Japan and global standards
Michel Prada, Meeting of FASF stakeholders, Tokyo, November 2014

Introduction
Ladies and gentlemen, distinguished guests, it is an honour to be with you once again. I have become a frequent visitor to Tokyo since becoming Chairman of the IFRS Trustees back in 2012.

I would like to begin by thanking Kazuaki Kama and Masaji Miyako of the Japanese Financial Accounting Standards Foundation for their exemplary leadership. I also wish to express my gratitude to Yukio Ono, Takehiro Arai, Atsushi Kogasaka and the other members of the Accounting Standards Board of Japan (ASBJ) for their excellent co-operation. I know Hans Hoogervorst deeply appreciates the constructive and high quality contributions of the ASBJ in its dealings with the IASB.

I also wish to thank Joji Okada and Takafumi Sato, who both serve admirably as Trustees of the IFRS Foundation, and their former colleagues Aki Fujinuma and Noriaki Shimazaki. Aki and Noriaki were excellent Trustees and continue to be active in supporting our work here in Japan.

Finally, my thanks also go to representatives from the JICPA, the Keidanren and many other organisations that are working hard to improve financial reporting globally and greatly contribute to our work.

My presentation to you this morning will include two themes. First, I will take stock of developments here in Japan, but also around the world. Second, I will peek into the future, to share with you our plans. Of course, I am very happy to respond to any questions that you may have. More than anything, I visit you this morning with the spirit of "Shoshin" – the "beginner's mind", to listen to your views and to benefit from your wisdom.

Taking stock
First, let us take stock. Although I am not an accountant, I have been deeply involved in accounting matters for many years. I served as Chairman of the Technical Committee of the International Organization of Securities Commissions, or IOSCO, when, in the year 2000, it endorsed the use of International Accounting Standards for the purpose of cross-border listings. That decision provided the necessary institutional blessing for the idea of global accounting standards to be taken seriously. It led to the restructuring of the IASB, and with it, the goal of a single set of global accounting standards.

Back in 2000, there were many sceptical voices about whether this goal was achievable. However, as of today, that goal is close to being achieved. Almost every country in the world, including the United States, allows international companies to use IFRS for cross-border listings.

This was a remarkable achievement. However, it did little to help international investors that were struggling to deal with a multitude of different, and often incompatible, accounting regimes around the world. For example, an investor in the global automotive sector may need to compare financial statements of companies in China, France, Germany, India, Japan, Korea, the United Kingdom and the United States. If the financial statements of companies from these countries are prepared in accordance with different accounting standards, then the basis on which net profit is calculated can vary from company to company. The only way to reconcile such differences is for investors to delve into the accounting standards, and few investors are accountants.

Incompatible national accounting standards add cost and translation risk to investors and to the global economy, whereas global accounting standards bring transparency, accountability and efficiency to global capital markets. That is why the G20 Leaders, Financial Stability Board, the International Monetary Fund, the World Bank and IOSCO are united in their support of our work and our mission of global accounting standards. Indeed, the Financial Stability Board only two months ago reaffirmed its commitment to "the continuing relevance of a single set of high quality global accounting standards."[1]

However, adoption of IFRS is more than just a public good. As the use of IFRS continues to increase, so do the benefits to companies that are preparing their financial statements in a language that is understood globally. Academic research has shown that investors have a clear bias for the familiar[2]. When it comes to international investing, IFRS provides that familiarity.

Our own analysis shows that for most industry sectors in the world, IFRS is now the predominant basis on which companies' financial statements are prepared. As that trend continues, then so too will the costs of being outside the familiarity of the IFRS system. After all, international investors have a choice of where they invest their precious capital. In jurisdictions where the use of IFRS is optional such as Japan, the question for CFOs is whether you want to be inside or outside the familiarity of that international system.

The good news is that much of the world has now completed its transition to IFRS, and the remaining parts of the world, such as Japan, are well advanced in their preparations to do so.

We long suspected that this was the case. However, last year we began a project to validate our assumption. We asked former member of the IASB, Paul Pacter, to undertake a thorough research project on the use of IFRS around the world.

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[1] Financial Stability Board (2014) *Press Release: FSB Plenary meets in Cairns, Australia*, www.financialstabilityboard.org,

[2] For example, see Foad, H (2010), *Familiarity Bias*, in Behavioural finance: Investors, Corporations and Markets, Wiley, USA

Paul began by conducting a survey of national standard-setters from each country about whether and how they applied IFRS within their specific jurisdiction. He then supplemented this research with further information from the large accounting firms as well as securities regulators from around the world. Finally, Paul asked the relevant public authority in each jurisdiction to validate his findings. As a consequence of this methodology, we have a high degree of confidence in the veracity of the research.

The results are very encouraging. Paul found that of the 138 countries researched, 114 of those countries already required the use of IFRS for domestic reporting purposes by all or most public companies. That is, four-fifths of researched countries now mandate the use of IFRS. Furthermore, he found that countries made few, if any, adjustments to the Standards, and when they did they were regarded as transitional steps on the path towards full IFRS adoption.

Progress is also advanced in those countries that are yet to require the use of IFRS.

You may be aware that China has already transitioned to Chinese Accounting Standards that are similar to IFRS. However, you may not know that Chinese companies representing more than 30 per cent of the total domestic market capitalisation in China also report using full IFRS for the purpose of their dual listings in Hong Kong, while Hong Kong has itself been fully on board with IFRS since the beginning.

In India, IFRS developments continue to move at a pace. The new Indian Government recently announced its intention to transition to Indian Accounting Standards based on IFRS. These are encouraging developments. However, the 'familiarity' of IFRS comes only from full use of our Standards and we are working with the Indian authorities to minimise any divergence from our Standards.

In the US, it is fair to say that progress has been slower than anticipated. Nonetheless, one should not minimise the similarities between IFRS and US GAAP and the many positive developments regarding convergence, such as converged Standards for segment reporting, business combinations, fair value measurement and, most recently, revenue recognition.

On top of this, use of IFRS in the US is far more advanced than many realise. US investors are already prolific users of IFRS financial statements, holding more than eight trillion dollars of foreign holdings, most of which are denominated in IFRS. Also, the SEC oversees the IFRS-compliant financial statements of nearly 500 international companies listed in the US. Those companies have a combined market capitalisation of trillions of dollars – representing a significant market for US investors. The SEC Chairman, Mary Jo White, has indicated in public forums that IFRS is a high-priority item for the SEC and that there is a need to provide some clarity on the SEC's position about the domestic use of IFRS in the US. We look forward to working with the new SEC Chief Accountant Jim Schnurr on this important topic.

This leaves Japan. As I have already said, there are very deep ties between the IFRS Foundation and Japanese stakeholders. Indeed, in many ways this is a model relationship.

Japan is represented at all levels of our organisation. The ASBJ and the various Japanese stakeholders here in this room provide very high quality and thoughtful input to the work of both the IFRS Foundation and the IASB. Masa Kono, Vice-Minister for International Affairs, is Chairman of the IFRS Monitoring Board. Tokyo is home to our only international office, supporting the needs of the Asia-Oceania community. Indeed, the credentials for the office becoming a regional centre of excellence have been recently enhanced with the appointment of a technical member of staff who is fluent in both Cantonese and Mandarin.

Furthermore, Japan provides generous financial support for our work, and you continue to provide excellent staff on secondment to both our London and Tokyo offices. By the way, the Trustees are working hard to ensure that the extent of Japan's financial support to our work is replicated elsewhere in the world, with particular reference to those jurisdictions that have yet to meet in full their funding obligations.

The Japanese authorities have taken a careful and considered approach to the use of IFRS in Japan. It is interesting to note that support for global accounting standards is now part of the Japanese government's growth strategy. Indeed, the 'Japanese option' on IFRS is being watched carefully by other jurisdictions because it allows larger, multinational Japanese companies to benefit from IFRS without immediately imposing the burden of transition on smaller, more domestically focused companies.

It is encouraging to see the number of companies voluntarily transitioning to IFRS growing so rapidly. I understand that, as of today, 46 domestic Japanese companies with a combined market capitalisation of 63 Trillion Yen have adopted or announced plans to adopt full IFRS. According to the annual reports of these companies, the top three reasons for transitioning to full IFRS were comparability with global competitors, the spread of their shareholder base and management efficiency.

It is also encouraging to see the use of IFRS being one of the considerations behind the inclusion in the recently launched JPX-Nikkei 400 Index – an index that, according to a recent article in the *Financial Times*, is very popular with international investors. [3]

Of course, Japan is also midway through the introduction of a further domestic accounting framework, known as Japanese Modified International Standards, or JMIS. I have no strong views on JMIS, and it is up to the Japanese authorities to

[3] '*Japan groups take a shine to JPX-Nikkei 400 Index*', Financial Times, 15 June 2014, www.ft.com.

determine what transitional steps to IFRS are required. However, if investor familiarity is the goal then this can only come from the full use of IFRS.

Future priorities

Up until now, I have described how we have achieved our original goal of worldwide use of IFRS for cross-border listings, and we are well on our way to achieving our subsequent goal of IFRS being truly global standards. IFRS is now spoken fluently in every part of the world, either as a primary or secondary language. In the fullness of time, I am confident that the IFRS map of the world will be completed.

As Trustees, we have worked hard to ensure that the institutional underpinnings of the IFRS Foundation and the IASB have kept pace with the growing responsibility of becoming a global standard-setter. In the short time since the IFRS Foundation began its work, we have completed two Constitutional Reviews and two Strategy Reviews. Each of these reviews has introduced major enhancements to the transparency and accountability of the IFRS Foundation and the IASB. For example, the formation of the IFRS Monitoring Board, considerable enhancements to the IASB's due process, including a public consultation on the IASB's agenda, and the creation of the Accounting Standards Advisory Forum, or the ASAF.

I read with interest the comments by Francoise Flores, Chairman of the Technical Experts Group of the European Financial Reporting Advisory Group, or EFRAG, who said in a recent publication that continued improvements and refinements to our governance and due process has led to the IASB 'coming to a real level of independence, that of a standard-setter that makes decisions only after having thoroughly considered others' views and arguments, explained its decisions and reported on the consequences thereof.'[4]

The Trustees are now beginning preparations for the next public consultation on a review of the structure and effectiveness of the IFRS Foundation that will take place during 2015. This consultation will build on the achievements of enhancements provided by the two previous Strategy Reviews and the two Constitutional Reviews. We are keen to hear any further ideas for improvement. However, there are several themes that the Trustees have already identified.

First, we will consult on the optimum size of the IASB. According to our Constitution, the IASB can have up to 16 members with appropriate geographical and professional diversity. One of the main reasons for having such a large Board was to provide sufficient resources for regional stakeholder outreach. However, in recent years other mechanisms have been developed to support this important goal. The ASAF has been an excellent innovation for connecting the IASB with important stakeholders from around the world. Furthermore, the advent of regional groups of accounting standard-setters has further enhanced

[4] '*Direct involvement of stakeholders in the IFRS standard-setting process*', Francoise Flores in 'Europe's Future in global markets', ICAEW, October 2014, www.icaew.com.

our contacts with important regional- and national stakeholders. Today, we have the EFRAG in Europe, the Asia-Oceania Standard-Setters Group, and the Group of Latin American Standard-Setters. The Pan African Federation of Accountants also does an excellent job of co-ordinating views from across that region. All of these bodies are represented on the ASAF.

So, the question is whether these innovations mean that a smaller, more focused IASB would be appropriate. We will seek feedback on this before determining how to proceed. The Trustees are also planning to seek input on improvements to further enhance the governance and accountability of the IFRS Foundation, as well as to protect the independence of the IASB. In parallel with this review, we will also complete a review of the ASAF. The ASBJ is a founding member of the ASAF and your views are particularly welcome.

Close

I will now draw to a close, to provide the opportunity for further questions. I have described how the original IOSCO goal has now been achieved, with almost every country in the world permitting the use of international standards for cross-border use. Moreover, our research shows that four-fifths of the world now require the use of IFRS for domestic reporting, and while the IFRS map of the world is not yet complete, we are well on our way to its completion. Japan is an excellent example of that progress.

Finally, I have talked about how the IFRS Foundation and the IASB have evolved to meet the responsibility of being a global accounting standard-setter, and how we plan to review our structure and effectiveness during 2015 and, if necessary, introduce further enhancements.

Thank you for your time, and I look forward to your questions.