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Learning the Language:
Challenges being encountered in the adoption of IFRS

Good afternoon. I am happy to be here today to discuss this important challenge in our profession along with my colleague, Mr. Michael Hughes of KPMG. I would like to thank the conference organizers for inviting me and you, the audience, for attending.

We have already heard much about convergence today—the progress of IFRS and the impact it is having on regulators and securities markets. I would like to add my own views on IFRS as we attempt to adapt to this fundamental change in financial reporting.

IFRS is just that—fundamental. On 1 January 2005, we entered a new era—an era in which a common language will be used for financial reporting. It is an exciting era, with many possibilities and opportunities. But it is different than anything we have encountered before—I would like to emphasize that right from the start.

Since IFRS is so very different, it presents a whole range of challenges. There are many questions that still need to be answered even as we are moving forward with IFRS. Today I would like to discuss some of those challenges, in general and in terms of the audit profession. I would also like to make some personal observations about those challenges as chairman of Deloitte Touche Tohmatsu.

Before moving on to the challenges of IFRS, however, I want to provide some context from my perspective as an accountant. Principally, how does IFRS differ from other accounting and reporting systems and why have so many jurisdictions adopted this basis of accounting?

As I stated earlier, IFRS is different. It is the first time there has been an attempt to develop a common accounting language in an international setting. Generally, accounting standards in the past have been regionally or nationally based. IFRS, in contrast, is a language without borders, not rooted in any particular legal or regulatory jurisdiction.

In addition, IFRS is still emerging as a global accounting language—that is important to stress. It is still very young, compared with its peers. The United States has been setting detailed accounting standards for sixty years, and its current standard-setter, the Financial Accounting Standards Board, is over thirty years old. The European Accounting Directives are only slightly younger. By comparison, the International Accounting Standards Board is still in its infancy.

This does not mean it is ill-equipped for its task, however. On the contrary, the IASB brings together a wealth of global experience, giving it a rare ability to develop accounting standards based on best practices from around the world. It is also in a unique position to work without a national bias. As an international body, it has brought together people of experience and integrity from around the world to work towards the best possible solutions. It has no incentive to favour certain national methodologies over others. In fact, if it did, it would lose much of its credibility. This independence is critical to its wide support but it is also a problem, for critics see it as 'answerable to no one.' As such, the IASB's parent body is taking steps to improve the transparency and effectiveness of its oversight while maintaining the Board's independence. DTT strongly supports these changes.

IFRS is also different because it is based on a view that the providers of finance—equity and debt—are the primary users of general purpose financial statements. This perspective—well-accepted in North America, the U.K., Australia, and Hong Kong—is relatively new to most countries in the European Union and is a fundamental change from those countries that are emerging from managed economies. Specialised users, for example tax authorities and compilers of financial statistics, may not find what they are looking for in a set of IFRS financial statements and may need different financial reports.

This "investor-useful" perspective is fundamental to IFRS. It is the touchstone against which the IASB tests all its decisions. It may be sympathetic to companies who are now facing the growing demands of the world's capital markets. But if a trade-off is to be made between the cost of preparing information and the benefits users will gain from that information, the user will usually win.

Although the adoption of IFRS may seem onerous and alien, there is good news for preparers in the long run. Before IFRS, a company in Switzerland, with shares registered or listed in different countries would have to present its financial information in accordance with several different sets of accounting standards: US GAAP, UK GAAP, Japanese GAAP, Hong Kong GAAP, and so on. The sheer cost of maintaining this information is immense. Now the same company needs to maintain just two sets of financial information: IFRS and—if its securities are registered with the U.S. Securities and Exchange Commission—U.S. GAAP.

This brings us to one of the greatest benefits of IFRS—that it should ultimately lower the cost of capital. First, because the internal costs of compliance—all the accounting systems necessary to maintain the same basic information according to different accounting standards—will be reduced. More of the company's productive capacity can be spent on being productive, rather than on compliance. Second, because investors, analysts, and regulators will have to know only one or two accounting languages, they should be able to price securities more efficiently. As they become familiar with the language of IFRS, and as more companies report using IFRS, users, especially analysts, will be able to compare companies from different countries directly, without making rough and ready adjustments.

The benefits of a global accounting language are recognised beyond governments. Shortly after the Asian currency crisis of the late 1990s, the World Bank encouraged the use of international accounting standards. The extent to which these have been implemented is considered in the Bank's regular Report on Standards and Codes (ROSC) assessments.

I have highlighted some of the benefits of IFRS to companies and preparers, but there are, of course, the challenges. Most of these relate to the issues of IFRS interpretation, application, and expectations. IFRS is here. It arrived on the first of January. But that does not mean it is like a light switch; that we can turn it on and IFRS is suddenly applied in a clear and consistent manner everywhere. It will take time. It is understandable that with all the potential advantages of IFRS, stakeholders will want to see its consistent application immediately. But this just isn't realistic.

One of the main the problems is that since IFRS is a new and emerging accounting language, no one is familiar with it. Some of you have worked in the field for several years and may know the basic grammar and some of the vocabulary; but no one has had to use this particular language to communicate with investors. As such, we are bound to run into situations in which we will have different views on how to communicate what we want to say.

As such, the arrival of IFRS does not guarantee uniformity and it will not bring immediate consistency. We must have no doubt about that. It will not bring uniformity because there are accounting alternatives built into the standards: not as many as there once were but still more than many of us would like. There will also be situations in which the use of judgement will be required. The combination of these two unavoidable facts is that reasonable people applying the standards in good faith will reach different conclusions about the recognition, measurement, presentation, and disclosure of items in financial statements.

Nor will IFRS bring immediate consistency. Accounting standards are applied and enforced in relation to a local environment and tradition. Thus a person in France will approach an IFRS issue bearing in mind their experience of how they would have accounted for the transaction under French GAAP. Someone in the U.S. will approach the problem with a U.S. mindset. Ultimately, the goal is to approach the problem with an IFRS mindset. And that will take time and effort.

I mentioned earlier that one of the strengths of the IASB is its non-jurisdictional nature: unfortunately, that brings with it challenges, in particular that there is no single enforcement authority for IFRS. Thus, every country or region's regulating bodies will be responsible for compliance. These regulators have differing objectives: a securities regulator and an insurance regulator have different objectives even though they might be regulating the same entity. Once again, IFRS will be susceptible to the influence of national cultures and market practices.

Another challenge is the interpretation of IFRS. Many jurisdictions have committees that interpret the application of their local accounting standards to specific fact patterns. But the International Financial Reporting Interpretations Committee—the IASB's interpretative body—can only take on a limited number of interpretive issues each year. Indeed, the market can only absorb a finite number of interpretations in any one year. Fortunately, the IFRIC has been rigorous in assessing questions submitted to it, and the vast majority are rejected. The IFRIC does not want to become a 'market for excuses' and we support that. The primary candidate for an interpretation is when there is a conflict within or between standards. Put another way, not all judgement calls require an 'interpretation'; they are simply the result of working with principle-based standards.

Finally, investors, analysts and other users need time to learn and understand this new accounting language. They will be presented with information that may be new to them. There is a greater emphasis on fair value measurement, which the IASB and others view as more value-relevant. But with that comes greater volatility in net income, which makes preparers and other parties very uncomfortable. Again, investors, analysts, and preparers must be prepared for a learning curve that may stretch over the next two years or so.

All of these issues have made the immediate and consistent adoption of IFRS an immense challenge. We cannot ignore it. However, the security regulators in Europe and elsewhere have signalled that they are looking for a high degree of consistency in the application of IFRS right from the start. The Committee of European Securities Regulators is even seeking to establish a mechanism to assure consistent interpretation of IFRS by listed companies in all EU member states.

No regulator has been more aggressive in its expectations than the U.S.'s SEC, which is emerging as the de facto primary interpreter and enforcer of accounting standards for many of the world's top companies. The SEC chief accountant made his own view clear, stating that he strongly encourages "SEC foreign private issuers who will adopt IFRSs in 2005—and their audit firms—to be particularly diligent in their initial application of IFRSs. This will assist investors, standard setters, the SEC staff, other securities regulators and others to gain insight as to whether the implementation of IFRSs is consistent when viewed cross-border.[1]"

The SEC chief accountant's words point to another issue: the role of the professional accounting firms in all of this. With the challenge of consistency at odds with stakeholders' expectations, what can the accounting profession, especially the major international firms, do to address these challenges?

Of primary importance, accounting firms—international, regional, national and local—must all work to *promote* consistency rather than *creating* it. In recent weeks I have heard the comment that it is up to the major international firms to work out the application of these standards and lead the charge on consistency. I disagree. Accounting firms are not standard-setters and it would be inappropriate for us to act as if we are.

This is particularly critical in light of the aggressiveness of regulators these days. Regulators should not have, and must not be given, the sole right to tell the world how to interpret and apply IFRS. Their opinions are, of course, important. But -- and this is critical in the first few years of IFRS -- if an entity applies a standard in a legitimate manner that is different from another entity whose understanding of the standard is equally appropriate in the circumstances, regulators must accept that.

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1 Donald T. Nicolaisen, 'A Securities Regulator Looks at Convergence', *Northwestern University Journal of International Law and Business*; April 2005 (http://www.sec.gov/news/speech/spch040605dtn.htm)

However, accountants can, and should work to encourage consistency—for the sake of our clients and for the sake of efficient global capital markets. As our experience with these standards grows, views will coalesce and 'generally accepted' treatments in many circumstances will emerge. But this will not happen in 2005.

Ultimately, it is the responsibility of all stakeholders to promote the consistent application of IFRS. The international accounting firms have already agreed that knowledge sharing on the subject of IFRS is in the public interest. All of us -- users, national standard-setters, regulators, governments, as well as the accountants and the IASB -- must contribute to the body of knowledge that surrounds the application of IFRS in practice. We all must learn its possibilities and limitations, its benefits and the areas in which it needs improvement. This will take time and the understanding and acceptance of users and regulators.

On this point, accountants must manage the expectations of stakeholders. We need to avoid an overly ambitious vision of consistency. We need to educate stakeholders about the environmental barriers and cross-border issues impeding the consistent application of IFRS.

Do not misunderstand me: all accounting firms have a genuine interest in helping their clients apply IFRS in a high-quality way as quickly as possible. Neither the member firms of DTT nor—I have no doubt that Mr. Hughes would tell you—KPMG have an interest in a "lowest common denominator" application of IFRS. The world deserves high-quality financial reporting.
Deloitte, with the full backing of our global executive and supported by IFRS experts within the organization, is promoting excellence in the application of IFRS. We are achieving this through inquiry and consultation, analysis and discussion with our colleagues and others in our profession.

The member firms of DTT are working with the standard-setters to identify problems with the present standards and to fix those problems. We sincerely support the activities of the IASB and the IFRIC. As I said, we believe that the IFRIC is the only body that should issue interpretations of IFRS. We are not interested in seeing a burgeoning rule book, with multiple layers of formal and informal accounting guidance such as exists in the U.S.

Deloitte's people are working to leverage the experience within our member firms to assist our clients. As such, we will advise our clients on the application of accounting standards to particular fact patterns, just as we have done for years. This is the process of application of accounting standards—not interpretation. As experience develops, so too may our positions.

IFRS is an accounting language. But as with any language, it will develop and change. Participants in the global economy need to cooperate to make IFRS work, but they also need to temper their enthusiasm. Perhaps the greatest challenge we all face is to have the patience to permit IFRS to develop and give it the chance it deserves.

I will now turn over the podium to Mr. Hughes, who will further discuss this important issue. My best wishes to you all for a successful meeting.