

# IFRS news

Emerging issues and practical guidance\*

Supplement – June 2010

## IASB member reflects on the big issues at the Board

We are now in the middle of 2010, an important time in the IASB project timetable. In this article, IASB Board member Philippe Danjou gives a personal view of recent major developments at the IASB.

Significant developments took place in 2009 and early 2010: the Board has made great progress towards realising a globally accepted, high-quality set of financial reporting standards, and towards the completion of the technical changes sought by the G20 leaders in response to the lessons drawn from the financial crisis.

I believe that the smooth functioning of global financial markets requires the use – by all major entities, particularly financial institutions – of identical accounting standards; in addition, the simplification of certain standards inherited from the IASC is considered desirable by many users. Furthermore, the work of the IASB, as the body charged with developing the international accounting standards, goes hand in hand with the institutional reforms needed in this new environment.

I outline the most significant issues below.

### Reform of IASB governance

- The Monitoring Board, which represents the international market regulators (IOSCO, SEC and Japan's FSA) and recently joined by the European Commission, has begun its assignment to ensure that the IASCF Foundation is working in the public interest. A first report has been published.
- A new Constitution has been adopted by the Trustees, which plans to increase the number of Board members to 16 by 2011, including a balanced geographical distribution and a reduction in the length of their second term from five to three years; the gradual replacement of Board members shows an increasing emphasis on representing users and financial regulators.
- The reformed Constitution also requires public consultation before projects are added the Board's work programme. This will take place for the first time in the second half of 2010, for post-2011 guidance.
- The Board has significantly increased its engagement with the authorities responsible

for financial stability: for example, participating in the work of the Financial Stability Council and interacting with the Basel Committee on developing financial instruments standards. In addition, the Board is increasing its efforts to consult all stakeholders – in particular, its Advisory Council, whose role has been strengthened by the Trustees and membership renewal – as well as making more systematic use of ad hoc working groups and roundtables in different regions of the world.

### ‘Second wave’ of IFRS adoption by different jurisdictions

The convergence of global standards has accelerated in 2009-2010 with the emergence of a ‘second wave’. Real momentum has begun, which seems irreversible. For example:

- A reform programme in June 2009 targeting the complete adoption of standards by Japan. This year selected international, listed companies are able to prepare their financial statements using IFRS instead of Japanese standards; also in Japan, the end of the optional use of US GAAP is scheduled for 2015.
- Brazil’s adoption of IFRS from 2010;
- Argentina, Canada, India, Indonesia, South Korea, Malaysia, Mexico and Singapore, to name only the most significant countries, to join the IFRS community in the next two years;
- The SEC’s publication in February 2010 of a statement confirming its long-term plan, having accepted in 2007 IFRS financial statements for FPIs. This will lead the SEC to make a decision in 2011 on the integration of IFRS into the system of US company reporting. Many observers feel that the US will not be able to remain separate from the OECD countries that have adopted IFRS; and US investors are increasingly familiar with the accounts published under IFRS by major global companies. Thirty-eight per cent of companies in the ‘Fortune Global 500’ report under IFRS, and this proportion is expected to exceed 50% within two years;
- IFRS for SMEs, published in its final form mid-2009, already adopted in 30 jurisdictions. The European Commission has launched a consultation among Member States suggesting the use of the IFRS for SMEs for the modernisation of accounting directives and/or to permit the optional use of the IFRS for SMEs.

### Priority to G20 financial crisis reforms and to US convergence projects

Since 2008, the Board has adopted a clear agenda and an ambitious schedule to simplify financial instruments standards and to clarify fundamental principles. The financial crisis has underlined the need for this programme, without highlighting any loopholes or essential weaknesses in the current IFRS.

Achieving the aim of convergence with US standards in 2011 and meeting the G20 leaders’ timetable requires a countdown to the publication of proposed standards (exposure drafts). This allows interested parties enough time to comment on the

proposals, and IASB’s staff and board members will be able to study the responses and possibly ask commentators to expand on particular points. Finally, the Board will be able to deliberate in public sessions on the amendments to initial proposals, while still being able to publish the amended proposals for comment, according to the criteria in the ‘Due Process Handbook’. It is because of this process that the majority of the proposals are expected to be published by mid-2010, as completion of the final standards is scheduled for 2011.

The main topics covered by the current programme are outlined below.

### Comprehensive reform of IAS 39

IAS 39 was first published by our predecessor, the IASC, in 1999. Because of the needs of ever-changing markets, the current standard is the result of a succession of revisions (some might say ‘patches’), clarifications and interpretations; but it has never been revisited in its entirety. The founding principles have receded, and the users of financial statements have indicated that the standard has become difficult to apply and understand.

In March 2008, the IASB and FASB published a joint Discussion Paper for public comment, exploring the possible ways of simplification – including the controversial idea of a ‘full fair value’ model, whereby all financial instruments packages are valued at fair value, with their counterparts in profit or loss. Based on the feedback received from the constituents, the IASB’s thinking then returned to a ‘mixed model’ approach, combining fair value measurement with amortised historical cost, which aligns better with the management of the relevant assets (a business model notion).

In a vote in May 2009, which I would personally call historic, the Board decided by a clear majority that full fair value was not desirable or feasible. A mixed model, supplemented by disclosures of instruments’ fair value in an appendix, would be likely to provide more relevant information for understanding future cash flows. The introduction of the concept of the ‘business model’ as the first distinguishing criteria for the classification of instruments has been widely welcomed: many commentators indicated that this approach struck the right balance between the different opinions. I hope that the consultation by the FASB will lead to the same conclusions and that convergence of these standards based on identical premises will be possible. This overall revision has been considered and endorsed by the high-level experts panel (Financial Crisis Advisory Group), created in the third quarter 2008 to assist the Board and the FASB in considering desirable outcomes.

Considering on the one hand the magnitude and complexity of the topics to be covered, and on the other hand the public authorities’ clear desire to see quick reform of the classification and measurement of financial assets – one of the main topics highlighted by the crisis – the Board split the project into three phases.

These follow on logically:

- The classification and measurement of financial instruments (Phase I);
- The risk of loss provisioning for those instruments that are not measured at fair value (Phase II); and
- Hedge accounting (Phase III).

The first phase of the project was completed on time in November 2009 with the publication of IFRS 9 on the classification and measurement of financial assets. This was supplemented in May 2010 with the publication of proposals for financial liabilities, which would solve the difficult issue of own credit risk in the fair value measurement of financial liabilities.

Regarding Phase II, proposals aimed at making credit risk provisioning less cyclical (the ‘expected credit losses’ approach) and aligning impairment methods to different instruments were published in November 2009. An inter-professional working group has been formed to study the implementation practicalities. The consultation period ends at the end of this month and a final standard should be out by the end of 2010.

The improvement of the principles and methods for hedge accounting has begun, including close consultation with companies.

Finally, the Board has undertaken studies into the conditions for derecognition of financial assets and liabilities (securitisation, repo transactions, defeasance, etc).

All these projects closely involve accounting experts from the Basel Committee, the market authorities, users, preparers and other stakeholders.

#### **IAS 27 and SIC 12 on consolidation – ED 10**

Without questioning the consolidation model based on the control concept, the issue is to specify how the risks and rewards approach – which is useful for analysing who controls a special purpose entity – can be combined with the general approach. The FASB will use this exposure draft as a basis for its consultation.

#### **Realisation of other convergence projects gets support from Pittsburgh G20 summit**

The G20 leaders would like most of the convergence work to be completed by mid-2011. The Board and the FASB have decided to double their efforts to achieve this.

Following the joint meeting held in the third quarter last year, the joint work programme contained in the 2006 Memorandum of Understanding (MoU) has been confirmed and an updated programme has been published in November 2009; it is more restrictive in terms of timing and work procedures. Since that date, a joint meeting of the Boards has been held every month, supplemented as necessary by interim meetings. The most important subjects contained in the MoU relate to financial instruments (see above), accounting for lease contracts, post-

employment benefits, debt and equity classification, revenue recognition and financial statement presentation. A consistent definition of fair value-related concepts is also planned to fully align the IASB guidance and FAS 157.

#### **Insurance contracts and non-financial liabilities (IAS 37)**

The insurance contracts project is led by the IASB; an exposure draft should be published in the third quarter 2010. The FASB participates in discussions but has not yet decided whether to launch a consultation.

There has been notable dissent at the Board over the IAS 37 revision project. There has also been a general rejection of proposals published in 2005 and completed in 2009. It has therefore been decided not to hurry the conclusion of these debates.

#### **Conceptual framework**

Plans for modernisation of the conceptual framework, conducted jointly with the FASB, continue but at a rate that some would prefer to see accelerated.

#### **Adapting the programme?**

The intensity of this programme obviously raises many issues, such as:

- A need for active participation in our consultations, given the abundance of proposals;
- The adaptation of systems and accounting processes for companies under IFRS;
- The impact on the users of financial statements.

Some have mentioned a new ‘IFRS big bang’ in 2011. The IASB is aware of this and has decided that standards issued in 2010 will not be mandatory before 2012; and standards issued in 2011 will not be mandatory before 2013. The effective dates will also be coordinated as needed. In future, the effective dates will be twice a year: 1 January or 1 July. Finally, a study has been launched on how to simplify transition to IFRS.

Of course, the schedule is not fixed, and the two Boards should periodically re-evaluate its feasibility. A joint study with the FASB is under way to determine the relative priorities of different projects and the logical links between them, and to optimise the scheduling of publications, taking into account the constraints mentioned above. A joint press release at the end of last month announced that modifications to the previously agreed timetable of publications will be discussed with the Trustees and the Monitoring Board. Progress and changes in plan are assessed in a quarterly report published by both bodies, and the next quarterly report is about to be published.

After almost 10 years of sustained effort, the IASB has made decisive progress towards the ambitious goal formulated by its proponents – namely, creating a set of high-level international financial reporting standards, adopted by all companies for the public benefit.