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‘IFRS – ten years later’: a standard-setter’s view

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This essay is based on a response to Professor Ray Ball’s PD Leake Lecture delivered at the Institute of Chartered Accountants of England and Wales in October 2015. The views expressed in this essay are those of the author and do not necessarily represent the views of the International Accounting Standards Board (the Board) or the IFRS® Foundation.

Keywords: IFRS Standards; enforcement; comparability; Conceptual Framework

Introduction

Professor Ball’s essay covers a number of reflections on experience with, and research about, the costs and benefits of widespread adoption of International Financial Reporting Standards (IFRS Standards) from 2005. As a response from a practitioner (non-academic), this essay responds to some, but not all, of the issues covered by Professor Ball. It focuses on the following points:

- What has adoption of IFRS Standards delivered to capital markets?
- Who are the Board’s stakeholders?
- What factors and trade-offs should be considered in Standard-setting?
- How can stakeholders provide input to, and influence, the Board?

In this essay, I assert that adoption of IFRS Standards has delivered improvements in the usefulness of financial reporting by giving users of financial statements with knowledge of IFRS Standards a single basis for assessing the reported amounts and disclosures. I also argue that this has improved users’ visibility into the quality of enforcement regimes around the world, with enforcement encompassing both external audit and market regulators. In contrast to Professor Ball’s arguments that contracting should be a significant consideration in setting financial reporting requirements, I highlight and support the Board’s focus on users in capital markets who lack the ability to compel additional information such as alternative measurements of performance and financial position. I expect that information provided for capital market participants also

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should be useful for private contractors but believe that Professor Ball's concerns about the need for stability to simplify reporting for private contracting does not outweigh the need for IFRS Standards to be updated in response to concerns from a broader range of stakeholders. I offer comments about the standard-setting process to provide insight into balancing stakeholder engagement with the risk of politicisation.

What has adoption of IFRS Standards delivered to capital markets?

I agree with many of the points that Professor Ball raised in his essay, including his observation that adoption of high-quality standards does not automatically lead to high-quality reporting. He also highlights that improvements in the quality of enforcement are in some ways an unexpected consequence of the move to IFRS Standards. I saw enforcement improvements in the wake of wide-scale adoption of IFRS in 2005, and I remember discussions anticipating this in the late 1990s, when I was working at the US Securities and Exchange Commission and was involved with the International Organization of Securities Commissions (IOSCO). A number of market regulators were gearing up their enforcement activities to increase, by several orders of magnitude, their engagement and impact with issuer reporting, and in anticipation of the adoption of IFRS Standards. They were not investing in enforcement systems for national standards that they expected would be replaced by IFRS Standards. Markets adopted IFRS Standards in part to reduce friction in international flows of capital, and many also saw it as a way to upgrade the quality of financial reporting in their jurisdiction. Consequently, a concurrent investment in enforcement 'made sense' as a reinforcing mechanism to the adoption of IFRS Standards. This is my point of agreement with Professor Ball about the adoption of IFRS Standards having driven enhanced enforcement activities. And, just as companies became more comparable because of elimination of reporting differences, so did the enforcement effectiveness of different market regulators. I believe that adoption of IFRS Standards improved visibility regarding quality of enforcement because I see IFRS Standards as a raking light – clear, angled light that is unforgiving in revealing flaws – for the quality of application and enforcement.

While neither the IASB nor the IFRS Foundation is or ever will be an enforcement body, we do care about quality of adoption, which is why we have a goal of supporting consistent application of IFRS Standards. If you look at the Board's work plan, you will see an entire category of technical activity focused on consistent implementation of IFRS Standards. The Foundation also has worked to strengthen ties with enforcement bodies, including IOSCO, in a joint effort to keep raising the quality of IFRS Standards in practice.[1]

Having shared several points of agreement with Professor Ball, I now get to disagree wholeheartedly with one of his related points – that adoption of a single set of standards discards information regarding reporting quality. I view IFRS Standards as stripping away a layer of fog or distraction. Differences in accounting standards do not necessarily signal differences in the quality of reporting. If you are putting a wider range of reporting entities onto a single set of standards, as an enforcer (or investor) you have a clearer light – that harsh, raking light that allows you to see differences more quickly and clearly. Whether you are an enforcer or an investor, you are able to read financial statements with a single set of expectations about what information you will get from those statements; and if you do not see it – if the information in the financial statements is incomplete – then you have a signal of the quality of reporting that is not masked by a lack of understanding of local reporting. For example, what global investor could be expected to know 20 different national requirements for disclosure about significant events after the balance sheet date? And if you do not know the details of such requirements, then how do you interpret silence about such events when using financial statements?

I also agree with Professor Ball's warnings about a number of risks that the Board faces in terms of keeping the adoption of IFRS Standards as a successful innovation in capital markets. As Professor Ball notes, there is a shortage of relevant academic research on the impacts, costs and benefits of adoption of IFRS Standards. He noted (in his list of references) material published by the European Commission staff which includes some useful data. There are reviews of adoption costs and benefits conducted in some other jurisdictions as well, including Canada, Japan and Korea.[2] But, overall, more research would be useful in this area.

Who are the board's stakeholders?

Before turning to the question of the Board's stakeholders, I want to highlight a significant disagreement with Professor Ball about the purpose of financial reporting and who the Board should be considering when writing IFRS Standards. The constitution that governs the International Accounting Standards Board sets out its mission as working in the public interest to serve investors, other participants in the world's capital markets and other users of financial information.[3] This is a different focus from the range of activities that Professor Ball suggests in his paper. He focuses on contracting and on globalisation, not only of capital markets, but also of labour markets, of product markets, and general economic globalisation. While this broader range of globalisation is relevant as context, the Board is focused on providing information first and foremost to investors in capital markets – to global capital market participants using financial statements as inputs to capital allocation decisions and stewardship assessments. Consequently, we are making decisions about what information has to be presented for those who have no ability to compel additional information from those who have or are seeking debt or equity financing in capital markets. That is a different situation from direct contracting between, for example, a lender and a borrower.

It was very helpful that Professor Ball put some of the changes he highlights within the context of broader globalisation developments. However, it is also important to note an implicit message in his discussion of how IFRS adoption can be seen to improve corporate governance – that accounting can be used to drive virtuous behaviour.

At one level IFRS Standards do not try to drive any specific behaviour; they seek to depict, as neutrally as possible, the activities and the consequences of the activities that companies undertake. IFRS Standards are not set with the purpose of motivating specific behaviours by management. We believe that accounting best serves capital formation, and therefore economic development, by providing unbiased information about what has happened – portraying the economic reality as it is – to those trying to allocate and price capital.

At another level, however, we recognise that accounting standards can influence behaviour. This was set out very convincingly by Louis Lowenstein that can be summarised by its subtitle: *You manage what you measure*.[4] 'Accounting' and 'accountability' are related words. But IFRS Standards are not an economic policy tool of national or global governments designed to incentivise specific behaviours in the same way as a government might introduce an investment tax credit or grants or other incentives for undertaking certain activities. When assessing IFRS Standards and the changes that they have driven, you have to do this within the context of our mission, which is to serve the public interest by developing standards that bring transparency, accountability and efficiency to financial markets around the world.

What factors and trade-offs should be considered in standard-setting?

Professor Ball points to the difficulties that come as a result of the Standards changing, with ongoing changes creating difficulties for debt contracting, especially for setting covenant requirements. The balance that the Board is trying to strike is how to be responsive and yet understand the costs of change and the benefits of a stable platform.

When we carried out our first Agenda Consultation in 2011, one of the clear messages we received from stakeholders was that we were not being active enough about repair and maintenance issues with existing IFRS Standards.[5] In some ways the last several years have been an embodiment of 'be careful what you wish for because you may get it'. We have been trying to both catch up and be more responsive to the demands of stakeholders to fine-tune the Standards, and that has, in turn, raised some concerns about stability.

Some other aspects of our balancing act that I would like to touch on include:

- Concepts versus operationality;
- Principles versus rules; and
- Comparability versus communication.

Concepts versus operationality. Concepts alone sound great until you get to the implementation stage. Preparers often call for some relief because of the costs associated with implementation. We saw that in a number of instances in discussions about our new Revenue Standard: 'You mean you really want me to analyse whether I am a principal or an agent in every taxation jurisdiction around the world? We need an exception from that.' That was a message coming particularly from the United States, where the same requirement also was being introduced. That kind of operationality concern is what creates exceptions and complexity in standards – but undiluted principles can be challenging in terms of operationality. There is no exact formula for getting this balance right – and it is a constant tuning not only while a Standard is being finalised but also when our IFRS Interpretations Committee considers issues.

Principles versus rules is often portrayed as a conflict, but I think that the two are complementary. The question is: to what extent should principles be complemented with implementation guidance that says 'this is the principle; this means for the issues in area of activities X, Y and Z that the following outcomes are expected from applying this Standard to those activities'. Thus, I do not see it as a conflict but as a second balancing act for the Board.

Comparability versus communication is a third balancing act. If you are focused on the ability to compare information produced by different reporting entities then you might be more concerned about the difficulty of making that comparison if presentations are tailored; for example, if there are few minimum line items or no mandatory standardised format of primary financial statements. Challenges in making comparisons between entities would be made worse if, for example, the business model of an entity affects measurement, presentation, aggregation and disaggregation as well as the determination of which line items and sub-totals are presented. But if we make financial statement presentation requirements too rigid, then financial statements are seen as less useful for communicating the entity-specific information that investors want, and reporting becomes more about compliance than communication. Comparability versus communication is a challenging and critical balancing act for IFRS Standards.

In light of these and other balancing acts that challenge the Board, I find, in contrast with Professor Ball, that a Conceptual Framework is a necessary and useful anchor both for us and for preparers and auditors of financial statements. IFRS Standards are used in a wide range of countries and, as Professor Ball noted, to report activities in different legal environments with different business practices. Having a single coherent framework is important context not only for the Board, but also for preparers of financial statements when addressing issues that might not be covered explicitly in the Standards. Therefore I disagree with using a case-based approach to standard setting. That approach seems a design for encouraging both gaps in and conflicts between Standards, and also for increasing the risk of inconsistency in understanding and application of IFRS Standards.

How can stakeholders provide input to, and influence, the Board?

Let me turn to strategy and structure. How do you balance buy-in via consultation with politicisation? One of the responses to this challenge is the structure of our organisation, which has evolved over the last 15 years. It includes a *Monitoring Board*, composed of public authorities responsible for overseeing capital markets, which is responsible for the public accountability of the organisation; *Trustees*, who are responsible for the oversight of due process and the governance; and the *Board*, which is responsible for the technical Standard setting. This structure safeguards the independence of the Board and Standard setting.[6]

Input to standard-setting is good, but politicisation is not helpful. Distinguishing between what is good and what is unhelpful input depends partly on when it is provided. If there is a ramp-up in input as we are approaching the end of a project, then that is a warning that politics rather than substance may be involved and that instead of receiving technical input on the project, we are in fact being lobbied to set aside decisions reached on the basis of input received, research and field testing conducted throughout the project. The most compelling input is much earlier in the process, when it can shape the requirements while all stakeholders are engaged. For the Standards to be of the highest possible quality, there needs to be a level of shared responsibility for their development. That entails soliciting input from a broad range of stakeholders across the world.

Conclusion

The points raised in this essay are complementary rather than contradictory to some, but not all, of the issues that Professor Ball raises in his essay. My overall conclusion is that I both agree and disagree with Professor Ball – and that I feel richer for having been challenged by him to think about what we have done, what has been achieved in terms of improving the efficiency and effectiveness of investment decisions in capital markets, and what and how the Board should move forward.

Notes

1. See Statement of Protocols for Cooperation on International Financial Reporting Standards, September 2013, http://www.ifrs.org/Use-around-the-world/Documents/IOSCO-IFRS-Foundation-Protocols-2013.pdf.
2. See, for example, http://www.ifrs.org/Alerts/PressRelease/Pages/Tokyo-Stock-Exchange-data-show-voluntary-adoption-of-IFRS-by-Japanese-companies-continues-to-grow.aspx; https://portal.feicanada.org/enews/file/CFERF%20studies/2012-2013/The%20cost%20of%20IFRS%20transition%20in%20Canada%20-%20July%204,%202013%20-%20final.pdf; http://www.ifrs.org/Meetings/MeetingDocs/Trustees/2013/January/AP4-Korean-Adoption.pdf; http://ec.europa.eu/finance/accounting/docs/ias-evaluation/20150618-press-release_en.pdf.
3. http://www.ifrs.org/The-organisation/Governance-and-accountability/Constitution/Documents/IFRS-Foundation-Constitution-January-2013.pdf.
4. Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 Columbia Law Review (April 1996).
5. http://www.ifrs.org/Current-Projects/IASB-Projects/IASB-agenda-consultation/Documents/Feedback-Statement-Agenda-Consultation-Dec-2012.pdf.
6. See the overview of the IASB and IFRS Foundation structure available at http://www.ifrs.org/About-us/Pages/How-we-are-structured.aspx.