

Prepared statement of Sir David Tweedie,
Chairman of the International Accounting Standards Board
before the Economic and Monetary Affairs Committee
of the European Parliament

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Madame Chairwoman, members of the Committee, my colleagues and I welcome this opportunity to appear before your committee to discuss the current status of the work of the International Accounting Standards Board (IASB) and the adoption of International Financial Reporting Standards (IFRSs) in the Member-States of the European Union. This is my second time before the ECON Committee, and I am delighted that I have been invited again. A continued dialogue between the IASB and your committee will help to ensure an open exchange of ideas and benefit our shared interest in developing high-quality accounting standards throughout the world. It is our hope that we will have continued opportunities to discuss these matters with you in the future.

I also note that members of the Trustees of the International Accounting Standards Committee (IASC) Foundation, who have oversight over the IASB, have agreed to appear before the committee on a regular basis. Their regular appearances will enable the members of this committee to share their views and concerns regarding the IASC Foundation and IASB's governance and accountability. I know that new Chairman of the Foundation, Tommaso Padoa-Schioppa, and the seven other European Trustees look forward to meeting with you shortly.

The Committee has asked me to address a number of items, including the progress of convergence between the IASB and our US counterpart, the Financial Accounting Standards Board (FASB), the status of IAS 39, and the outcome of the IASC Foundation Constitution Review. I will leave the Constitution Review to your discussions with the IASC Foundation Trustees, because they are responsible for Constitutional issues. I will, however, give you a sense of how the IASB has attempted to respond to the many issues voiced by the many interested parties regarding the IASB's consultative procedures and due process.

The effort to date

This meeting is particularly timely. Companies and auditors throughout the European Union and in nearly 75 other countries throughout the world are busy preparing their first full year accounts under the 'stable platform' of IFRSs. This is an important milestone in the development of a financial reporting infrastructure reflective of realities of the modern marketplace and, for Europe, the emergence of a common European capital market. The political leadership in Europe has played an important leadership role in encouraging this development.

It seems to me that in recent months, coverage of the IASB has focused on disagreements on particular standards and the short-term costs of implementing the standards. That is understandable as companies in Europe, the Asia-Pacific region, Latin America, and Africa adjust to the new standards for the first time. There will always be a one-time, upfront cost of adopting a new set of standards. But lost in this discussion is the discussion of the benefits that are being and can continue to be achieved from the adoption of IFRSs.

When the EU's finance ministers chose to adopt IFRSs in 2001 in Lisbon and the European Parliament approved the regulation, they did so because of the long-term economic benefits deriving from IFRSs and as a result of their vision for governance for the world's increasingly integrating financial markets. It is worth mentioning these benefits again.

For companies operating in multiple countries, such as in the 25 EU Member-States, the acceptance of international standards will cut the cost of complying with various national regimes. Until last year, subsidiary companies of multinationals in Europe needed to comply with different national standards in each jurisdiction and then the parent company needed to consolidate these different national accounts into a single statement according to its home country's requirements. This process was extremely costly and inherently wasteful of scarce resources.

A common financial language, applied consistently, will enable investors to compare the financial results of companies operating in different jurisdictions more easily and provide more opportunity for investment and diversification. The removal of a major investment risk – the concern that the nuances of different national accounting regimes have not been fully understood – should reduce the cost of capital and open new opportunities for diversification and improved investment returns. This point is particularly relevant at a time when companies, countries and individuals are increasingly dependent upon capital markets to provide a secure retirement for their employees.

For auditors, a single set of accounting standards should enable international audit firms to standardise training and better assure the quality of their work on a global basis. An international approach for accounting should also permit international capital to flow more freely, enabling audit firms and their clients to develop consistent global practice to accounting problems and thus further enhancing consistency. Finally, for regulators, the confusion associated with needing to understand various reporting regimes would be reduced.

The logic behind the case for international standards is clear. I am heartened by the fact that our consultations reveal that there still remains broad support in Europe and elsewhere for the objective of international standards.

At the same time, the IASB recognizes that concerns have been raised about the outcome of our work and the pace of change to date. You should note that the initial work programme of the IASB was not of our choosing. It was the decision of the European Union to adopt IFRSs that dominated the IASB's initial work programme. We changed our priorities and timetable from what they would otherwise have been only to accommodate the European decision to adopt IFRSs in 2005.

As the members of the Committee know, the IASB's work was not given a clean sheet of paper. The IASB inherited a set of 34 standards from its predecessor organization, 14 of which were criticised by the International Organization of Securities Regulators (IOSCO). These standards included the standards on financial instruments. Conscious of the fact, that in the light of the IOSCO criticisms the 14 "defective" standards would not be accepted by regulators world wide, the IASB was confronted with the choice of either improving the standards before EU adoption in 2005 or having the EU adopt and then changing the standards shortly thereafter. The IASB chose the first approach, and the result was the majority of our initial work programme – the improvements project.

During our first few years, we were also presented with an opportunity. The US Securities and Exchange Commission (SEC) and the FASB have always been consistent supporters of international standards. However, following the collapse of Enron and other financial scandals in the US, the willingness to accept international approaches to accounting standards grew. It was this changing mood that led the FASB and the IASB to capture what we saw was a small window of opportunity. The Norwalk Agreement was the result. I believe that we would have lost momentum for convergence in the United States, the world's largest capital market, if we had not acted when we did.

Therefore, our initial work program was aimed at improving the inherited set of standards and at initiating a convergence process with the US, essential to making IFRSs truly global standards. The result was the stable platform, which was completed in March 2004. We recognize that this initial work program entailed an unprecedented amount of change. (17 amended standards and six new standards). I can guarantee that this amount of change in such a short period of time will not occur again.

Convergence v. stability: A false choice

All of this brings us to the present and the IASB's plans for the future. As I mentioned earlier, the IASB recognises the enormous amount of change involved for those companies, investors, and auditors working under the new IFRS system for the first time. It is incumbent on the IASB to allow time for all interested parties to adapt to the new standards and, as Commissioner McCreevy aptly stated, provide time for IFRSs to 'bed down'. We all have an interest in making sure that companies apply IFRSs consistently in a manner faithful to the intent of the standards. That will take time, patience and cooperation of those involved in the adoption and enforcement of IFRSs. The effort to create a stable platform of standards, established by March 2004 and not to change before the end of 2006, was meant to accomplish this objective.

Nevertheless, there are sceptics of the IASB's commitment to stability of the standards. Some have observed that our stable platform has not been so stable, and that the IASB has been prone to change its standards since March 2004. These changes have, however, been aimed at dealing with concerns raised about implementation issues. For example, amendments to the fair value option, the first-time adoption standard, the pension standards, and others are examples of when the IASB responded to cases put forward by regulators, auditors, and preparers. It is clear that as the standards receive closer scrutiny through continued use, the need for other minor amendments may arise. The IASB hopes that these cases will be relatively infrequent. We will resist the temptation to create exceptions and special rules to address narrow interests.

Our commitment to stability, however, cannot and must not mean that the IASB should stop its work on new standards altogether. Our task is not complete. The 'roadmap' on the removal of the US GAAP reconciliation that both the European Commission and the SEC staff support provides the IASB with clear direction. The IASB is responding by tailoring our agenda to balance the desire for stability with the need to press ahead with convergence.

This balance is possible, because of the changed perspective of the US SEC staff regarding the reconciliation requirement. The US SEC staff has stated on several occasions, following the publication of the roadmap, that they would be willing to recommend mutual

recognition of IFRSs and US Generally Accepted Accounting Principles (US GAAP), **provided a robust convergence process was in place and would continue following the removal of reconciliation requirement.**

From the standard-setting standpoint, this changed attitude following the roadmap was a revelation. The IASB and the FASB would no longer need to concentrate on a possibly endless series of changes, the very changes that would make the stable platform unstable, to get the reconciliation removed. In consultation with the SEC and the European Commission, the IASB and the FASB agreed that trying to eliminate existing differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead a new common standard should be developed that improves the financial information reported to investors.

Under this arrangement, convergence work would run on two tracks. First, the goal by 2008 is to reach a conclusion about whether existing major differences in the following few focused areas should be eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas. For the IASB, this would mean changes in six targeted areas, including borrowing costs, joint ventures, government grants, segment reporting, impairment, and income tax. The FASB would also need to make changes to six of their standards. Convergence is a two-way street.

Second, and more substantially, the goal by 2008 is to have made significant progress on a number of areas identified by both Boards where current accounting practices of US GAAP and IFRSs are considered outdated and candidates for improvement. All of the proposed topics have been either on the Board's agenda for some time or on our active research agenda (the stage before joining the main agenda.) This, therefore, is a programme involving minimal change to our existing agenda.

I should stress that the proposed arrangement with the FASB does not mean completed standards or even exposure drafts on these topics by 2008. On all of these topics, which include consolidations, pensions, leasing, revenue recognition and financial instruments, the IASB will follow its full consultation process and will generally only reach the phase of issuing either discussion papers or exposure drafts by 2008.

Therefore, the great majority of the work associated with the achieving the “roadmap” will occur after 2008. On those projects completed before 2008, the IASB will consider the possibility of delaying implementation dates with the option of early adoption for those seeking to list in the US.

In this manner, I am confident that we will address Commissioner McCreevy's call for no new standards requiring major change during this period of adjustment. Stability will be granted, but progress must occur. Only in this manner can we capture the unique opportunity before us—the integration of the world's major capital markets.

It is the IASB's and the FASB's intention to lay out its specific short- and long-term priorities in a public document shortly. As mentioned earlier, many of the topics are already on our respective agendas. We have already consulted our respective advisory councils, business leaders, and the staffs of the European Commission and the US SEC. Our Trustees have considered and supported this strategy.

The direction of convergence

In the IASB's consultations throughout Europe, we often hear, 'Convergence yes, but not at any price.' The strategy outlined above should address questions regarding the pace of convergence. However, we have heard concerns about the possible substance of the new standards as well.

In general, other concerns outside of issues of pace arise on two grounds. First, those who support a more principles-based approach to accounting worry about increased complexity and do not want convergence to lead to a rulebook approach to international standards. My colleagues and I are committed to writing principles-based standards, because we believe that principles-based standards are easier to apply and actually cause more rigorous and consistent application of the standards' intent. This does not mean standards will be more lax. The contrary will be the case. A well-defined principle will allow for few exceptions and bright lines, which have been used to obfuscate financial results for too long.

Of course, the ability to sustain a principles-based system depends as much on companies, regulators and auditors, as it does the standard-setter. If abuses of the principles arise, standard-setters will be forced to take preventive action. If lawyers and regulators continually second guess honest judgments made by preparers and auditors, the demand for rules will arise, and the IASB will find it difficult to resist. In the end, standard-setters will provide the financial reporting community with the standards that they deserve.

While the IASB's determination to write principles-based standards will reduce complexity, the simple fact is that the modern economy is full of complex transactions. The accounting standards reflect this reality. However, we also recognise that the great majority of companies in Europe and elsewhere are small and medium-sized entities (SMEs) and that SMEs will find it difficult to comply to a set of standards written for companies operating in the capital markets. For this reason, the IASB is developing a simplified set of standards for SMEs. While we have no authority to require these standards for SMEs, it is our expectation that such a simplified set will be used in many of those countries using IFRSs for listed companies.

Secondly, undoubtedly, complaints with our standards will always persist. Any independent standard-setter will be unable to reconcile the perspectives of all interested parties. Many of the issues of concern about the FASB-IASB joint work is based upon concerns about the possible extension of the use of fair value accounting in new standards. To date, the IASB has issued very little new uses of fair value in the new standards issued by the Board, but clearly questions of the extent and relevance of new fair value measurements will arise in the future in a number of projects. The FASB and the IASB intend to address the issue of measurement as part of the Conceptual Framework projects that the Boards are jointly undertaking. Our respective staffs are now developing a work plan for the measurement aspect of the framework project to enable a public debate on the benefits of the range of measurement attributes (in particular, cost and fair value) and when each should be used to take place later this year.

The status of IAS 39 and financial instruments

Much of the debate on fair value has focused on IAS 39 and accounting for financial instruments. The history of IAS 39 is well known by now. The original IAS 39 was developed

by our predecessor, the IASC, over a 12-year period, and finalized in 1998. Recognizing that the inherited IAS 39 was difficult to apply, the IASB attempted to address implementation concerns raised, eliminate inconsistencies, and ease application issues. The decision to have a stable platform of standards by March 2004 precluded fundamental review of IAS39.

In the process of the improvements project, other concerns on IAS 39 were raised. These discussions in Europe particularly were contentious, and the result is that European Commission adopted IAS 39 with two 'carve outs'. One of those carve outs, the fair value option, has been removed. However, the other remains. With respect to the remaining carve out of certain hedge requirements of IAS 39, a team of IASB Board members and staff has had extensive technical discussions, including five meetings since 2004, with the European Banking Federation (FBE) aimed at resolving this issues. Despite these efforts, a number of important questions that the IASB team raised regarding the FBE's proposals remain unanswered. These include the key question of identification of the risk being hedged. Once this and the other questions have been satisfactorily answered, the IASB team would then prepare material for deliberation by the full IASB in public, as required by our due process procedures.

It is important to note, however, that any proposed solution must be understandable, consistent with the principles underlying the hedge accounting requirements of IAS 39, and in line with the IASB's long-term objective of simplifying and improving the accounting of financial instruments.

Role of Europe in the Discussions

I mentioned earlier that Constitutional matters are the domain of the Trustees, but I would like to address the matter of European involvement in the organisation. I know that the Chairwoman and the members of the committee has raised this point on several occasions.

Interested parties in Europe participate in the IASC Foundation and the IASB in a variety of ways. First, the IASC Foundation Constitution requires that six of the 22 Trustees come from Europe. In fact, there are now 8 European Trustees, and Tommaso Padoa-Schioppa recently assumed the Chairmanship from Paul Volcker.

On the IASB's composition, the Trustees concluded that geographical considerations should not determine the membership of the Board. However, eight of the fourteen members of the IASB hold EU passports, and five reside in the European Union on a full-time basis. The Committee should also be aware that the Trustees are currently advertising for candidates on the IASB and this provides interested Europeans an opportunity to put their names forward.

Nearly one-third of the 40 members of the Standards Advisory Council are European, and the SAC will have a greater role in advising the Trustees and the IASB on strategic matters.

In my mind, however, nationality has less of a role to play than the IASB's responsibility to account for the views of the many interested parties in Europe and elsewhere. It is in our consultative processes where we must account for many diverse views voiced throughout Europe. In conjunction with the Trustees' Constitution Review, the IASB enhanced its due process and consultation procedures and has published these procedures on its Website.

Without the pressure of time in preparing for the EU-2005 deadline, we also have greater ability to consult with a wide range of groups on our projects. We have established working groups on three projects, will make greater use of discussion papers on major projects, and use field visits where appropriate.

At the same time, behind the scenes, consultations with leading groups throughout Europe are increasing. We hold regular meetings with the CFO Forum of the European Round Table of Industrialists and UNICE, European analysts, and accounting specialists from Europe. Last year, we initiated a series of European road shows to discuss issues of practical implementation and will make this exercise a regular occurrence. We have also encouraged the continued participation of European national standard-setters in our deliberations, because these national standard-setters have a vital role in identifying issues of local concern to their constituents.

Finally, as I have previously stated, there is an important role for the Technical Expert Group (TEG) of the European Financial Reporting Advisory Group (EFRAG) to play. With EFRAG's role now addressed, the IASB would like to continue and enhance its regular dialogue with EFRAG on convergence issues to ensure that we understand European views and concerns before we meet with the FASB. Already, our members and senior staff attend and participate in all the meetings of the TEG. My colleagues and I have regular meetings with Stig Enevoldsen, the TEG's Chairman, and his staff. I look forward to an increase in this activity in the coming months. The degree of extensive consultation and interaction in Europe will ensure that IASB is aware of and is able to take into account the views of European users, preparers, auditors, and public officials.

No time for rest

We are at a key juncture in the development of international accounting standards. Nearly 100 countries are using IFRSs and are working hard to ensure their consistent application. The other major economies of the world, Japan and the United States, and the fastest growing emerging economies, China and India, are converging with IFRSs.

This progress in a relatively short-period of time provides ground for much optimism. We have a real opportunity now to ensure the smooth adoption of IFRSs in Europe and elsewhere and remove the US reconciliation requirement that serves as an impediment to the further integration of world's capital markets. If successful, we will create a financial reporting infrastructure appropriate for the global modern economy.

Let us avoid the temptation to rest on our laurels now. We should move forward, conscious of the practical challenges, but cognizant of the greater goal still ahead.