The bumpy path towards global accounting standards

Speech by Michel Prada, Chairman of the IFRS Foundation Trustees

Frankfurt, 16 October 2013

Thank you Clemens for your introductory remarks. It is my honour to share with you this evening some observations about our work to develop a global language of financial reporting. Germany has been a long-time supporter of this work, permitting the use of international accounting standards even before the IASB was created.

The Deutsches Rechnungslegungs Standards Committee, or DRSC, does a fine job of representing German interests and viewpoints to the IASB, while German companies also provide generous financial support to the IFRS Foundation.

That commitment is reciprocated. In addition to Clemens acting as a Trustee and member of the Executive Committee, we have Martin Edelmann serving as a Member of the IASB while beforehand Elke Koenig, now President of BAFIN, served as a member of the IASB. Indeed, while the diversity of the IASB is impressive, with more than 25 countries represented among the IASB's Board and technical staff, around 10% of technical staff come from Germany. In addition, Liesel Knorr of the DRSC serves as a member of the Accounting Standards Advisory Forum while Christoph Hütten, Chief Accounting Officer of SAP, is a Vice-Chairman of the IFRS Advisory Council.

Given this long history of cooperation and the extensive German representation at all levels of the organisation, Frankfurt seemed a natural choice to host this meeting of the Trustees. My role this evening is to serve as a warm-up act for the main event – a panel discussion on German perspectives on the work of the IASB and progress towards global accounting standards.

As the warm-up act I cannot promise any jokes, but I would like to make three points that I believe are important when discussing international financial reporting.

First, that the gains of IFRS in Europe must be protected. Processes can be improved and endorsement systems can be streamlined, but the *fundamental* premise of Europe's commitment to IFRS as global standards has to remain intact and undiluted.

Second, it is a sad fact of life that the work of the IASB will always be controversial. Global accounting standards are a form of economic globalisation, and globalisation in many parts of the world, included in some circles in my own country, is not universally supported. More precisely, our governance structure, which is necessary to protect the independence of the standard-setting process, will continue to seem unfamiliar to many people, including some politicians, particularly in Europe.

Third, that the IFRS Foundation and with it the IASB, are continuing to evolve, and with that evolution you will see a more holistic and inclusive approach where we work even more closely with others to support the development of the standards but also their consistent application and implementation.

I will discuss each of these points in turn.

Protecting the gains of IFRS in Europe

Most of us are old enough to remember life in Europe before IFRS. I certainly am! Before IFRS, Europe had more accounting languages than Member States. Many in Europe had become concerned about the number of European companies beginning to use US GAAP, while huge differences existed between accounting standards in Europe and around the world.

This became most obvious when in 1993 Daimler-Benz switched from German to US GAAP in order to become the first German company with a secondary listing in New York. A profit of around six hundred million Deutschmarks recorded using German GAAP turned into a loss of almost two billion Deutschmarks when reporting using US GAAP[1]. How were investors expected to make sense of such incredible differences?

A little later, the Lisbon Strategy of 2000 set out an ambitious strategy for a single European market. Of course, a single market needed a single set of accounting standards. Europe had spent decades trying to come up with a European set of accounting standards, but Europe's model of consensus-based decision-making made it difficult to achieve the level of specificity required for accounting standards with rigour and discipline.

That is why adopting IFRS provided Europe with an off-the-shelf solution – a decision endorsed by the European Parliament with the support of more than 95 per cent of MEPs.

Research commissioned by the European Commission has shown that the transition has been 'challenging but ultimately successful'. Most of the rest of the world took the lead from Europe. As a consequence, IFRS has gone on to become one, if not *the* most successful example of global financial regulation. It is now more than a decade since Europe decided to adopt IFRS. As time has passed, many have forgotten what life was like before IFRS.

After more than eight years of IFRS, it is quite right that Europe should take stock and see whether improvements to its own processes can be made.

That is why, for example, as Trustees we have been very happy to contribute to the work of Philippe Maystadt in his review of how to improve the EU's point of interface to the IASB. We are also supportive of the upcoming review of the IAS regulation by the European Commission. We also recognise the need to work in close cooperation with the European institutions – the Parliament, the Commission, the Council, EFRAG, ESMA and many others. They have invested a great deal in our work. It is important that we recognise this investment and to provide them with the confidence that this was a wise investment.

[1] See Camfferman and Zeff, "Financial reporting and global capital markets", 2007, Oxford University Press

At the same time, speaking as a proud European, we must be cautious about protecting these hard-fought gains. It might seem minor to tweak the Standards for use in Europe, to better reflect European preferences, or to revise the endorsement criteria so that non-endorsement of a Standard or Interpretation becomes more likely.

I understand that Mr Maystadt has cautioned against this in his draft report. Nonetheless, it would be easy to inadvertently cross the Rubicon. A tweak here, a failure to endorse there and very quickly you can have Standards that are once again incompatible with other parts of the world. A decade of progress unwound. This is something that we must all guard against. As the saying goes, "Nostalgia isn't what it used to be". The good-old days of European accounting were not as good as some seem to believe.

We all need to be vigilant to ensure that Europe continues to be a champion in global financial reporting, for the good of Europe and for the stability of the global financial system.

The messy business of standard-setting

I now move on to my second point. What I call the messy, controversial, unpopular business of accounting standard-setting. The G20 Leaders have repeatedly requested that we deliver a single set of global accounting standards. Let's take a moment to unpick what that means, namely one set of accounting standards used worldwide. A single way to describe the financial performance and the situation of a company. The same throughout the world.

This uniformity that comes with globalisation is often controversial. It can trample over established and familiar practices that have evolved over many decades. Cultural nuances can be challenged. The way that a German company is managed can be very different to that of a French or an American company. Yet the G20 has asked the IASB to come up with a single set of metrics to compare these companies on a like-for-like basis. No wonder this is controversial, difficult and time-consuming work. We made a great step forward in 2005 and have continued to make excellent process in signing up more countries and addressing issues in practice.

Then there is transparency. The IFRS Foundation is a private sector, not for profit, organisation acting in the public interest. As such, it has had, together with the IASB, to earn its legitimacy. That legitimacy comes from the extent of its governance, of its consultation process and the transparency of its activities. Such transparency is essential if we are to demonstrate that the IASB has weighed up all of the options, considered the costs and benefits of its Standards and given proper consideration to the feedback that it has received.

However, transparency is a double-edged sword. Transparency means that that everything is on display, warts and all. Can you imagine the Board meetings of your own organisation being open to the public? Where every Board paper is published on your website?

Where politically sensitive discussions between Board members take place with observers sitting on your shoulder, one row back from the Board table and the discussion webcast in real time around the world?

Don't get me wrong. This extensive transparency is entirely necessary to maintain confidence in our Standards. However, standard setting is tough work, and often subject to extensive lobbying by those who do not like the changes being proposed. Of course, our transparency means that the messy business of standard-setting takes place in front of a worldwide audience. That is one reason why the standard-setting process can sometimes appear to be so complex, lengthy and sometimes disjointed.

Then there is our somewhat unique governance structure. According to US academic Francis Fukuyama, the perennial problem for international organisations is balancing the competing challenges of efficiency and legitimacy. At one end of the continuum, he sees organisations such as the United Nations with high levels of legitimacy but controversial levels of efficiency. At the other end of the continuum, he describes multinational corporations with extremely high levels of efficiency but low levels of legitimacy. In between, there are literally thousands of international organisations, each with their own view on the correct balance between legitimacy and efficiency.

The challenge for the Trustees is where to position the IASB on this continuum. IFRS is primarily used by the private sector, so our processes must be sufficiently efficient to deliver standards that meet their needs. At the same time, IFRS are written into law in more than 100 countries so there is a clear public interest role.

This need to balance public-interest legitimacy and private-sector efficiency for Standards is evident throughout the work of the IASB. Some will continue to call for the IASB to have more direct government oversight. However, a UN-style of consensus-based decision making is unlikely to deliver accounting standards that impose the necessary rigour, discipline and comparability on financial reporting by multinational corporations.

At the same time, those who become frustrated at the slow progress of standard-setting or the endless rounds of consultation should ask themselves what aspect of the IASB's transparency and due process they are prepared to sacrifice? Any alterations could, of course, lead to unintended consequences with regard to the technical independence of the standard setting process. I guess here in Frankfurt, home of the ECB, you fully understand how important it is to protect IASB's technical independence.

This hybrid structure – an independent IASB, oversight by Trustees and public accountability through the Monitoring Board, will continue to be a delicate balance. However, I do believe that it gets the balance about right between legitimacy and efficiency. To paraphrase Winston Churchill's quote about democracy, it is the worst of all institutional structures, apart from all of the others that have been tried.

I strongly believe that the IASB does this difficult task extremely well. They deserve our full support for the tough decisions they must take.

A new chapter in financial reporting

Finally, I will finish on how I see the future of financial reporting continuing to evolve.

The title of the IFRS Foundation's 2012 Annual Report was 'a new chapter in global financial reporting'. The report described the remarkable achievements of the first chapter while setting out a vision for a second chapter in the history of the organisation. The characteristics of chapter two reflect the conclusions of the Trustees' Strategy Review and signpost our priorities for the coming years.

First, we have moved from a period of bilateral convergence with the FASB to a more inclusive, multilateral approach to standard-setting. This involves much tighter integration with a range of national and regional standard-setting bodies, including the FASB. This is best illustrated by the formation of our new Accounting Standards Advisory Forum, or ASAF. The ASAF has now met twice in person and once via conference call.

In only six months, this group has become one of our most important forums for dialogue with the standard-setting community. This shows how the manner of standard-setting has continued to evolve.

Second, we will deepen our co-operation with other international and regional organisations. This will enable us to monitor and encourage greater consistency in the adoption, implementation and enforcement of our Standards. We recently concluded an agreement with IOSCO to do just that. IOSCO did play a major role when they endorsed the IASC core standards in 2000, thus triggering an evolution that few would have anticipated at that time.

Securities regulators have indeed a major role to play together with standard setters. The IASB, today part of the global financial architecture and a member of the Financial Stability Board, must ensure that its Standards are capable of being applied and enforced on a globally consistent basis. But Securities Regulators are best placed to monitor the use and promote the consistent application of those Standards.

During the past year, we published more than 80 profiles that describe how individual jurisdictions are applying our Standards. Our Implementation Committee will soon follow up on this exercise. We therefore look forward to a fruitful cooperation with IOSCO globally and also here in Europe with ESMA.

Third, we have continued to strengthen the institutional structure of the organisation. I have already mentioned the ASAF, which our Executive Director, Yael Almog, has been instrumental in driving forward. We have also completed a review of the IFRS Interpretations Committee and a comprehensive update to the due process followed by the IASB.

In addition our Education and Content Committee has recently launched an important programme designed to help educators train the next generation of accountants. Each of these initiatives signposts a more inclusive and holistic approach to accounting standard-setting as we enter a second chapter in the history of the IFRS Foundation.

Conclusion

Let me now draw to a conclusion.

The Trustees fully support the work of Philippe Maystadt in looking for improvements in the way Europe interfaces with the IASB. At the same time, the gains that European investors and companies have enjoyed from the full adoption of IFRS must be protected and the relevance and soundness of financial information should not be hindered for the sake of other concerns however well founded they may be.

I also believe that globalisation in accounting standard-setting will continue to be as complex and difficult as any other form of globalisation. Questions about legitimacy and accountability will not go away and we will make our best efforts to demonstrate that we do serve the public Good in a proper way.

Finally allow me to conclude on a positive note. As an old timer of international cooperation in the financial field I truly believe that the innovations to our institutional structure, the improvements to the inclusiveness of our processes and the broader interest that we are taking in the full lifecycle of financial reporting have already delivered material improvements in the quality of financial reporting. All of this will add to the integrity and efficiency of global financial markets.

Ladies and gentlemen, thank you for your time and I now look forward to a lively and informative panel discussion.