Future of IFRS: what purpose(s) do we want annual accounts to serve?

Co-hosted by Dr Syed Kamall MEP and Theodor Dumitru Stolojan MEP

- 8 May 2013 -

Welcome speech

Syed Kamall, MEP

Panel 1 The relevance of IFRS in today's economic environment, are they still fit for purpose?

moderated by Richard Martin, Head of Corporate Reporting, ACCA

- Philippe Danjou, Member of the board, International Accounting Standards Board
- Professor Stella Fearnley, Bournemouth University
- Danny Van Quaethem, Financial analyst, Societe Generale Private Banking NV
- Claes Norberg, Confereration of Swedish Enterprise, BusinessEurope
- Roger Collinge, Head of Corporate Governance Group, UK Shareholders Association
- Gérard de la Martiniere, Caisse des Dépôts et Consignations

Philippe Danjou

Member of the board, International Accounting Standards Board

November 2011

International Financial Reporting Standards

The relevance of IFRS in today's economic environment, are they still fit for purpose?

Philippe Danjou
Member of the IASB

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

IFRS™

Global markets need global standards

- Global accounting standards will provide the **bedrock** on which to build a stronger, more transparent financial system

- Urgent need to for **a level playing field in financial reporting** (financial services)

"We reaffirm our objective to achieve a single set of high quality global accounting standards"

G20 Leaders Communique, Cannes 201

IFRS™

Progress towards global standards

- 2001: No major economies use international stds.
- 2012: 100+ countries require or permit IFRSs
- **2/3rds of G20 now require IFRS**

Source: IASPlus / Deloitte

G20 Members requiring use of IFRS	Adoption year
European Union	2005
U.K.	2005
France	2005
Germany	2005
Italy	2005
South Africa	2005
Australia	2007
Brazil	2010
Canada	2011
Korea	2011
Mexico	2012
Argentina	2012
Russia	2012

Remaining G20 following different paths to IFRS adoption

- **China:** Substantially converged with IFRSs
- **India:** Awaiting decision on ‘IFRS as adopted by India
- **Indonesia:** Using IFRS 2009, seeking to update
- **Japan:** Voluntary use of IFRSs (growing use), Government continues to consult on mandatory use of IFRSs
- **Saudi Arabia:** Required for financial services; objective of full compliance with IFRSs
- **United States:** IFRS Permitted for non-US companies (circa. 500+ using IFRS), decision outstanding on domestic use

The IASB has become a global organisation

- **Global standards:** 100+ countries, 46 translations of standards
- **Global diversity:** 27 nationalities represented among 16 Board and 59 technical staff (53% European)
- **Global governance:**
  - Monitoring Board: Public accountability (inc. Commissioner Barnier)
  - Trustees of IFRS Foundation: Governance (Chaired by Michel Prada)
  - IASB: Independent standard-setter (Chaired by Hans Hoogervorst)

Long-term investing

- IFRSs designed to provide investors with maximum transparency, both for short and the long term decisions
- Long-term investors require point in time, reliable and unbiased performance measurement
  - To hold management to account
  - To make mid-course corrections
  - To adjust for external factors

Prudence (vs. systematic measurement bias)

The concept is not dead, but alive and kicking:

- Proposed expected credit loss model to replace incurred loss
- Asset impairment test on a DCF basis
- Risk adjustments required when marking to model
- Liabilities for guarantees and warranties to be immediately recorded; also long-term provisions for pensions / site renovations
- Inventory carried at lower of cost or net realisable value
- Strict rules for limiting off balance sheet activities
- Proposals for leases to be on balance sheet

"We do not accept that IFRS has led to a loss of prudence…the concept of prudence continues to permeate accounting standards"

UK Secretary of State, 201

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

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Claes Norberg

Confederation of Swedish Enterprise, BusinessEurope

Roger Collinge

Head of Corporate Governance Group, UK Shareholders Association

Future of IFRS

European Parliament
8 May 2013
R A Collinge
UK Shareholders’ Association

Future of IFRS

- UK Shareholders' Association: Representing private shareholders: support from the Swedish Shareholders' Association, Aktiespararma
- Working with a group of UK institutional investors and advisers:
- Universities' Superannuation Scheme
- Railpen
- The Cooperative Asset Management
- Royal London Asset Management
- London Pensions Fund Authority
- Threadneedle Investments
- Local Authority Pensions Fund Forum
- National Employment Savings Trust
- Governance for Owners
- Managing in total over 250bn euros of investments

Future of IFRS

- Concerns:
- Accounts should help to:
- improve economic stability
- underpin responsible corporate governance
- reign in excessive pay

- By:
- Showing a true and fair view
- Being drawn up on a prudent basis
- Reporting on the stewardship of the shareholders’- the owners’- money

Future of IFRS

- True and Fair

- 4^{th} EU directive (Section 1,2,3)
- Dividends to be paid out of profits “ made”
- IFRS include unrealised profits
- Mark to model

Future of IFRS

- Prudence
- Accounts did not warn of the financial crisis

- Elimination of prudence from the IASB Conceptual Framework

- Intellectual arrogance: We claim to be able to measure risk- but we cannot

- Legal requirements: “.. valuation must be made on a prudent basis…” (4th Directive clause 31.1.c: 7th Directive clause 29)

- Law cases: Tomberger: Bauunternehmung: Banque Internationale pour L’Afrique Orientale

Future of IFRS

- Stewardship

- Not in Conceptual Framework
- Requires a different attitude to “usefulness”
- Supported by Standard Life who manage over 200bn euros of investments in a recent letter to the Financial Times of London.

- Action required:
- Review EU approved IFRS to ensure that they comply with EU law
- Return prudence: we deceive ourselves if we think we can measure risk
- Re- assert True and Fair
- Ensure strong independent auditing

Gérard de la Martiniere

Caisse des Dépôts et Consignations

Future of IFRS: what purpose(s) do we want annual accounts to serve?

Association of Chartered Certified Accountants (ACCA)

European Parliament

Brussels, 8 May2013

PANEL 1 :
The relevance of IFRS in today's economic environment, are they still fit for purpose ?

Gérard de La Martinière :

« A strategic priority : to restore the conditions of long term investment »

A positive stock tarnished by the financial crisis

- The introduction of IFRS has brought real progress in improving financial reporting and integration of the European financial system

- Unconditional support of companies (notably the multinational ones) and “good boy” attitude of the EU

- But the crisis raises strong questions about the suitability of a repository too focused on the short term and amplifying market volatility

An illustration of IFRS's weaknesses through the case of Long Term Investment

- Presentation of the National Conference on Long Term Investment : the result of an analysis work realised in France in 2011 with the support of the French financial actors

- Assessing the extent of long-term investment needs of the European economy (infrastructure - industrial equipment - research and innovation - Sustainable Development)

- Questioning the origin of funding that will meet these needs:

  • Inability of public budgets
  • Diversion of international capital
  • Forced withdrawal of financial institutions constrained by crippling regulations

The need to channel the household savings toward Long Term Investments

➢Long-term savings are potentially huge (at least in continental Europe): it will continue to increase with the need to cover the longevity risk

➢But household savings is typically affected by a strong preference for liquidity and the illegibility of the modern financial markets discourages its direct investment

➢It is necessary to restore the channelling circuits of these savings toward LTI through a « balance sheet intermediation » of the financial institutions, including by cautiously fostering the « short term resources transformation » in long uses

➢The new prudential regulations are likely to seriously undermine this capacity

particularly Solvency II

➢Until now, the accounting standardization represented by IFRS

completely ignored the point

The LTI regime is to invent

- The investment activity of any economic actor can not be validly analyzed independently of the structure of its liabilities (Asset & Liability Management)

- The duration of liabilities, whether statistical, contractual, or legal (in terms of taxation), determines the investment horizon

- The investment horizon determines the optimal assets allocation that must combine safety and performance according to the fiduciary obligation incurred with respect to the principal

- The performance evaluation of asset management can only be conceived through the portfolio management (the “line by line process” is meaningless)

- The fact that investments tools are negotiable or not is secondary compared to the « Asset & Liability Management discipline »

Further thought on the fair value concept

- The « mark to market » approach is perfectly adapted to the description of trading activities, to the mutual funds activities (with daily valuation) and, more generally, it is adapted to the balance sheets exposed to liquidity risks
- But this approach is a nonsense for the evaluation of financial statements that have the capacity and the fiduciary duty to invest for the long term
- It is imperative to further the thinking on accounting in order to develop a new approach on “fair value” projected at maturity of liabilities, which may neither be the “book value” nor the “market value”
- IFRS standards admit the notion of long-term investment for industrial equipment and goodwills : then, why do they ignore this reality when investment is made in tradable securities? Why appearances must they always outweigh reality?

Business model et auditability

- A long-term investment policy is based on a streamlined expectancy of global cumulative performance forward : the fair value of the assets that I buy today to meet a commitment to be settled in X years is the probabilistic value I withdraw from this asset when I will have to sell it to resolve my commitment

- The accounts must strive to track this using value and its possible variations to measure the performance of management ; in parallel, risk measurement can pass through the detection of temporary spreads with instant market values

- The auditor in charge of the accounts certification will have to to decide on the robustness of the evaluation of the projected values, as he already does in other cases (e.g. goodwill impairment) and then will justify its added value,

  which is nonexistent when simply applying the « market value »

What position for EU ?

- EU lacks growth and must courageously remedy to the excessive indebtedness. But in the same time, EU must open the path to the economic recovery : recovery can only come from investment

- EU is the first customer of the IFRS and is now released from American control because of the recent decision by the SEC

- Europe must require the international accounting setter to accelerate the adoption of a standard appropriate to the reality of the LTI business model

- It is necessary to set aside the dogmatic debates that have prevented the setter until now to deal seriously with the subject (e.g. the endless discussion on insurance regulation)

- I do rely on EFRAG to lead the way

Thank for your attention !

Q&As

Panel 2 What does Europe need to change as IFRS enter its second decade?

moderated by Liesel Knorr, Chair of the DRSC (Accounting Standards Committee of Germany)

- Francoise Flores, Chairman, European Financial Reporting Advisory Group
- Didier Millerot, head of Accounting and Financial Reporting unit, DG MARKT, European Commission
- Roxana Damianov, European Securities and Markets Authority
- Mark Vaessen, Chairman Corporate Reporting Policy Group, Fédération des Experts-Comptables Européens
- Gordon Kerr, Cobden Partners

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How To Prevent Banks Falsifying Capital and Profits under IFRS

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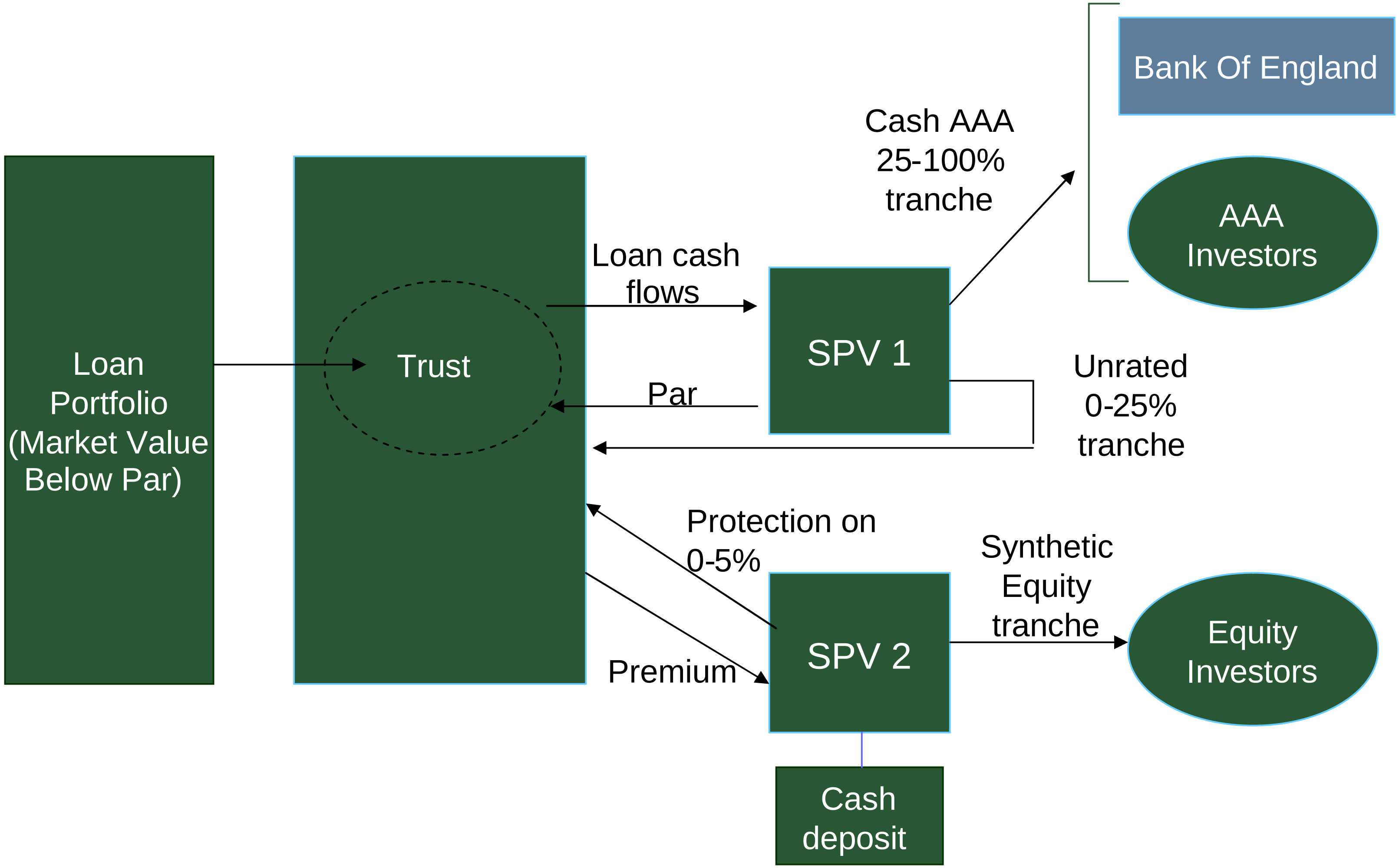
Helping Nations Solve Banking Crises

UK Bailed Bank Social Housing Portfolio



Cobden Partners
Helping Nations Solve Banking Crises

Achieves

- 2 Separate transactions
- AAA tranche pledged to central bank to fund 75% of portfolio
- Credit Derivative hedge of 0 – 5% via the second transaction reduces capital consumption (Basel 2 or 3) from 4% to about 0.5%, creating the false impression of £340mm of new bank capital on this £10bn portfolio
- Banks try hard not to sell below par loans, or losses will have to be booked, even under IFRS and Basel

Fixing The Problem

- Restore Management and Auditor Accountability
- Conflicts in European laws should be Resolved
- Auditor Rotation at least every 3 years
- True and Fair
- Prudence
- Start with redraft or revocation of EC Regulation 1606/2002, July 2002

Contact , Further Information, and Disclaimer

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More detail in “The Law of Opposites, Illusory Profits in the Financial Sector”

available at www.cobdenpartners.co.uk/ papers

The views expressed are those of the speaker

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Q&As

Concluding remarks

Theodor Dumitru Stolojan, MEP

Sandwich Lunch