

IAS Plus Update.

G20: Implications for IFRSs

The leaders of the Group of Twenty (G20), bringing together representatives of 19 of the world's largest national economies plus the European Union, held a summit meeting in London on 2 April 2009. Following this meeting, they issued a communiqué setting out their plans for stimulating the recovery of the global economy. The G20's plans address a wide range of areas including economic stimulus, enhanced regulation of systemically important entities, and strengthened financial systems. The Leaders' Communiqué was supplemented by a Declaration on Strengthening the Financial System (the Declaration), which elaborated on the Communiqué's comments on the financial system, and a number of reports from G20 working groups. In addition, the Financial Stability Forum (FSF) issued documents with specific recommendations on financial reporting issues.

In this newsletter, we focus on issues that affect financial reporting and highlight areas in which the International Accounting Standards Board (IASB) and IASB Foundation (IASCF) Trustees are already active or have announced plans to address the G20's recommendations.

Strengthening the financial system

The G20 leaders called on the IASB and the US Financial Accounting Standards Board (FASB) "to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards".

This is consistent with G20's regulatory reform action plan developed at its November 2008 summit in Washington D.C., which called for not only greater regulatory coordination across national lines but also stated that "[t]he key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard".

The Declaration reiterated the G20's principles of strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets and reinforcing international cooperation. They agreed that the IASB and the FASB should improve standards for the valuation of financial instruments based on their liquidity and investors' holding horizons, while reaffirming the framework of fair value accounting.

The G20 reaffirmed fair value as an appropriate measurement base. However, the call for valuing financial instruments based on the investor's 'holding horizon' may open the door for more items to be measured at amortised cost, provide greater opportunities to use 'business models/management intent' for measurement and result in the moving away from an exit notion for fair value where the investor's intent is to hold the instruments for longer periods or until maturity.

The G20 leaders also welcomed the Financial Stability Forum's recommendations on procyclicality that address accounting issues.

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Recommendations regarding accounting standards

As part of accomplishing the goals outlined in the Leaders' Communiqué, accounting standard setters were asked to take action by the end of 2009 to address the following.

- **Reduce the complexity of accounting standards for financial instruments.**

The IASB has already committed itself to revise IAS 39 *Financial Instruments: Recognition and Measurement* 'in months, not years'. At the IASCF Trustees' meeting on 2 April 2009, the Chairman of the IASB, Sir David Tweedie, promised that proposals to replace existing financial instrument Standards would be published within six months. Key decisions to be made include classification (including the possible elimination of the 'held-to-maturity' and 'available-for-sale' categories), measurement (defining the measurement attributes), impairment loss models (incurred loss model vs. alternative approaches), reclassifications between measurement categories, and use of the fair value option.

- **Strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information.**

The IASB has already committed itself to and has started reviewing alternatives to the current 'incurred loss' model in IAS 39. This analysis will include evaluating an 'expected loss' model and other models such as those commonly referred to as 'dynamic provisioning.'

- **Improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty.**

See above on loan-loss provisioning. The IASB has published an exposure draft (ED 10 *Consolidated Financial Statements*) for public comment. The ED would revise the consolidation guidance under International Financial Reporting Standards (IFRSs) and significantly increase the disclosure requirements for off-balance sheet risk exposures. Also, an exposure draft on derecognition of financial instruments was issued on 31 March 2009 to improve the guidance on derecognition and align it to the proposed consolidation model. On valuation uncertainty, the IASB has announced that it will issue an exposure draft on fair value measurements in April 2009. Further, in October 2008, the IASB Expert Advisory Panel published guidance on measuring and disclosing the fair value of financial instruments in markets that are no longer active. The IASB has also committed itself to look at ways to incorporate some of the Expert Advisory Panel's guidance into existing Standards – some of the guidance has already been included in the recent amendments to IFRS 7 *Financial Instruments: Disclosures*.

- **Achieve clarity and consistency in the application of valuation standards internationally, working with supervisors.**

The report from the IASB Expert Advisory Panel mentioned above can be seen as a first step in this process. Further, by establishing a Monitoring Board for the IASCF, whose members are drawn from financial market regulators, interaction and co-operation by the IASB with supervisors should be enhanced.

- **Make significant progress towards a single set of high quality global accounting standards.**

Both the FASB and the IASB have agreed to converge certain of their standards as part of their Memorandum of Understanding (updated in 2008). The US Securities and Exchange Commission has recently issued a proposed roadmap that provides a timetable for the mandatory use of IFRSs for US public companies, subject to meeting specified milestones. The IASB also works with the Accounting Standards Board of Japan and other national standard setters to pursue the goal of developing a single set of high quality global accounting standards. This goal also forms part of the mission statement of the Monitoring Board for the IASCF.

- **Within the framework of the independent accounting standard-setting process, improve involvement of stakeholders, including prudential regulators and emerging markets, through the IASB's constitutional review.**

The Monitoring Board and the reconstituted Standards Advisory Council (SAC) should improve stakeholders' involvement. The SAC, which is the formal advisory body to the IASB, has been restructured recently and now is made up of individuals from representative organisations that have an interest in standard setting and represent relevant constituencies.

Recommendations by the G20 working groups

After the G20 met in November 2008, it established four working groups to address the G20 action plan. Reports from these groups were published on 2 April 2009. Two of these working groups' reports made recommendations that have an impact on accounting standards and the standard-setting process in general and should be assessed in conjunction with the G20's Leaders' Communiqué and Declaration:

- Working Group 1 (WG1): Enhancing Sound Regulation and Strengthening Transparency; and
- Working Group 2 (WG2): Reinforcing International Cooperation and Promoting Integrity in Financial Markets.

WG1 recommendations

WG1 recommended that accounting standard setters should **strengthen accounting regulation of loan loss provisions** by considering alternative approaches to recognising and measuring loan losses that incorporate a broader range of available credit information (recommendation 13). It further called for an examination of potential changes to the relevant Standards to dampen adverse dynamics as a result of fair value accounting. This would include revisiting the measurement guidance when 'data or modelling is weak'. The accounting standard setters are prompted to work together with the Basel Committee on Banking Supervision (BCBS).

The IASB is already working on this issue (see above). It was apparent from the IASCF Trustees' meeting in April 2009 that there is support for improving the presentation of any additional regulatory provisions effected through reserve appropriation rather than recognition in comprehensive income.

Further, WG1 recommended accelerating work on **reducing complexity in accounting for financial instruments and enhancing presentation standards** to enable users to better understand the uncertainties surrounding the valuation of financial instruments (recommendation 22).

This will be addressed in the IASB's efforts to replace IAS 39 where proposals are expected at the end of the third quarter 2009. The IASB also has a project on its agenda that addresses presentation of financial statements; the proposals were set out in a discussion paper issued in October 2008.

Another recommendation by WG1 is the increase in efforts to **facilitate global convergence of accounting standards** (recommendation 23). This should be supported 'by sharing the experience of countries that have completed this process and by providing technical assistance.'

While the IASB generally does not provide technical support, its due process caters for a post-implementation review of new Standards, which could pick up potential application issues that have arisen in practice.

In addition, WG1 calls for standard setters to work with prudential supervisors to identify ways to address both **financial sector stability and transparency in financial reporting**.

WG1 further notes that the IASB has indicated that it will analyse whether the accounting treatment for movements in exchange rates leads to excessive fluctuations in financial results in periods of high volatility of exchange rates.

WG2 recommendations

WG2 welcomed the recent decisions of the IASCF Trustees to **improve the accountability, governance and legitimacy of the IASB**, particularly the formation of the Monitoring Board that monitors and reinforces the public interest oversight function of the IASCF. However, it calls for complementary measures to **enhance further government arrangements**, including expansion of membership and increased representation of a broader range of stakeholder groups and interest. It also recommends **more regular meetings** between global accounting standard setters, including FASB and IASB.

Recommendations by the Financial Stability Forum

The Financial Stability Forum (FSF), to be expanded and renamed the Financial Stability Board, also issued three reports on 2 April 2009. The reports address principles for sound compensation practices, principles for cross-border cooperation on crisis management and recommendation on procyclicality. The latter report contains recommendations by the FSF on financial reporting. These recommendations are largely consistent with those made by the G20.

The FASB and the IASB are called to issue a statement reiterating that existing standards require the **use of judgement to determine impairments** under the 'incurred loss' model as the report concluded that this has not always been the case in practice. In the view of the FSF, such a statement by the standard setters would help improve practice in application of the standards, lessen the procyclicality and enhance consistency of the information provided.

The FSF also recommends reconsidering the 'incurred loss' model and analyse **alternative approaches** for recognising and measuring loan losses. The creation of a 'resource group' by both the FASB and the IASB to provide technical input and accelerate the process is proposed.

The report also recommends that the standard setters and supervisors look into ways to use **valuation reserves or adjustments** for financial instruments carried at fair value when the data or models used in the valuation process are 'weak'. In the view of the FSF, this would avoid overstatement of income where there is significant uncertainty about valuation (e.g. for instruments not traded in active markets). The adjustments/reserves could be based on the degree of uncertainty surrounding the valuation process. Finally, the FSF calls standard setters and prudential supervisors to examine other possible changes to accounting standards to dampen adverse dynamics potentially associated with fair value accounting and their implications on capital measures. It identifies three areas where changes could help meeting this objective:

- use of fair value accounting for financial instruments of credit intermediaries;
- transfers between financial asset categories (reclassifications); and
- simplifying hedge accounting.

Key resources referred to in this IAS Plus newsletter

G20 Leaders' Statement *The Global Plan for Recovery and Reform*.

G20 Declaration on Strengthening the Financial System.

G20 Progress Report on the Actions of the Washington Action Plan.

G20 Working Group 1 Report: *Enhancing sound regulation and strengthening transparency*.

G20 Working Group 2 Report: *Reinforcing international cooperation and promoting integrity in financial markets*.

FSF Addressing Procyclicality in the Financial System.

IASB: *IASB Responds to G20 Recommendations* (Press Release 7 April 2009).

IASB: IASB response to the global financial crisis.

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