

STATEMENT OF SIR DAVID TWEEDIE  
CHAIRMAN, INTERNATIONAL ACCOUNTING STANDARDS BOARD,  
BEFORE THE  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
OF THE  
UNITED STATES SENATE

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Mr Chairman and Members of the Committee:

I have been asked to appear here today in my role as Chairman of the International Accounting Standards Board (IASB). This is my second appearance before this Committee, the previous occasion being in February 2002, and I wanted to use this opportunity to give you an update on the work of the IASB and, particularly, its joint effort with the US Financial Accounting Standards Board (FASB) to bring about international convergence of accounting standards.

When I last appeared before the Committee, you were considering a legislative response to Enron's collapse and other corporate scandals. Let me say that I believe the work spearheaded by the Committee and the many others involved with the creation of the Sarbanes-Oxley Act has served as a catalyst for positive change in accounting and financial reporting throughout the world. Many other countries have undertaken similar reforms, and in Europe and elsewhere many of the principles of the Sarbanes-Oxley Act have been adopted. At the same time, differences will inevitably arise between US and other national and international audit standards. I would suggest that the model for convergence being used by the IASB and the Financial Accounting Standards Board (FASB) might provide a

useful framework for the convergence of audit standards worldwide. I will leave it to Paul Boyle to discuss the specific reforms undertaken by the United Kingdom.

The effective functioning of capital markets is essential to our economic well-being. In my view, a sound financial reporting infrastructure must be built on four pillars: (1) accounting standards that are consistent, comprehensive, and based on clear principles to enable financial reports to reflect underlying economic reality; (2) effective corporate governance practices, including a requirement for strong internal controls, that implement the accounting standards; (3) auditing practices that give confidence to the outside world that an entity is faithfully reflecting its economic performance and financial position; and (4) an enforcement or oversight mechanism that ensures that the principles as laid out by the accounting and auditing standards are followed. The Sarbanes-Oxley Act refocused attention on these pillars and provided many useful approaches to improve the financial reporting environment.

As to the first of the four pillars that I mentioned—accounting standards—much has been accomplished both internationally and in the United States during the past two years. Today, I wish to focus on two significant developments in the standard-setting world that are, I believe, of immense significance. First, there has been a growing acceptance of international accounting standards throughout the world. Second, the effort to bring about convergence between International Financial Reporting Standards (IFRSs), as developed by the IASB, and US generally accepted accounting principles (US GAAP), as developed by the Financial Accounting Standards Board (FASB), has gathered pace. I will come back to convergence shortly.

## **The logic of international accounting standards**

As the world's capital markets integrate, the logic of a single set of accounting standards is evident. A single set of international standards will enhance comparability of financial information and should make the allocation of capital across borders more efficient. The development and acceptance of international standards should also reduce compliance costs for corporations and improve consistency in audit quality.

During the past two years, many countries have agreed to adopt IFRSs for publicly traded companies by either 1 January 2005 or 1 January 2007. As widely reported in the press, the European Union has adopted a regulation that will require publicly traded companies to apply IFRSs beginning next year. It is expected that in addition to the more than 7,000 publicly traded companies in Europe, hundreds of thousands of unlisted companies will choose to adopt IFRSs as well, depending upon different national rules.

The momentum in favour of adopting international standards is not limited to the European Union. Recently, Australia, New Zealand and Russia followed the EU's lead in requiring IFRSs. A Deloitte & Touche survey now estimates that 92 countries will either require or permit the use of IFRSs for public accounts of traded companies by January 2005. Additionally, many other countries, such as China and many of the ASEAN countries, have a policy of seeking convergence of national standards with IFRSs.

## **Convergence efforts with the United States**

As I mentioned earlier, the IASB and the FASB have made much progress on convergence of IFRSs and US GAAP during the past two years. I should also say that we

have received strong support from the US Securities and Exchange Commission (SEC) and the European Commission for this initiative, as well as from the corporate community throughout the world.

Our convergence drive began formally after the first FASB-IASB joint meeting in September 2002. At that meeting, in a decision later formalised by a memorandum of understanding now known as the ‘Norwalk Agreement’, the two boards agreed to try to eliminate the differences between their existing standards in the near term and to work together on long-term projects to ensure that the principles behind, if not the wording of, new standards will be the same.

The boards’ shared philosophy on convergence is clear. Our goal is to develop a single set of **high quality** accounting standards that can be used internationally. This is not convergence for convergence’s sake, but an attempt to improve the consistency and quality of financial reporting worldwide. I have already mentioned the potential benefits for global capital markets. More narrowly in the United States, as my colleague Bob Herz, Chairman of the FASB, often says, this is an opportunity to “kill three birds with one stone” by:

- improving US reporting
- simplifying US standards and standard-setting; and
- offering US market participants the benefits of international convergence.

I want to give you some examples of the depth of co-operation under way between our two boards. We have a full-time IASB board member who maintains an office at the FASB and participates in their deliberations. The boards meet jointly twice a year. We

have video links between each other's meetings, so Board and staff members can participate in and observe the other's discussions. We have established joint staffing teams to work on several major projects.

Though there are doubters on both sides of the Atlantic, convergence really has been and will continue to be a two-way process in an effort to build a set of standards that are truly 'best of breed'. Both boards have shown their commitment to change towards the better answer and to accept the input of other national standard-setters when neither US GAAP nor existing IFRSs have a high quality solution. The IASB has brought many international standards into line with US GAAP through the IASB's Improvements project and its standards on business combinations (which eliminated the pooling method and the amortisation of goodwill) and non-current assets held for sale and discontinued operations.

The FASB has already published four Exposure Drafts related to our short-term convergence project and it is expected to finalise those proposals as Standards in the coming months. As the Committee knows, the FASB has also proposed bringing the US requirements on accounting for stock options into line with the international standard.

Other major projects on which we are working together include revenue recognition, performance reporting, and other business combination issues. We are also committed to keeping our work programmes aligned to ensure that differences do not arise in the long-term once the short-term convergence objective is achieved.

Without putting a specific date on convergence, both the IASB and the FASB hope that the major differences between US GAAP and IFRSs will be eliminated in the next few

years. Of course, the elimination of these differences will increase pressure on the SEC to remove the reconciliation requirement for non-US listed companies. That is a matter for the SEC and not standard-setters. The point is that if we do our job and eliminate the differences, the main reason for demanding a reconciliation will no longer exist.

### **Potential impediments to success**

All of this provides grounds for optimism about the prospects for convergence and improved financial reporting. However, both the IASB and the FASB face serious challenges. Some of these challenges are intellectual. The standard-setting bodies are tackling difficult conceptual issues, on which there is little or no consensus. Some of the more challenging topics already on the IASB's agenda include insurance accounting, leasing, pensions and financial instruments—to name a few. Reaching a common international standard on such topics will not be easy, because we are all starting from different points with different national practices and cultural backgrounds. What is incumbent upon the IASB, the FASB, and other bodies concerned with standard-setting is to set up a process that engages the interests involved and evaluates the many options in an even-handed manner.

We also must overcome resistance to change in general. Both the FASB and the IASB recognise that in the aftermath of Enron and the adoption of new accounting standards corporate preparers and auditors have come through a turbulent period. It is our responsibility to help manage the timing of new requirements. At the same time, market participants should recognise the general public good, and the potential long-term

economic benefits, that will flow from promoting common financial reporting rules for the world's capital markets. I am not underestimating the challenge here.

Convergence with an international approach will inevitably raise the questions of rules versus principles in the United States. I note that both the SEC and the FASB have already done some excellent research of the possibilities and consequences of adopting a more principle-based approach. Internationally there is a clear desire to maintain a more principle-based approach to accounting. In the United States, I sense a similar desire to reduce the complexity and sheer volume of accounting literature. That will not be easy and may take time to evolve, but I believe the benefits of such an approach will help reduce the complexity of US standards and improve accounting in general. Of course, the issue is not black-and-white, and there will always be a need for some explanatory guidance for the principles. But in promoting international convergence, we are determined to focus on crafting principles that are sufficiently clear to make detailed rules unnecessary.

Lastly, if convergence is to succeed, we must resist attempts to reject standards through political processes rather than the standard-setting process when local or regional interests perceive adverse consequences in particular standards. I am not dismissing the right of national authorities and legislatures to examine the standards and the need for effective oversight of standard-setting boards. What I am saying is that if political pressures in a national or regional context are able to overrule standards that have been developed in a deliberate and open manner, then it may lead to a system of "beggar thy neighbour" which will not produce the consistency and quality of accounting standards that the world's markets demand.

The standard-setting process, both in the United States and internationally, has carefully constructed mechanisms aimed at assuring both the independence of the technical board and sufficient due process including public consultation and transparent decision-making. At the IASB, we have a body of Trustees, chaired by Paul Volcker, which has responsibility for oversight and ensuring that the IASB is working in the public interest. The role of the Trustees is also to protect the independence of the decision-making process of the IASB, on the basis that neutral and fair accounting standards, set independently, are in the best interest of investors.

As Mr Volcker recently testified to another Senate committee, “The net result of politicized national decisions would be to weaken, perhaps irreparably, one of the foundation stones of effective accounting practices in a rapidly globalizing world economy.” I believe that allowing such a situation to occur would be to waste a real, and possibly a once in a generation, opportunity to develop truly global high quality accounting standards.

Thank you for your continued support of independent standard-setting and international convergence. I would welcome your questions.