



FINANCIAL  
REPORTING  
FACULTY

# THE FUTURE OF IFRS

INFORMATION FOR BETTER MARKETS INITIATIVE



# ICAEW AND IFRS

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. ICAEW is a professional membership organisation with a truly global reach. It is also a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.

ICAEW's members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. ICAEW ensures that these skills are constantly developed, recognised and valued. Since 2003, the world-leading ACA qualification has been based around IFRS requirements. ICAEW has also produced online certificate-level and diploma-level IFRS learning programmes, available to all.

ICAEW has been a persistent champion of the creation of a single set of high-quality global accounting standards and their application by publicly traded and other companies around the world. Indeed, it was former ICAEW President Sir Henry Benson (later Lord Benson) who spearheaded the movement to tackle diverse global accounting practices, leading to the setting up of the IASB's predecessor – the International Accounting Standards Committee (IASC) – in 1973.

In 1997, ICAEW published a far-sighted paper entitled 'The International Dimension'. This paper helped to move the debate about global accounting standards centre stage in the UK at a time when few others in the UK had contemplated a future when UK GAAP would be replaced by standards set by an international organisation.

ICAEW's Financial Reporting Faculty shares the IASB's vision of widely-applied, high-quality, international accounting standards. The faculty works closely with the IASB, providing comprehensive responses to all of its consultations – on new and revised standards, and on governance and related matters – drawing on the experience of our members in the business, public practice and investment communities around the world. The faculty does not, however, offer its support to the IASB lightly. Where necessary, its responses are critical, especially where proposals are unduly complex, and offer practical suggestions for improvement. Close engagement with board members and senior staff on all aspects of IFRS Foundation governance, strategy and technical proposals helps to ensure that ICAEW, through the faculty, retains considerable influence in this area.

ICAEW made a significant contribution to the successful adoption of IFRS by UK-listed companies in 2005. ICAEW expertise in this area was reflected in its selection by the European Commission to deliver a comprehensive study in 2007 covering all aspects of first time application of IFRS by European Union member states. In 2008, ICAEW was commissioned by the United Nations to prepare a follow-up report on the UK experience of IFRS implementation, which was presented in Geneva in October that year.

ICAEW also actively engages with policy-makers and academics in the United States on financial reporting matters. Each year, we organise a number of panel sessions at the American Accounting Association (AAA) annual meeting. In August 2012, at the meeting in Washington DC, ICAEW brought together leaders in accountancy theory and practice to discuss 'The future of IFRS: where do we go from here?'

ICAEW's Financial Reporting Faculty was established in 2008. It is committed to providing its members with the practical help they need in today's complex world of financial reporting. The faculty provides its members around the world, ICAEW and non-ICAEW, with clear and accessible assistance across a spectrum of financial reporting issues, keeping them up to date with changing regulations and standards. Its specialist online resources range from technical briefings and factsheets, to apps, webcasts, blogs and bespoke online standards trackers.

The faculty's thought leadership programme, *Information for Better Markets*, helps to set the agenda for the future development of financial reporting. As part of this programme, the faculty hosts an annual academic conference that brings together leading thinkers from around the world to discuss key issues affecting financial reporting. The event attracts an international audience, including business people, auditors, and standard-setters from the global financial reporting community. The 2010 conference was on the theme of 'Adopting IFRS: the global experience', and was followed by publication of the papers presented at the conference in the academic journal 'Accountancy and Business Research'.

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# 1. EXECUTIVE SUMMARY

The use of IFRS has continued to spread across the globe. Nonetheless, as 2012 draws to a close, not everything in the IFRS garden is rosy. Some 10 years after the IAS Regulation became law across the European Union, some momentum has been lost as major convergence projects have stalled, and the United States and some other significant economies are hesitating as they consider whether to commit to IFRS. The IASB Chairman, among others, has recently expressed concern about the convergence programme, related IASB operational issues, and the position of the SEC. But we think it is important to step back, to put things into perspective. Supporters of a single language of accounting should not be unduly dismayed by the inevitable setbacks. Instead we need the widest debate possible about what more needs to be done to safeguard the long-term success of this ambitious project. We hope that this paper can make a positive contribution to that debate.

The theoretical advantages of a universal financial language are supported by an increasing body of academic evidence which shows that moving to IFRSs does indeed bring significant benefits. For international investors, in particular, the move to IFRS since 2005 has been transformational. The current suite of IFRSs is far from perfect. In some respects they seem overly complex, and in some instances quality has been compromised by the G20-endorsed programme to converge with US GAAP. But despite these and other shortcomings, we believe that the IFRS product has inherent strengths and advantages that fully justify support for IFRS by those seeking to realise the vision of a high-quality, global set of accounting standards.

The spread of IFRS around the globe has been – and continues to be – a remarkable success story. Today well over 100 countries – including more than two-thirds of the G20 – require or allow their listed companies to prepare their financial statements using IFRS or national standards based closely upon IFRSs. But momentum has slowed, and a range of important questions are now being asked about where the project goes from here.


A number of long-term factors, not least the increasingly cross-border nature of trade and capital-raising, have contributed to a clear need for a widely-accepted set of international accounting standards. There are barriers too, including differences in national institutions that reduce the chances of uniformity of accounting, as well as shorter-term challenges that appear to be threatening the success of the IFRS project. For example, the hesitancy of the US to commit to IFRS is widely regarded as a major setback. There are also concerns about consistency of implementation. A few even blame IFRS for creating the global financial crisis.

It is, we accept, by no means certain that IFRS will ever be regarded as a truly global set of standards. However, we believe that barriers and challenges to IFRS can, in time, be overcome.

Firstly, although the global financial crisis did expose the need to improve aspects of financial instruments accounting and disclosure, IFRS generally weathered the crisis well. Claims that financial reporting somehow caused or prolonged the crisis are largely unsubstantiated. Academic research to date has failed to find any significant connection between fair value accounting and the crisis. Secondly, the delay in US adoption may not be such a bad thing, if the IASB consolidates what has been achieved to date before having to address the practical implications of a more decisive commitment to IFRS reporting by the US. Finally, we should not be overly concerned about relatively minor local differences in how IFRSs are applied, especially as the advent of common standards may accelerate improvement to corporate governance, auditing and regulatory regimes around the world. The goal of the IFRS project should not be achieving complete uniformity across the globe. It should be to ensure that financial reporting facilitates, rather than acts as a barrier to, international trade and investment.

Some economies already have strong national GAAPs. For them the case for moving to IFRS may not be clear-cut, at least in the short run. But others should not be discouraged. The fact that the US is still hesitant about a radical shift away from its own high-quality standards should not be taken as any reflection on the suitability of IFRS reporting for other markets. Other jurisdictions should think carefully about the well-evidenced benefits of adopting IFRS. The transition will be challenging, but the challenges are ones that others – including the disparate countries of the European Union – have already shown can be overcome. At the very least, listed companies should be given the option of moving to IFRS. Companies can assess for themselves whether the benefits of transition outweigh the costs.

The era of convergence between IFRS and US GAAP should be ended formally in a matter of months, not years. Further amendments to proposed and existing IASB requirements designed to harmonise standards with the US would not be justified unless they represent a significant improvement in IFRS financial reporting. The IASB should now focus its attention squarely on the needs of the 100 plus jurisdictions that have officially adopted its standards, and on working to encourage those countries that have moved their standards close to IFRS – notably China – to take the final steps towards full IFRS reporting. Nonetheless, the IASB must continue to liaise closely with the United States; any notion of removing the SEC from the Monitoring Board or



removing US citizens as Trustees or IASB Board members should, for the foreseeable future at least, be resisted. It would be counter-productive, and divisive. The US remains the world's largest capital market, and its long tradition of standard-setting means that it has much to contribute by way of financial reporting expertise.

Turning the vision of a truly global set of standards into a reality involves huge challenges that are likely to require significant organisational change at the IASB, alongside constructive commitment by all key stakeholders around the world. The next phase requires the collective stakeholder shoulder to be put to the IFRS wheel.

The G20 governments should play a more decisive role in support of IFRS reporting. They should continue their long-term support for a single set of global accounting standards, but recognise that the most practical way of achieving this in the short term is for all G20 members to allow optional use of IFRS in their capital markets. They should take on proportionate shares of the funding required to support international standard-setting and should press others to follow suit.

Regulators need to play their part. It is not the IASB's job to enforce its standards. The IASB needs more active support, including through IOSCO, and regulators around the world need to work together more closely to deliver consistent enforcement. Each regulator needs to ensure that it does not stifle the exercise of professional judgement or stray into the area of general interpretation.

Above all else, the IASB must become a truly global organisation. Managing the competing demands of its increasingly diverse list of constituents is undoubtedly one of the biggest operational challenges facing the IASB today. The IFRS Foundation – like any other successful, international organisation with a global brand to build and support – must continue to look long and hard at proven ways of decentralising its non-core responsibilities and sharing potential responsibilities. Many of the ideas for its future operations are untested and many serious challenges lie ahead.

Critically, this must involve finding a way of creating an effective feedback mechanism that enables it to work successfully with other organisations without leading to organisational paralysis. This requires a good deal more debate and organisational experimentation. Simply replicating what national standard-setters have done in the past will not suffice. The mindset needs to change for good. There is no well-tested model for standard-setting on a global scale, so good practice and the mechanisms necessary to achieve it will need to evolve over time.

The challenge is above all to demonstrate that the IASB is an organisation that listens and learns as well as leads, that it is a global body that belongs to and is responsive to its national stakeholders, without embedding operational inefficiencies or layers of advisory groups and due process that in time might paralyse effective decision making. But the journey has only just started.

There are other related, fundamental issues to address. For example:

- Evidence-gathering will be critical in future, but the challenges involved in ensuring that the right research is undertaken by the right bodies, at the right time, with the right degree of IASB oversight, should not be underestimated.
- The complexity of IFRS reporting requirements may discourage some countries from fully embracing international standards; the IASB should strive to minimise unnecessary complexity in its standards and hold fast to the vision of principles-based standards that require a reasonable degree of judgement.
- There is a need to establish operable models for undertaking effects studies and post-implementation reviews. There are few good precedents. The IASB should be prepared to redesign the approach and scope of reviews should initial results prove disappointing.
- Major changes in the scope and reach of the board's activities will not be possible unless the IFRS Foundation's funding system is established on a secure and sustainable basis.

Success is not guaranteed. But the faculty believes that these challenges can be overcome with the full and constructive support of IFRS stakeholders. It won't be easy, and it may take longer than some would like. But if the IFRS Foundation evolves into the type of organisation we envisage, backed by the G20 governments and the right sort of regulation, we may well in due course look back on the IASB's second and third decades and conclude that they were just as successful as – if not more so than – its first.

## 2. INTRODUCTION

### THE SPREAD OF IFRS

In the midst of the global financial crisis that began in mid-2007 with the bursting of the bubble in the United States housing market, the G20 group of countries publicly endorsed the aim of establishing a single set of high-quality global accounting standards. Much has been achieved since then, with use of International Financial Reporting Standards (IFRS) – the standards published by the International Accounting Standards Board (IASB) – continuing to spread across the globe. There is a growing body of evidence that as the use of IFRS has grown, financial information has become more transparent and more comparable.

### FALTERING PROGRESS?

Nonetheless, as 2012 draws to a close, not everything in the IFRS garden is rosy. Major convergence projects on key topics such as financial instruments and leases have begun to falter, with globally acceptable solutions still out of reach, despite concerted efforts by the standard-setters.

IASB chairman Hans Hoogervorst has in recent months expressed frustration at the lack of progress being made, complaining in the context of convergence efforts of ‘dysfunctional working processes and dysfunctional decision making’ and conceding that as the IASB has ‘broken deadlines so often ... nobody believes them anymore.’ He has commented that completing the leasing project will be an ‘uphill battle’ and has described as ‘deeply embarrassing’ the failure to find a workable model that would require financial assets to be impaired on an expected loss basis.

What’s more, the much-anticipated firm commitment by the US Securities and Exchange Commission (SEC) on the adoption of IFRS, or their incorporation into US Generally Accepted Accounting Principles (US GAAP), seems more elusive than ever. The July 2012 SEC staff paper gave no clues as to when the US would make the move to IFRS, and while the United States may be ‘well-prepared for a successful transition’ according to Mr Hoogervorst, others – such as AICPA chairman Gregory Anton – have recently warned that the ‘absolute soonest’ IFRS will be applied in the US will be in five to six years’ time.

So while some continue to argue that the momentum behind IFRS becoming a truly global set of accounting standards is irreversible, others claim that there is a danger that the coalition of countries supporting IFRS could break apart, and that, rather than moving inexorably towards a single set of accounting standards, we could return to a world of highly fragmented national standards and national standard-setting.

### PUTTING THINGS INTO PERSPECTIVE

It is important, however, to step back and put things into perspective. We should remind ourselves that the idea of a set of global standards isn’t a new one. Indeed, the genesis of the project can be traced back to at least the 1970s, when ICAEW played a key part in the establishment of the IASB’s predecessor, the International Accounting Standards Committee (IASC). Put simply, supporters of a single language of accounting should not be unduly dismayed by recent setbacks – such an ambitious international project will inevitably encounter delays and disappointments along the way.

## ABOUT THIS PAPER

This therefore seems an opportune moment to pause for thought. In this paper, ICAEW's Financial Reporting Faculty ('the faculty') takes a step back from the detail to rehearse the benefits of a global set of standards, to take stock of what has been achieved to date, and to encourage the widest debate possible about what more needs to be done to safeguard the continuing success of this ambitious project. We focus on the longer term, although inevitably this means assessing the impact of some important near-term issues, notably the current impasse on convergence and US adoption of IFRS.

This paper is designed to raise awareness of the key issues among those concerned with preparing or using financial statements and to stimulate discussion among standard-setters, regulators and other interested parties across the globe. We hope it can make a positive contribution to the lively debate about the future of the IFRS project.

In such a short paper, there are inevitably important issues and developments that are not addressed at all, or are addressed only in passing. One is the growing awareness of the need for more integrated corporate reporting. The faculty supports the work of the International Integrated Reporting Council in this area. We anticipate, however, that traditional financial reporting will continue to be a key focus of investors and other users, and will form the bedrock in future of integrated reports. With this in mind, we have set out to retain in this paper a clear focus on the evolution of international financial reporting.

**If you have any comments or observations on the issues raised and views expressed in this report, please email them to [frfac@icaew.com](mailto:frfac@icaew.com)**

The use of IFRS has continued to spread across the globe. Nonetheless, as 2012 draws to a close not everything in the IFRS garden is rosy. Some 10 years after the IAS Regulation became law across the European Union, some momentum has been lost as major convergence projects have stalled, and the United States and some other significant economies are hesitating as they consider whether to commit to IFRS. The IASB Chairman, among others, has recently expressed concern about the convergence programme, related IASB operational issues, and the position of the SEC. But we think it is important to step back, to put things into perspective. Supporters of a single language of accounting should not be unduly dismayed by the inevitable setbacks. Instead we need the widest debate possible about what more needs to be done to safeguard the long-term success of this ambitious project. We hope that this paper can make a positive contribution to that debate.

# 3. THE BENEFITS OF A GLOBAL SET OF STANDARDS

## THE BENEFITS OF A UNIVERSAL FINANCIAL LANGUAGE

A universal financial language offers many well-documented advantages. Cross-border businesses benefit from reduced preparation costs, and cross-border trading in securities increases as international investors can more readily compare the performance of companies based in different countries. In turn, it is argued that this results in increased market efficiency and a reduction in the cost of raising capital for companies, which ultimately helps to boost growth.

The rapid spread of IFRS in recent years means that these benefits are no longer theoretical. A growing body of research shows that they are increasingly evident in practice. For example, in 2007, ICAEW wrote a detailed report for the European Commission on the implementation of IFRS in the European Union in 2005. This concluded that adoption of IFRS by the then-25 member states, each with their own very different financial reporting traditions, was challenging, but successful. We also commissioned academic research, which found that there was indeed cost of capital benefits of adopting the standards across Europe. Other, more recent academic studies have shown broadly similar effects.

The academic evidence reveals that the extent to which the potential benefits of adopting IFRS are realised varies from country to country. It depends significantly on a number of local factors, including – among other things – the quality of the standards that were used before adopting IFRS and the degree of compliance, monitoring and enforcement. Research on the application of IFRS since 2005 shows that understanding this local institutional context is crucial. Nonetheless, we should not underestimate the clear value of what has been achieved to date. For international investors, in particular, the move to IFRS has been transformational.

## SOME POTENTIAL COSTS

Of course, switching to a new accounting framework also presents businesses with considerable costs and short-term challenges. Accounting policies need to be assessed and updated. Information systems need to be upgraded or replaced. Controls need to be redesigned. Employees need to be trained, and investors need to be educated.

So transition can be painful. But it is often accompanied by wider, incidental benefits. By encouraging companies to reconsider, for example, relevant processes, controls, IT systems, business practices and accounting policies, new ideas and better ways of doing things often emerge. Short-term pain can result in longer-term practical gains, for regulators and others as well as businesses, over and above the oft-quoted benefits of lower accounting costs, increased comparability and a lower cost of capital.

## WHY IFRS?

The faculty believes that investors and businesses will benefit from the availability of a set of truly global, high-quality accounting standards, providing the foundation for transparent and comparable financial statements that clearly reflect economic reality and improve investor confidence. Indeed, we have been a persistent champion of the creation of such a set of standards and broadly share the IFRS Foundation's vision of the IASB as a global standard-setter.

IFRSs have the unique advantage of being designed for an international audience, of being developed in an environment free from legal and other national constraints. They benefit from the neutrality that this brings to the standard-setting process. This, arguably, contrasts with US GAAP, which has its roots in a very specific regulatory and legal system and a tradition of political intervention that makes it less suitable for application by entities beyond the confines of the United States.



Perhaps most importantly, IFRSs have the advantage of being primarily principles-based. Producing standards based very firmly on principles rather than prescriptive rules, with a minimum of sector-specific material, application guidance and interpretations, results in a clearer and more understandable body of accounting literature. It is more likely to produce standards that are sufficiently flexible to accommodate complex and unforeseen eventualities and changes in the financial and economic environment. It encourages the application of professional judgement by companies and auditors, without frequent requests to standard-setters to elaborate on existing requirements by adding rules and implementation guidance. Importantly, it also reduces the opportunity for circumventing the intentions of standard-setters, something more likely in a more rules-based environment.

It seems fair to say that the more detailed nature of US GAAP and the greater use of 'bright lines' have contributed in the United States to the development of a more prescriptive, complex and diverse body of accounting literature. This needs to be avoided in an international context. A principles-based approach to standard-setting is fundamental to the success of IFRS as the standards are increasingly adopted by jurisdictions with differing traditions of reporting and regulation.

Despite these advantages of IFRS, the faculty does not offer its support to the IASB lightly. Where necessary, our responses to IASB consultations are highly critical. The current suite of IFRSs is far from perfect. In some respects, they seem overly complex, and in some instances quality has been compromised by the rush to converge with US GAAP. Improvements to the standards can undoubtedly be made. In particular, it is imperative that work on the new approach to accounting for the impairment of financial assets is completed without any further delay. The faculty also believes that the IASB should review how company performance is reported as a priority. A definitive view on what is meant by performance, the purpose of net income and the rationale for distinguishing income statement items from those taken to 'other comprehensive income' is long overdue. As users tend to be focussed on earnings as a key reporting metric, until this issue is satisfactorily resolved there will remain prima facie grounds for continued criticism of IFRS reporting.

But, despite these and other shortcomings, we believe that the IFRS product has inherent strengths and advantages that fully justify support for the IASB by those seeking to realise the vision of a high-quality, global set of accounting standards.

The theoretical advantages of a universal financial language are supported by an increasing body of academic evidence which shows that moving to IFRSs does indeed bring significant benefits. For international investors, in particular, the move to IFRS since 2005 has been transformational. The current suite of IFRSs is far from perfect. In some respects they seem overly complex, and in some instances quality has been compromised by the G20-endorsed programme to converge with US GAAP. But despite these and other shortcomings, we believe that the IFRS product has inherent strengths and advantages that fully justify support for IFRS by those seeking to realise the vision of a high-quality, global set of accounting standards.

# 4. TAKING STOCK – WHERE ARE WE TODAY?

## A REMARKABLE SUCCESS STORY

The spread of IFRS around the globe has been – and continues to be – a remarkable success story.

When in 2002 the EU made its landmark decision to require all of its listed companies to use IFRS in their consolidated financial statements from 2005 onwards, few would have anticipated that so many of the world's major economies would follow suit quite so quickly. Today well over 100 countries, including more than two-thirds of the G20 countries, require or allow their listed companies to prepare their financial statements using IFRS or national standards based closely on IFRS.

This does not mean that in each of those jurisdictions all companies are required to apply IFRS, or that IFRS are adopted without amendment. For example, while most publicly accountable entities in Canada must prepare their financial statements using IFRS, some – most notably those that have rate-regulated activities – do not currently have to apply IFRS. While all listed entities in some major jurisdictions except financial institutions must prepare their financial statements using IFRS, in others it is only such institutions that must use IFRS.

However, despite such limitations, the spread of IFRS does mean that the financial information published by major international businesses – which is where the case for global standards is strongest – is more comparable than ever before.

## CONVERGENCE WITH US GAAP

Throughout the past decade, the IASB has been working closely with the US standard-setter, the Financial Accounting Standards Board (FASB), to converge the requirements of IFRS and US GAAP.

Since the convergence project was set in motion in 2002 by the Memorandum of Understanding between the IASB and the FASB (the 'Norwalk Agreement'), much has been achieved. Today the two sets of standards are significantly more aligned than they were a decade ago. The success of the convergence project is perhaps best illustrated by SEC's acceptance that IFRS are a high-quality accounting framework. Some would point to the forthcoming converged standard on the critical topic of revenue recognition as a key success. But the formal era of convergence is expected to draw to a close once the outstanding joint projects have been completed.

## A LOSS OF MOMENTUM?

The endgame of the convergence process has long been expected to be a positive decision by the SEC on the adoption of IFRS in the US. This decision had been expected during 2011. A positive decision at that stage would perhaps have cemented the status of IFRS as a truly global reporting language. But 2011 came and went without a definitive statement, and 2012 will be no different. The long-awaited final SEC staff report on the IFRS work plan, published in July 2012, did not moreover contain a recommendation to the Commission on whether, how or when the US should transition to IFRS. That recommendation will be made at some later, as yet undetermined, date. So there is at present no timetable of any sort for a final decision.

This indecision – along with other salient factors such as the global financial crisis, the inability of the IASB and the FASB to reach full agreement on some of their remaining convergence projects, and various local concerns – has had an effect on other countries, which have also delayed decisions on IFRS adoption. So, while in the last few years a number of major economies – including Brazil, Canada, South Korea and Mexico – have successfully made the move to IFRS, some momentum has been lost. Japan has announced that its plans to move to IFRS have been delayed, with mandatory adoption in 2015 or 2016 no longer a possibility as had once been hoped. Plans for Indian companies to transition to a new domestic GAAP based on IFRS have not yet come to fruition. In both cases, no new date for switching to IFRS has yet been set.

## QUESTIONS, QUESTIONS

So, after a period when it seemed that IFRS might sweep the world in short order, progress has slowed, and there are growing concerns over whether a single set of international accounting standards is an achievable goal. Many are concerned that some significant economies – the United States, Japan, India and others – have yet to commit to adopting IFRS, or to incorporating them without substantial modification into their domestic standards. How, some ask, can IFRS be regarded as a truly global set of standards when such major players are continuing to drag their feet over if, when and how they will finally join the IFRS community? If the United States in particular continues on its own path, what are the implications for the success of IFRS?

Others, including the staff of the SEC, are worried about just how consistently the standards are being applied by those countries which have already adopted IFRS – the extent to which they are speaking one global ‘language’ rather than a series of local ‘dialects’. If the IASB cannot prevent local standard-setters adapting IFRSs to fit their local needs rather than adopting them wholesale, or deter them from issuing local interpretations, is there a viable future for global standards?

In the wake of the global financial crisis, some have also begun to ask more serious questions about IFRS. Were they somehow responsible for the crisis or at least for exacerbating the downturn, and if so, would IFRS countries be better off returning to their previous domestic GAAPs?

Finally, the success of the IFRS project in itself spawns a further challenge. As more and more countries adopt the standards, it will undoubtedly become harder to reach a global consensus on significant changes. How can the IASB satisfy the demands of a large and diverse number of ‘constituencies’ around the world? And, as the curtain starts to fall on the era of convergence, should the United States retain its first-among-equals status, regardless of its failure to commit to the application of IFRS by its domestic issuers?

We hope that the suggestions and observations which follow in this paper go some way to suggesting answers to these and other important questions as interested parties around the world contemplate the future of IFRS.

The spread of IFRS around the globe has been – and continues to be – a remarkable success story. Today well over 100 countries – including more than two-thirds of the G20 – require or allow their listed companies to prepare their financial statements using IFRS or national standards based closely upon IFRS. But momentum has slowed, and a range of important questions are now being asked about where the project goes from here.

# 5. IS A GLOBAL SET OF STANDARDS REALLY ACHIEVABLE?

## SOME FUNDAMENTAL DRIVERS

The project to create a global set of standards is a long-term one. Those who wish to determine whether it is an achievable goal need to look well beyond the next few years. Rather, we need to understand the long-term factors that will ultimately influence the degree of success of the project over the next 10 to 20 years, and beyond.

Support for the idea of a single set of international accounting standards has grown in recent decades as both trade and capital-raising have become increasingly cross-border in nature. Businesses are increasingly expanding into new territories as they seek alternative markets for their goods and services or move processes offshore to save costs. Similarly, investors are more interested in purchasing shares in companies worldwide, while those companies themselves are increasingly inclined to raise new funds in the most advantageous capital market, regardless of where in the world that may be.

All of these factors have contributed to the need for a widely-accepted set of international accounting standards. International businesses need to understand the published accounts of potential trading partners, while investors need to be able to compare investment opportunities and monitor the performance of existing investments. The need to assess the effect of differing reporting requirements in different jurisdictions not only increases the costs for companies or investors looking to expand or invest overseas, but may also deter them from doing so.

In the financial services sector, as was seen during the credit crunch of 2008, differences in reporting requirements between countries can make it more difficult for regulators to monitor and control global institutions that are increasingly interdependent. As the business world becomes ever more interconnected, the need for an international set of accounting standards becomes more pronounced. Even if the global financial crisis has blunted enthusiasm for some aspects of globalisation, the case for a single financial language remains strong. In today's interconnected world, it is increasingly difficult to explain convincingly why accounting should differ from country to country.

Another factor supporting the long-term movement towards global standards is that many countries don't wish to incur the expense of establishing and maintaining their own standard-setting bodies. In decades gone by, some of these countries adopted US or other foreign GAAPs instead of developing their own domestic standards.

The standards issued by the IASB now provide a high-quality alternative, and in recent years, many smaller countries have moved to using IFRS or the IFRS for SMEs. Other, larger countries could afford to create their own accounting standards, but think it unrealistic that the rest of the world would take the trouble to understand their own particular local requirements. So the adoption of IFRS gives them credibility and visibility in international markets.


## SOME FUNDAMENTAL BARRIERS

Inevitably, there are also deep-seated factors that will continue to hinder progress towards a single set of international accounting standards. For example, different financial reporting regimes may be appropriate for different types of firm. While international standards are most obviously relevant to companies raising capital in international markets, they may seem less relevant to some other companies and some other types of reporting entity. Some regulators of financial institutions have also asked whether those institutions should be subject to a separate accounting regime.

There is often more than one 'right answer' in accounting. Everybody has a view on how to do things. This makes standard-setting challenging at the best of times, and, on a global scale, much more so. There are risks that an international standard-setter will be too slow to act or will adopt lowest common denominator solutions. In the long run, this could discredit the standard-setting process. If it is to avoid these pitfalls, the IASB may need to change its modus operandi in some fundamental ways. This is important, and is something that we return to in Section 8.

The lack of a global regulator to ensure uniform adoption and enforcement will tend to reduce the benefits of common accounting standards. Some countries announce that they are adopting IFRS into their national GAAP, but then adapt it either to suit local circumstances or, perhaps, because there are some things with which they disagree. Clearly, the more that countries change IFRS when they adopt it, the less we can talk meaningfully about a single set of global standards.

At the same time, increasing attention is being paid to how IFRSs are implemented in practice in different jurisdictions. Financial reporting is an institution that complements other national institutions. What suits one country may simply not suit another. So as well as the threat of local adaptations and interpretations, differences in national enforcement regimes, legal systems, auditing practices, corporate governance, ethical norms, financial services industries, and education and training mean that a single set of standards is unlikely to produce uniformity of accounting around the world, at least for the foreseeable future. There are doubts, inevitably, about how much a single set of accounting standards can achieve without the mechanisms for securing uniform implementation and enforcement.



In the long run, it will be these sorts of factors that determine whether or not a single set of standards becomes a reality. In the meantime, there are some short-term challenges to consider.

### **SOME CURRENT CHALLENGES**

The current hesitancy of the United States to commit to IFRS is widely regarded as a major obstacle that must be overcome if the IASB is to attain the status of a global standard-setter. To a large extent, the reticence of the US reflects a series of short-term factors. Clearly, the ongoing economic slowdown in the US means that now is not a good time to be imposing new regulatory costs. And even if the SEC was determined to push ahead with IFRS implementation, the 2012 Presidential election and the SEC's focus on implementing the formidable Dodd-Frank Act would have seriously constrained what could be achieved. Nonetheless, the SEC's indecision about how and when to move to IFRS has been widely presented in a very negative light, with some suggesting that it could even derail the whole IFRS project.

In the wake of the global financial crisis, some people have begun to ask questions about whether financial reporting – or deficiencies in it – played any role in causing or prolonging the biggest recession since the 1930s. Critics have pointed at fair value (or 'mark to market') accounting and loan loss provisioning in particular, claiming that these elements of IFRS were in some way seriously flawed, meaning profits, bonuses and dividend payments were artificially-inflated in the run up to the crisis.

Rather more parochially, some UK critics of IFRS have made other serious claims, often related – for example, that the use of IFRS is contrary to UK or EU legislation, that the EU endorsement mechanism is flawed, or that IFRS results in distributions that are not only imprudent, but also illegal. These challenges have led to sometimes nostalgic calls in the UK for the IFRS project to be abandoned, and for a return to the 'good old days' when domestic standard-setters ruled the roost and prudence was more in evidence. Although many regard the evidence to support this stance as not compelling, there is a danger that with repetition, the clear and certain messages conveyed will become accepted wisdom.

### **OUR PERSPECTIVES**

#### **Time to put distractions to one side**

Those who share the aspiration of a global set of accounting standards should not be distracted by the largely unsubstantiated claims that financial reporting somehow caused or prolonged the global financial crisis. Academic research to date has failed to find any significant connection between fair value accounting and the crisis. Similarly, there is so far a lack of compelling evidence for arguments that loan loss provisioning had a significant role to play. The crisis did expose the need to improve aspects of financial instruments accounting and disclosure, and the fact that some of this work is still incomplete, notably on the impairment of financial assets, is deeply disappointing. But IFRS generally weathered the global financial crisis well.

When other current criticisms of the use of IFRS in the UK are examined dispassionately, they have often been found to lack foundation, sometimes attributing strengths to old UK GAAP that do not stand up to scrutiny. They tend, nonetheless, to have the effect of deflecting attention from issues of profound and pervasive significance, including the challenges of global standard-setting and the growth of complexity in financial reporting, discussed below.

In our view it is time for the financial reporting community in the UK and internationally to put these distractions to one side. It should focus instead on the tangible long-term benefits that will be reaped – not least in terms of economic growth and stability – if in coming years substantial progress towards the goal of providing the world's markets with high-quality, transparent and more internationally comparable financial information can be maintained.

#### **US hesitancy is not necessarily such a bad thing**

It is nonetheless reasonable to question whether the goal of a widely-applied international set of standards can ultimately be achieved in full, given the hesitancy of the United States and other key countries. However, we should not be disheartened by the current reluctance of the SEC to sanction the application of IFRS by US-listed companies or to incorporate IFRS into US GAAP.

As we discuss below in Section 6, we think that the US will in due course decide to move to IFRS. The lack of a firm commitment from the SEC in the meantime is, of course, not ideal. But there is an alternative way of looking at things. Perhaps the delay is, in fact, not such a bad thing. After its rapid expansion in recent years, maybe now is the time for the IASB to consolidate what has been achieved to date and to strengthen its procedures and processes before taking another quantum leap forwards.

## IS A GLOBAL SET OF STANDARDS REALLY ACHIEVABLE?

If the US were to embrace IFRS too soon, it might be to the detriment of other IFRS adopters around the world as it could lead to a further period of flux and uncertainty as the FASB pushes for further changes to international standards to meet the needs of its own constituents rather than those outside the US. On the other hand, a period of consolidation would allow the IASB to strengthen its institutions over the next few years, to evolve as an organisation, before having to address the practical implications of a more decisive commitment to IFRS reporting by the US.

It is important to recall, too, that in recent years, the two sets of standards have moved steadily closer together as a consequence of the IASB-FASB convergence agenda. Many differences have been eradicated. The formal era of convergence may quite rightly be drawing to a close, but the two boards will without doubt continue to talk to each other in the future. The US will continue to influence the direction of travel. Regardless of whether a formal decision to adopt IFRS is made by the SEC or not, financial statements prepared under IFRS and US GAAP will continue to become more comparable as time goes by.

### **100% uniformity may never be possible**

Beyond the United States too, it is highly unlikely that we will ever see everybody around the world using IFRS, or invariably using unabridged, unamended standards as published by the IASB and in line with the effective dates mandated in individual standards. It is impossible to write standards that please all of the people, all of the time, and jurisdictions will wish to retain ultimate political sovereignty in this area. It is therefore inevitable that some countries within the IFRS community will from time to time be unable or unwilling to adopt individual standards without amendment. Similarly, we must accept that countries will sometimes feel the need to issue interpretations to enable international standards to be applied effectively within their own jurisdictions. This is a reality that is not going to disappear tomorrow, although we expect continuing pressure from both markets and international regulators and development agencies for such countries to align their own standards as closely as possible with IFRS. Indeed, recent experience has shown that countries that initially make changes to IFRS tend to revert in time to full compliance in order to realise the full benefits of applying internationally-recognised standards.

### **A global language with different dialects**

Differences in IFRS implementation that arise from differences in corporate governance, auditing and regulatory regimes will no doubt persist for a long time to come. We do not live in a homogeneous world, and we just have to accept that. We should not expect that even a single set of global standards will mean complete uniformity across the planet. Local differences – some deliberate, some accidental – seem likely to be a feature of the world for the foreseeable future. But we can expect their significance to decline over time as both regulatory and market forces tend to push further towards globalisation. We should therefore not be overly concerned about local differences in how IFRSs are applied, provided they remain relatively few in number and relatively minor in nature. It should not be forgotten that previous national GAAPs were not free from inconsistency of application. Dialects and accents within national financial languages always existed. Is it realistic to expect IFRS to be any different, especially given their global reach?

There are wider potential benefits, too, in applying common accounting standards, despite local institutional differences. The application of consistent standards – introducing a constant for the first time into the corporate reporting environment – allows analysis (by academics and others) for the first time of the practical impacts of different enforcement regimes and other local institutions. The common application of IFRS has the potential to highlight the need for institutional change and to act as an agent for the acceleration of improvements to corporate governance, auditing and regulatory regimes around the world.

### **What is important is understandability**

So, in judging the consistency of application of IFRS, we should be alert to opportunities to minimise differences, but must be pragmatic. As long as high standards of reporting are maintained, we should not worry too much about local dialects emerging, so long as they are close enough to the mother tongue to be understood without difficulty. For the time being we should, perhaps, focus more on this broad notion of understandability of financial reporting, to be content to see incremental progress towards more comparability over the coming decades. After all, the goal of the IFRS project should not be achieving complete uniformity across the globe. Rather, it should be to ensure that financial reporting facilitates, rather than acts as a barrier to, international trade and investment.

The IASB itself should also not be overly concerned about differences in how standards are applied or interpreted locally, unless it becomes clear that poorly-worded or unclear drafting of one of its standards, or translation issues, lie at the heart of the matter. The IFRS Foundation can help by enhancing the scope of educational activities designed to improve IFRS skills and knowledge. But the IASB's role is to write financial reporting standards that can be widely understood and applied around the world, to provide a constant among local institutional diversity. Effective enforcement mechanisms are of course critical to the success of the project to create a global set of standards. This is a matter we return to later. But the IASB is not responsible for enforcing them in individual jurisdictions, and it should not and cannot shoulder that responsibility.

#### **Detailed rules are not the solution**

Finally, in this context, a note of caution. Companies in the early stage of IFRS implementation face many challenges, particularly in jurisdictions where the existing accounting framework relies heavily on a detailed body of rules. However, few of the issues involved are likely to merit the publication of formal interpretations by the IFRS Interpretations Committee. A proliferation of

interpretations would dilute the primarily principles-based nature of IFRS, and might well stymie the emergence over time of good practice and common market-driven understanding. That said, where a pervasive concern is clearly the result of inconsistencies or a lack of clarity in the standards, the IASB should make fixing the problem a priority for the post-convergence era.

#### **Some conclusions**

To conclude, it is by no means assured that IFRS will ever become a truly global set of standards. There remain significant challenges that must still be overcome and there could be difficult times ahead. Nonetheless, the faculty expects the worldwide trend towards reporting using IFRS or standards that are closely aligned to IFRS to continue in the longer term, and to benefit preparers, investors and other users of financial reports. In Section 8 below, we consider what must be done and by whom to safeguard the continued success of the IFRS project.

A number of long-term factors, not least the increasingly cross-border nature of trade and capital-raising, have contributed to a clear need for a widely-accepted set of international accounting standards. There are barriers too, including differences in national institutions that reduce the chances of uniformity of accounting, as well as shorter-term challenges that appear to be threatening the success of the IFRS project. For example, the hesitancy of the US to commit to IFRS is widely regarded as a major setback. There are also concerns about consistency of implementation. A few even blame IFRS for creating the global financial crisis.

It is, we accept, by no means certain that IFRSs will ever be regarded as a truly global set of standards. However, we believe that barriers and challenges to IFRS can, in time, be overcome.

Firstly, although the global financial crisis did expose the need to improve aspects of financial instruments accounting and disclosure, IFRS generally weathered the crisis well. Claims that financial reporting somehow caused or prolonged the crisis are largely unsubstantiated. Academic research to date has failed to find any significant connection between fair value accounting and the crisis. Secondly, the delay in US adoption may not be such a bad thing, if the IASB consolidates what has been achieved to date before having to address the practical implications of a more decisive commitment to IFRS reporting by the US. Finally, we should not be overly concerned about relatively minor local differences in how IFRSs are applied, especially as the advent of common standards may accelerate improvement to corporate governance, auditing and regulatory regimes around the world. The goal of the IFRS project should not be achieving complete uniformity across the globe. It should be to ensure that financial reporting facilitates – rather than acts as a barrier to – international trade and investment.

# 6. NON-IFRS JURISDICTIONS: WHY MOVE TO IFRS?

## MOVING TO IFRS

For many countries adopting IFRS, especially those jurisdictions without a well-established national GAAP, the potential benefits of adoption are clear. For some countries that have not yet adopted IFRS – particularly the United States and Japan – the advantages of doing so are not as clear-cut. It is these large and highly developed economies which are, in some cases, yet to be convinced of the benefits of IFRS adoption.

The United States is the prime example. It already has a robust set of highly-respected accounting standards. Its companies have easy access to low-cost funding on its domestic capital markets, which are large and deeply liquid. Nonetheless, it is well-known that many large US businesses with significant international operations are keen to move to IFRS reporting, not least to reduce their accounting costs by adopting the same accounting standards in their operations throughout the world. But it has been argued that the economic benefits for US public companies as a whole moving directly to IFRS would be outweighed by the significant cost and effort involved in transitioning from US GAAP. Thus although views are likely to change over time as other capital markets grow in importance, there is currently little appetite for change in some quarters, especially in the current economic climate.

With respect to other more developed economies, few provide for the use of the standards issued by the IASB without measures to vet the suitability of those standards. Some countries have made their own national standards fully convergent with IFRS without necessarily giving up the right to amend future standards or issue additional guidance, if circumstances dictate. Other jurisdictions – most notably the EU – have adopted an endorsement approach, whereby individual IFRSs are approved for use in that jurisdiction on a standard-by-standard basis provided they meet prescribed criteria. Moving to IFRS does not necessarily involve ceding all power over standard-setting, nor should it.

In the wake of the US non-decision on IFRS adoption, it appears that it will be some time before the major economies that have yet to commit to IFRS – with or without an endorsement mechanism – make a decision to do so. However, in the meantime, it is likely that they will continue to seek to align their domestic standards gradually with IFRS. It is also unlikely that countries which have already adopted will seek to diverge significantly from IFRS, as the failure to conform might result in a reversal of reductions in cost of capital and in a loss of credibility in international capital markets, making conversion to IFRS a wasteful exercise. So while the period of rapid progress in IFRS adoption may be behind us for the time being, it seems that its spread around the globe is likely to continue, albeit more slowly, and perhaps less visibly.

## US GAAP: AN ALTERNATIVE TO IFRS?

This means that the global standard-setting environment may continue to be a competitive one, with US GAAP still viewed as an alternative to IFRS by some, such as Japan. However, as noted earlier, US GAAP is not a truly international framework for accounting. It may have been drawn on as an off-the-shelf, high-quality solution by some countries around the world in previous years, but it should not be regarded as a valid global alternative to IFRS. It has been developed specifically for the US market, often on an ad hoc, industry-by-industry basis. Despite recent efforts at codification, US GAAP is a complex body of literature, heavily-influenced by local legislation and other constraints. It does not tend to travel very well. Neither is the FASB an international standard-setter. It is composed entirely of US citizens making decisions in the interests of US stakeholders.

There does not, in any case, seem to be evidence to suggest that the coalition of countries that supports IFRS will fall apart. Among the first wave of adopters – including the European Union, Australia, New Zealand and South Africa – IFRS has become the accepted language of accounting at least for listed companies, and in some cases, for many other companies. The benefits of improved comparability in their financial reporting are increasingly taken for granted. For them, and for many other jurisdictions, adopting US GAAP or returning to their old domestic GAAPs – which increasingly look as if they belong to a simpler, bygone age – are simply not realistic options.

## OUR PERSPECTIVES

### All listed companies should be given the option of using IFRS

All jurisdictions outside the IFRS community should carefully consider the pros and cons of moving to IFRS or standards that are closely aligned to IFRS. Whether this should be by adopting IFRS directly or by introducing some form of endorsement mechanism will depend on the circumstances of each jurisdiction, although the latter is probably inevitable in the case of most developed economies.

The faculty acknowledges that some governments and regulatory authorities still harbour doubts about moving to IFRS. Some say that the transition will be challenging. Of course they are right. But they are facing challenges that others – including the disparate countries of the EU – have already shown can be overcome. Others say that businesses do not want to make the change because it will be too costly, especially given the economic uncertainty that prevails in much of the world. We advocate a simple solution: provide listed companies throughout the world with the option of moving to IFRS. Let the market decide. Companies can assess for themselves whether the benefits of transition outweigh



the costs. The challenge for the IASB in all of this is to ensure that IFRS is a principles-based product of the highest quality that demonstrably meets the evolving information needs of international investors.

#### **Time for the US to take a leap of faith?**

When we say that all jurisdictions should consider moving to IFRS, or at the least providing an option to use IFRS, this includes the United States. We understand why the SEC is concerned about implementation of IFRS in other countries. But if the Commission wishes to influence this, the best course of action in our assessment would be for the US to take that leap of faith and to indicate that it will adopt IFRS itself at a specified future date.

The key question for the SEC should be whether IFRS is good enough for domestic US registrants, or not. In our view, IFRS is indeed a set of high-quality standards. It can be improved, but that will always be true. We don't expect ever to arrive at a set of accounting standards that cannot be improved or that does not need to change in response to changes in markets and technology. Unless there is a willingness to accept the risk of the US entering self-imposed isolation, where international companies operating in an increasingly IFRS world might look to other markets for their primary listings and ambitious students of accounting might seek out training in IFRS rather than US GAAP, the SEC seems likely in due course to conclude that IFRS is good enough for use in the United States, and on that basis begin moving towards adopting IFRSs or incorporating them into US GAAP.

Importantly, this would not result in a loss of power for the SEC. The Commission will continue to monitor and enforce the implementation of financial reporting standards in the US, including for foreign registrants. It would not cede its sovereignty on this important issue by simply permitting application of the IASB's standards.

#### **IFRS as the principal set of global standards**

In the meantime, it appears that in some sense, competition between the IASB and the US standard-setters will continue, both in terms of ideas and in terms of the choices available at national and entity level over the choice of accounting framework. In this competitive environment, the IASB needs to continue to demonstrate to the rest of the world that IFRS deserves to be the principal set of global standards. This requires a focus on ensuring that IFRSs are as high-quality and understandable as they can be and firmly principles-based. It also means engaging effectively with the IASB's increasingly diverse group of global stakeholders over its forward agenda, exploring the opportunities to reduce complexity and extending a helping hand to countries with implementation challenges.

#### **Some conclusions**

Ultimately, in our opinion, the fact that the US is still hesitant about a radical shift away from its own high-quality standards should not be taken as any reflection on the suitability of IFRS reporting for other markets. The US – with its huge capital markets and long standard-setting history – faces a dilemma that is, perhaps, unique. In some senses, it can perhaps claim to be a special case. But the faculty believes that in the longer term, it will be untenable for the US to be an island of national GAAP in a world where almost everybody else is using IFRS. If knowledge of US GAAP declines around the world, the SEC will accordingly reach a decision that meets the global needs of US investors and businesses. In the meantime, the SEC might consider making an option available to major US companies to report under IFRS rather than US GAAP.

Some economies already have strong national GAAPs. For them the case for moving to IFRS may not be clear-cut, at least in the short run. But others should not be discouraged. The fact that the US is still hesitant about a radical shift away from its own high-quality standards should not be taken as any reflection on the suitability of IFRS reporting for other markets. Other jurisdictions should think carefully about the well-evidenced benefits of adopting IFRSs. The transition will be challenging, but the challenges are ones that others – including the disparate countries of the European Union – have already shown can be overcome. At the very least, listed companies should be given the option of moving to IFRS. Companies can assess for themselves whether the benefits of transition outweigh the costs.

# 7. ENDING CONVERGENCE

## THE END OF AN ERA?

The end of the formal era of convergence between IFRS and US GAAP is said to be near. After more than 10 years of working in close tandem, the IASB and the FASB are due to bring their formal partnership to a close. Just what role the United States will play in the future development of IFRS remains unclear, but the nature of its role is very important for the future direction of international accounting.

Some would argue that as long as the US does not require the use of IFRS for its domestic issuers, it should forgo the influence it currently has over international standard-setting. For example, in July 2012 European Commission spokesman Stefaan De Rynck said, in what is widely regarded as a reference to the continued indecision of the US, that it is 'becoming more difficult to justify the representation of jurisdictions not applying IFRS in the IASB governance framework'.

But others contend that it would not be in the best interests of the IFRS community to exclude the US. They argue that the SEC should continue to play the constructive role it plays now in IFRS development and oversight, claiming that it would be a big mistake to terminate US involvement with the IFRS Foundation as this could damage the credibility and quality of IFRS.

## OUR PERSPECTIVES

### Time to draw a line under the era of convergence

In our view, the era of convergence between IFRS and US GAAP should be ended formally in a matter of months, not years. There is a very real possibility that without a decisive break, we will still be talking about the imminent end of convergence in a year's time, or even beyond. Convergence has served its purpose, and there is little desire on either side to continue with it. For existing projects, the IASB should only proceed to a converged solution where that is attainable in the short term, and without jeopardising the quality of the outcome. Any further amendments to proposed and existing IASB requirements designed to harmonise standards with the US would not be justified unless they represent a significant improvement in financial reporting for all IFRS preparers and users.

### The US still has much to contribute

Nonetheless, the United States remains the world's largest capital market. It is unique in its size and influence. Its long tradition of standard-setting sets it apart from many other countries that have adopted or are considering adopting IFRS. It has much to contribute by way of financial reporting expertise. In our view, continuing to work with US standard-setters will only serve to make IFRS stronger in the longer term, further increasing the prospects of their global acceptance, especially if knowledge of US GAAP gradually declines around the world. Thus the IASB must continue to liaise closely with the US regardless of whether the US commits to adopting IFRS or incorporating IFRS into US GAAP in the short to medium term. Any notion of removing the SEC from the Monitoring Board or removing US citizens as Trustees or IASB Board members should, for the foreseeable future at least, be resisted. It would be counter-productive, and divisive.

### High-quality standards are paramount

However, the IASB must not put reaching agreement with the United States ahead of finding quality solutions. Dialogue is always a good thing, and the outcome of some of the convergence projects – perhaps most notably the revenue recognition project – shows what the boards can achieve when they work well together. But other projects have not gone so well. For example, the short term prospects for agreement between the two boards on financial asset impairment, lease accounting and insurance look – to varying degrees – bleak.

Writing good-quality standards is never easy. It is important to get them as right as possible, and it inevitably takes a great deal of time and effort. Finding a solution that works for all sides is the ideal result, but won't always be realistic. In such circumstances, the faculty believes that the IASB must in future hold firm and – where necessary – be willing to accept that it has not been able to reach a satisfactory agreement with its counterparts in the US rather than compromising quality in order to accommodate the FASB's views.

### **Key projects must be completed very soon – with or without US backing**

In our view, it is much better henceforth that the two boards go ahead and issue their own separate, distinct standards – aligned where possible – rather than muddle through and issue a weakened compromise solution, or simply do nothing. We have reached the point whereby the boards should simply agree to disagree on the key projects. At this juncture it seems that it is principally the concerns of the FASB's constituents which are preventing the publication of international standards that are urgently needed. Now is the time for the IASB to push ahead with its proposed solutions – with or without the FASB's support. Unless it is willing to make such a bold move, improvements to financial reporting that are badly needed may be delayed still further.

If separate standards are issued by the two boards, this does not necessarily mean that convergence efforts have failed. Rather, it means that they have stalled. Ultimately the pressure to converge to the accounting favoured by global users will tend to lead one or the other of the two boards to adjust their position. Indeed, it may be easier for them to do so having seen the two alternatives in practice and with the benefit not only of hindsight, but also of rigorous effects studies and post-implementation reviews. In the meantime, in some cases, limited additional disclosures might be justifiable to enable users to better evaluate key differences between financial statements prepared under the two sets of standards. This approach has already been applied to offsetting of financial assets and financial liabilities, where the IASB and the FASB could not find a common solution acceptable to their constituents, but nonetheless agreed that additional disclosures were necessary to aid comparability.

### **The IASB must work with all of its global constituents**

Some may argue that without a firm commitment from the United States, the IFRS project can never be considered a complete success. As we have already discussed, for much of the past decade the IASB has been focused on convergence with US GAAP. This has brought important benefits, and we have already made the case for the IASB continuing to work closely with the FASB. But the US is just one jurisdiction, albeit a very important one. Perhaps now is the time for the IASB to focus its attention squarely on the needs of the 100 plus jurisdictions that to some degree have officially adopted its standards, and who currently do not always feel that their voices are adequately heard, and on working to encourage those countries that have moved their standards close to IFRS – notably China – to take the final steps towards full IFRS reporting. As discussed below, proposals for an Accounting Standards Advisory Forum may be a step in the right direction.

### **Some conclusions**

A positive outcome as the IASB and FASB enter into a new phase in their relationship is not assured; the US could, for example, see IFRS drift away over time towards non-US views of financial reporting, in which case, it may never accept them. But if the IASB can engage effectively with a more diverse group of global stakeholders – while simultaneously improving its standard-setting processes – it will only serve to further strengthen IFRS and, perhaps, bring nearer the day when the United States feels that its interests are manifestly served by a bold shift towards membership of the global IFRS family.

The era of convergence between IFRS and US GAAP should be ended formally in a matter of months, not years. Further amendments to proposed and existing IASB requirements designed to harmonise standards with the US would not be justified unless they represent a significant improvement in IFRS financial reporting. The IASB should now focus its attention squarely on the needs of the 100 plus jurisdictions that have officially adopted its standards, and on working to encourage those countries that have moved their standards close to IFRS – notably China – to take the final steps towards full IFRS reporting. Nonetheless, the IASB must continue to liaise closely with the United States; any notion of removing the SEC from the Monitoring Board or removing US citizens as Trustees or IASB Board members should, for the foreseeable future at least, be resisted. It would be counter-productive, and divisive. The US remains the world's largest capital market, and its long tradition of standard-setting means that it has much to contribute by way of financial reporting expertise.

# 8. A NEW APPROACH FOR A NEW ERA

## TURNING VISION INTO REALITY

We have already discussed how the use of IFRS has grown in recent years and argued that its continued spread around the globe is a desirable long-term goal. However, turning the vision of a truly global set of standards into a reality involves huge challenges that are likely to require significant organisational change at the IASB, alongside constructive commitment by all key stakeholders around the world with an interest in high-quality and comparable financial reporting. The governments of the G20 nations have a key role to play, as do national and regional standard-setters and regulators. The next phase requires the collective stakeholder shoulder to be put to the IFRS wheel.

## THE ROLE OF THE IASB

The Trustees of the IFRS Foundation, the oversight body of the IASB, recently undertook a far-reaching review of the strategy and vision of the organisation. This review was conducted in parallel with a separate governance review by the IFRS Foundation Monitoring Board, which oversees the work of the Trustees. Both reviews were concluded in February 2012.

These twin reviews set out a number of important recommendations and observations regarding the role of the IASB, often requiring further work and elaboration. One was the pressing need for a long-term, global funding strategy. Another was a call for the IASB to strengthen and formalise its relationships with standard-setters, regulators and accounting bodies around the world.

The Trustees also reiterated that thorough and transparent due process is essential to developing high-quality, globally accepted accounting standards. Major improvements have been made in recent years. For example, the IASB's outreach activities are far more extensive and inclusive than was once the case. The introduction of public agenda consultations every three years was another positive development. Nonetheless, the Trustees made a number of important recommendations for further improvement, including establishment of a dedicated research capacity.

## NATIONAL AND REGIONAL BODIES

As the use of IFRS – and more recently the IFRS for SMEs – has spread across the globe, questions have inevitably been asked about what role should be played by national standard-setters in countries where global standards have been adopted. Some have made the case for national bodies continuing, for example, to develop local standards for not-for-profit organisations or micro-entities. The Trustees also envisage a number of new roles: undertaking research, providing guidance on the IASB's priorities, encouraging stakeholder input from their own jurisdictions into the IASB's due process and identifying emerging issues.

The emergence of regional bodies such as the Asian-Oceanian Standard-Setters Group (AOSSG) and the Group of Latin-American Standard Setters (GLASS) provides the IASB with the opportunity of not only working with national standard-setters, but also with regional groups. The Trustees proposed that a network of national or regional standard-setters could undertake coordinated research, field testing and outreach activities. It is argued that this would allow the IASB access to a broader pool of talent when considering difficult issues and could potentially improve both the overall quality of IFRS and consistency of application.

## REGULATORS AND GOVERNMENTS

Once they have been developed, IFRSs need to be endorsed, implemented, audited and enforced on a globally-consistent basis. Robust enforcement is a critical aspect of good financial reporting. Without it, there will be no certainty that information reported under IFRS will be reliable or comparable. The Trustees therefore recommended that the IASB works more closely with securities regulators, auditors and accounting bodies to improve consistency of implementation around the world.

The G20 has endorsed the aim of establishing a single set of high-quality global accounting standards. The G20 governments set the world's standard-setters this ambitious goal at their London summit in April 2009, in the early days of the global financial crisis, and they have reiterated it several times since. They believe that such standards will strengthen the financial system and reduce the prospects of similar crises occurring in future.

## OUR PERSPECTIVES

### It is time for the G20 to show leadership

The G20's continued support is critical if the project to create a single set of high-quality global accounting standards is to succeed. But financial reporting – the bedrock of investor confidence – has slipped down the international agenda. While the G20's communiqués repeatedly call on standard-setters to make progress towards a single set of high-quality global accounting standards, it is questionable whether all of the governments involved are really doing enough to ensure that the vision becomes reality.

Ultimately, whether the world gets a single set of accounting standards will be determined by governments, not by standard-setters. All that standard-setters can ensure is the quality and relevance of the standards they issue. It is easy to assign blame to the IASB or the FASB for lack of substantial progress. But the standard-setters, after all, only set standards. No matter how good those standards are, they can't require a country to adopt them, or ensure that they are properly applied. It is the governments of the countries themselves, and the regulators that are accountable to them, which must decide whether to adopt IFRS or not.

The G20 countries themselves should continue their long-term support for a single set of global accounting standards, but also endorse a series of shorter-term steps that will take us towards the achievement of the long-term goal. Doing so will result in the G20 leaders playing a more decisive role in support of IFRS reporting. While many have adopted IFRS, others have not. If the G20 countries want the world to commit to international accounting standards, they themselves must be willing to show the way. The time has come for them to show leadership and adopt IFRS or align their domestic standards as closely to them as possible, and as a minimum to reinforce clear public commitments to IFRS by allowing optional use of IFRS in their capital markets by all listed companies. They should also take on their proportionate shares of the funding required to support international standard-setting and press others to follow suit.

### Regulators have a vital role to play

The IFRS Foundation, by expanding its educational initiatives, can improve understanding of IFRS and the skills needed to apply principles-based standards. But it cannot on its own ensure consistent application of its standards around the world. It needs more active support from regulators, including the International Organization of Securities Commissions (IOSCO), as only they can ensure consistent and coordinated enforcement of the standards internationally.

Regulators around the world need to work together more closely to exchange information, share perspectives and experiences and ensure enforcement is consistent. They need to ensure that by their actions and style, they do not encourage disclosure of immaterial items or stifle the exercise of the professional judgement that underpins the application of principles-based standards. They should avoid straying into the area of general interpretation or application guidance. In turn, the regulators need the clear support of G20 governments.

Consistency of enforcement across the world will be an essential corollary of the adoption of global accounting standards. But it is not the IASB's job to enforce its standards, and in any case, combining the roles of policeman and lawmaker carries inherent risks that should be avoided.

### The IASB must become a truly global organisation

Managing the competing demands of its increasingly diverse list of constituents is undoubtedly one of the biggest operational challenges facing the IASB today. It has come a long way in a short time, growing from little more than a fairly peripheral body to – perhaps – the world's first truly global standard-setter in little more than a decade. As its global reach continues to grow, it is becoming increasingly clear that the IASB can no longer micro-manage everything centrally from its London offices. The IFRS Foundation – like any other successful, international organisation with a global brand to build and support – must continue to look long and hard at proven ways of decentralising its non-core responsibilities and sharing potential responsibilities, including the building of local capacity around the world.

## A NEW APPROACH FOR A NEW ERA

Critically, this must involve finding a way of creating an effective feedback mechanism that enables it to work successfully with both national and regional organisations to identify issues, find solutions, monitor implementation and address calls for additional guidance, without leading to organisational paralysis. Ultimately, it is only by engaging with and listening closely to its constituents that the IASB will be able to write standards that are widely accepted and that can cope with the different and evolving business models and economic systems that exist around the world. Failure to act will result in the board fast becoming out of touch with its new constituents, inevitably resulting in further diversity of practice emerging as individual countries, dissatisfied with what is happening at the centre, begin to look for local solutions.

### **Global standard-setting is different to national standard-setting**

How to create a global feedback mechanism that works effectively in practice requires a great deal of debate and organisational experimentation. There is much to consider. Simply replicating what national standard setters have done in the past will not suffice. The mindset needs to change for good. There is no well-tested model for standard-setting on a global scale, so whatever tentative conclusions are reached, good practice and the mechanisms necessary to achieve it will need to evolve over time.

### **National and regional standard-setters have much to contribute**

Some of the new regional bodies encompass countries that may seem to have little in common in key respects, other than a degree of geographical proximity. Others are, perhaps, not yet truly representative of the regions in question, and technical capacity is variable. But the early indications are that they can contribute effectively to shaping the global debate and sharing experience. The IFRS Foundation needs to embed good lines of communication with the regional bodies and work with them closely to ensure the relationship is an open and constructive one that leads above all to acceptance of the principles-based nature of IFRS and the outcome of IASB agenda-setting and due process.

Regional groups cannot, however, displace national standard-setters as key partners of the IASB. The efficiency of the standard-setting process will clearly be enhanced where coherent and broadly-agreed regional views can be reached and presented to the IASB. However, this process should not dilute the richness of the debate or deny national standard-setters with a minority point of view a fair hearing. In many cases, it may continue to be better for regional groupings to present a balance of views to the IASB rather than attempt to agree upon a single solution. The former will ensure that the views of all jurisdictions are heard and understood. Experience shows that the latter invariably leads to tensions and dissatisfaction.

Nonetheless, it is possible to envisage closer involvement with key national and regional standard-setters – as well as with securities regulators, auditors and national accounting institutes – helping over time to transform the IASB from a body still often perceived as being dominated by Europe, the United States, or both, into a truly global and accountable organisation. This in turn should help to engender an increased sense of ownership among stakeholders around the world, perhaps reducing the likelihood of local amendments, interpretations or so-called carve-outs. The challenge is above all to demonstrate that the IASB is an organisation that listens and learns as much as it leads, that it is a global body that belongs to and is responsive to its local stakeholders, without – crucially – embedding operational inefficiencies or layers of advisory bodies and due process that in time might paralyse effective decision making. The recent opening of an office in Tokyo and the current proposals for an Accounting Standards Advisory Forum may prove to be steps in the right direction. But the journey has only just started.

While care needs to be taken to avoid excessive disruption to constituents, a process of continued improvement in due process is essential. The faculty believes strongly that regular and inclusive due process is the hallmark of an effective and credible standard-setting process. It is crucial that both IASB agenda-setting and due process are seen as the embodiment of best practice in global standard-setting, subject only to the key consideration of operational efficiency.

### Good quality research is essential

In our view, a key challenge here is to ensure that standard-setting activities – especially major agenda decisions and discussion papers – are preceded by an effective evidence-gathering phase that takes full account of relevant accounting research. The faculty has pioneered efforts to ensure that there is constructive engagement between the global accounting academic community and other financial reporting stakeholders. In our view, this change need not involve the IASB building an extensive and expensive in-house research capacity, but adequate resources should be dedicated to activities such as comprehensive early-stage literature reviews and engaging with relevant academics, national standard-setters, accounting bodies and other organisations that undertake and sponsor accounting research.

In selecting external partners for research, the board should exercise a stringent quality control process. The depth and breadth of research varies between organisations and the board should gravitate toward those bodies with a history of high-quality research papers that have demonstrably clear relevance to standard-setting activities.

This process will take time, but it will be time well spent. If undertaken well, due process incorporating early relevant research carried out under the auspices of the IASB should lead to timely identification of the likely impacts and possible contentious issues related to potential projects, ultimately resulting in better agenda decisions. In some cases, that will mean deciding that a topic should not be taken on to the active agenda. It may also mean that proposals that are issued by the IASB in the future will have stronger foundations than perhaps some of those that we have seen in recent years. By the time an exposure draft is issued, the IASB should have already consulted widely and its thinking should be well-advanced. This in turn should mean that there is less need to issue the re-exposure drafts that have become more common. But the challenges involved in ensuring that the right research is undertaken by the right bodies, at the right time, with the degree of IASB oversight necessary to ensure that it truly contributes to the efficiency and credibility of the standard-setting process, should not be underestimated. If the IASB achieves this over the next few years – which the faculty believes is possible – it should lead to a significant improvement in the standard-setting process.

### Complexity must be tackled

There are other fundamental questions to be addressed, that may affect very significantly the way that standard-setting is undertaken. One is how to assess critically the demands of users for more and more information.

Listed companies have seen a relentless growth in the length and complexity of their financial statements in recent years. Many preparers contend that the time has come to re-evaluate what disclosures are really needed. The complexity of IFRS reporting requirements may even discourage some countries from fully embracing international standards. A number of commentators have suggested that it would be possible to simply ‘take a red pen’ to swathes of IFRS disclosures, eliminating many existing requirements at a stroke. Some have suggested that the IASB do just that. However, in our experience major investors and analysts value the contents of audited annual financial statements as a natural starting point for analysis, as a regular point of reference, and as a source of validation of financial results and position. They typically want more disclosure, not less. The scope for unforeseen consequences of a rush to cull disclosures is enormous.

Addressing this conundrum is critical to the future success of the IASB. A number of organisations are exploring the issues. The faculty’s forthcoming paper on ‘Disclosure in Financial Reporting: Problems and Solutions’ will consider some radical changes to the way that standard-setting is undertaken. Academic papers commissioned for the faculty’s December 2012 *Information for Better Markets* conference, ‘Who is financial reporting for?’ will be published in 2013. These initiatives may help identify changes to the standard-setting process that allow requests for the inclusion of additional disclosure requirements in IFRS to be assessed more critically. In the meantime, the IASB should strive to minimise unnecessary complexity in its standards and to hold fast to the vision of principles-based standards that require a reasonable degree of judgement in their application.

### Effects studies and post-implementation reviews are critical

Another key question for the next phase of international standard-setting is how best to establish operable models for undertaking effects studies and post-implementation reviews.

The development of a robust and widely-accepted methodology for effects analysis is very important. Effects analysis should be embedded as an essential and continuous part of standard-setting, commencing at an early stage. A timely determination of possible positive and negative effects associated with the development of a standard could allow limited resources to be targeted more efficiently and reduce subsequent calls for revision.

Similarly, effective post-implementation reviews should not only identify whether a particular standard is functioning as intended, including questions of uneven implementation, important though this is for maintaining the credibility of IFRS reporting. They should also in practice provide a mechanism for obtaining insights into how well the IASB assessed the case for the new standard, listened to the concerns of constituents, and made decisions that were not only technically valid but also addressed concerns over practicality and complexity. The first attempts at such an exercise are likely to highlight the difficulties of undertaking an effective review – that is, the difficulties of engaging reporting entities and users in a way that provides real insights and improved accountability. There are few precedents in this area. But concerted efforts to create an effective model that identifies significant issues and suggests ways to improve future standard-setting activity should continue, and stakeholders need to be willing to engage actively in the process.

The IASB should be prepared to redesign the approach and scope of its effects analysis and post-implementation reviews should early results prove disappointing.

### Establishing a global funding system remains a key priority

The major changes we envisage in the scope and reach of the IASB's activities will not be possible unless the IFRS Foundation's funding system is established on a secure and sustainable basis such that its continued effective and independent operation can be assured.

The Trustees should redouble their efforts to establish such a global funding system, with a greater number of countries contributing to the IFRS budget. This work remains a key priority.

### Some conclusions

In summary, there is little doubt that as the IASB embarks on its second decade, it is entering truly uncharted waters. Success is not guaranteed. Many of the ideas for its future operations are untested and many serious challenges lie ahead. But the faculty believes that they can be overcome with the full and constructive support of IFRS stakeholders. It won't be easy, and it may take longer than some would like. But if the IFRS Foundation evolves into the type of organisation we envisage, listening and learning as much as leading, and backed by the G20 governments and the right sort of regulation, we may well in due course look back on the IASB's second and third decades and conclude that they were just as successful – if not more so – than its first.



Turning the vision of a truly global set of standards into a reality involves huge challenges that are likely to require significant organisational change at the IASB, alongside constructive commitment by all key stakeholders around the world. The next phase requires the collective stakeholder shoulder to be put to the IFRS wheel.

The G20 governments should play a more decisive role in support of IFRS reporting. They should continue their long-term support for a single set of global accounting standards, but recognise that the most practical way of achieving this in the short term is for all G20 members to allow optional use of IFRS in their capital markets. They should take on proportionate shares of the funding required to support international standard-setting and press others to follow suit.

Regulators need to play their part. It is not the IASB's job to enforce its standards. The IASB needs more active support, including from IOSCO, and regulators around the world need to work together more closely to deliver consistent enforcement. Each regulator needs to ensure that it does not stifle the exercise of professional judgement or stray into the area of general interpretation.

Above all else, the IASB must become a truly global organisation. Managing the competing demands of its increasingly diverse list of constituents is undoubtedly one of the biggest operational challenges facing the IASB today. The IFRS Foundation – like any other successful, international organisation with a global brand to build and support – must continue to look long and hard at proven ways of decentralising its non-core responsibilities and sharing potential responsibilities. Many of the ideas for its future operations are untested and many serious challenges lie ahead.

Critically, this must involve finding a way of creating an effective feedback mechanism that enables it to work successfully with other organisations without leading to organisational paralysis. This requires a good deal more debate and organisational experimentation. Simply replicating what national standard-setters have done in the past will not suffice. The mindset needs to change for good. There is no well-tested model for standard-setting on a global scale, so good practice and the mechanisms necessary to achieve it will need to evolve over time. The challenge is above all to demonstrate that the IASB is an

organisation that listens and learns as well as leads, that it is a global body that belongs to and is responsive to its national stakeholders, without embedding operational inefficiencies or layers of advisory groups and due process that in time might paralyse effective decision making. But the journey has only just started.

There are other related, fundamental issues to address. For example:

- Evidence-gathering will be critical in future, but the challenges involved in ensuring that the right research is undertaken by the right bodies, at the right time, with the right degree of IASB oversight, should not be underestimated.
- The complexity of IFRS reporting requirements may discourage some countries from fully embracing international standards; the IASB should strive to minimise unnecessary complexity in its standards and hold fast to the vision of principles-based standards that require a reasonable degree of judgement.
- There is a need to establish operable models for undertaking effects studies and post-implementation reviews. There are few good precedents. The IASB should be prepared to redesign the approach and scope of reviews should initial results prove disappointing.
- Major changes in the scope and reach of the board's activities will not be possible unless the IFRS Foundation's funding system is established on a secure and sustainable basis.

Success is not guaranteed. But the faculty believes that these challenges can be overcome with the full and constructive support of IFRS stakeholders. It won't be easy, and it may take longer than some would like. But if the IFRS Foundation evolves into the type of organisation we envisage, backed by the G20 governments and the right sort of regulation, we may well in due course look back on the IASB's second and third decades and conclude that they were just as successful as – if not more so than – its first.

# APPENDIX – SOME SOURCES ON WHICH WE HAVE DRAWN

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# ACKNOWLEDGEMENTS

In preparing this report ICAEW Financial Reporting Faculty staff discussed the key issues with a wide range of international preparers, regulators, users and auditors of financial statements, as well as a number of leading academics. The views expressed in this report are not necessarily those of any of these contributors. The faculty is very grateful for their comments and contributions.



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