some time to browse through the extensive information on the use of IFRS that is now available to access from our website.

Compared with other global standards, such as the Basel capital requirements for banks, the use of local adaptations is very limited. The fact that most IFRS adopters seem to be able to resist the temptation to tinker with our standards is truly remarkable. Why would this be the case? This is the question I would like to answer in the next part of my presentation.

First of all, I think that most jurisdictions draw comfort from our highly developed due process. Never before in my long career in public policymaking have I worked in such a transparent environment. All our board papers and all our board meetings are accessible to the public.

We have comprehensive requirements for comment periods and outreach, so we are unlikely to overlook issues raised around the world. A standard that has benefitted from such elaborate due process is far more likely to be high quality and to stand the test of time. Through the creation of the Accounting Standards Advisory Forum, we are further ensuring the inclusiveness of our standard setting. Through ASAF we hope to get timely and insightful input to our standard setting. This should further mitigate the risk of non-endorsement of our standards.

Secondly, the governance of the IFRS Foundation has improved markedly over time. The establishment of a Monitoring Board gave the IFRS Foundation a firm public setting. Our accountability to the Monitoring Board gives additional assurances that the IASB is not a free-floating ivory tower, which we, of course, never were. At the same time, this multilateral body of securities regulators has reinforced the independence of the IASB from undue lobbying from any single jurisdiction.

Thirdly, most constituents also draw comfort from the fact that they have an endorsement mechanism in place. In almost all jurisdictions these endorsement mechanisms are a simple yes-or-no decision to accept a standard. Rarely do they involve a process that is likely to lead to detailed adaptation of IFRS to perceived local needs.

Yet these endorsement mechanisms are very effective in two ways: they create a safeguard as they leave ultimate sovereignty in standard setting in local hands. Secondly, the possibility of non-endorsement ensures that the IASB will have to listen very carefully to its constituents. The fact that so few jurisdictions fail to endorse our standards as issued hopefully reflects the fact that we do listen well and make changes where they will lead to a better standard.

Finally, I believe that it is the technical nature of accounting standards that makes them relatively easy to accept. IFRS aims to achieve a neutral description of economic reality rather than to shape economic reality, such as the capital norms for banks as prescribed by the Basel Committee.

True, accounting standards are not free from judgement and they can be subject to fierce controversy. Sometimes accounting standards can even become politicized, especially when they shed light on risks or practices that people would rather keep in the dark. Yet most accept that accounting standards are essentially technical rather than political. For this reason, most jurisdictions accept that the standard setting is best done by an independent board, provided that proper procedures for due process and accountability are in place.

Despite these safeguards, there are some who believe that rather than having a single, global language of financial reporting, we should switch to a Basel-style of global principles, which should then be adapted and formalized in local standards. I think that would be a recipe for disaster. In fact, this approach has been tried in accounting before, to no success.

The IASB's predecessor body, the IASC, developed accounting standards that were intended to serve as the basis of national accounting rules. All that happened was that countries took those international standards they liked and altered those they did not. The end result was that after decades of trying, the international community had to admit defeat, which led to the formation of the IASB with a new mission of a single set of global accounting standards.

Even when our constituents disagree with part of our standards, they almost always resist the temptation to alter them. Local adjustments are viewed with suspicion by investors, so most jurisdictions will simply take IFRS in full. Also, most of our constituents accept that if local adaptations were to become rife, the benefits of having a global standard would be undermined.

The financial crisis has demonstrated the need for rigorous economic standards that provide maximum transparency. The country profiles show that IFRS has come a long way to provide transparency to investors around the world. They are a cause for celebration about what has been achieved, as well as a yard stick on the work that we yet have to do.

So what is left to do? For a start, it is clear that some large and important economies have not yet (fully) adopted IFRS. But even in such countries more progress is being made than many people are aware of.

Japan already permits the use of IFRS. Currently, 17 of Japan's largest multinationals are using IFRS for domestic reporting. The Japanese Business Association, the Keidanren, has estimated that in the very near future that number will increase to 60 Japanese companies reporting using IFRS, representing around 20% of total market capitalisation of the Japanese Stock Exchange. Contrary to what many think, the dynamics of IFRS in Japan are still quite strong.

In the United States, the SEC's 2007 decision to permit non-US companies to report using IFRS while listing in the United States was a major game-changer. Today, more than 450 Foreign Private Issuers reporting using IFRSs as issued by the IASB, representing trillions of dollars in market capitalisation. So the use of IFRS in the United States is far from marginal.

This, and the fact that US investors increasingly invest in the IFRS-part of the world, explains why the American SEC remains very interested in progress being made by the IASB.

China is different. It has chosen a strategy of convergence of its standards with IFRS for all listed companies. China has already made great progress and has reached substantial convergence with IFRS.

There is still work left to do, but we have to acknowledge that the Chinese had a lot of catching up to do. The Chinese government remains firmly committed to the ultimate goal of full convergence with IFRS.

Despite the enormous progress in adoption of IFRS around the world, we understand that adoption in itself is not enough. Obviously, proper application of the standards is just as important. Proper application is primarily the responsibility of preparers, auditors and regulators. Our role is secondary, but we do to help these parties in promoting proper application around the world.

At the same time, it is clear that the risk of improper application around the world can never be a reason to not pursue global accounting standards. Even an unevenly applied global standard provides much more global comparability than an equally unevenly applied multitude of diverging national standards.

Indeed, the existence of a common language helps bringing problems to light.

For example, in 2013 Cass Business School published an analysis of how well asset impairment under IFRS was applied across the European Union[2]. The report concluded that while compliance was generally good, there was scope for improvement.

However, this very report could not have been written in the absence of a single accounting language in Europe. Thanks to IFRS, the report was able to clearly identify indications of application problems in specific jurisdictions.

Taken as a whole, the commitments of the G20 and the international organisations identify a clear end point of a single set of high quality, global accounting standards. The profiles published today provide an indication of the remarkable progress made towards this end point. They also show that deviation from IFRS is rare, while such arrangements are considered to be transitional with almost all of these topics being addressed by our new agenda.

At the same time, these hard-fought gains must be protected. History would not thank us if we allowed a reversal of the progress made in the last 12 years.

The support of the G20 and the broader international community must continue to be harnessed in order to complete our work, for the benefit of investors, to deliver a global language of financial reporting.

I thank you for your time.

[2] Cass Business School, Accounting for asset impairment: a test for IFRS compliance across Europe, www.cass.city.ac.uk