Keynote Speech 2

NATIONAL STANDARD SETTERS : A NEW ROLE IN A GLOBALIZING WORLD
By Gilbert Gélard, Member of the International Accounting Standards Board.
London School of Economics, May 11, 2009.

THE OPINIONS EXPRESSED IN THIS TEXT ARE THOSE OF GILBERT GELARD, NOT THOSE OF THE IASB.

In a rapidly globalising world, the interdependence between sovereign states and between economic entities has reached a point never known before. Paradoxically, the recent financial crisis and its economic aftermath are a sign that globalization has won the game, be it in a damaging way. The way mismanagement in a single important particular market and country grew into a pandemic would not have been possible if finance had not already been global. However, the cure is not in less globalization, but in better regulation and enforcement, as the world leaders embodied in the G20 have pledged to establish in early April 2009.

It so happens that as of today, the world of finance is globalized, for good or bad, but without regulations to match.

Focussing on listed companies, especially multinationals whose securities are traded worldwide, one might think that they operate on one single market ,a pretty efficient one , if not perfectly so. A high degree of efficiency would require, it seems , a fairly high degree of common regulations to ensure the much sought-for level playing field .
Indeed such level playing field does not exist, and no serious attempt has been made to obtain it in the various regulatory fields that would require addressing if the markets were to have a chance to work efficiently.

Such unification has not been attempted in most relevant areas .

Securities regulators are still very much national . In the European Union, which was from 1956 aiming at free circulation of people and capital- the premise of the foundation of the then Common Market between the six founding countries- there are 27 national regulators and the role of CESR , the umbrella consultative body , is at best coordination and a search for best practices .
Prudential regulation for the financial sector, i.e. banking and insurance industries, is even more of a patchwork. In Europe, each member state has one or several, and in the US each of the 50 states has its own insurance regulator , and strangely nothing of the kind at the federal level.
It must take a strong belief in the strength of the invisible hand to be confident that such conditions would lead to a smooth functioning of markets. The issue is not whether regulation is useful- that is beyond doubt- but to adapt it to a globalized world efficiently and without excess.
There is one exception to the vacuum of worldwide regulation . This exception is IFRS, i.e. the International Accounting Standards prepared by the International Accounting Standards Board, the IASB.

THE GLOBAL ACCOUNTING EXPERIMENT.
The IFRS aim at being the set of standards followed by listed companies worldwide to present their financial statements to their present investors and those who might consider investing.
When the IASB succeeded the IASC in 2001, it was given a sudden boost by a decision taken soon after by the European Union. The IFRS would become from 2005 on the accounting standards

followed by European issuers to prepare their group accounts, by - passing member states ‘ laws and regulations.
This followed a political choice made at the EU level to shelve the old permissive and inefficient accounting directives issued in the 70’s for a more prescriptive and internationally recognised set of standards. It required a decision on which of two sets of standards – US GAAP or IFRS- would be applied in Europe. The choice for IFRS triggered a wave of adoption by other countries (Australasia, South Africa, China , India, Canada) and convergence moves in Japan , Mexico and South America. The prospect of one single set of accounting standards, at least for listed companies, would be achieved after completion of a programme of convergence before 2011 between US GAAP and IFRS. The IASB and the FASB would work closely together. The convergence programme received the blessing of both the US SEC and the EU Commission.

This is what the French economist Nicolas Véron has called the “Global Economic Experiment” in a study published in 2008 by the European think tank Brueghel. He underlines the striking success of the first truly global piece of economic legislation , while underlying the challenges and obstacles that are a threat to the ultimate success of what he calls “a global experiment”.
In my view the biggest challenges are not technical but political. Here are a few :

First, the EU has de facto a sense of ownership over the IASB. Having adopted the system early on and being the only major constituency to apply the standards fully- except for one carve out on part of one standard- they hardly accept the concept of independence that is inherent in standard setting.

The media themselves are prompt to oppose US standards to what they wrongly call European standards, i.e. IFRS,ignoring the widespread application in the rest of the world. Such confusion is unlikely to go away before convergence with US GAAP is substantially achieved and more big countries have fully adopted IFRS.
Time is here an important issue.
During the recent financial turmoil, accounting standards were attacked, allegedly for having caused or at least amplified the crisis. Although it is now universally acknowledged that accounting was in no way a cause of the crisis, the attacks have continued . One of the reasons, rarely mentioned, may be that , being the only truly global set of financial regulation , it is the most obvious target and the easiest one.

The governance of the IASB may also be seen as a peculiar one for an institution that has gained such prominence in the world .Its role of quasi- lawmaker in Europe is resented by politicians in Brussels and in certain member states . Tommaso Padoa- Schioppa, once chairman of the trustees of the IASCF the oversight body of the IASB, used to describe this unique and particular structure as “alien” to ways things are normally done in Europe, meaning Brussels and the continent . That is being addressed by a recent and on going reform of the IASCF constitution .

It is not surprising that such a success story be challenged . After all , many well established and vital institutions have seen their roles questioned , turned upside down and even have believed their existence to be threatened by the emergence of the IASB as a world body .Such is the case of the national standard setters , such as the UK ASB and its counterparts around the world . It is however noteworthy that , while the success of the IASB definitely modifies the roles of the various national standard setters in various degrees ,it does not negate their existence , nor their usefulness.

VARIOUS TYPES OF STANDARD SETTERS.

All standard setters have been impacted by the emergence of the IFRS as global standards for the entities particularly exposed to global markets, i.e. listed companies.
However , one cannot understand the issues without first describing the spectrum of bodies labelled as standard setters around the world . Describing them all would be an impossible and pointless task, but a few examples will show how they operated before the IASB took the lead.
During the last twenty years, the existing standards setters ceased to be controlled by the accounting and auditing professions to become independent from them .It was generally felt that accounting was of public interest and there was a risk that accountants would devise self serving rules, a classic perception of conflict of interest.

In the Anglo Saxon world , this meant a status whereby the body was independent and issued accounting pronouncements under its sole authority. This was possible because the statutes and laws in typical Anglo-Saxon countries contained almost no accounting provision. Until the accounting provisions of the EU directives came into force in the late 70's and early 80's , UK company law was exempt of any accounting provision. When , reluctantly, the UK had to introduce some accounting provisions in their company law to comply with the EU directives, they did the bare minimum and went as far as to state that in case of conflict the accounting standards issued by the standard setter would prevail. This gave the standard setter absolute power to make accounting standards. This model was prevalent in the Commonwealth countries , although in Canada the standard setter remained attached to the accounting professional body, the CICA.

This contrasts heavily with the situation in Germany where at that time there was no standard setter at all. Indeed, the German Accounting Standards Board was created in 1998 because Germany had to deal with foreign accounting standards such as the IASC pronouncements and US GAAP. The creation of a standard setting body in Germany was a consequence of the growing globalisation of accounting, it was not needed before. Why is that?
Germany is the extreme example in the Western world where accounting , i.e. the HGB (Handels Gesetz Buch) was totally a subset or a part of commercial law .Every provision was written in statute , no need or possibility to go beyond.
The situation was pretty close in France where a famous motto ran :" accounting is the algebra of law", which means that law dictates and accounting just puts figures ,when needed, around it. However , the French had a standard setter ,the Conseil National de la Comptabilité, with limited power but a significant consultative role.
Globally, with nuances , Europe was split in two with and Anglo-Saxon model in the North and a Latin and German model in the South. This matches to some extent an ancient divide between the Napoleonic Code based on Roman law and the Common Law approach.
These two models extended elsewhere .For instance the Japanese model was very close to the German model .Professor Chris Nobes wrote authoritative books more than 20 years ago on those topics.
A special place is occupied by the US standard setter, the FASB. Organised under a foundation , it has issued authoritative pronouncements in its own rights since 1973, showing many attributes of independence. However , its standard setting power is a delegation from the US Security and Exchange Commission (SEC) , a powerful government agency. Although it is technically a national standard setter, the predominance of the US capital markets makes it de facto the other international standard setter , at par with its counterpart the IASB. How this equilibrium will change in the future is of course a big question.

It thus appears that prior to the IASB becoming the global leader, standard setters, where they existed , were pretty diverse as to their roles, power, clout, background, independence .
Apart from the US de facto exception, they had at least one thing in common: each of them served the need of a limited jurisdiction, typically one sovereign state ,in a world where accounting provisions remained local, tied to local commercial law and very often to tax rules.
Globalisation generally and the Single European Market as far as Europe is concerned were to make this chequered picture obsolete.

WHAT HAS CHANGED FOR NATIONAL STANDARD SETTERS WORLDWIDE.
The spreading of IFRS throughout the world has dramatically changed the national standard setters 'scene .
First, it prompted countries that had no standard setter per se to create a body that would at a minimum liaise with the IASB and in particular with IFRIC, the body of the IASB that interprets, as needed, the IFRS's. These bodies are very different from country to country and their mission may vary widely. In Germany , for instance, the GASB deals only with consolidated (group) accounts as opposed to separate accounts which remain strictly under the German Commercial Code under significantly different accounting principles. Italy also very recently created its standard setter, the OIC.
Second, their roles differ widely depending upon what choice their country has made regarding IFRS's. Three typical situations may be described:
Case1.
Some countries have gone for full adoption, including consolidated and separate accounts, regardless the size of the entities and whether they are listed or not. This is for instance the case in Australia and New Zealand and is going to be the case in Canada and Some Latin American countries. It is also the case in a few European countries , but no major one, except to a certain extent Italy , has made that choice.
Case 2.
Some countries have left an option for companies to fully adopt or to remain under local standards.This requires from the national standard setter that it maintains the local accounting system in good order. Sometimes the local system is gradually changed to converge with the IFRS , so that the gap would eventually diminish. This process is generally slow, painstaking and inefficient .One of the issues in countries having made this choice is the allocation of rare resources and the lack of interest of the best experts in a purely local set of standards. Most of the major European countries have adopted to various degrees the optional use of IFRS beyond the consolidated accounts of listed entities for which the EU requires the use of endorsed IFRS's. Some have prohibited the use of IFRS's for the separate accounts, even for listed companies.
Case3.
Some countries take the route of adaptation instead of adoption . Between adapting and adopting there is a world of difference. Some jurisdictions claim that the local standards they design using IFRS's as a benchmark or a model are" in substance equivalent to IFRS's."In such countries, the standard setter is of course very busy ,watching what the IASB does and preparing the adaptation of its pronouncements to the allegedly specific needs of its own countries.
Nobody knows to what extent the accounting standards produced under such a method will be close to or far away from full IFRS's. If anything , the use of a formula like " prepared under IFRS as adopted by country X" is unclear and potentially misleading. It may well be for instance that a country adopted all the standards, except that it decided not to apply IAS 39 or IFRS 7 to banks

The use of the word IFRS to label such standards is not only bad information , it a threat to the brand itself.

Due to the variety of political, legal and economic environments, the inputs of the various standard setters into the global accounting standard setting are bound to be very diverse .We have just shown that one of the determining factors is the political choice made by the state as to the extent of the use of IFRS's in its jurisdiction.

A country or a region having tied itself to the pronouncements issued by the IASB is likely to involve itself actively in the process, through its standard setter, but not only. Such an example is Australia. It has adopted IFRS across the board , its standards are full IFRS, word for word, just renamed AIFRS (A for Australian) for legal reasons. It has withdrawn its own interpretations and given up interpreting standards. One obvious question comes to mind . Why would Australia need a standard setter? The answer is : they need one absolutely to be involved in the due process. For instance , national standard setters , such as the Australian one , are involved early on in the research phase that precedes the an agenda decision by the IASB. Such early involvement is of great importance to assess the need of and scope for a project and give preliminary orientations. Also, the vigilance as regards the debates and due process is much greater in a constituency where entities know they will be directly affected by the IASB's ultimate decisions.
Canada , who will be applying full IFRS from 2011, will probably adopt an attitude similar to that of Australia. It has always been an active participant in the process. Canadians also perhaps experienced that following US GAAP would not have given them sufficient influence on the decisions of their Southern neighbour.

When a country uses IFRS's only for consolidated accounts and/or for listed companies, the standard setter still has benefits in getting involved in the IASB work, beyond the mere responses to the consultations. The problem for such a standard setter is one of finding the adequate resources and allocating them between local work and international work.

It may be ,especially in the developing world, that some follow the lead of South Africa, who decided to abandon totally domestic standards and replace them by the incoming "IFRS for SME's" that will become South African Standards, except for listed companies that of course use full IFRS's.

For all standard setters, one of the problems will be to obtain and retain adequate and sufficient resources. It is certainly more exciting and career enhancing to deal with global standards than with local ones which are applicable to smaller unlisted entities.
Yet, it vital to have local standard setters of good quality .Lack of resources in the major national standard setters would impoverish the system globally and be detrimental to global standard setting.

Thus, if standard setters have a role to play in this new world ,they should be careful on how to use scarce resources. There is also one thing they are tempted to do and should refrain from doing: they should not try to second- guess nor to interpret IFRS's . The argument that something is so specific to their jurisdiction that the correct solution to an issue can only be developed locally appears to be ill- founded in almost all cases. An apparently purely local question can and should always be upgraded to a more general issue likely to be encountered somewhere else in the world. The interpretative issues should be sent for examination to IFRIC which is the competent body. The only thing a standard setter should be allowed to issue regarding IFRS is guidance and educational material , provided this guidance is not an interpretation by another name. Different local flavours of IFRS's should be avoided at all costs .The memorandums of understanding proposed by the IASB to standard setters is quite specific on the question of interpretations.

Discipline is all the more important because the underlying national cultures and attitudes are still there , leading to different readings of the same words. In that regard, the bodies best placed to avoid the common accounting language to drift into different dialects are the large accounting firms with a worldwide coverage.

CONCERTATION BETWEEN STANDARD SETTERS

The emergence of global standard setting has led standard setters to coordinate their efforts on an ad hoc , usually regional basis.

European Union.

The role of a national standard setter of any member state of the European Union is obviously conditioned by the EU regulation adopting IFRS as the accounting standards for group accounts of listed companies. The process of adoption , called endorsement, is an ongoing one in which a body called EFRAG plays a key technical role. Although EFRAG is not a standard setter, some of the major standard setters in Europe (France, UK,Germany)in attend its monthly meetings , where they have an observer status with no voting right. Inside EFRAG, they have formed a research group that help EFRAG in its proactive role to put forward papers under the acronym of PAAinE. They deal with topics that feed , inter alia, into the research much wanted by the IASB in areas like pensions, leasing, distinction between liabilities and equity, revenue recognition, etc…Their research papers are not following a request by the IASB, but they tend to deal with topic that are either contemplated or being developed by IASB.Not being under the pressure for an immediate outcome , they tend to be fundamental and may be an good starting point for future work. An example in their recent paper on pension accounting .

Meetings of world standard setters

The IASB organises one update meeting each year and the world standard setters have their own regular meetings several times a year. The former meeting is purely informative but maintains a link between the IASB and standard setters who rarely participate to the debates for lack of resources. The latter have a more structured agenda and gives feedback to the IASB.

WHAT WILL BE THE IMPACT OF THE IFRS FOR SME's?

The soon to be published IFRS for non publicly accountable companies (private companies) named IFRS for SME's is likely to change significantly the landscape of accounting standards and consequently the roles of the standard setters . Although the IASB has not had the ambition to impose this standard to anyone, it has created a lot of interest in many parts of the world. It is likely that some countries will envisage following the route taken by South Africa , that is using the SME IFRS as their own local standard for non listed companies.

Alternatively, some may choose to use it for certain of its entities on criteria of size or other criteria. Some countries having opted for full IFRS for all entities might want to reconsider that choice if they think that a simpler , yet of IFRS quality, standard is better for non listed and smaller companies

This may bring about a new interest and involvement in IFRS by some standard setters. It will take some time to evaluate the consequences.

TOWARDS A SINGLE SET OF STANDARDS ?

When dealing with standard setters vis-à-vis the IASB , I have deliberately put apart the FASB. Indeed , the position and the outreach of the US standard setter are unique, in the sense that it has been dominant for a long time and has been the only credible alternative to the IASB and IFRS.

What has made the US GAAP less attractive was its extreme complexity often referred to as rule based (versus principle based) although this phrase is in itself too simplistic. It was also the desire of Europe and other big players not to depend upon decisions that might privilege US national interests.
It is in itself remarkable that the SEC endorsed the programme of convergence Memorandum of understanding) that would lead ultimately to a single set of international standards and even more remarkable that it accepted before the 2007 year end that foreign issuers listed in the US might file IFRS accounts without reconciling to US GAAP. Let us not forget that this waiving of reconciliation had been discussed and rejected for at least twenty yeasrs There is now talk of US preparers being allowed to opt for IFRS under conditions , even though the final move to IFRS for US preparers remains uncertain as to occurrence and timing.

If anything , and whatever the current events are, the need for clarity and transparency has never been greater, nor the case for a single set of standards more compelling . But a level playing field does not depend on accounting standards alone . There need to be proper enforcement , quality auditing, adequate securities and prudential regulations. Accounting has just been the pathfinder. As such , the global standard setter is much exposed. The rigorous due process of deliberations and wide consultations it follows are a good protection . However, the pressures occasioned by the crisis for quick fixes require much vigilance and reactivity if the quality of financial reporting has to be maintained.

LIST OF ACRONYMS USED:

CESR: Committee of European Securities Regulators
IFRS: International Financial Reporting Standards.
IASB: International Accounting Standards Board.
IASC: international Accounting Standards Committee
US GAAP: Generally Accepted Accounting Standards (United States)
FASB: Financial Accounting Standards Board
IASCF: IASC Foundation.
ASB: Accounting Standard Board (UK)
EU: European Union
CICA: Canadian Institute of Chartered Accountants
HGB : Handelsgesetzbuch (German Commercial Code)
SEC: Securities and Exchange Commission (United States)
GASB: German Accounting Standards Board
OIC: Organismo Italiano di Contabilita
IFRIC: International Financial Reporting Interpretations Committee)
SME: Small and Medium-sized Entities
EFRAG :European Financial Reporting Advisory Group
PAAin E: Proactive Accounting Activities in Europe.