Let's Have a Single

An interview with Sir David Tweedie, chairman of the International Accounting Standards Board

By Ramona Dzinkowski

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With the growing adoption of International Financial Reporting Standards (IFRS) and the continued momentum toward convergence on the part of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), many companies in America are questioning when and if the Securities & Exchange Commission (SEC) will set a date where U.S. firms can file under IFRS. In the meantime, other questions remain about the adoption of IFRS in the U.S. and elsewhere around the world. Against this backdrop, the IASB will be releasing an unprecedented number of new standards over the next several months, many of which will have wide-ranging impacts for various industries and companies around the world. In this exclusive interview for *Strategic Finance* in the U.S., IASB Chairman Sir David Tweedie answers some pointed questions that are top of mind for many executives at home and abroad.

RD: One traditional argument for the global adoption of IFRS was that a common framework for financial reporting would increase the transparency and comparability of financial results between companies

Set of Standards

from different countries, thereby creating a level playing field for capital and ultimately improving capital mobility. To what extent does this apply to the emerging economies such as China and India under their capital ownership conditions?

SD: Our goal, supported by the G20 and others, is to develop a single set of high-quality, principles-based accounting standards. Given that a single standard will need to be applied consistently in both developed and emerging markets, the IASB works hard to seek input from all jurisdictions throughout the standards-setting process.

This is important for several reasons. First, the G20 and others have encouraged the IASB to ensure that our standards meet the needs of emerging economies. Second, many of these economies are the primary drivers of global growth right now, so their needs should certainly be taken into consideration. Third, institutional investors are investing heavily in many of these emerging economies, so comparability of financial information between all markets is important.

RD: Should the U.S. convert to IFRS, are there likely to be certain impacts on financial reporting that will be felt differently across various industries there? Will the evolving IFRS have different impacts on companies in different countries but within the same industry? What does this imply for performance comparability? Can this be explained in the notes and the MD&A [Management Discussion and Analysis] effectively?

SD: Much of the change will be felt by U.S. companies, regardless of what the SEC decides on U.S. adoption of IFRS. Our joint work with the FASB on the improvement and convergence of IFRS and U.S. GAAP means that by 2011 the two sets of standards will be substantially similar. Convergence, not adoption, will have the greater impact on U.S. financial reporting.

RD: Some have argued that the IASB and the FASB should just get on with convergence as quickly as possible, whereas others say that the more time available, the better. In your view, what are the advantages/disadvantages for U.S. companies having to adopt IFRS in 2013 compared to a later date, say 2016? Are there any other issues that might stall the completion of these last, and very large, joint projects?

SD: We need to get the job done, but in a way that does not sacrifice quality for speed. That's what our recently announced work plan sets out to achieve. We have given priority to completing the most important projects by June 2011. This will be done in a way that minimizes the burden on interested parties who wish to comment on our work.

The important thing is for the U.S. to make a decision on U.S. adoption of IFRS in 2011. No one likes uncertainty. U.S. companies want to know what is coming down the line, and the rest of the world is keen to see that the U.S. is on board in its support for global standards.

The actual date of switchover is secondary and should reflect U.S. domestic needs, although there seems little point in going through the trauma of switching to converged standards and then again to global standards.

RD: Although the G20 has called for major joint projects of the FASB and the IASB to be complete by 2011, the exposure draft process has been slowed somewhat to allow interested parties to comment on proposed standards. What are the costs and benefits of slowing down this process?

SD: I wouldn't say the process has been slowed. What we have tried to do is to give priority to the most important projects for completion by June 2011.

Both the IASB and the FASB are frequently told that we are trying to do too much—that we should focus on the most important projects. That is what we have done, which will allow others the time to provide high-quality input, which is an essential ingredient in the development of high-quality standards.

RD: Some observers point to differences between FASB and IASB proposals surrounding very complex accounting standards and their underlying concepts (i.e., Purpose of Other Comprehensive Income and conceptual differences in what variables constitute a change in a company's own credit—IFRS 7 vs. FASB ED "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities"). Taking this particular issue as an example, what are the broader potential impacts to a company's accounting, financial reporting, and economic position of the FASB vs. the IASB view?

SD: Although the IASB and the FASB are seeking to develop common accounting standards, there is no guarantee that two independent boards will always reach the same conclusion. You highlight just one example, but there are many others. This is why I do not believe convergence is a sustainable, long-term solution. "Similar" standards will always be different as the devil is in the details.

RD: We see some very complex standards coming down the pipe in the near future. For the nonexpert audience, can you provide some high-level insight into the main issues/changes to current financial reporting using IFRS as well as potential economic/ industry impacts surrounding the emerging standards? For example: fair value measurement, statement of comprehensive income, financial instruments (impairment and hedge accounting), revenue recognition, leases, insurance, contracts, pensions.

SD: Most of the projects you highlight are standards that we inherited from our predecessor body or that were temporarily knocked into shape in order to be fit for purpose when Australia, Europe, and others adopted IFRS in 2005.

We had always intended to revisit these standards—and to do so in a way that results in an improved and convergent outcome. The recent financial crisis has provided one of the greatest stress tests of financial reporting for many generations, so we are using what we learned from this experience to improve global financial reporting standards.

For fair value measurement, we have adopted the three-level hierarchy that has proved popular in the United States, as well as the recommendations from a panel of experts we put together on applying fair value measurements when markets become inactive.

The reform of financial instruments accounting gets a fair amount of interest. We've already completed the first part of the project in publishing IFRS 9, "Financial Instruments," and we are consulting widely on the second phase of the project dealing with impairment of financial instruments. We expect to publish the third and final part of the project dealing with hedge accounting in the next few months.

Our proposals on revenue recognition are already published, as are pensions. Proposed standards on insurance and leases will be published shortly, and we have comprehensive outreach programs in place for all of these major standards to ensure that all viewpoints are taken into consideration.

RD: With regard to convergence overall, to what extent is the devil in the details?

SD: The convergence program is important to align global accounting standards, but the ultimate goal has to be a single set of standards. It is highly unlikely that convergence will lead to identical standards. Only adoption will eliminate the "devil" you refer to.

RD: The development of an IFRS for extractive industries is now on the IASB agenda. Is this "interest group" standards setting? Are there enough unique characteristics in these sectors to warrant separate IFRS, or are the issues better addressed by other industry reporting standards?

SD: In general we try to avoid developing standards for specific industries, but there are some unique features in extractive industries that need to be considered. Some interest groups have put forward proposals that we have referred to in one chapter of the discussion paper. We will consider responses to this consultation before deciding whether to add this project to the IASB's formal agenda.

RD: To what extent are we likely to see specific IFRS evolving for other sectors with unique characteristics?

SD: As I previously mentioned, this is something that we try to avoid, but in some cases we have no choice as the economics are unique to a particular sector. The insurance sector is a good example. Insurance companies are unique in that they receive payment up front for a service that may never be delivered. Extractive activities may be another, but I suspect that others will be few and far between.

RD: In your view, do you see any (new or old) arguments emerging from various interest groups suggesting that there will be clear winners and losers resulting from the emerging standards and convergence overall?

SD: It's difficult to say. In developing new IFRS we do take into consideration the costs and benefits of change, as well as a general assessment of the impact of the change. But it's not our job to identify the winners and losers as a result of that change.

RD: In you view, to what extent will the continuing economic malaise in the U.S. have an impact on the SEC's roadmap, i.e., potential adoption date, if at all? In other countries?

SD: I'm sure the SEC will take it into consideration as part of its cost-benefit analysis of a move to IFRS. I would argue, however, that it's more cost effective to change once rather than adopting the new standards under U.S. GAAP and then switch again to IFRS at some point in the future.

RD: Some suggest that "mark to market" has been one of the principal culprits in the failure of some of the large U.S. financial institutions and the credit crises in general. How do you respond to this view?

SD: That's certainly a view that I heard expressed vigorously during the crisis but less so now. Post-crisis analysis has shown that poor lending decisions, a lack of risk management, overleveraging and insufficient bank capital requirements, the complexity of financial instruments, and a lack of due diligence on the part of investors all contributed to the crisis.

That's not to say that the accounting was perfect, and we are working through a comprehensive program of enhancements that will result in improved transparency and disclosure of financial information to investors and other users of financial statements.

RD: If it's true that IFRS will create greater transparency and comparability and increase capital mobility, is there a direct link worldwide in the adoption of IFRS and the economic recovery in America?

SD: I don't think so. By the time we've completed our convergence work, IFRS and U.S. GAAP will be substantially similar, so I wouldn't have thought that switching from one to another would make any material difference in the U.S. Elsewhere in the world, particularly in emerging markets, adopting IFRS undoubtedly helps to attract inward investment in a region and helps to reduce the cost of capital, so that may have a positive impact on the economic recovery in certain parts of the world.

RD: Under what circumstances do you see that U.S. issuers will accept a principles-based approach with little or no guidance? Are there other options?

SD: Financial reporting across the world, including the U.S., is moving to a principles-based approach with minimal guidance. The new, converged standards under U.S. GAAP have been written in this way, so, regardless of whether the U.S. adopts IFRS, principles-based is the direction of travel.

The reasons for this are simple. Producing audited financial statements in compliance with almost 20,000 pages of rules is prohibitively expensive, reduces comparability, and makes little use of the skills and training of accountants to apply their professional judgment.

RD: Emerging economies, specifically China and India, are fueling much of the world's economic growth. Many of these economies have significantly different business and legal environments from those operating in Europe or North America. Can you talk to some of the unique reporting issues in those economies and what some of the issues surrounding convergence/adoption are?

SD: Clearly there are challenges in providing a single approach to accounting that meets the needs of both developed and emerging economies. That is why we go to great lengths to seek input from around the world when developing IFRS. For example, it is a great deal easier to apply fair value measurement when you have deep and liquid markets as you do in the United States. In countries such as India and Korea, foreign exchange translations can cause difficulties, whereas we've needed to look at related-party transactions to avoid reporting problems in China and other countries where the state can hold equity stakes in many companies. **SF**

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