THE FINANCIAL REPORTING COUNCIL
PRESENTS

THE 2012 KEN SPENCER MEMORIAL LECTURE

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6:30 pm, 29 May 2012

Lecturer: Mr Warren McGregor
Former Member, International Accounting Standard Board

Master of Ceremonies: Ms Lynn Wood, Chairman, Financial Reporting Council

Mr Ken Spencer AM

Ken Spencer AM played a pivotal role in creating the International Accounting Standards Board (IASB) and in enabling the very bold experiment — the establishment of a single set of global accounting standards known as International Financial Reporting Standards (IFRS). He had an intense commitment to the improvement of financial reporting through accounting standards, nationally and internationally. Along with international business leaders such as Paul Volcker, the Former Head of the US Federal Reserve, Ken Spencer was instrumental in organising funding and independent membership for the IASB.

A copy of Mr McGregor's lecture follows.

(The views expressed in this paper are those of the author. They do not necessarily reflect the views of the Australian Government or the FRC.)

The 2012 Ken Spencer Memorial Lecture

Setting Accounting Standards: Politics, Processes, Philosophies and Personalities - the experience of the IASB[1]

Warren McGregor
29 May 2012

Introduction

[1] This lecture is based in large part on an article "Personal Reflections on Ten years of the IASB", to be published in the Australian Accounting Review in September 2012.

This lecture is about a journey that Ken Spencer set out on but sadly did not complete. Ken was passionate about accounting standard setting, having been directly involved domestically early in his professional career and more latterly at an international level. He believed that high quality financial reporting conveyed significant benefits to the business community, the broader economy and the well-being of a country's citizens. This belief, initially focussed at a national level, soon extended to the international level. He was appointed to the Board of the International Accounting Standards Committee (IASC) in 1983, became chairman of the group of national standard setters known as the G4+1 in 1998 and was appointed as an inaugural member of the IASC Foundation Trustees in 2000. He shared a vision with a number of leading national and international accounting standard setters and capital market regulators that the world would be a better place if a set of high quality global accounting standards was developed and adopted by countries around the world in place of their national, often idiosyncratic, accounting standards.

Ken was an integral part of the beginning of the final leg of this journey. As you will hear, he played a critical role in establishing the infrastructure that has taken the world to within reach of that vision. IFRSs are now required or permitted in more than 120 countries.

I was with Ken during the stages of the journey he did complete, nationally with the Australian Accounting Standards Board and earlier incarnations, and internationally with the IASC, the G4+1 and the International Accounting Standards Board (IASB). It is a great honour to be able to share with you the journey that Ken was unable to take. I am sure he would have relished the challenges the IASB had to face and the obstacles it had to overcome, and he would have been immensely proud of what it has achieved.

Standard setting – not for the faint hearted

Those not familiar with standard setting and the intricacies of financial reporting can be forgiven for thinking it is all rather arcane and mundane. That couldn't be further from the truth. Setting accounting standards involves changing hearts and minds and it confronts all of the challenges legislators face when attempting to introduce controversial legislation. This lecture will take you inside that process and give you an insight, warts and all, into the politics of international standard setting, the effect on the standard setting process of differing philosophies and cultures, and the role of some of the key personalities involved in international standard setting, including both their influence and the effect on them personally. But first, let me take you back in time to explain how the

IASB we know today came about. The political machinations surrounding the formation of the IASB were to be a forerunner of things to come.

Evolution of the IASC to the IASB

The IASB evolved from its predecessor body the IASC which was established in 1973 with the objective of promoting the international harmonisation of accounting standards. However, its role quickly became one of developing standards for countries that either did not have a capacity to develop their own national standards or were in the formative stages of developing such a capacity.

The transition to the IASB began in earnest in 1987 when the International Organisation of Securities Commissions (IOSCO) floated a proposal to the IASC that if it were to improve its standards, IOSCO would consider endorsing them for use by its members. Over the next 13 years the IASC embarked on an intensive program designed to improve its standards. As this process took place it eventually became clear to the IASC leadership that it would need to do more than merely improve its standards for national securities regulators, in particular the US Securities and Exchange Commission (SEC), to fully support the use of International Accounting Standards (IASs). Specifically, it became evident that to achieve global acceptance of IASs major structural changes to the IASC would have to occur.

This outcome was disappointing but no great surprise to the IASC leadership. During the long developmental period there had been growing disquiet that IOSCO, led by the SEC, would keep moving the goal posts. As the IASC leadership came to accept that it had to restructure to meet its goal of having securities regulators endorse its standards, and indeed in order to survive, the battle began in earnest over the model that should be employed. The protagonists effectively fell into two groups; the SEC and the G4+1, a group of leading Anglo-American standard setters that began meeting on a regular basis from 1994, who favoured the independent expert model, and the continental European countries and the European Commission (EC) who favoured more of a representational model. The former model places emphasis on independence and technical expertise with a smaller number of mostly full-time board members, the latter on representation of the key constituents and broad consensus, with a larger number of mostly part-time board members. Those supporting the independent expert model won the battle, but as subsequent events perhaps demonstrate, they may have lost the war.

Getting started at the IASB

The inaugural members of the IASB had been handpicked by Ken Spencer, who had been appointed by the IASCF Trustees as the Chairman of the Nominating Committee, and David Tweedie the newly appointed IASB Chairman. Most of the members of the Board knew each other, having worked together on the board of the IASC and/or the G4+1, and all had deep knowledge of financial reporting.

Assembling a group of acknowledged financial reporting experts was in keeping with the standard setting model ultimately agreed by the IASC Board. However, Spencer and Tweedie went considerably further. They appointed a group of people that they believed could work well together, had already demonstrated strong belief in the Board's mission, were by and large of like-mind and were intent on reforming financial reporting.

Two other things were evident from the composition of the Board; it would be perceived as being able to "compete" with the FASB, ie it had "acquired credibility", and there would be no start-up time. These factors were particularly important if the IASB was to have an early impact in pursuit of its mission to establish a single set of high quality global accounting standards, since it had no power to force companies or countries to use its standards and, at the beginning, it had no constituency as such. In effect, it had to rely on a perception that it could produce high quality accounting standards and it had to get some runs on the Board quickly to prove that it could.

So it was with a somewhat free and unencumbered spirit that the Board commenced operations in April 2001 – it was well resourced compared to the IASC, reform-minded, had no cumbersome constituents and had a clear vision of the areas of financial reporting that were in need of reform. However, that relative peace and tranquillity was soon shattered by the decision of the European Union (EU) to embrace International Financial reporting Standards (IFRSs) in their quest to develop a deep and liquid European capital market.

The European Union's decision – a watershed event

The EU's decision, formalised in June 2002, had been foreshadowed two years earlier by the EC. Interestingly, in setting the initial agenda, we had not focussed on the prospect of the EU adopting our standards. Indeed we were surprised when we learned that the EU would pursue that course of action. However, once it became clear the EU would adopt its standards and, moreover that it would require most EU listed companies to begin using them in 2005, the Board turned its attention to developing a "stable platform" of new and revised standards by March 2003.

The EU's decision was one of two watershed events that have occurred since the IASB began operations. With the stroke of a pen the IASB had a major constituent. Furthermore, it was the catalyst for other countries to embrace IFRSs. The Financial Reporting Council announced soon after the EU decision that Australia would adopt IFRSs at the same time as the Europeans, on the grounds that not to do so would place Australian companies at a competitive disadvantage. The South Africans also decided to adopt IFRSs for application in 2005 and Hong Kong and New Zealand soon followed suit.

Political pressure

When countries make the transition to IFRSs, inevitably there will technical issues the IASB is called upon to address because certain accounting practices in the adopting countries are incompatible with existing IFRSs. When Australia made the change, it was accounting for internally generated intangible assets and accounting for exploration and evaluation activities. In New Zealand, it was accounting for puttable shares by agricultural cooperatives. In Europe there was a range of issues, including accounting for puttable shares, accounting for share-based payments and two issues relating to IAS 39 Financial Instruments: Recognition and Measurement; use of the fair value option and hedge accounting.

As the IASB endeavoured to deal with these issues, it was lobbied heavily by the affected entities and their supporters. The Board successfully navigated its way through these early challenges, except for the IAS 39 issues of concern to the Europeans. As has often proven to be the case since the IASB began operations, it has been the banking industry that has provided the greatest challenge. The European banks, in particular the major French banks, wished to continue using hedge accounting for certain hedges of interest rate risk, such accounting being incompatible with the hedge accounting requirements in IAS 39. The Board refused to change the standard because it would have violated one of the fundamental tenets of the standard, viz. that derivatives should be measured at fair value with changes in fair value recognised in income – the change being proposed would, for example, have resulted in losses on hedging instruments being shown as assets in the balance sheet. I recall one of my colleagues on the Board asking representatives of the banks at the time if they would be prepared to lend against such an "asset". They were not amused.

At the same time the European Central Bank (ECB) was lobbying the Board to restrict the use of the fair value option in IAS 39. The ECB was particularly concerned that banks would mark to market their loan books and, in good economic times, be encouraged to undertake excessive lending as their reported net assets increased. The ECB was also concerned about the seemingly anomalous impact on reported profits resulting from the effect of changes in a bank's own credit risk on the fair value of its financial liabilities.

As the IASB stood its ground, particularly on the hedge accounting issue, the European lobbying effort was taken up by Jacques Chirac, the French President. Chirac wrote to the President of the European Commission, Romano Prodi, protesting the Board's failure to accede to the banks' request and questioning the wisdom of the EU's previous decision to embrace IFRSs.

The EC continued to press the IASB right up to the publication of the revised IAS39, with the threat of non EU endorsement hanging over the Board. Chairman Tweedie was targeted during this time and the attacks on him became very personal. The Board held its nerve and the EC managed to find a way to placate the banks and the ECB by carving out the offending provisions of IAS 39. The Board had some sympathy for the ECB's concerns but was not able to effect an amendment before IAS 39 was endorsed by the EU in 2004. It did make an amendment to restrict the use of the fair value option in 2005. However, the hedge accounting carve-out remains today and has been a source of continuing concern to the EC and the IASB.

This episode was the first real test of the Board's independence and helped establish its credibility as a serious standard setter. However, it came at a price. It heralded a long period of frosty relations with the EC and engendered a fierce determination in the French to replace the IASB with a European standard setting board at the earliest opportunity.

Notwithstanding the unsatisfactory outcome with the EU over IAS 39, the completion of the stable platform of standards in 2003 ready for adoption by European, Australian and South African companies in 2005 was a major achievement. In the space of two years the Board made a range of significant improvements to the standards it had inherited from the IASC and introduced a number of new standards, some of them dealing with complex and controversial issues. At the time, many observers, including some with experience in standard setting gave the IASB little hope of completing its program in the specified time frame.

Post card from America

I have observed on a number of occasions both during my time on the Board and since, that when the EU decided to adopt IFRSs for use by its member states it did not appreciate fully the implications of effectively delegating law making authority to an independent private sector standard setting body. In contrast, the Americans knew only too well the influence the IASB could ultimately have on their domestic reporting. So when the IASB decided to add a project to its initial agenda on share-based payments and held a meeting soon thereafter in Washington to engage with US constituents, it received a hostile reception.

At a public meeting of the IASB's Standards Advisory Council, US Council members angrily declared that after having spent so many years debating and finally rejecting the idea, the US would never agree to expense stock options. At a private meeting with representatives of the Financial Executives Institute, we were told in emphatic terms that they had spent $US 70 million defeating the FASB and would do the same again to defeat the IASB if they had to. To top it off, President Bush made a public statement to the effect that there is no need to expense stock options since they are equity transactions. Of course Enron collapsed and the rest is history; the FASB followed the IASB's lead and amended its standard to require stock options to be expensed.

IFRS 2 was a significant achievement for the IASB. Not only did it fill a major gap in the IASB's standards and thereby improve financial reporting of share-based payments, it also demonstrated that the Board had the courage to take on highly political topics and see them through.

Learning Japanese

Although Japan did not signal its intention to consider replacing Japanese GAAP (JGAAP) with IFRSs in the IASB's early years, it took a close interest in the work of the Board from day one. The early Board meetings had a large complement of Japanese observers present, taking copious notes and exhibiting particular interest in the contribution to Board debates made by the Japanese Board member, Tatsumi Yamada.

The Japanese engaged regularly with the IASB and sought to press their arguments for incorporating key features of JGAAP into IFRSs, no doubt with an eye to the possibility of Japan replacing JGAAP with IFRS. Meetings were held regularly with the Accounting Standards Board of Japan (ASBJ), the Keidenren (the Japanese industry body) and the Financial Services Authority.

Although over time a range of issues was identified, those relating to business combinations and the sanctity of "net income" were probably the most strongly debated. The Japanese objected to the proposed changes to the business combinations standard relating to the non amortisation of goodwill and the use of "carry over accounting" for so-called "true mergers". They argued that the Japanese approach, particularly their support for merger accounting, reflected a cultural difference and should be allowed to continue.

As for net income, the Japanese believe that because of the importance of the net income metric to investors, all items of income and expense should ultimately be recognised in net income. In other words, items initially recognised in other comprehensive income (or equity) should eventually be recycled to profit or loss. This ran counter to the strongly held view of the large majority of IASB members who believed that items of income or expense should be recognised in comprehensive income only once.

With both sides holding diametrically opposed views on these and other key issues it is not surprising that discussions between the Board and its Japanese constituents were often hostile in the early years of the Board's existence. Furthermore, the Japanese Board member often found himself to be the target of his countrymen's angst. As was expected of all IASB members, Yamada voted according to what he believed would be in the best interests of improving financial reporting; and this often ran counter to the views of his countrymen.

Few on the IASB had an intimate knowledge of Japanese customs and this hampered relationships between the Board and Japanese constituents early in the Board's life. For example, few understood that Japan is a consensus society and that great lengths are taken to gain support for new initiatives from key constituents before they are introduced. The ASBJ's due process reflected this fact.

Victim of its own success?

The IASB stirred up a hornets' nest when it stuck to its guns on the controversial elements of the stable platform, viz. IAS 39, IFRS 2 and IFRS 3. The naivety which characterised the EU's foray into IFRS use was soon replaced with a fierce desire to clip the Board's wings. A similar sentiment existed in Japan. We were about to see the practical import of intense political pressure on the Board, which pressure continues unabated to this day.

The IASC Foundation's inaugural constitution contained a provision which requires the Trustees to review the constitution every 5 years. The 2005 review provided just the opportunity to lobby for changes, and the Trustees, perhaps reluctantly, were prepared to oblige the protagonists. Three areas were targeted; Board membership, voting and due process.

There was a view that the Board was too technical and hell bent on introducing more fair value into IFRSs. The Trustees were persuaded that the Board needed to be more "rounded", so they introduced an amendment replacing "technical expertise" as the primary criterion for Board membership with "professional competence and practical experience". Those appointed to the Board following this amendment typically did not have the strong technical backgrounds that characterised the original appointees and most had little if any standard setting experience. To what extent this change was driven by the revised criterion or by the replacement of Ken Spencer with the French Trustee, Bertrand Collomb, as Chairman of the Trustee's Nominating Committee, is open to conjecture.

Under the original constitution, exposure drafts and standards needed a simple majority to be approved. The amended Constitution required a super majority, 9 of 14 members. Conceivably, the greater number of votes required to approve a document, the more difficult it would be to introduce change, particularly if that change is controversial. As it turned out, I don't believe this change had the impact those promoting it might have expected it to. It is true that on occasions the higher threshold made it more difficult to resolve issues. However, the Board generally operated in a very collegiate manner and members worked hard to resolve issues in a timely manner.

One sure way to slow down a standard setter is to extend its due process. When the Board commenced operations it replicated the process that had been followed by established national standard setters for many years. That process was set out in the original Constitution and contained a limited number of mandatory steps, such as issuance of an exposure draft of proposals, and a number of non-mandatory steps such as issuing a discussion paper on major projects, holding public hearings, and undertaking field tests. Under pressure from constituents, the IASB's due process has been extended significantly. The Board is now also required to undertake a more formal process when adding topics to its agenda, is required to issue a feedback statement for every new IFRS or major amendment to an IFRS, is required to issue an effects analysis for every forthcoming new IFRS or major amendment to an IFRS, and is required to undertake a post-implementation review normally two years after every new IFRS or major amendment to an IFRS. In addition, the Trustees formed a Due Process Oversight Committee to monitor the Board's adherence to its due process. The Board is required to meet regularly with the Committee to review and discuss due process compliance and, in particular to alert it to issues attracting controversy and explain how the Board is dealing with those controversies.

Removal of the US GAAP reconciliation requirement – the second watershed event

At the time the IASCF Foundation Trustees were mulling over how to respond to the mounting criticism of the Board without overly hampering the Board's ability to pursue its mission, a development occurred that would that would ultimately lead to an impetus being given to the Board that would rival the EU decision in 2002. In December 2007, the SEC removed the requirement for foreign private issuers to reconcile from IFRSs to US GAAP.

This decision was a watershed event for the IASB in its quest to have the US embrace IFRSs and, ultimately, to have in place a single set of high quality global accounting standards that are used around the world. By removing the reconciliation requirement, the SEC effectively endorsed the use of IFRSs in the

US domestic capital market. Private foreign issuers could now use IFRSs to raise capital in the US and US investors would be using IFRS financial statements to make investment decisions. Moreover, it would now be very difficult, if not impossible, for the SEC to resist requests from US domestic issuers to be able to use IFRSs in place of US GAAP since the SEC had already deemed IFRS financial statements suitable for consumption by US investors. Pressure from, in particular, US multinational companies will continue to grow as more and more of their subsidiaries and overseas branches report under IFRSs, and the benefits of using a single set of accounting standards throughout the group for both external reporting and internal management purposes become more and more evident.

Kick starting the convergence process

In August 2008, the SEC agreed to publish a rule proposal containing a roadmap for the potential use by US issuers of financial statements prepared in accordance with IFRSs as issued by the IASB for purposes of their filings with the SEC. The roadmap set out various milestones that, if achieved, could lead to the required use of IFRSs by US issuers in 2014. The SEC undertook to make that decision in 2011.

The IASB and FASB had reaffirmed an earlier commitment they had made (the Norwalk Agreement) to converging IFRSs and US GAAP by issuing their own roadmap early in 2006. The roadmap had a clear focus on providing the SEC with reassurance that the boards would focus their efforts on the convergence program and, hopefully, encourage consideration of removal of the reconciliation requirement. With the issue of the concept release in 2008 the focus shifted to adoption of IFRSs by US domestic companies and the boards sought to redouble their convergence efforts. The boards issued an update of the 2006 MOU which reaffirmed their commitment to converge their standards and established a goal of completing the major MOU projects by 2011. The agenda was very ambitious and a number of members of both boards were sceptical of the ability of the boards to meet their goal. However, both Tweedie and the Chairman of the FASB, Bob Herz perceived the need to keep the pressure on as the prospect of a positive SEC decision in 2011 seemed to be within grasping distance.

The planets seem to be aligned for the IASB. However, then came the global financial crisis.

Impact of the global financial crisis (GFC)

In October 2008, the IASB faced a crisis of its own. During the course of a meeting of the IASCF Trustees in Beijing, the IASB leadership was informed by the EC that unless the IASB agreed to make an immediate amendment to IAS

39, ie without due process, the EC would make its own amendments within a week! This threat had materialised because of the impact on European banks of falling asset prices and the prospect of them having to recognise in their third quarter financial statements large losses on certain financial assets that had been classified as at fair value through profit or loss. If these assets could be reclassified to the held-to-maturity category, which reclassification was not permissible under IAS 39, the amount of the write-downs would be significantly reduced. Under US GAAP, reclassifications of financial assets that had been similarly classified were sometimes permitted and so the argument was made to the IASB that it should similarly permit such reclassifications.

This was a classic case of regulatory arbitrage. The European banks could see a storm approaching and were desperately seeking a way out. They clutched at the difference between IFRSs and US GAAP and claimed competitive disadvantage. All knew this was a beat up; for all intents and purposes the two sets of standards had comparable requirements. Reclassification of financial assets out of the trading category to the hold-to-maturity category under US GAAP was permissible but only in very rare circumstances, and very few, if any, had ever occurred in practice.

But this was not the time to let the facts get in the way of a good story. The EC had already weathered the earlier storm over the use of IFRSs by EU companies when the banks had revolted over the IAS 39 hedge accounting requirements. They perceived the implications of the pending write-downs to be so severe that failure to get the IASB to change the standard this time would force them to do more than simply amend the standard themselves. And that, in a nutshell, was the dilemma facing the IASB. Make an amendment permitting reclassifications or hold its ground as it had done in 2004 and risk the loss of its EU constituency and face the prospect of never achieving its ultimate goal of world-wide adoption of IFRSs. As I noted earlier, the French had been conducting a campaign to have the IASB replaced by a European standard setter, most likely a remodelled EFRAG, ever since the 2004 events took place. This was the opportunity they had been waiting for and would no doubt have grabbed it with glee.

The IASB weighed the situation facing it and with great reluctance agreed to the EC's demands; IAS 39 was amended to permit reclassifications and the amendment was backdated to 1 July 2008. The IASB did not take the EC's threat, and the determination of the French, lightly. It reasoned that the loss of credibility it would face in making the amendments to IAS 39 was a price worth paying to keep alive the prospect of achieving its ultimate goal. The take up of IFRSs around the world to that time had been remarkable and, with Canada having recently announced its intention to move to IFRSs in 2011, Japan beginning to move in the same direction and the SEC having announced its concept release, the prospect of achieving that goal seemed very real.

The GFC also impacted the IASB in more pervasive ways. As world leaders assembled from time to time under the umbrella of the G20 to discuss the causes of the crisis and to identify reforms to the financial system to prevent future crises, the role of regulators and standard setters came under the microscope. The IASB and the FASB were repeatedly targeted in G20 communiqués, with recommendations referring to the need to complete specific projects related to areas of concern identified, to complete their convergence projects by 2011 and to continue to pursue the establishment of a single set of global accounting standards. This pressure added to the self-imposed pressure of the MOU and caused frenzied activity at the boards.

This period of introspection by political leaders and their regulatory bodies also brought a broader issue to the fore – the relationship between financial stability and financial transparency. Calls began to emerge from some quarters for the IASB's mission to be expanded to include the need to consider the effect on financial stability as well as the needs of investors when drafting accounting standards. Specifically, advocates of such a change proposed that the IASB should consider the consequences of new standards for the world's economies and financial systems. This was a significant concern because the two objectives could be in conflict and the IASB would be in an invidious position trying to navigate its way through such conflicts.

This issue needed to be handled delicately. Emotions were running high at the time and the concerns of the banks and the banking regulators were getting plenty of air time. Arguments were advanced that the current objective is not necessarily inconsistent with a financial stability objective because by providing transparent information to investors in the capital markets timely information about the financial position of financial institutions is made available. The point was also made that regulators can require additional information to be provided that supplements the IFRS financial statements, for example, identifying additional "provisions" within equity to cover unexpected losses.

The IASB addressed the issue in the revision of its conceptual framework, which was published in 2010. The Board concluded that altering the objective of general purpose financial reporting to cater for the needs of regulators and fiscal policy decision-makers would be "…inconsistent with its basic mission, which is to serve the information needs of participants in capital markets". But it also went on to note that "…providing relevant and faithfully represented financial information can improve users' confidence in the information, and thus contribute to promoting financial stability".

Finishing the MOU

A goal of the IASB and FASB mentioned previously was completion of the major MOU projects by 2011. The 2008 MOU update had identified 9 remaining major projects that were to be completed by that date. In 2010, four of those projects had been completed or were nearing completion, viz. Fair Value Measurement, Consolidations, Derecognition and Post-Employment Benefits. However, the boards were struggling to complete the remaining five MOU projects, viz. Leases, Revenue Recognition, Financial Instruments (which, courtesy of the GFC, was now focussing on impairment of financial assets), Financial Statement Presentation and Financial Instruments with the Characteristics of Equity (debt/equity project), and the non-MOU project on Insurance that they had decided to develop jointly.

The boards were finding it difficult to maintain momentum on these projects, partly as a result of the difficulty of working together. That should not be surprising since they are separate independent boards with, to some extent, different standard setting philosophies, have separate staffs and are geographically separated. This impediment was exacerbated when the broader constituency began to voice its concerns that the boards were proceeding too quickly on too many fronts. The general theme was that there were too many matters to absorb and respond to thoughtfully and that the quality of the final products would suffer unless the boards advanced on fewer fronts and slowed down. In large part these concerns were genuinely expressed, although no doubt some saw it as an opportunity to delay (perhaps indefinitely) the introduction of some far reaching reforms.

The reaction of constituents did not come as a surprise. The Board knew it was a demanding timetable for all concerned and was acutely aware of the desire of some sections to, opportunistically, impede the boards' progress. In fact the IASB leadership had been considering which of the six projects might be able to be back burnered. What did come as a surprise was the FASB threatening to unilaterally respond to the concerns. As it happened, the boards responded jointly to the concerns by suspending further work on the Financial Statement Presentation project and the debt/equity project. However, the action proved to be in vain in terms of enabling the boards to complete the remaining four projects by 2011. Indeed it seems likely than none of them will be completed before 2013, with the revenue recognition project being the only possible exception.

Although the major MOU projects were not all completed by mid-2011, most of the eleven projects identified in the 2006 MOU were completed. Of those left uncompleted, the technical development of the leases project and the revenue recognition project, was all but completed by mid-2011. The same is true of the non MOU insurance project. In addition, most of the so-called short-term MOU projects identified in earlier versions of the MOU were completed by mid-2011.

The MOU was a massive undertaking. Although there is, understandably, disappointment that some important MOU projects remained uncompleted at the end of the first 10 years, the completion within that time period of the large bulk of the MOU projects, both short-term and long-term was a major achievement.

SEC procrastination

Whether it was the distraction of the GFC, the change of leadership, or something else, the SEC failed to meet its previously communicated intention of "…making a decision in 2011 on whether adoption of IFRs is in the public interest and would benefit investors". Indeed, a decision has still not been made.

The alarm bells started ringing when the new SEC Chairman, Mary Schapiro, who succeeded Christopher Cox in January 2009, stated during her confirmation hearings that, "I will not be bound by the existing roadmap that's out for public comment", and expressed reservations about the quality of IFRS and the independence of the IASB. This too was a disappointing development as the first 10 years drew to a close. However, the US has come a long way since the IASB began operations, indeed much further than most commentators dared hope in 2001. Moreover, as I noted earlier, the future direction had effectively been set in stone when the SEC removed the reconciliation requirement

Political pressure continues unabated

In 2009, in response to criticism, particularly from Europe, that there was no link between the independent private-sector IASB and the government agencies charged with regulating the capital markets, the IFRS Foundation Trustees changed the Foundation's Constitution to cede some of its authority to a Monitoring Board comprising, in most part, securities regulators. The IASB and its Advisory Council were concerned about this development because if it was not handled carefully it could impair the Board's independence. This could be the case if the Monitoring Board was able to interfere in Board appointments or was able to direct the Board in respect of its agenda or the content of its standards. This has not occurred to date, but there were some worrying signs in 2011 as the Monitoring Board volunteered its view on how the Board should manage its agenda in the light of constituents concerns referred to earlier, and when it issued its proposed improvements to the IFRS Foundation's governance arrangements.

Have the anticipated benefits of IFRSs been realised?

If Ken was here tonight I think he would agree with me that the IASB has achieved a great deal to date, and that it stuck steadfastly to its mission; to develop a single set of global accounting standards that can be applied around the world. With IFRSs now used in more than 120 countries I think he might even conclude "mission accomplished". However, knowing Ken he would remind me that I haven't told the whole story. I can visualise him jutting out his jaw and saying, "that's all very well Warren but you haven't told us if there have been any real benefits?

That is a fair question and one that is not so easy to answer. Indeed if you believe all you read in the press in this country, you might be tempted to think that the whole exercise has been a very costly one yielding few, if any, benefits. Comments have recently been made, for example, that financial statements are now much more complex under IFRSs and investors have given up using them. While some might view this recent reporting as something of a beat up, it does reflect the concerns of some constituents that IFRSs are not realising the anticipated benefits.

When the EU decided to adopt IFRSs it identified a range of benefits which encapsulate those that have been promoted by the proponents of IFRSs; elimination of barriers to cross border trading of securities, financial statements that are more reliable and transparent and can be more easily compared, an increase in market efficiency, and a reduction in companies' cost of capital.

There has been a good deal of academic research looking at these and other potential benefits of IFRS. While some of this research is negative and some inconclusive, the research supports the view that there have been positive benefits. In particular, the evidence demonstrates that the European stock market perceived net benefits from IFRS adoption and that there was a reduction in the cost of capital amongst some European firms. Moreover, there is a great deal of academic research that concludes that when the local regulators/auditors do their jobs properly, the quality of information reported under IFRSs has increased.

Let me turn to a couple of specific criticisms of IFRS financial statements in an Australian context; complexity and investors' disinterest.

I am pleased to see the FRC taking an interest in the issue of complexity. A report by an FRC Task Force titled "Managing Complexity in Financial Reporting" will be released soon and I commend it to you. I agree with the Task Force's views that there are a number of sources of complexity, one of which is the increasing complexity of business operations, and that the challenge is to manage complexity. While there are improvements that could be made to IFRSs, particularly in the areas of disclosure and financial statement presentation, something the IASB itself has acknowledged, it is simplistic to level all of the complexity criticisms at IFRSs.

The often heard criticism of IFRS financial statements that they must be of little value to investors because they never ask CFOs any questions about them is, prima facie, alarming. It is also counter intuitive, and, to my knowledge, it is not a view commonly expressed in other parts of the world. Yes investors will take an interest in non-GAAP measures of earnings but that does not mean they ignore IFRS information. The evidence is clear from academic studies that IFRS amounts are reflected in share prices. So, somehow the information is getting in there - whether directly from the financial statements or indirectly from other sources, and the financial statements are effective in summarizing the information investors use to set share prices. In an Australian context, perhaps I could be so bold as to suggest that the absence of questions from investors is partly due to the increased transparency of the financial statements under IFRSs. Some may have forgotten that before IFRSs, Australia did not have standards on financial instruments, share-based payments or defined benefit plans , and we had an ineffective standard dealing with impairment of non-current assets.

There is also no shortage of anecdotal evidence that the use of IFRSs has produced real benefits. Only a week or so ago I had a conversation with a CFO of a large Australian multi-national company about current IFRS developments. During the course of that conversation he mentioned that dealing with the US investment community had become so much easier and more effective since they began communicating using a common accounting language.

Future of Financial Reporting

I would like to conclude this lecture by sharing with you my thoughts about the future of financial reporting.

I believe IFRSs will continue to be embraced around the globe, but the pace of new admissions will slacken. The US will continue to procrastinate and will eventually be dragged kicking and screaming by economic imperatives. Japan will be on board before the US and will also mount the final hurdle driven by economics. A number of countries, such as India will flirt with carve-outs but will eventually adopt the standards in full. The French will continue to give the IASB a hard time but will not succeed in replacing them with a European standard setter. IFRSs will be used throughout the world.

I believe public sector and private sector not-for-profit reporting will soon begin to attract more attention worldwide. The IFRS Foundation Trustees will eventually expand the organisation's mission to encompass reporting by not-for-profit entities in the public and private sectors and the prospect of having a global set of financial reporting standards for not-for profit entities will be significantly enhanced. No doubt the French Government will relish the prospect!

What of integrated reporting? Much of what is being proposed is intuitively appealing. However, those doing the promoting need to hasten slowly or they will frighten the horses. I believe the best strategy is to allow integrated reporting to evolve naturally within the context of the existing financial reporting framework. The primary vehicle for this evolution should be the management commentary accompanying the financial statements. Standardisation is a long way off but may eventuate if there is a coalescing around best practice.

What would Ken think of all of this? I'm pretty sure he would agree with my comments about the world of IFRS, but would probably accuse me of being too optimistic. I could never get him interested in public sector financial reporting, so he would probably say he doesn't care. As far as integrated reporting is concerned, he would probably tell me I must be smoking something because I'm off with the fairies again. But that was Ken, in his own real world!