IFRS

IASB Speech

Switzerland and IFRS

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Speaker: Hans Hoogervorst, IASB Chairman

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Ladies and gentlemen, distinguished guests, it is an honour to be with you today here in Switzerland. Let me begin by thanking our co-hosts, the Swiss Institute of Certified Accountants and Tax Consultants, and the leadership of the Swiss GAAP FER Foundation for their ongoing co-operation.

The theme of this evening's event is 'IFRS in Continental Europe'. IFRS has had a transformative effect on the quality and consistency of financial reporting around the world, including Europe. Tonight, I will provide you with a brief update on our work to establish IFRS as the global standard for financial information.

At the same time, we are not deaf to concerns about increasing complexity and disclosure overload in financial reporting. I hear these concerns wherever I go and I know they exist here in Switzerland as well. I will offer some perspectives on the causes of complexity and what we are trying to do about it. Hopefully we can carry over these themes to the panel discussion that will follow.

Progress towards global standards

First, global standards. Capital markets around the world are closely coupled and interconnected. Before IFRS, the accounting for the most basic metrics, such as revenue and profit, differed significantly depending on where in the world that company was listed. Investors were easily misled; it was a mess.

Today, the situation has vastly improved. Our latest research has analysed the financial reporting requirements of 138 countries. It shows that 114 countries now require the use of IFRS for all or most publicly listed companies. 12 more countries permit its use. For most of these jurisdictions, IFRS is no longer a new development; it's just business as usual.

In Europe, it is 10 years since the then 25 Member States simultaneously made the transition from national accounting standards to IFRS. The European Commission has recently undertaken a consultation on Europe's experience of IFRS. The more than 200 responses it received are very encouraging. Most respondents argued that the introduction of IFRS has resulted in improvements to the quality and consistency of financial reporting across the European Union. These findings are consistent with other post-IFRS assessments undertaken by other adopting countries, such as Canada and Korea.

IFRS is also used extensively in the few remaining major jurisdictions that do not yet require the use of IFRS. In Japan, the number of companies voluntarily switching to full IFRS has significantly increased in the recent past. In the near future, about 25 per cent of the Japanese market capitalisation is expected to have adopted full IFRS. The top three reasons cited by these companies for choosing to make the transition to full IFRS are comparability with global competitors, the spread of their shareholder base and management efficiency.

In China, companies representing more than 30 per cent of the total market capitalisation of the Shanghai Stock Exchange produce IFRS-compliant financial statements as a result of their dual listings in Hong Kong.

The Indian government announced last month the latest step in its own convergence programme with IFRS. From 2017, listed Indian companies will be required to report using new Indian Accounting Standards, which are much closer to IFRS. We will continue to work in close co-operation with the Indian government to bring these new Standards fully into alignment with IFRS.

Switzerland and IFRS

Of course, Switzerland was one of the first countries to permit the use of International Accounting Standards. Swiss companies have a choice between IFRS, US GAAP and Swiss GAAP, and almost all companies listed on the SIX Main Standard choose to report using IFRS. This is not surprising when you consider that international investors own around 60 per cent of the shares in companies listed on the SIX Main Standard. International investors are entirely familiar with IFRS, but less so with Swiss GAAP.

However, there have been some recent examples of Swiss companies moving from IFRS and US GAAP to Swiss GAAP. Most of those companies were SMEs listed on the domestic segment of the stock markets. Some, however, are bigger and one is even listed on the Swiss Market Index. The main motivation seems to be concerns about complexity and disclosure overload. Indeed, some companies switching from IFRS to Swiss GAAP have been able to reduce their disclosures significantly.

So this is something we need to take a look at. Is IFRS indeed too burdensome in terms of its complexity and its disclosure requirements? Have we found the right balance in the trade-off between complexity and completeness, or has the pendulum swung too far in the direction of excessively lengthy disclosure requirements?

Complexity and volatility

Oscar Wilde once said that the truth is rarely pure and never simple. I doubt Oscar Wilde had any interest in accounting, but he could have been talking about it.

I fear that most of the complexity and length of financial reporting is a reflection of an increasingly complex economic reality. If we really want simple reporting, we should do away with derivatives, defined benefit pension schemes should go out of the window, companies should stop dressing up liabilities as equity instruments, companies should stop taking over other companies, insurers should stop mixing insurance with investment products and the list goes on …

Clearly, this is not going to happen, so complexity is a reality we have to live with. Having said that, not all complexity is a given. In the development of IFRS, the IASB is constantly confronted with trade-offs between our desire to give as much information as possible on the one hand, and our wish to keep costs for preparers manageable on the other hand. You need only to look at the differences between Swiss GAAP and IFRS for these trade-offs to become clearly visible.

There can be no doubt that Swiss GAAP is simpler and that it allows the reporting entity more freedom in the methods it uses to measure certain assets or liabilities. Let me give you two examples of this.

First, under Swiss GAAP, goodwill resulting from acquisitions can be directly written off against equity or else it can be amortised. This relieves reporting entities of the burden of yearly impairment exercises that is required under IFRS. We acknowledge that impairment testing is costly. That is precisely the reason why in the *IFRS for SMEs* we allow companies to amortise goodwill over time. But what is also evident from both academic research and our own outreach is that goodwill impairment contains very important information for investors. Amortisation of goodwill, on the other hand, has traditionally been completely ignored by investors, and is immediately added back in their analyses.

So I believe that IFRS gives the investor more relevant information in this respect than Swiss GAAP, but I admit it comes at a price. In our Post-implementation Review of IFRS 3 *Business Combinations*, we will take another look at this trade-off.

A second big difference between Swiss GAAP and IFRS is pension accounting. Under Swiss GAAP, a company has more freedom in its estimation of its pension liability. I have no doubt this can be more attractive for the reporting company, but there is a price to be paid, which is a loss of comparability. In addition, Swiss GAAP allows more room for smoothing changes in the pension liability. This reduces volatility, but it does not fully reflect the economic reality behind the pension liability. So, again, the comfort provided by Swiss GAAP to the preparer comes at a price to the investor.

Some predict that our upcoming Leases Standard will be another incentive for Swiss companies to switch from IFRS to Swiss GAAP. Again, I acknowledge that our new leasing Standard will involve costs for the reporting entity, but I think these costs should not be exaggerated. I am also convinced that they are more than compensated for by the benefits of this Standard to both the investor and the lender. Current lease accounting simply does not give a true and fair depiction of economic reality. Let me just give a clear example of how misleading the off-balance-sheet treatment of leases can be. Recently, we analysed five retail chains that went into liquidation during the financial crisis. We compared the debt reported in their balance sheets to their off-balance-sheet lease commitments. The reported debt of these companies was seven to 90, that's nine-zero, times lower than the debt that was hidden in their leases. Our new Standard will make these liabilities clearly visible and it is high time that this was done.

Disclosures

One of the areas in which the IASB is determined to make complexity more manageable is our Disclosure Initiative project. Financial disclosures have been ballooning for many years, and some of the information disclosed provides little in the way of useful information to investors. Tackling this problem requires co-ordinated action by standard-setters, regulators, companies and auditors. However, I do believe the IASB needs to take the lead.

In June 2013, I launched a 10-point plan to help preparers do away with boilerplate disclosures that are of limited value to investors. We are well on our way to delivering on this plan.

In December last year, we issued amendments to IAS 1 *Presentation of Financial Statements* that encourage companies to apply professional judgement in determining what information to disclose in their financial statements. For example, the amendments clarify that immaterial information should be actively avoided in the financial statements. We will also give preparers more flexibility in presenting their accounting policies.

This is just a first step. Our next objective is to identify and develop a set of general principles for disclosure in IFRS. The IASB plans to publish a Discussion Paper on this subject in 2015. If you believe that improvements in disclosures are required, then I ask you to take the time to comment on our proposals. As I said earlier, we all need to work together in order to solve this problem.

Close

Ladies and gentlemen, I hope I made clear in my speech that the IASB takes the issue of complexity in financial reporting very seriously. We are ready to act where we can, but I have also made it clear that we cannot compromise on our primary goal of faithfully reflecting economic reality. I am looking forward to further exploring this issue in the panel discussion and I thank you for your time.