

The benefits of IFRS Standards to emerging economies

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Intro

It is a great pleasure to be here in Peru. This is the first time I am able to visit your country, which is world famous for its natural beauty and its fascinating history. Peru is also one of the most dynamic economies of Latin America, so it was truly high time that I pay you a visit.

Peru's experience with accounting goes back to its pre-Hispanic history. The Incas had a fascinating system of record keeping in which they made use of the so-called Quipu's. Quipus are strings with knots whose shape and location represent numbers. They were used as a type of accounting 'books' to record –among others- the inventory of agricultural storage houses.

Accounting has changed a fair amount since the days of the Quipus. However, the importance of having a sound system for keeping tab of inventory and transactions was clearly just as relevant then as it is today.

And that brings me to the focus of my speech today. I will talk about the role of capital markets in an economy, the benefits of IFRS Standards to emerging economies and what the IFRS Foundation and the International Accounting Standards Board are doing to deepen our cooperation with emerging economies.

Capital markets

The development of capital markets is very important to a country's economic growth and prosperity. As companies grow, they need capital. Along with banks, financial markets provide that very important capital. And for financial markets to deliver, they need both companies to list and investors who are willing to provide funding to important infrastructure and other projects.

Latin America's share in the global capital markets is still relatively small. Most governments in this region know they have to step up to promote the development of their capital markets. The Government here in Peru is working hard to increase the attractiveness of the capital market to companies and to pull in the investors.

A prerequisite for investors –both foreign and domestic- to entrust their money to companies is that they have access to financial information they can trust. And that is where we come in. The International Accounting Standards Board develops IFRS Standards, which are now required in more than 80 per cent of the jurisdictions in the world.

The mission of the IFRS Foundation and the IASB is to develop IFRS Standards that bring transparency, accountability and efficiency to capital markets around the world. This is important to everybody, as it fosters trust, growth and long-term stability in the global economy.

To help explain why IFRS Standards matter, we have developed a short video. It is only two minutes long and I would like to share it with you. Here we go.

As the video says, financial information is the lifeblood of capital markets. Having access to financial information that can be trusted is really important to investors – and perhaps especially important if they are geographically far removed from the projects and companies they invest in. IFRS Standards enables investors in Asia and Europe to understand and to compare the financial statements of a company in Peru. IFRS Standards connect Peru with countries as far apart as Poland, Portugal and Panama.

In addition to the global comparability, I believe IFRS adoption has a key role in the development of the Mercado Integrado Latinoamericano (MILA). The effort to integrate stock exchanges from Colombia, Peru, Mexico and Chile under one trading platform was launched in 2011, allowing listed companies to access investors in all four markets.

We know there is still limited activity in MILA, in terms of trade volume, but the fact that IFRS Standards are a common feature of the listed companies can surely contribute to its development.

The spread of IFRS Standards

Let me now give you a brief overview of IFRS use around the world today. I have already mentioned that over 80 per cent of countries require the use of IFRS Standards. That is huge progress compared with where we were 15 years ago, when the IASB was established. Back then, the world was a patchwork of national accounting standards. Today, we have a much more uniform picture. More than 120 countries require the use of IFRS Standards and others permit their use. Here in Latin America, IFRS Standards are required in all the largest markets while a couple of smaller markets permit their use.

There are still some big countries around the world that are not yet fully on board. But in the large Asian economies, we have seen quite a lot of progress over the past year or two. Chinese standards are already very similar to IFRS Standards and China has recently reconfirmed its commitment to

work towards full adoption. India has this year introduced a new set of standards that are almost word-for-word IFRS. In Japan, companies have the option to use IFRS voluntarily and their number is growing very rapidly. More than 120 Japanese companies already use IFRS Standards¹. They represent more than 20 per cent of the of the Japanese market capitalisation. Several other companies plan to switch to IFRS Standards.

Now you may ask; what about the US? The US continues to use US GAAP but foreign companies listed on US stock exchanges have been able to use IFRS Standards for almost a decade. Some Peruvian companies that are listed both here in Lima and in the US benefit from this option.

Benefits of IFRS Standards

Having uniform Standards internationally makes life easier for managers of companies that operate across country borders. But that is only one of the benefits of IFRS Standard.

Research from different parts of the world has shown that the introduction of IFRS Standards in many cases also lowered the cost of capital. Why is that? Foreign investors do not have time to become familiar with national accounting standards. And if they are not familiar with an accounting language, they will simply charge a risk premium. These costs are likely to be passed on to the company and country they are investing in.

Many studies have found that the benefits of IFRS adoption outweigh the costs. That was the conclusion after 10 years of use of IFRS Standards in the European Union². Research in Korea³ has found that smaller listed companies have seen an increase in foreign investment after five years of IFRS use. The benefits experienced will, of course, vary from country to country, depending on the starting point. But it is clear that especially emerging economies, such as Peru, benefit most from IFRS adoption, because it immediately contributes to the credibility of their capital markets.

Working with emerging economies

Let me now talk a bit about how the IASB as an organisation is working to ensure input from emerging economies.

To set standards that work for the whole world, we need to collaborate closely with a range of stakeholders around the globe. Before we make any changes to our Standards, we consult widely. Discussions with national accounting standard-setters are an important part of this consultation process.

¹ <http://www.jpix.co.jp/english/news/1020/20160720-01.html>

² http://ec.europa.eu/finance/accounting/docs/ias-evaluation/20150618-report_en.pdf

³ <http://www.ifrs.org/Alerts/PressRelease/Pages/Five-years-on-Korea-sees-benefits-of-IFRS-adoption.aspx>

A few years ago, we established the Accounting Standards Advisory Forum, or ASAF, as a key channel to gather input from around the world. ASAF consists of national standard-setters and regional groups. The Grupo Latinoamericano de Emisores de Normas de Información Financiera (GLENIF) is a member of ASAF and it makes sure the voice of Latin America is heard in the standard-setting process. Peru is one of the national standard-setters that make up GLENIF.

But we also have other means of getting input from emerging economies. In 2011 we established the Emerging Economies Group. We did so to enhance the participation of emerging economies in the development of IFRS Standards. The focus of the group is primarily on issues around the implementation and application of the Standards. Argentina, Brazil and Mexico are the Latin American members. Of course, these countries talk to their GLENIF partners when contributing to the Emerging Economies Group.

Our current and future priorities

Before I close, I would like to touch upon our current and future work. This will be covered in detail by my colleagues throughout the conference, so I will be brief.

We appreciate that the significant changes we have made to our Standards over the past couple of years are keeping companies and others very busy at the moment. They are working hard to prepare for the new Standards on revenue, financial instruments and leases that are coming into force in 2018 and 2019. Therefore, a lot of this conference focuses on the implementation of these Standards.

We have one more major Standard to finalise, namely the new Standard on insurance contracts. This very important Standard will be published early next year. Once the insurance project is out of the way, should we conclude that we are done?

This week we have published the Board's Agenda for the coming years. In response to what we heard around the world, the new Agenda's central theme will be 'Better Communication'. We recognise that companies sometimes experience financial reporting as too much of a compliance exercise. Investors often believe that the financial statements depict performance in an insufficiently clear manner.

Our Standards are partly to blame for that. The fact is that IFRS Standards prescribe very little in the way of formatting the income statement. We define revenue, we define profit or loss, but we do not define very much in between. We do not at all prescribe subtotals in the income statement. Companies can basically do what they want. As a result, there is little comparability above profit or loss.

Companies also increasingly present alternative performance measures to investors, which is basically adjusted IFRS numbers. This information is easier for users to consume, but it almost always paints a rosier picture than reality.

So what will this ‘Better Communication’ theme mean in practical terms? We will not propose to dramatically increase the information requirements. But we are going to look at how this information is presented, how it is grouped together, and in what form it is made available. We want to make sure that companies can better tell their story through the financial statements, in a way that is clear, objective and consistent.

The central building block of this work will be our Primary Financial Statements project. Its focus will be to improve the organisation of the statement of profit or loss, the statement of cash flows and the statement of financial position – the balance sheet.

We will be looking at possibilities of defining commonly used subtotals in the income statement, such as operating income and earnings before interest and tax (EBIT). We might look at creating more disciplined ways for companies to adjust their earnings for infrequently occurring components of income. We also need to do more work on electronic reporting, as financial information is increasingly being consumed electronically.

‘Better Communication’ will be a central theme and a source of inspiration for the coming years. It responds to feedback we received through our various consultations, and it will hopefully deliver material improvements to the communications value of financial statements.

Close

That brings me to the close of my speech today. I have talked about the importance of capital markets for a country’s growth and prosperity; the spread of IFRS Standards around the world and the benefits the Standards bring. I have also talked about how we are working to deepen our cooperation with emerging economies. I look forward to hearing from the upcoming eminent speakers and wish you all a good conference. Thank you.