Practical Implementation Issues of International Financial Reporting Standards (IFRS)

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At the UNCTAD Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR)
21 November 2005, Geneva

1. I wish to present the problem about International Financial Reporting Standards from the viewpoint of the emerging markets.

The Need to Adopt International Standards

2. Emerging markets have very little choice. They have to join in the globalization process. They want to participate in the flow of free trade. They want to speed up the process of industrialization. They want to modernize their financial markets. To do so, they need funding from outside to finance their investments. They need to have investment by the public sector in physical infrastructure, as well as by the private sector in manufacturing and production capacities.

3. Emerging markets therefore have no choice. To source funding from outside, they have to link their financial markets and their capital markets to the world. They have to stand in line to compete with other emerging markets for international capital. Therefore, they have no choice but to adopt international standards, International Financial Reporting Standards included.

4. Look at the famous capital standard issued by committee under the Bank of International Settlement. There was no law to force any country to adopt this standard. But all the countries rushed to adopt the standard, much to the surprise of even those people who were involved in its setting. Any country that ignores the BIS capital standard will simply subject its domestic banks to face fewer trading limits, smaller borrowing lines and higher financial charges when they do business abroad. Most emerging markets have therefore moved to adopt this standard.

5. The problem with international standards, however, is that sometimes there are certain situations and specificities that may be common only to emerging markets, and not the developed markets. These situations and specificities may render international standards either hard to be applied in those emerging markets, or may even lead to different results unintended by the standard setters. The question to ask is therefore, whether in the process of setting international standards, have the problems and the specificities that may exist only in emerging markets - - have they all been fully considered?

Lack of Participation by Emerging Markets

6. I must point out that international standard setting bodies are in deed dominated by developed markets. This is perhaps to be expected. The developed markets are the ones that have the money, or are able to function as financial centers that pool in the money.

7. International financial institutions and fund managers in the developed markets then disburse these money to destinations all over the world. The developed markets therefore represent the side of the investors. They are the ones to take the risks with these money, therefore, it is right that they should demand standards and systems that help them to safely manage this process. It is to be expected that the developed markets should dominate the international rule setting process.

8. However, the rules once announced apply to all countries. And the countries that find difficulty with the rules afterwards simply have to find ways to lobby for its change or amendment afterwards. This lack of participation in the rule setting process in international bodies must be addressed.

Specific problems about IFRS

9. We in Thailand have found a few specific problems about IFRS that I wish to highlight. I want to highlight them because I think that they may also apply, perhaps not today but one day in the future, to other emerging markets.

10. The first example is about IAS 39 on debt restructuring. Debt restructuring is when banks renegotiate with its non-performing debtor to reschedule the payment term. The new term will stretch further into the future, say, allowing the debtor to gradually repay the loan in installments over the next, say 7 years.

11. The issue is how to calculate the value of this restructured loan in order to recognize the loss. IAS 39 specifies that the new cash flow should be valued by discounting the new cash flow using the interest rate prevailing at the time of the original loan contract. Now, this makes sense because one wants to measure the loss incurred from income forgone. The income forgone should therefore be reflected by the interest rate prevailing at the time that the bank made the original loan.

12. However, in some emerging markets, there could be a sea change in the financial environment as if there has been a paradigm shift in the level of interest rate. This actually happened in Thailand.

13. We entered a major crisis in 1997, the start of the Asian crisis. For many decades before the crisis, Thailand's investment exceeded saving. Therefore, the level of interest rate above 12% a year was common. Loans were therefore made with reference to this 12% rate. But after the crisis, between 2001 to now when banks went through their loan restructuring, interest rate was mostly around 6% a year. Domestic investment went down substantially and stayed down, resulting a excess liquidity that was difficult to get rid of. The problem of liquidity trap in Thailand was not as bad a Japan, so we are now gradually clawing our way back.

14. Now, IAS 39 requires the restructured loans to be discounted at the 12% rate. But does it make sense to do so in the new environment of 6% rate? To force the banks to discount at 12% instead of 6% would not only increase the losses to banks. Fortunately, Thailand partially solved this problem by setting up a national asset management entity that entered into agreement with banks to share losses at the end of its operation.

15. I think there is an argument for the standard to allow for the option of using the current market interest rate in the calculation of net present value of the restructured loan in the case where the shift in financial market environment is so severe as to set a new paradigm for the country.

16. The **second example** is about segment reporting. IAS 14 requires companies to report revenue, cost and profit for each segment of the business. The purpose is to provide information so that investors can project future results for each segment based on past performance.

17. We had an example of a company that as part of its operation manufactures training shoes for export. However, all of its sale was only to one customer, owner of a big American brand name. The company complained that after it disclosed profit for its shoe division, its customer promptly saw the high level of profit and pressured for lower prices. The company ended up with its results out in the open while its competitors, both inside the country and outside, lied low in the dark.

18. In this case, therefore, I think there is an argument for the standard to give exemption to companies that have a few buyers commanding a dominant share not to have to report segment results.

19. The **third example** is about goodwill. The paper prepared for this conference correctly pointed out that under the revised IFRS 3, Business Combinations, goodwill is not amortized but rather is tested for impairment annually, in accordance with IAS 36, Impairment of Assets.

20. This is fine for developed countries where market competition for goods and services that affects goodwill is normally quite free and predictable. But in many emerging markets, there are many factors that may affect the value of goodwill than the developed countries. Because goods and services in emerging markets tend to be of lower technological complexity, goodwill may be easily subjected to technological changes. This may bring down the value of goodwill suddenly. Political changes can also lead to redistribution of rights related to commercial market activity that can also affect the value of goodwill without notice.

21. Similarly, when market dominance of one product or one brand name is too prominent while the overall market is still small, new entries can erode the position of the leader more quickly than in developed markets. Such changes can impair the value of goodwill in emerging markets in a more sudden manner than in developed markets. In this case, therefore, I think there is an argument for the standard to allow for the option of amortization of goodwill where the risk to its sudden impairment is high.

Introduction of IFRS in Thailand

22. Despite the difficulties cited, do you think Thailand have decided not to adopt the IFRS? I told you before. Emerging markets have no choice but to adopt international standards sooner or later. Thailand is no exception. We announced our intention to do so by the end of next year. However, we shall do so only for companies in the capital market. For companies outside the capital market, only the local standard will apply. This

is necessary in our case because accounting standards become part of the law, and failure to comply result in criminal penalty.

23. To force international standards on all companies would not only be unfair to those that may violate the law out of simple misunderstanding, but also impose high costs on companies big and small to produce international standard reports that are of interest to no one.

24. I think it makes sense to restrict IFRS only to companies in the capital market, and I recommend other countries to consider this approach. But we plan to carve out not only the non public companies, we also plan to carve out some provisions that we deem to be unsuitable for the local market too, such as the three examples cited. Basically, companies in the capital market that can comply with IFRS fully could do so. But we may add certain alternatives, additional options for companies to choose so as to better reflect the local environment. However, we shall make clear when the companies do not fully follow the IFRS, they have to state so. They have to point out that they make use of the carve-outs provided by the Thai standard setter.

25. The Thai approach can therefore perhaps be called the IFRS minus. We shall announce full adoption, but make clear that certain carve-outs are available. Investors shall be clear when carve-outs are used, and they can decide by themselves whether to invest in these companies or not.

Need for Regional Representation

26. Finally, I think there is no substitute for finding ways for emerging markets to be better represented in the rule setting process. The option of one country after another adopting the international standards but with specific carve-outs can only be second best at most. Instead, these specificities should be discussed and debated by the standard setters.

27. In order to do that, emerging markets should be represented in all bodies at all levels. The process for selection within a region should be clearly set. All regions should have their chance to be actively involved, to bring up their specific situations to be thoroughly examined, even if the final outcome is not changed.

28. I shall close by saying again that if you want the rules to apply to everybody, then everybody must have a say in setting the rules.