

Assessing the wider impact of financial reporting standards

10 May 2017

European Accounting Association Conference, Valencia

Jean-Paul Gauzès, EFRAG Board President

Introduction

Good afternoon ladies and gentlemen, distinguished academics. I am very pleased to have the honour to speak at the 40th meeting of the European Accounting Association in the beautiful city of Valencia.

I thank the organising committee and in particular Begonia Giner and Araceli Mora for inviting EFRAG to give this address. Both Begonia and Araceli have been EFRAG TEG members and have brought valuable contributions to our discussions in bringing the academic perspective to our work. I know that it has sometimes been challenging to represent the academic perspective in a group of members with diverse backgrounds. However, a diversity of views enriches the European debate and I am certain that your contributions made a difference.

A 40th anniversary is significant: 40 years of bringing together academics in Europe to discuss a wide range of topics for three days. When you turn 40 you are over the hill, but as a famous American cartoonist said, when you are over the hill, you begin to pick up speed. I am, therefore, confident that these conferences have a great future ahead.

Compared to the European Accounting Association, EFRAG is young – a rebellious teenager - only 16 years old! (too young in some countries to drink your wonderful wine).

Many of you (I hope), already know EFRAG, the European Financial Reporting Advisory Group.

EFRAG

EFRAG's mission is to serve the European public interest by developing and promoting European views in the field of financial reporting. EFRAG works to ensure that the European views are properly considered in the IASB standard-setting process and in related international debates.

EFRAG has three streams of activities: firstly, our research work in which we try to provide thought leadership designed to encourage international debate, influence the IASB's agenda and contribute to the IASB's projects from a European perspective. Secondly, EFRAG provides the European views in the IASB's standard-setting process, starting from early-stage through to the post-implementation review. This to ensure that the resulting standards are fit for Europe.

Then, when the IASB has issued the final or revised standard or interpretation, EFRAG's third activity is to advise the European Commission on whether this meets the criteria for endorsement for use in Europe. This includes whether endorsement would be conducive to the European public good.

Today in the second half of my speech, I will also share our experiences in assessing the wider impact of financial reporting standards. But, I can already reveal that it is not easy to do.

EFRAG's public-private sector model is representative of public and private stakeholders with an interest in financial reporting, as reflected in our funding and organisation structure. EFRAG interacts with European and national organisations, political, supervisory and regulatory authorities, and representatives of preparers and users of financial statements, the accountancy profession, National Standard Setters and of course academics.

EFRAG's legitimacy is built on transparency, governance, due process - including field tests, impact analyses and outreach events - public accountability and thought leadership.

Research and the role of evidence

With the conclusion of its major projects, the IASB is focusing more on its research work. The pause in new major standards flowing out from the IASB will free some resources. This will enable EFRAG to focus more on our own research as well as providing early stage input to the IASB's longer term projects.

There is a growing consensus that financial reporting developments should be based on a firm foundation of evidence. Our research needs evidence to define the problem and identify and evaluate alternative ways forward. A recent example of this work is EFRAG's study on goodwill and impairment. In this study EFRAG investigated the trend of goodwill and impairment losses from a sample of some 400 large European companies over a 10-year period for different industries. And in the end, as often happens in research, we concluded that there was more to investigate!

In this context, it is clear that timely and relevant academic research will be in demand.

EFRAG's cooperation with academics

Cooperation with academics is therefore very important for EFRAG. I hope you will consider it as good news that EFRAG will be seeking for more academic input in its effort to influence developments in financial reporting from a European perspective. Looking forward, what are the opportunities for future cooperation between EFRAG and the academic community?

Academics are represented on the EFRAG Board (where a number of our Board members are part-time professors), on the EFRAG Technical Expert Group and other Working Groups. However, we are certain that we could improve our working relations with academics and have taken a number of important steps.

We launched our new Academic Panel in the beginning of April. The Panel will contribute to the debate on current IASB topics, and assist with the scope definition and methodology of EFRAG's own research projects. The Panel will also review public calls for literature reviews and the research questions for EFRAG's research work being outsourced over time. Panel members will also be involved in reviewing the output.

EFRAG was surprised by the number and high quality of applications we received for this Panel. Over 50 applications! I can assure you that this was well beyond our expectations. We thank all those that applied both from all over Europe, and beyond. We really want to stay in contact with these excellent academics who expressed such an interest. We have therefore decided to create an EFRAG Academic Network in addition to the Panel. This is a virtual platform through which academics will receive information about our activities and can contribute to them. EFRAG is happy to receive additional applications for the Network – feel free to contact us.

European public good assessment including impact analysis

There is increasing attention being paid to the wider impacts of financial reporting, including on economic behaviour. There have been calls to deepen and strengthen the assessment of these impacts as part of evidence based standard-setting. The IASB published its first effects analysis on a major standard with IFRS 16 *Leases*.

Since the implementation of the Maystadt reform, EFRAG is requested to assess the European public good in developing its endorsement advice.

Philippe Maystadt is a former Belgian Finance minister and former president of the European Investment Bank and was appointed by the EC to advise on the reform of EFRAG. Impact analysis is an important element of the European public good assessment.

Historically, EFRAG's main focus was on assessing the cost/benefit balance of new Standards, in addition to assessing the technical endorsement criteria in the IAS Regulation. In doing so, EFRAG relied mostly on public consultations and surveys.

The European public good is a wide and undefined concept, with its meaning depending on each particular standard. The European Commission issued a non-paper in 2016 that provided broad guidelines and indicated the elements that have to be taken into account as including:

- not endangering financial stability;
- not hindering European economic development;
- impact on competitiveness of European entities; and
- adding value for Europe by delivering improved financial reporting.

The European Commission specifies in its request for endorsement advice any other factors that should be considered in the European public good assessment. Such other factors could include implications for long-term investing; implications for SMEs and possible changes in stakeholder behaviour and their impact. For example, for IFRS 16 *Leases*, EFRAG was asked to consider the possible impact on the leasing industry and on SMEs access to finance as a result of any change in demand for leases.

The European public good assessment therefore requires EFRAG's analyses to move beyond technical accounting and to consider the possible wider impacts on the economy. This is a challenging task, especially because the impact analysis must be conducted before a Standard is implemented. In other words, we have to make predictions.

Impact analysis can have both qualitative and quantitative elements. For instance, it was possible to simulate the quantitative impact of bringing operating leases on the balance sheet and project it to the whole population of European IFRS preparers. For the next big Standard – IFRS 17 *Insurance Contracts* – it is not possible to do the same, as each company under the current IFRS 4 may use a different approach, and so the starting point varies.

Quantification of the impact on financial stability and economic growth is extremely challenging. This is why the European Commission requires EFRAG to provide only negative assurance: we assess the risk of major deleterious effects but we are not asked to prove a positive effect.

Quantification of implementation and ongoing costs is also complex since most entities have not started with implementation. Quantification of the benefits is almost impossible. This makes the weighing of costs and benefits and reaching a conclusion a complex exercise. Gladly, EFRAG has proven to be up for the task.

Another question is to what extent impact analysis, notably the macro-economic considerations, can be assessed at individual standard level or that one has to look at the whole package of standards?

Also, to what extent should the interaction between financial reporting and prudential regulations be considered? The ECB, EBA, EIOPA and ESMA are

official observers with speaking rights on our Board. They contribute to EFRAG's European public good assessment notably in the area of financial stability. Examples are the input provided by the ECB on the impact on financial stability and by EBA bringing the prudential perspective in the IFRS 16 *Leases* endorsement advice.

In developing our endorsement advice, EFRAG may sometimes decide that specific economic or other expertise is needed. For IFRS 16, EFRAG commissioned a study from an economic consultancy. This study provided input to EFRAG's analysis of potential changes in the behaviour of preparers, investors and lenders and the impact of any such changes on the European economy. The conclusions we drew in our endorsement advice are of course solely our responsibility.

Consideration of the impact of a potential standard should be an integral part of the standard-setting process from the research phase to the Post Implementation Review stage. Ex-post academic research is a key input into Post Implementation Reviews, whereas, in the early research phase, academic expertise is more likely to help to define the problem and identify various options.

EFRAG's symposium

EFRAG is pleased to sponsor a symposium on Friday after lunch that is also addressing the wider impact of IFRS from a range of angles and with excellent speakers with different backgrounds. We will discuss our experiences with IFRS 16 *Leases* in more detail. It was our pilot case and we will share with you what we learnt. The symposium will address questions such as: What should ex-ante analysis aim to achieve; how can they be effectively conducted and what are the challenges? What is the role of empirical and of anecdotal evidence? What and how can academics contribute?

It is definitely a relevant discussion, so I would like to invite you to come and debate these questions with our speakers' panel.

Conclusion

In conclusion, assessing the wider impact of financial reporting standards plays an increasingly important role in standard-setting and endorsement decisions. Entering a domain that has a wider focus than technical may require skills beyond those traditionally applied in considering IFRS Standards. It certainly will result in an increased focus on impact analysis and evidence. Meeting all expectations will be challenging. The academic community, our Academic Network and our Academic Panel have an important role to play.

Thank you for your attention and I wish you all a good and fruitful conference.