

EFRAG Conference 28-11-2019**Michel Prada: IFRS development—where are we?**

Ladies and gentlemen,

It's a pleasure and an honour to participate in this conference and I'm grateful to EFRAG Board President Jean-Paul Gauzès for inviting an old-timer to deliver a speech as an introduction to this meeting, and to have an opportunity to catch up with a number of old friends.

When I asked Jean-Paul what he was expecting from me, he answered, 'you just say whatever you wish'. This was a risky proposal, offering "carte blanche" to a veteran who has no more institutional responsibilities nor external control, only some sense of self control...

Having thought about the history of IFRS, during which I was an actor among others for many years, and which I have now witnessed from the outside for exactly one year, after having handed over to Erkki Liikanen, I've first decided to revisit some of the debates that took place when I was involved and that are still occasionally reopened. I then thought it would be appropriate to address some of the new issues the IFRS Foundation and the IASB are facing.

The EU has been a leading player in the history of IFRS, being the first major economy to implement them, an active participant in the conception of the standards and also a leading player in the oversight of the Foundation. At the same time, Europe has also been the most vocal of critics, which in some situations created a tension that had no equivalent in the world. I guess there was some French influence in this, as this is a behaviour that is quite familiar to my compatriots.

Focusing on the positives, Europe really does deserve a great deal of credit for encouraging most of the rest of the world to follow suit. If we take stock of the ongoing progress in large Asian economies, it is

only the US which continues to go their own way—for reasons we well know.

When focusing on the core debates, I identify three main topics on which I have some views that I would like to share with you.

The first is the concept of ‘European interest’ with regard to IFRS. I must confess that I have never understood what that meant when speaking about accounting standards. As a convinced European citizen, I see a number of domains where there is an obvious and strategic need to defend and promote the European interest, and I’m often disappointed by our slow progress and our collective lack of ambition to deal with these issues. I therefore hope sincerely that our new Parliament and Commission will deliver. But do we seriously believe there is a European way of dealing with amortisation, revenue recognition or leasing? Of course, there are lively technical debates on these issues and possibly different solutions to address them but these are conceptual and, akin to physics or chemistry, not linked to national or regional considerations. Fortunately, I have the feeling that this debate is behind us as most market players have clearly opted against an EU version of IFRS, and rightly so.

The second debate is in relation to financial stability. This one is obviously more complex. As a matter of principle, I tend to consider that accounting has little to do with financial stability which mainly depends on the good functioning of markets and the relevance of macroprudential and political management. Accounting is there to describe economic reality. It does not trigger this reality per se, although we know that the mere description of a phenomenon has obvious consequences on the behaviour of stakeholders who observe it and react to it. The choice is thus fairly simple: is it better to hide the truth or to face it? The answer is pretty clear to me as transparency is of the essence for efficient markets. Having said that, I recognise the solution is less obvious than for the first debate I mentioned. Being an art as well as a science, accounting may take stock of some aspects of

financial stability issues, if only because of the principle of prudence which is one of the core principles of the accounting conceptual framework. Three good examples are the compromise on the use of historic cost versus fair value, the evolution of the standard for provisioning and the ongoing discussion on goodwill.

The last debate relates to accounting and long-term strategies. Here again, I tend to believe that those who blame accounting standards for encouraging short-termism are misguided. The truth is that a long-term strategy requires relevant funding arrangements which those who have to decide are sometimes unable or unwilling to implement : namely a significant proportion of equity and a debt that is structured along the profile of positive and plausible cashflows. The history of Eurotunnel is there to remind us of this relatively mundane principle. But, here again, accounting standards may take in consideration long-term issues, as shown when the Financial Crisis Advisory Group, formed to advise the IASB and the FASB on their responses to the crisis, advocated in favour of a differentiation between instruments held to maturity and those available for sale.

On the whole though, I have the feeling that these heated debates are mostly behind us.

Allow me therefore to address the future.

Besides the undebatable task of maintenance and implementation of the standards for financial reporting, where a lot remains to be done notably with regard to the consideration given to non GAAP measures, we witness today a questioning of the IFRS Foundation regarding, firstly, the consequences of digitisation-which I shall not address because of my incompetence in this domain- and, secondly, its possible role in relation to new reporting requirements linked to ESG requirements and more globally 'non-financial' reporting. Indeed, those who would like the IFRS Foundation to get involved in this

domain pay tribute to the professionalism and efficiency of the IASB. But is their view justified?

Together with Hans Hoogervorst, the talented Chairman of the IASB, I do share the view that the fundamental evolution of politics in the direction of sustainable development is welcome and that progress by corporates and financial institutions in this direction should be a priority for the years to come.

First of all, and having been convinced by the recent and remarkable Patrick de Cambourg's report on this issue, I do believe that there is an urgent need for objectivity and legitimacy of the concepts and standard-setting in these new domains if we wish to avoid the risks of hypocrisy, political correctness, greenwashing and other misrepresentations of the performance of corporates and financial instruments. But can accountants play a leading role in this evolution? I have mixed views on this and see basically three different situations.

The first one is the most obvious and simple but also the most tricky: there is a need for an appropriate regulation and pricing of the negative externalities that derive from our collective wrong behaviours, either by taxation or by markets. Some ten years ago, I chaired a committee in France on the organisation of carbon markets. Where are we today? Quite disappointing, isn't it? Anyway, if we were bold enough to do it, accountants could step in and design the relevant standards, as it is their job to measure costs and benefits. Wherever there is a possibility for financial measurement, there is no doubt accounting standard-setters should take the lead and, by the way, I understand they actually do it, for example in dealing with the accounting standard for Emissions Trading Schemes.

A second situation is when there is no clear pricing but there exist some possibilities to try and identify the consequences of ESG strategies and obligations on the situation and performance of firms. Maybe then there is a way for accounting standard-setters to play a

role, and I understand that this is precisely what the IASB is considering when looking at the possible enrichment of the so-called Management Commentary.

The third situation would see the IFRS Foundation transformed into some kind of supermarket of standard-setting, dealing with all sorts of non-financial reporting matters. This is particularly obvious when dealing with social issues, consumer protection, corporate governance and the like. These do require specific standards and reporting but I don't think it is a task for accountants.

Contrary to the situation regarding accounting standards, I see a true European interest in taking the lead regarding ESG standard-setting and reporting. This is a necessary task if we want to avoid wishful thinking and unfair competition within EU markets, between firms and between products. From this point of view, the present situation regarding the description of financial instruments offered to the public with regard to their green, sustainable or ethical characteristics is not fully satisfactory, as underlined on the occasion of recent AMF "Entretiens" in Paris and by Sven Giegold in his remarkable speech on this occasion. Accountants may accompany the process, but can't be leaders if pricing is not there. And pricing is both of the essence and extremely challenging as shown in France recently with the Gilets Jaunes reacting violently to a carbon tax. The road towards ESG will be bumpy and will require great political skills as well as specific and effective transition tools. This has been well analysed in a recent and excellent paper published by Bruegel.

In summary:

IFRS has been a remarkable success story for the EU, and the EU has been a remarkable supporter on the world stage for IFRS and global standards. A classic win / win for both sides. EFRAG role should be commended for its positive contribution to this success.

Nonetheless, these gains cannot be taken for granted and need be protected, particularly when discussing topics such as the European interest.

And finally, whilst I am supportive of efforts to improve and standardise ESG reporting and of the contribution of accountants, where possible, to this difficult task we should not rely on accountants to be the ones that save our planet.

I thank you for your attention.