International Financial Reporting Standards

Establishment and Worldwide Adoption of IFRS: A Brief Analysis of Its Relationship with Economic Consequence

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.
Agenda

• Worldwide adoption of IFRS: from dream to reality
• The mission of IASB: why has IFRS become global basis of financial reporting
• The economic reasons to use IFRS: a few examples from the region
• Issues and challenges: IASB and IFRS family are facing
Worldwide adoption of IFRS
Worldwide adoption of IFRS

• 1999, IASC board decided to restructure itself into IASB
• When IASB started to work in 2001, no country used IFRS as national legal basis of financial reporting.
• Today, more than 100 jurisdictions are using IFRSs
Worldwide adoption of IFRS

- **122 jurisdictions (83%)**: require IFRS for all or most domestic publicly accountable entities (listed and financial)

- **15 jurisdictions**: permit or require IFRS for at least some domestic publicly accountable entities

- **10 jurisdictions**: not permitted IFRS for any domestic entities

Worldwide adoption of IFRS

• When countries are considering their adoption or convergence policy, IFRS has become the only choice
• IFRS is supported by major international organizations related to financial reporting.
• Although IASB was restructured based on SEC’s terms, the standards established by it have replaced US GAAP to become global language of financial reporting.
• 43 years after the creation of IASC, and 15 years after the establishment of IASB, the dream to establish global accounting standards has become a reality.
The mission of IASB: Why has IFRS become global basis of financial reporting
Worldwide adoption of IFRS

• Why companies and jurisdictions are encouraged to use IFRS?
• Why jurisdictions are rapidly moving towards IFRS family?
Our objectives as specified in IFRS Foundation’s constitution

- to develop, in the public interest, a single set of **high quality, understandable, enforceable and globally accepted** financial reporting standards based upon clearly articulated principles.
From general objective to a mission statement

• The objective deals with the ‘what’, but not ‘why’

• It does not adequately describe
  – Why is our work so important?
  – How do we serve the public interest?
  – Are accounting standards only of interest to investors?
  – Does our work have broader relevance?

• The mission statement published last year by IASB tries to answer these high level questions in a few short paragraphs
“Our mission is to develop IFRS that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.”
IFRS brings ‘Transparency’

International comparability

Quality of financial information

Users make informed economic decisions
IFRS brings ‘Accountability’

Reduce information gap

Capital providers

People to whom they have entrusted their money

Provide information needed to hold management to account
IFRS brings Efficiency

Use of a single, trusted accounting language

Investors

- Better capital Allocation

Businesses

- Lowers the cost of capital
- Reduces international reporting costs
Economic consequence of IFRS

Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.”
Economic reasons to use IFRS: examples from the region
South Korea

• South Korea’s economic success has served as a role model for many developing countries
• It was one of the four Asian tigers or small dragons in the late part of last century.
• It became one of G20s formed right after recent global financial crisis
• In 2007, it became earlier major full adopter of IFRS in this region.
• **Key economic reason to fully adopt IFRS**
  - Reduce and eliminate ‘Korean Discount’ because of around 10% GAAP difference.
Japan

• Japan has allowed US GAAP financial statement in domestic market for many years because some giant Japanese companies, such as Toyota, have big operation and have listed their shares in US market.

• Japan started from 2010 to allow companies to publish IFRS financial statements in local market.
Users of IFRS v US GAAP in Japan

• Since then, the voluntary users of IFRS have been increasing rapidly from 4 to 121.
• At the same time, users of US GAAP have been reducing steadily from 32 to 19.
Japan

• Key reasons to voluntarily use IFRS

1. Efficiency in business management
2. Enhanced comparability with competitors
3. Better communication with international investors
4. Better describes business performance
5. Facilitates greater access to international finance
China

• China sets its own accounting standards substantially converged with IFRS
• In addition, out of 296 Mainland China companies listed in Hong Kong, 251 use IFRS, 45 use Chinese GAAP.
• Based on the annual reports by those companies, reported GAAP difference is minimal.
Closeness of Chinese GAAP with IFRS: based on AH companies’ annual report

2008–2014年H股与A股净利润、净资产差异率变化趋势

- New profit
- Net asset

2008 2009 2010 2011 2012 2013 2014
-0.24% 0.01% 0.07% 0.06% -0.08% -0.04%

2.43% 0.99% 0.66% 0.33% 0.24% 0.11% 0.12% 0.10%

净利润差异率（H股-A股） 净资产差异率（H股-A股）
China

- **Key reasons to use IFRS**
  - Reform and growth of the economy in general, and that of business enterprises in specific.
India

• Recently published local GAAP with a few major differences from IFRS
• Interestingly, a few large Indian corporates listed only in India are planning to provide full IFRS financial statements voluntarily, and on occasion full audited IFRS financial statements.
• **Key reason to do so**
  - an international investor base, for whom the language of IFRS is the most familiar one.
Issues or challenges: IASB and IFRS family are facing
1. Should national interest dictate the formation of IFRS?

- Unclear picture of US approach towards IFRSs does create negative impacts on the establishment of one set of high quality global standards:
  - Hard to reach same or similar major principles in many major projects
  - Delay the finalization of major convergence projects
  - A few countries took convergence rather than adoption approach or postpone their decision
1. Should national interest dictate the formation of IFRS?

- No 1 reason for US not to have made its mind towards IFRS is to protect the interest of the US investors.
- While recognizing that US has the longest and richest standard setting and enforcement history,
- and the best academic and professional basis of accounting standards and practice,
- I would question whether such a policy is truly beneficial
  - to US investors facing two sets of financial information based on US GAAP and IFRS, and
  - to so many American conglomerates having subsidiaries in many jurisdictions using IFRS
1. Should national interest dictate the formation of IFRS?

- Funding has become an important issue for IASB in the past several years.
- Although contributions from developing countries are increasing, the one from US is unsecured.

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<td>3,287</td>
<td>8</td>
<td>Italy 553</td>
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<td>2</td>
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<td>1,810</td>
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<td>France</td>
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1. Should national interest dictate the formation of IFRS?

American seats in IASB and our Trustees have been gradually reducing

<table>
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<tr>
<td></td>
<td>Total</td>
<td>US</td>
</tr>
<tr>
<td>2002</td>
<td>19</td>
<td>6</td>
</tr>
<tr>
<td>2007</td>
<td>22</td>
<td>5</td>
</tr>
<tr>
<td>2011</td>
<td>20</td>
<td>4</td>
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<td>2016</td>
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Is declining US influence in international standard setting in line with the country’s best interest?
2. To what extent should economic consequence be considered in standard setting process?

• Many of Professor Zeff’s works documented the influence of economic consequence or political lobbying in the standard setting process in the US.

• In its early, IASB had the luxury not to be heavily influenced by lobby groups or gave much less consideration to economic consequence of its standards.

• After recent financial crisis, entities in major economies become very sensitive to the economic consequences of new IFRSs requirements.

• Hence, many comments expressed to us are on economic rather than technical ground.
2. To what extent should economic consequence be considered in standard setting process?

• This has also made some of our major standards difficult to complete.

• In a few cases, people challenged the problems in our due process when we made swift changes to our standards partially because of economic reasons.

• In a few other cases, we have to put some thorny issues or even completed amendments on shelf simply because of no consensus on whether they economically make sense.
3. How should we balance between transparency and volatility in performance reporting?

• We are also struggling with some conceptual issues:
  – current value versus historical cost,
  – relevance versus reliability,
  – balance sheet versus income statement focused, etc.

• The key is how to balance between transparency and volatility in performance reporting and in real economy.

• In some people’s mind, transparency means more current values of assets and liabilities, and changes in them be reflected immediately in income statement.
3. How should we balance between transparency and volatility in performance reporting?

• However, we are facing count arguments favouring cost based measures.

• While some accept current values in balance sheet, they would not agree to reflect all changes in income statements.

• The reason is concerning on volatility in income statement which may not faithfully represent the financial performance of an entity and its management.

• This has resulted in more and more OCIs in our recently newly established or amended standards.
4. How should we give adequate considerations to unique issues resulted from many countries?

• Since over 100 jurisdictions are using IFRS, it has become a very challenging task for IASB to respond to the unique technical issues from all over the world.

• Fortunately,
  – we solved the related party disclosure, deemed cost, regulated interest rate, and other issues from China.
  – We made amendment to our biological asset standard based on the request from Malaysia.
  – We found moderate solution to the accelerated depreciation issue from Japan.
  – We keep silent on the dividend tax related rule set by Taiwanese regulator which some in IASB feel not in line with our standards on income tax.
4. How should we give adequate considerations to unique issues resulted from many countries?

• By contraries,
  – We did not give timely solution accepted by Indonesians on how to account for right to use land.
  – We have also not found solution to the issue from Canada on rate regulatory activities after nearly 10 years’ efforts.
5. How should we ensure / enhance relevance of financial reporting under IT environment?

- Volume of IFRS doubled within 10 years, including more detailed disclosure requirements.
- This results in ongoing debate on information shortage or overload:
  - Sophisticated, institutional investors: the more the better
  - Others: too much, important information is obscured, even experts feel hard to understand published information
- In addition, we see two trends
  - Companies publish more performance measures in the name of APM, KPI, etc.
  - Financial data aggregators like Bloomberg are providing more information to users updated timely.
5. How should we ensure / enhance relevance of financial reporting under IT environment?

• Would IFRS based information become marginalized?

• How should we ensure and enhance IFRS based financial information under IT environment?

• As a regulator and a standard setter for nearly 20 years, I do not think either standard setters or regulators would be able to find a complete set of information best suit market needs, and solve effectively all the thorny recognition and measure issues.

• The two trends I just mentioned might give us sign of hope.
An “Events” Approach to Basic Accounting Theory

George H. Sorter

In 1966, after two years work, a committee of the American Accounting Association issued a Statement of Basic Accounting Theory.1 Undoubtedly, the most startling recommendations were the sanctioning of current costs and the advocacy of two column (historical and current) reports. To this member of the committee, however, even more startling was that the near unanimous agreement the recommendations was arrived at following two very divergent paths originating from two very dissimilar basic analysis and evaluation of the committee’s monograph but perhaps also stimulating discussion and criticism of a new approach and suggest new avenues of research and experimentation to make accounting more responsive to present day conditions.

Two Views—Value and Events

The Value Theory

The “Value” school within the committee, or as they would probably prefer to be termed the “User need” school, assumed that users’ needs are known and...
‘Value Approach’ or ‘User Need Approach’

• Assume that users’ needs are known and sufficiently well specified.

• Therefore, accounting theory can deductively arrive at and produce optimal input values for used and useful decision models.
Sorter’s criticism on ‘User Need Approach’

• There are many and varied uses of accounting data and it is impossible to specify input values that are optimal for the wide range of possible users;

• For each specified use different users utilize a wide range of different decision models far been unable to describe; and

• Neither economists nor accountants have been able to advance the theoretically correct decision models.
‘Events Approach’ suggested by Sorter

• Purpose or function of accounting is to provide information about relevant economic events that might be useful in a variety of possible decision models.

• Therefore, less rather than more aggregation is appropriate, and

• The user, rather than the accountant, must aggregate, assign weights and values to the data consistent with his forecasts and utility functions.
Events Approach: the reality and near future

• In early 1980s when I studied for PhD, I was deeply attracted by Professor Sorter’s thoughtful ideas.
• In my mind at that time, his ideas represent the remote future.
• But under modern IT and communication environment, they represent reality now or at near future.
• The key issue is whether we have reacted timely and adequately.
Thank you

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