

Statement of IASB Chairman Sir David Tweedie

Before the Economic and Monetary Affairs Committee of the European Parliament

10 April 2007

Brussels

Madame Chairwoman, Committee Rapporteur, members of the Committee, I welcome this opportunity to appear before the Economic and Monetary Affairs Committee to discuss the current status of the work of the International Accounting Standards Board (IASB) and issues regarding the governance of the IASC Foundation and the IASB. This is my third time before the ECON Committee. I am delighted that I have been invited again and look forward to working together to build a stronger relationship. The IASB and our oversight body, the Trustees of the IASC Foundation, are taking steps to increase our interaction with the ECON Committee in the future, which I will come to later in my remarks.

I understand the Committee is considering a working document today regarding International Financial Reporting Standards (IFRSs) and the IASB's governance. I hope that my remarks touch on the issues raised in the document and assist in your deliberations.

A new world for IFRSs

Six years ago this week, the IASB began operations for the first time. The mission given to us was and remains to create a single set of high-quality and principles-based financial reporting standards that are used throughout the world's capital markets. It is easy to lose sight of the fact that when those involved with the restructuring of our predecessor organisation, the IASC, approved our Constitution in 2000, very few countries and companies throughout the world were using what were then called International Accounting Standards (IASs). A significant body of opinion existed, not restricted to the United States, that US Generally Accepted Accounting Principles (US GAAP) would eventually become the international norm for companies and investors operating in international capital markets. Finally, there was no guarantee that, guided only with a new Constitution and a vision, the newly created group of 19 Trustees would succeed in establishing and financing a new organisation.

In these six short years, much has changed. More than 100 countries throughout the world, including the 27 European Union member states, require or permit the use of International Financial Reporting Standards (IFRSs), developed by the IASB. This number is expected to rise substantially within a relatively short timeframe. The transition to IFRSs, which culminated in the mass adoption of IFRSs in these countries in 2005, has gone relatively smoothly and without any shocks to the financial system. We have sought to provide additional stability by announcing that we would require no new standards to be applicable before 2009 and to give at least one year between the time a standard is completed and is required for application.

The financial scandals in the United States earlier in the decade, coupled with increasingly attractive European and Asian markets that use IFRSs, is challenging the primacy of US GAAP as the preferred financial reporting framework for the raising of capital. The major emerging and transition economies of the world—Brazil, China, India, and Russia—are adopting or considering the adoption of IFRSs, not US GAAP, in an effort to become integrated in the world's capital markets and attract the investment necessary to finance their development. Similarly, Canada, Chile, Israel, and Korea have all recently announced their planned abandonment of national standards for IFRSs.

There is clear momentum towards accepting IFRSs as a common financial reporting language throughout the world. Today, companies in the European Union are benefiting from reduced compliance costs associated with the removal of the need for the consolidation of different national accounts into a single statement to meet their home country's requirements. Investors are able to make comparisons of companies operating in different jurisdictions more easily. Regulatory authorities are now more able to develop more consistent approaches to supervision across the European economies.

None of this is to suggest that IFRSs are yet a global standard. Many important economies—for example, Japan and the United States—are still in the process of converging. Therefore, much work remains to be done by all of us involved in the preparation and adoption of IFRSs, if we are to achieve our shared vision of making IFRSs the world's primary financial reporting language.

It is worth recognising the important leadership role that the European Union and the European Parliament have played in reaching this point. Europe took a brave and farsighted step when it decided not to choose a uniquely European approach to financial reporting, but instead spearheaded efforts for an international approach. As the leader in IFRS adoption, Europe is already reaping some of early benefits. Only last week, the *Financial Times* reported that Europe eclipsed the United States in stock market value for the first time since the early 20th century.[1] As with any decision to adopt a multilateral approach, sometimes countries will need to forego particular national or regional interests, but that is the price of maintaining the integrity and functioning of the system.

As momentum towards a common set of international standards has built, the relevance of the IASB's work to the world's economy naturally invites increased scrutiny of our operations and the standard-setting process. This is something that the IASB Foundation Trustees and my IASB colleagues and I welcome. At the same time, I would ask for your help as elected representatives within the European Union, a leading beneficiary of IFRSs, in sustaining and protecting the project underway. Any unnecessary shock to the emerging IFRS system could derail what is becoming a global consensus around IFRSs.

Today, I would like to focus my remarks on a number of areas where this Committee has expressed interest in the past. First, I will discuss steps that the IASB and the Trustees have taken to improve the accountability and transparency of organisation. This includes recent decisions regarding the

Trustees' oversight of the IASB, feedback given by the IASB to commentators on our proposals, and our engagement with the European Parliament. Second, I will provide an update of our convergence efforts with the United States. Finally, I will report on the progress of accounting standards aimed at small and medium-sized entities (SMEs).

Bolstering accountability and improving consultation

I should say that as IASB Chairman, I have no responsibility in approving and amending the Constitution and am not responsible for setting the accountability procedures of the IASC Foundation and the IASB. That is the role of the Trustees, and I will leave it to future meetings between the Trustees and the ECON Committee to discuss the Committee's views on our Constitution and accountability. I will, however, bring you up-to-date on the latest developments in these areas.

The IASC Foundation Constitution, which the European Commission had a strong hand in creating, has as its central operating premise that the independence of judgment of the IASB should be appropriately protected from particular national or special interest pleading. To maintain their independence, all full-time IASB members must sever their ties with former employers. Importantly, IASB meetings between outside parties and more than five members of the Board must be open to the public, and all decisions are made in public meetings. These requirements make the IASB uniquely transparent and enhance the credibility of IFRSs as a set of standards set in the public's interest. Also, decisions now require a supermajority of the fourteen members, reducing the likelihood that any single perspective can dominate.

At the same time, the Trustees are designed to reflect a broad spectrum of interests and regional perspectives. Of the 22 Trustees, seven are from Europe, six from Asia-Oceania, five from the United States, and one each from Africa, Canada, Latin America, and the Bank for International Settlements. The Trustees are responsible for appointing members of the Board, for assuring adequate financing, and for general oversight. The Trustees ensure the IASB's compliance with agreed procedures and ensure that the IASB takes into account the wide range of opinion on technical matters, and acts generally in the public interest. The Trustees are, however, not to opine on specific technical accounting issues. I believe that the emphasis on appropriate independence, combined with Trustee oversight, is an essential strength of the organization, enhances the credibility of IFRSs, and has been an essential element in attracting other countries to accept IFRSs.

Of course, independence brings responsibilities and requires accountability. From its advent, the IASB has held itself accountable largely by working in a transparent fashion, with decisions made following extensive due process and review procedures. As I mentioned earlier, the organisation has come a long way quickly. We are making continual improvements on the basis of experience and with the benefit of listening carefully to comments and suggestions made to us.

Many of the members of the Committee will be aware that we published due process handbooks for the IASB and the International Financial Reporting Interpretations Council (IFRIC). These handbooks, available on our Website, describe the procedures that both the IASB and the IFRIC follow before reaching conclusions on the standards. The IASB provides two formal comment periods on major standards, each lasting a minimum of 120 days. To gather the broadest input from those affected by IASB proposals, we have extended the use of roundtable discussions and are benefiting from the enhanced role of the Standards Advisory Council (14 of the 40 members are European, with the European Commission as an observer) in the development of the IASB's agenda.

On the transparency front, to enable observers throughout the world to follow our discussions, both the IASB and the IFRIC broadcast their meetings over the IASB's Internet site and provide extensive observer notes. Recently, the Trustees abolished the IFRIC Agenda Committee to enhance the transparency of IFRIC's agenda selection process.

The IASB is increasingly extending its due process in order to receive broader input. With the 2005 amendments to the Constitution, we now use a "comply or explain" approach for all non-mandatory aspects of our due process. The IASB is publishing Discussion Papers in order to receive an extra round of commentary on major projects. Finally, we are benefiting from the use of working groups on topics that require a broad range of expertise, such as insurance, pensions, leasing, financial instruments, financial statement presentation, and SMEs.

At last week's Trustees meeting in London, the Trustees approved proposals for a more effective interface between the Trustees and the IASB in considering the IASB's work programme. This is aimed at reinforcing Trustee oversight. The IASB welcomes this. In addition to the normal reporting by the IASB at public Trustees meetings, members of the Trustees' Procedures Committee will be responsible for meeting with the IASB at least twice annually to review the IASB's work and to reflect the views of key stakeholders. The Trustees' Procedures Committee then would report back to the full Trustees during the public sessions of the Trustees.

Last week, the Trustees considered the comments received from the European Commission and others on our working procedures and responded positively to those comments. The Trustees are working with the IASB to build a framework that makes more explicit how cost-benefit considerations are taken into account when the IASB addresses new standards. Using field research and building upon its consultative processes, the IASB will seek to explain the impact of new standards on capital markets more clearly. Furthermore, the IASB will establish feedback statements related to comments received throughout the consultation process, enabling respondents and others to see clearly how the IASB dealt with comments received. Other regulatory groups, including the Committee of European Securities Regulators, adopt this approach to explain their conclusions, and the IASB will look to them as models.

The Trustees also discussed the need for a more active engagement on both the Trustee and IASB-level with key stakeholders, including the European

Parliament. It is fair to say that we have not established regular contact with the members of the ECON committee, and the IASB wants to rectify this. Likewise, I know that the Trustees hope to be invited to appear before the Committee twice annually to update the Committee on oversight, funding, and other relevant matters. My colleagues and I on the IASB would welcome a similar opportunity. We are now dedicating more resources to this effort. We have recently appointed a new Director of Corporate Communications, who is an available resource for you and your staff, and I am pleased that he has had the opportunity to meet with some of your staff already. Our aim is to identify issues of concern to the European Parliament at the earliest stage possible, rather than at the end of our due process.

Finally, before turning to the IASB's work programme, I wanted to say something about the composition of the IASB. Again, it is the Trustees who select the members of the IASB. However, it is worth noting that the IASB's composition is changing over time, and consistent with the Constitution Review, the Trustees are placing an increasing emphasis on practical experience with IFRSs. With the most recent appointments, Jan Engström, the former Chief Financial Officer of Volvo Group, and Philippe Danjou, who is here today and formerly served as the Chief Accountant of the French securities regulator, joined the IASB. In July, Zhang Wei-Guo will become our first member from China. Three IASB members, two from North America, are leaving at the end of June, and the balance of the IASB is beginning to change significantly from the original body.

Though geographical balance is not a primary consideration, the simple fact is that the IASB will have fewer Board members from North America and more members with practical IFRS experience from a wide range of accounting traditions. As more countries use IFRSs, there is likely to be a larger pool of qualified candidates with both the technical expertise and professional competence, and it is important that the IASB continues to benefit from a broad diversity of professional and practical experiences.

Convergence and the Future of IFRSs

Since I was last before the Committee, the IASB and the US Financial Accounting Standards Board agreed a Memorandum of Understanding that established a work programme that would eliminate the need for reconciliation requirements. The February 2006 Memorandum of Understanding shifted the emphasis of the convergence process. 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 both in need of significant improvement is not the best use of the IASB's and the FASB's resources—instead a new common standard should be developed that improves the financial information reported to investors.

Convergence work is now running 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, the six targeted areas are borrowing costs, joint ventures, government grants, segment reporting, impairment, and income tax.

The FASB has considered or is also considering changes to six of their standards.

Under the second track outlined by the Memorandum of Understanding, the goal by 2008 is to have made significant progress in eleven areas identified by both Boards where current accounting practices of IFRSs and US GAAP are considered outdated and candidates for improvement. The areas include financial instruments, consolidations, leasing, pensions, and business combinations, among others. We expect to complete only one of these projects, business combinations, before the end of the year, and the large majority will not be completed before 2011 or 2012. This will give us the opportunity to undertake adequate consultation. Also we can take advantage of the removal of the reconciliation requirement, which should have been accomplished during this timeframe.

In Europe and elsewhere, some view the convergence programme with concern. They fear that convergence will be one-sided, will lead to the importation of US GAAP and its 'rules-based' approach into IFRSs, and will not improve accounting. Others include in their concerns either a belief that the US SEC will not remove the reconciliation requirement or a view that lifting the reconciliation requirement will have limited benefits. Whilst respecting these concerns and being very conscious of them, I believe that there is evidence to suggest otherwise. Indeed, we are working vigorously to ensure that the concerns are not realised.

Let me address the point regarding the value of removing the reconciliation requirement, because this is not about just cutting the costs of registration for a few hundred companies listed in the United States. It is about making IFRSs a truly global standard. As I pointed out before, the number of countries using IFRSs is increasing rapidly. In my travels throughout the world, I am struck by the fact that the appropriate regulatory authorities have been willing to adopt IFRSs only with reasonable confidence that IFRSs will be accepted in US markets eventually. This certainly is the case in China, India, Korea, the rest of the Asia-Oceania region, Canada, and Latin America, all of which have close ties with both Europe and the United States. We, and indeed the European Union, are working hard to achieve the elimination of the reconciliation requirement and to avoid anything that could damage the emerging international system.

In terms of the actual removal of the reconciliation requirement, that is not a decision for the IASB, but I can report that we are making solid progress towards the milestones listed in the Memorandum of Understanding. The IASB has regular monthly meetings where we assess our progress against these milestones, and we will maintain that determined focus.

On the removal of the reconciliation requirement, I will not make a prediction, but recent SEC pronouncements regarding their commitment to the roadmap are also encouraging. From the SEC's remarks, it seems that the SEC is focusing more closely on the consistent and full application of IFRSs. It is also notable that there was also unanimous support for the reconciliation's removal among US investors, preparers, and policymakers participating at a 6 March SEC Roundtable on IFRSs. Furthermore, when referring to the logic behind the "roadmap", the SEC Chairman Christopher Cox stated at the Roundtable,

“... the SEC was seriously contemplating a system in which not only foreign [non-US] issuers, but also domestic [US] issuers will have that choice [between IFRSs and US GAAP].”^[2] This suggests that US companies could be using IFRSs in the near future.

Of course, not all of the changes proposed in the name of convergence will be universally popular—change is generally unpopular, and the pain is shared. Convergence between the FASB and the IASB is a two-way street and both sides must adapt for the greater good. At the same time, I am here today to state that the IASB is not seeking convergence at any price nor will the IASB adopt US GAAP blindly. I know that this is the view of the Trustees as well. I believe that the same could be said for the FASB’s approach towards convergence with IFRSs as well.

The IASB will make changes when the change improves the existing accounting and when we see that the benefit of the change will outweigh the costs. We benefit greatly from the expertise and experience from our colleagues at the FASB, and when working on the same issues, it makes sense that we aim to reach a common position on the financial reporting issues before us. However, the IASB will not sacrifice its objective of developing principles-based accounting standards. If the United States cannot accept the degree of judgement deemed appropriate elsewhere then the IASB may have to consider ways of ring-fencing the US guidance that contributes to the promulgation of rules. For example, the IASB may need to state that additional guidance associated with a jointly written standard would not be compulsory under IASB’s requirements.

I understand that some of the members of the ECON Committee have been contacted regarding IFRS 8 *Segment Reporting* and our project on fair value measurements. IFRS 8 was one of our short-term convergence projects. It is true that we replaced the existing international standard with the treatment for segment reporting used in Canadian and US GAAP. We did so only after careful consultation with our many stakeholders, more than two-thirds of whom supported the change to a management approach for segment reporting on the basis it more accurately reflected the way management runs a business. It is significant that BusinessEurope and national business associations in France (MEDEF and ACTEO) and Germany (including leading banking and cooperative groups) supported the change. Even the UK Investment Management Association (IMA), the body that recently used a press release to object to our standard after its approval, responded to the IASB’s exposure draft on segment reporting in the following manner:

“From the perspective of users of accounts, in principle we welcome the IASB replacing IAS 14, Segment Reporting, with the US SFAS 131, Disclosures about Segments of an Enterprise and Related Information. This standard is based on the way management view the entity, and we support it as it undoubtedly has advantages in that it enables users to see the entity through the eyes of management.”^[3]

Later in the same response letter, the IMA did express some reservations. Other investor groups, including the London Investment Banking Association and Fidelity International, were broadly supportive. You as policymakers will understand the difficulty of reconciling sometimes differing viewpoints on

specific elements of any proposal, particularly when the vast majority support the fundamental principle behind a proposal.

The IASB is also sensitive to the fact that some believe that the inevitable outcome of our project on fair value measurement to be the answer reached by the FASB. First, the intention of the fair value measurement project is not to add any new requirements to fair value assets and liabilities, where they do not already exist in IFRSs. Instead, the IASB is seeking to provide consistency and further guidance on how to fair value items where a requirement exists. The FASB had initiated a project with a similar aim in advance of ours, and because of demand from the US marketplace was forced to issue their standard in advance of ours. To save time, the IASB decided to use the FASB standard as a basis to initiate deliberations on an international basis. However, the IASB was uncertain whether the FASB standard would be sufficient for an international marketplace where efficient markets are not always readily apparent. For that reason, we decided to issue a discussion paper, rather than an exposure draft, and are open to suggestions.

Developing IFRSs for SMEs

As many members of the Committee know, the IASB recently issued a draft standard for small and medium-sized companies. Last time that I was before you, I received a number of questions regarding the appropriateness and the legitimacy of the IASB's issuing standards for SMEs. I am sure that many of you still hold those same concerns.

I would like to provide some background regarding the rationale behind our efforts to create a SME standard and the IASB's intentions regarding its adoption. As users of IFRSs note, the IASB primarily writes IFRSs with listed companies operating in sophisticated capital markets in mind. When the Trustees and the IASB consulted with different interested parties throughout the world, there was an uneasy feeling that the IASB was failing to live up to its obligations as an international organisation. During the Constitution Review, more than 40 participants representing institutions from emerging economies in Asia and Latin America called for the IASB to take into account the special needs of SMEs, and for that reason the Trustees urged the IASB to initiate a project aimed at SMEs.

With this context in mind, the IASB has attempted to draft a simplified, self-contained set of standards that are appropriate for smaller non-listed companies, but still based on full IFRSs. While it is right to state that the IASB considered a company with approximately 50 employees or more as the basis for thinking about SME standards, there are a number of ways a jurisdiction could consider the appropriateness of the SME standards for their particular circumstances. Some countries in the past have used a combination of factors, including revenues, public interest criteria, and employees. The IASB recognises that we do not have and would not claim the authority to define what a SME is, and any jurisdiction that uses the SME standard would need to reach that determination on its own.

In developing the proposal that is published for comment now, the IASB has sought to make modifications based on users' needs and cost-benefit

considerations, using the expertise of a broadly representative working group and external consultations. The proposal organises the requirements by topic to enhance readability, eliminates topics from the full IFRSs that are not relevant for most SMEs, simplifies accounting recognition and measurement, and removes choices for accounting treatment.

The result is a draft standard that is 254 pages, not much more than one-tenth of the size of the full IFRSs. Some may still think that the SME standard is too complex for SMEs and maybe that is the case—the project is very much a work-in-progress. We at the IASB are committed to taking the necessary time to get this standard right, because of the wide-ranging benefits that a SME standard may offer someday. For this reason, the IASB encourages the active participation of the SME community in our comment process. The IASB extended the comment process to six months, and the IASC Foundation authorised the translation of the proposal into French, German, and Spanish to facilitate broad participation. We are interested in learning whether further simplifications are necessary and would encourage you and your constituents to share their views.

It is the IASB's hope to have a workable and broadly accepted standard for SMEs in place by 2009. At the same time, it would be inappropriate for the IASB to prescribe what companies should or should not be able to use the IFRS for SMEs. It must be left to democratically elected bodies at national or European level to decide whether they can find any inspiration in the IFRS for SMEs standard. The IASB is therefore not advocating European-wide adoption. I can report that I recently attended a forum of Asia-Pacific regulators and standard-setters where there is much enthusiasm for the project.

Work to be done

We are at a key juncture in the development of IFRSs. The European Union has played a key leadership role in what is becoming a truly global initiative. Nearly 100 countries and growing are using IFRSs and are working hard to ensure their consistent application. The world's fastest growing emerging economies, China and India, are converging with IFRSs. And we are the verge of major breakthroughs with the United States and Japan.

This is no time for the IASB to rest on its laurels. We are certainly not complacent. The IASB recognises the relevance of its work to the world's economy and the wide range of interests at stake. It is up to us to make sure that we operate in a transparent and accountable manner, engage with and inform the key stakeholders on a timely basis, and develop standards that are of high quality, reflect economic reality, and are broadly respected.

It is understandable that the European Parliament is taking an increasing interest in IFRSs. It is my hope that the IASB will continue to build a constructive relationship with the Committee. I know that the Trustees wish to do the same. We are close to creating a financial reporting infrastructure appropriate for the global modern economy. Let's work together to finish what has been started.

I look forward to hearing your views and answering any questions that you may have.

[1] Tony Tassell, "European bourses eclipse US markets by value," 3 April 2007, FT.com, <http://www.ft.com/cms/s/f10e4dec-e17f-11db-bd73-000b5df10621.html>.

[2] Christopher Cox, Chairman's Address to the SEC Roundtable on International Financial Reporting Standards, Washington, DC, March 6, 2007, <http://www.sec.gov/news/speech/2007/spch030607cc.htm>

[3] Comment Letter from the Investment Management Association, http://www.iasb.org/NR/rdonlyres/B4918CB2-851E-4235-A9C8-D824ACF1C7CC/0/16_227_ED8CL162.pdf.