Vincenzo La Via
WCOA Opening Ceremony
November 10, 2014

Ladies and Gentlemen,

It is an honor to have the opportunity to address this audience in this very important event and I thank very much IFAC and its Italian partner organization for the invitation.

The congress you will be holding over the next three days is of extreme relevance, not only because of the eminence of the speakers who are going to intervene, but also because of the very important topics which you will discuss.

In my remarks today I would like to start by paying tribute to your profession and then entertain you with a few considerations on a number of topics, in particular from a European perspective.

In this vein, first of all let me say that the accountancy and auditing professions play a key role in our economies, which are based essentially on private initiative. By providing a reliable picture of the economic and financial situation of firms, your profession is at the heart of the market mechanism. The latter requires economic agents and investors to continuously make consumption and investment decisions on the basis of profit opportunities and economic perspectives. In order for these decisions to be efficient and maximize social welfare it is indispensable that the information they are based on are correct, reliable and comparable.

Therefore, in providing their services, accountants and auditors are of benefit not only to the firms that pay their fees, but also to a variety of stakeholders, primarily investors, and to society at large. It is not misplaced to say, in this perspective, that your profession performs a valuable social service with significant positive externalities.

Having said this, in the remainder of my intervention, I would like to spend a few words on the role of accounting principles and standards in the unfolding of the financial crisis erupted in 2007/2008 and then focus on a few topics of relevance to the policy objective of ensuring the availability of reliable financial information, while minimizing the reporting burden to firms.

The issues I would like to briefly touch upon are the convergence of accounting standards at the international level and the evolving architecture in Europe to make sure that financial information is sound both for listed firms, using IFRS, and for SMEs, using National GAAPs subject to a certain degree of EU harmonization.

THE ROLE OF ACCOUNTING PRINCIPLES IN THE FINANCIAL CRISES

At the time of the outburst of the crises, a number of influential observers highlighted accounting principles and standards, namely the advocated excessive use of fair value, as one of the main drivers of the financial crises.

After some time, I have to say that I find it odd to assign the responsibility to accounting standards for all what we have gone and are going through. Of course, some flaws in accounting and auditing were detected and have been addressed thereafter. However, identifying accounting principles as the culprit of the process leading to the Lehman Brothers bankruptcy and to the global financial and economic crises that ensued is just too simplistic and overlooks a number of major failures that were at work to explain the knock out effects on the global financial market and economy.
This is not the time and place for me to recall what the root causes of the crises were but I would like to stress that, set aside the possibility of some procyclical effects induced by fair value, charging accounting principles with the responsibility of the crises is like a doctor who mistakes the symptoms of an illness for its underlying cause. The coming to a halt of some markets in 2008 and the price gyrations and illiquidity derived thereafter

was the result of hazardous credit decisions not properly subject to oversight and supervision by the private and public bodies that were supposed to operate for this purpose. The photography taken by fair price values was just a reflection of the harsh reality that was unfolding. Having said this, it also emerged clearly that fair value required some fixes especially if it is interpreted mechanically as marking to market.

The crises made clear that marking to market may simply be not possible if transactions suddenly disappear and market liquidity comes to a halt. In that case, accounting standard guidance was not sufficient in order to clarify how fair values should be derived in the absence of a reliable market price.

However, we should not forget that also historic cost accounting, the main alternative we have available to fair value, would have called for haircuts and impairments to be applied to financial instruments held in investors' portfolios.

The lesson I draw from these stylized considerations is that, first of all, one should not "shoot the messenger" for providing a message, which is a rather a reflection of reality and, secondly, if price falls during the crises were really transient and not permanent, the vicious circle between market turbulence and increased risk aversion by investors cannot be attributed primarily to how the information available is computed but, probably better, it is a matter of how such information is used in order to assess the perspectives of a certain investment going forward.

In conclusion, I consider the argument of fair value as the root cause of the crises being too far-fetched but at the same time I want to make clear that indeed much work to do emerged in accounting matters following the crises, which policy makers have done to a large extent, albeit not completely.

THE STRENGTHENING AND CONVERGENCE OF ACCOUNTING STANDARDS

I will recall here that the international community, through the G20, identified almost immediately after the crises the need for a "single set of high quality accounting standards".

Some years after that, we have to acknowledge that the progress on international convergence in accounting standards has fallen short of original targets, primarily due to the still relatively significant distance existing between the GAAPs adopted by FASB in the United States and the IFRS, as issued by the IASB, which find a predominant use in other world jurisdictions, including in the EU.

However, the lack of satisfactory progress on international convergence does not imply that progress has not been made on the objective of "high quality" pertaining to accounting standards. As far as IFRS are concerned, which are the accounting principles used in my own jurisdiction, the EU, the due process of standard setting, the identification of needs, the estimate and weighting of different elements and interests, the proactive cooperation amongst actors involved, are all factors that have seen major improvements. Also the use of marking to market to identify fair value has been adjusted taking into account the business model of the reporting institution and more guidance has been issued for so-called Level 2 and Level 3 asset valuation and for possible reclassification of assets across various categories.

As I don't want to enter into the technicalities, where you are much more knowledgeable than I am, I would like instead to make a few remarks on the European experience and on the steps we are taking inside the EU to do our part in the setting of high quality accounting standards and principles.

THE EUROPEAN EXPERIENCE

The new EFRAG

As you know, the EU is one of the major user of IFRS, which are adopted in our jurisdiction following a complex process involving both the European Commission and Member States, through the Accounting Regulatory Committee, which endorse IFRS on the basis of the technical advice given by the EFRAG, the European Financial Reporting Advisory Group.

Through this complex architecture the EU interacts with the IASB prior to IFRS adoption and, most of all, endorses the standards adopted by IASB as they are. Only on one occasion and for good reasons, did the EU make resort to a carve-out option when endorsing the IAS39 on the valuation of financial instruments.

In order to strengthen even more this process, in 2013 the European Commission gave mandate to Philip Maystadt to produce a report in order to explore possible weaknesses and ways to address them. The report – entitled *"SHOULD IFRS STANDARDS BE MORE "EUROPEAN? Mission to reinforce the EU's contribution to the development of international accounting standards"* – was indeed issued in November 2013 and contains a number of very useful suggestions and recommendations, which the EU is currently considering to implement or has already implemented.

In particular, the reform of the advisory body to the Commission and Member States just saw the light last 1 November when a new EFRAG was established with an enlargement of its membership and a revision of its working processes.

In essence, there was an awareness that the consideration of the objective of "public good", to which accounting standards must be aligned, required diverse skills and voices. Therefore the supervisory board of the EFRAG was enlarged to encompass National Standard Setter, beside professionals and practitioners and – in addition – observer status was granted to the three European Supervisory Authorities and to the European Central Bank in view of the public perspective they can bring in considering accounting standards' impact on the economic and financial system.

With this reform, inter alia, EFRAG will be better equipped in two fundamental tasks: (i) in the proactive phase providing comment letters to the IASB, the new EFRAG will greatly contribute to the objective of the EU speaking with one voice; (ii) in the endorsement phase, the new EFRAG will be in a better position and have more diverse skills to assess carefully the impact of accounting standards on the EU economic and financial system. The European Commission and the 28 Member States gathered in the ARC will greatly benefit from these new arrangements, which – as I have just said – came into effect on 1 November.

The Maystadt report, however, made also other very useful recommendations on which the EU will reflect further and act upon on the basis of the ongoing process of evaluation of the European Regulation, which about 10 years ago introduced the use of IFRS mainly for European listed firms.

While this is still work in progress, let me spend a few words on the new Accounting Directive which is due to be implemented by Member States by next summer.

The new Accounting Directive

IFRS are used in the EU essentially by listed firms, while Member States have the option to expand their use also by other entities. By the way, Italy has used extensively this option, much more than other Member States.

However, SMEs are subject to a different regime in view of the fact that regulation must be proportionate to the needs of different categories of agents. In the EU, national accounting standards apply to SMEs and these are subject to certain degree of harmonization, which has been recently redefined by the Accounting Directive issued in June 2013.

This new framework better combines the need for an adequate administrative and legal regime that caters for a reduction of the reporting burdens for SMEs, while safeguarding the key objectives at which the accounting legislation is aimed, namely providing key information on the economic and financial situation of the firms, ensuring the protection of shareholders and other companies' stakeholders, fostering the efficiency and competitiveness of business, promoting cross-border activity.

Essentially, reporting requirements are scalable according to the size of the reporting firm in order to take into account the balance between the benefits derived from the provision of more elaborate information and the administrative capacity of firms to sustain the reporting burden.

Taking due account of the scalability of the Accounting Directive, this will bring about a valuable contribution in the provision of reliable and comparable information about SMEs across members states. This is of paramount importance especially at this juncture where banking credit is scarce and SMEs, in particular mid-caps, must resort to other financing channels, primarily capital markets, where information requirements are key to spur investment and reduce asymmetries.

CONCLUDING REMARKS

In the context that I have briefly outlined, where many challenges – in particular of an international nature – still need to be addressed, the accounting and auditing professions play an important role towards building a credible and competitive economy adhering to high standards of reputation.

In particular in Europe, where we are in train to build a Capital Markets Union, complementary to Banking Union, to broaden and diversify the financial system, accounting and auditing will receive close scrutiny in view of being a key part of the information infrastructure, which is needed for agents to exercise their investment decisions with the necessary due diligence.

The need for greater transparency and more effective financial reporting has placed renewed pressures on preparers and auditors of financial statements, in which we trust in order to meet the greater and greater demand for high quality information. They have, you have, the skills and moral attitude which is necessary to provide independent and objective information on the profitability and risk profile of firms.

The current business challenges require professionals who are able to support corporate strategies and innovation, while using correct methodologies to preserve the confidence of investors. I am sure you will stand up to your responsibilities that usually go beyond mere compliance with the law and accounting principles and are aimed at providing the much needed professional support to secure development and innovation.

Against this background, globalization only makes your task even more difficult and I am sure that this Congress will be fruitful and help a productive exchange of views and experiences that is very much needed in today's challenging world.

Thank you for your attention.