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Key foundations for high-quality reporting: Good practices of monitoring and enforcement, and compliance

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Michel Prada, UNCTAD-ISAR Conference on International Standards for Accounting and Reporting

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Ladies and gentlemen,

It is my great pleasure to be here today and it is an honour to participate for the third time in this UNCTAD Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting.

For those of you who did not participate in preceding meetings, I'd like to remind that the Trustees of the IFRS Foundation are responsible for the governance and oversight of the International Accounting Standards Board (IASB). Among other things, we determine strategy, ensure adequate financing and, above all, safeguard the technical independence and impeccable process of the IASB.

The fundamental objective of our organisation is to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards. These International Financial Reporting Standards, or IFRS, require high quality, transparent and comparable information in financial statements and financial reporting.

Our Standards help participants in the world's capital markets, and other users as well, to make economic decisions on the basis of descriptions of the financial position and performance of for-profit companies that are as objective and as accurate as possible.

This vision has remained unchanged since the founding of the organisation in 2001. It has been publicly endorsed by many international organisations, including the G20, the World Bank, the International Monetary Fund, the Financial Stability Board and the International Organization of Securities Commissions, or IOSCO. Indeed, the United Nations, through UNCTAD, has been a vocal proponent of global accounting standards since the 1970s. Most importantly, a couple of weeks ago, the Financial Stability Board reiterated its support for this strategic objective.

Today, I would like to speak to you about the importance of global accounting standards, how they are applied around the world, and what the IFRS Foundation, with the help of other organisations, is doing to ensure that they are implemented rigorously and consistently.

Why global standards?

The case for global accounting standards is by no means a new one, but it remains compelling. We live in a world where business and economics transcend national boundaries.

In this environment, accounting using multiple national accounting languages is cumbersome and expensive.

This is obviously true for large listed companies with global operations. But large *private* companies, as well as small and medium-sized entities, or SMEs—and those who use their financial statements—can benefit from a common set of accounting standards. After all, financial institutions that serve them make loans across borders and operate multinationally. They have to rely on sound financial statements in making lending decisions and in establishing financing terms and interest rates.

In addition, private companies, including SMEs, need to evaluate the financial health of buyers and providers in other countries. Before those private companies or SMEs sell or buy goods or services on credit, they want to make sure that those goods or services will actually be paid for or delivered. In the same way, venture capital firms that provide funding for private firms and SMEs across borders have similar needs to those of analysts of listed companies. This is why the international organisation of private equity supports the development of IFRS and uses them for its operations. Finally, credit rating agencies try to develop ratings uniformly across borders, which is easier when dealing with an international accounting language.

Global accounting standards liberate companies from the burden of complying with different, and often incompatible, national accounting requirements. Investors no longer need to worry about whether revenue and profit in one country are calculated on the same basis in another country. Another advantage of IFRS is that it provides market supervisors and government leaders around the world with a standardised set of performance metrics on which to build globally consistent regulatory initiatives. I would like to emphasise that, in doing so, IFRS helps in the sound management of financial stability and helps regulators and market players to make enlightened decisions that foster sustainable, long-term investment.

In a world in which foreign direct investment accounts for a huge proportion of overall investment, it is in everyone's interest to reduce friction in the global system. That is what IFRS does.

For a painful example of how interconnected the world's markets have become, one need look no further than the last financial crisis. What began as a sub-prime mortgage and securitisation crisis in the US soon went on to contaminate almost every other capital market around the world. That led to the deepest recession in a generation. In the aftermath of the crisis, we are acutely aware that every national capital market, from the largest to the smallest, does not operate on its own, but functions instead as a component of the global marketplace.

It is hard to imagine a scenario in which this trend towards a fully globalised marketplace could be reversed. Against such a backdrop, it is increasingly difficult to justify the use of multiple and often incompatible national accounting standards.

I would now like to talk for a moment about how IFRS is being used in practice around the world.

Given the powerful arguments in favour of global standards, it is perhaps no surprise that well over 100 countries now require or permit the use of IFRS. We are now in a position in which IFRS is undeniably the de facto global accounting standard. Indeed, in its 2008 report on IFRS, UNCTAD noted that "What was only a vision three decades ago has now become a reality"[1].

The decision by the European Union to undertake a wholesale adoption of IFRS from 2005 gave IFRS credibility and momentum. Following the EU's lead, a number of other major economies followed. Since 2008, over 25 countries have joined the IFRS family by requiring IFRS for all or most listed companies. Many of these countries have substantial capital markets, including Argentina, Brazil, Canada, Israel, Korea, Mexico, Russia and Taiwan.

It is particularly encouraging that IFRS has received strong support from emerging economies.

[1] UNCTAD (2008), Practical implementation of IFRS: Lessons learned, www.unctad.org

Indeed, for many, the adoption of high quality accounting standards is seen as a prerequisite for any fast-growing economy that is looking to establish itself in the global market. This will not surprise anyone who understands how important it is to have a strong institutional framework in place before markets can develop fully.

The World Bank and the IMF have encouraged the use of IFRS to support the development of capital markets and, in turn, for the development of those capital markets to support global economic growth and stability. Indeed, research conducted in 2012 demonstrated that inflows of foreign direct investment had increased in developing countries that had adopted IFRS. This provided evidence that the use of IFRS, and its encouragement by organisations such as the World Bank, is beneficial.[2, 3]

Of course, global standards only function properly if everyone adheres to them. As tempting as it may be for jurisdictions to pick and choose those standards that appeal and omit those that do not, doing so would undermine the very essence of what we are aiming to achieve. The reality is that if you want to reap the benefit s of global standards, then everyone must commit themselves to adopt the same, single set of high quality standards.

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[2] Gordon, L. A., Loeb, M. P., & Zhu, W. (2012). The impact of IFRS adoption on foreign direct investment. Journal of Accounting and Public Policy, 31(4), 374-398.

[3] Tarca (2012), The Case for Global Accounting Standards - Arguments and Evidence: http://www.ifrs.org/Use-around-the-world/Documents/Case-for-Global-Accounting-Standards-Arguments-and-Evidence.pdf

Since 2012 we have been building a clearer picture of how IFRS has been adopted and applied around the world.

As a starting point we used responses to a global survey by standard-setters and other relevant bodies. We then drafted profiles for each of the jurisdictions that responded. We invited those who had responded to review the draft. We also extended that invitation to others, including regulators and international audit firms.

So far, we have completed profiles for 138 jurisdictions, representing around 96 per cent of global GDP. Eventually, we plan to have a profile for every jurisdiction of the world.

The results make for fascinating reading. As of today, four-fifths of the world now mandates the use of IFRS for all or most public companies. Of the remaining one-fifth, almost all countries permit the use of IFRS for some types of companies. The research has also shown that the jurisdictions surveyed have made very few modifications to IFRS and, where they did, the modifications affected only a few companies and were generally regarded as temporary.

We have also been encouraged by the growing use of th*e IFRS for SMEs.* To date, 68 of the 138 jurisdictions that we have researched have adopted the *IFRS for SMEs*, with a further 16 jurisdictions that are considering adopting it.

It is only five years since the *IFRS for SMEs* standard was issued, but already millions of companies have begun using it, and by doing so they have gained the benefit of improved access to capital.

Of course, we do not only want to see IFRS being used all around the world. We want to see it being used correctly and consistently.

While these statistics show how successful the IFRS project has been, we still have much work to do. High quality standards are only a start. To complete the package that results in what we can call good financial statements, we must ensure that the standards are applied within a strong regulatory and legal framework. That framework must also incorporate adequate institutions and procedures to enforce the correct use of the standards.

As a relatively small organisation, the IASB does not have the mandate nor the resources to enforce and monitor application of the standards that it creates. To some extent, that is up to governments, financial regulators, and auditors in individual jurisdictions. However, with the help of other organisations, we have undertaken a number of initiatives aimed at promoting the correct use and application of IFRS.

At the international level we have IOSCO, which co-ordinates efforts by national and regional securities regulators to protect investors and to ensure the highest quality of financial information.

Last year we agreed on a set of protocols with IOSCO, under which we agreed to deepen our co-operation in support of our shared commitment to the highest standards of financial reporting. I should also mention the protocol we have recently signed with ESMA, the European organisation of securities regulators, which has a similar objective.

At a grass-roots level we also recognise the important role that education can play, especially in jurisdictions that have only recently adopted IFRS. To a large extent, IFRS financial reports are based on principles, estimates, judgements and models instead of on merely arithmetical better "formal" depictions that may be correct in from a strict mathematical viewpoint but that are capable of being misleading. This is sometimes in contrast to some existing standards, which may be more rule-based.

To promote rigour and consistency in application, the IFRS Foundation Education Initiative has published teaching material designed to help educators train the next generation of accountants in how to make such judgements. The material is freely available and translated into all of the world's most widely spoken languages. The project is designed to improve the application of IFRS by helping the development of the skills and knowledge needed to interpret both IFRS or the *IFRS for SMEs*, and to make the judgements that are necessary to apply them.

In addition, the Education Initiative undertakes training in the form of regional multi-day IFRS teaching workshops. Much of this work takes place in the emerging markets—in the coming months we will hold workshops as far afield as Colombia and Mauritius. Most of these sessions are hosted jointly with local organisations, development agencies and financial reporting capacity-building projects. Shorter workshops are arranged at major international and regional academic accounting conferences. We are most grateful for the support of organisations such as the World Bank and the Asian Development Bank in conducting this work.

Of course, UNCTAD is also active in this area, assisting developing countries, and countries with economies in transition, to improve their financial accounting and reporting practices. I wholeheartedly support the work of UNCTAD and I am keen to hear your ideas for greater co-operation with the IFRS Foundation in this important area.

It is our hope that these efforts, whether they are undertaken by individual organisations or as collaborations, should bring great long-term benefits to the global financial reporting community. By improving the quality of accounting in every jurisdiction, we are not only working to the benefit of those individual countries. We are also contributing to the overall health of the global financial system.

Let me now mention the next steps that we will be undertaking in our work.

Despite the progress we have made in the last decade, there is still a lot to do. Most of the world is now using IFRS, but there are some significant jurisdictions that are still hesitating about adopting it. However, even in those countries that have not yet fully adopted, IFRS is well known and there are significant pressures in favour of adopting it.

In the US, which is of course a major capital market with a strong and sophisticated accounting framework, the Securities and Exchange Commission permits foreign companies whose securities trade in the US to file their accounts using IFRS. Nearly 500 companies already do this. US investors are prolific users of IFRS-based financial information. I am pleased to say that the efforts towards convergence with the US have delivered significant successes, most recently regarding the finalising of the important standard on Revenue Recognition and the decision to account for leases on the balance sheet.

An increasing number of Japanese companies are also adopting IFRS. In the last 12 months alone we have seen the number of Japanese companies voluntarily switching to IFRS double. Chinese accounting standards are substantially converged with IFRS, while many of China's largest companies report using full IFRS for their dual listings in Hong Kong.

Earlier this year, Singapore announced its intention to switch to IFRS, while in India we have seen the adoption of Indian Accounting Standards that are largely converged with IFRS, which is an important step on India's journey to fully adopting IFRS.

To conclude, I believe that the world is now fully aware of the benefits of global accounting standards. IFRS has, over the last decade, established itself as the most viable solution for ensuring comparability and transparency in the expanding global market. At the same time we are fully aware that the success of IFRS depends on the standards being applied rigorously and consistently across all jurisdictions. For this reason, we are working, with the help of many other international and national organisations, to ensure that this is realised.

Ladies and gentlemen, thank you for your time.