

**Prepared Statement of Sir David Tweedie,
Chairman of the International Accounting Standards Board,
to the meeting of the COUNCIL OF THE EUROPEAN UNION
(Economic and Financial Affairs)**

16 March 2010

I greatly appreciate the opportunity to appear before the ECOFIN Council again and thank the Spanish Presidency for the invitation. At the request of the Spanish Presidency, I will report on the progress that the IASB has made in achieving the 2011 convergence target set out by the G20, and issues related to the financial crisis raised by the G20 and the European Union.

At the September 2009 Pittsburgh summit, the G20 leaders stated, “We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011. The International Accounting Standards Board’s (IASB) institutional framework should further enhance the involvement of various stakeholders.” We have made significant progress on both requests.

Progress on convergence

As you know, since 2002, the IASB and the US Financial Accounting Standards Board (FASB) have worked closely to bring about convergence of and improvements to accounting standards. In September 2008, we updated our 2006 Memorandum of Understanding and established a 2011 target date for completion of our ongoing joint work. Since agreeing that target, we have worked vigorously towards that goal. At the same time, the G20 Leaders’ Statement in September 2009 was an important reminder of the need to fulfil our commitments. We welcomed that reminder and support for convergence.

Following that reminder, on 5 November the two boards issued a joint statement reaffirming our commitment to convergence in financial reporting and the June 2011 date emphasised by the G20 Leaders. In our statement we laid out specific updated and enhanced plans to complete our convergence work. This work addresses major subjects, such as consolidations, securitisations, pensions, leases and revenue recognition. Mindful of our public accountability requirements, the IASB and the FASB will report quarterly on our public website. We are working closely with our respective Trustee oversight bodies to remove any impediments to success. They have set up liaison arrangements to support jointly our work. In our soon to be published report, the Boards will state that despite the challenging technical issues to resolve, we remain on schedule to achieve the June 2011 target.

As an example of the recently intensified activity between the two Boards, we are now meeting together every month and have had more than 100 hours of joint meetings since the November statement. In March, the boards are meeting jointly for three consecutive afternoons by video, and then for three consecutive days in person in London the following week. These intensive discussions are achieving positive results. We plan to publish seven joint proposals in the next quarter. The Boards individually will also propose other changes to bring their own standards in line with each other.

We at the IASB believe that completion of this work programme is important to promote and facilitate the adoption of IFRSs on a global basis, as asked for by G20 leaders. This is particularly the case with the United States. As you know, the US Securities and Exchange Commission (SEC) recently reaffirmed the US commitment to make a decision in 2011 to adopt IFRSs by 2015 or 2016. The SEC emphasised the importance of convergence in improving financial reporting and reducing the cost of the transition to IFRSs. The IASB will do its part to ensure that IFRS is accepted globally. It is already used in more than 115 countries.

The relevance of the joint work with the FASB has broader global significance. Beginning this year and going through the year 2012, we are witnessing the second major wave of IFRS adoption. Brazil, India, Korea, Canada, Japan, Malaysia, Mexico, Argentina, and Indonesia, to name a few, are in the process of IFRS adoption. We do not want IFRSs to be a constantly moving target. By completing our convergence work in 2011, the IASB will provide a period of stability of accounting standards for newly adopting countries, similar to the “stable platform” given to European companies and investors between 2004 and 2009.

Enhanced stakeholder engagement in our work and agenda-setting

Before turning to our work on financial instruments, I want to explain how we have responded to the calls of the G20 and this Council to improve our stakeholder engagement. As I reported previously, assisted by the Financial Stability Board, we established an enhanced technical dialogue with prudential supervisors and other market regulators. We have also intensified our interaction with prudential supervisors through the Basel Committee and other bilateral contacts.

More generally, the IASB has stepped up its efforts to engage a broader range of interested parties in the early stages of standard development. Our consultation on IFRS 9 is an example of this effort. We held more than 100 meetings with investors, prudential supervisors, capital market authorities and other stakeholders in Europe and elsewhere to discuss the possible impact of our proposals. We hosted round tables in Asia, Europe and the United States. To consider the views of interested parties, we have held additional board meetings and education sessions.

We expect that the intensity of interaction with stakeholders will remain the norm in the future. This level of consultation will extend not only for the ongoing technical work underway but also to the IASB’s agenda-setting. After public consultation, the Trustees who oversee the IASB now require us to undertake public consultation on our work programme on a regular basis. We are now working with our Advisory Council on preparing for such a consultation on our “post-2011” agenda that will begin later this year.

IFRS 9 and addressing European concerns on classification

When I was here last, the IASB was nearly ready to publish its standard on the classification and measurement of financial instruments, IFRS 9 *Financial Instruments*. On 12 November, we published that standard.

In accelerating the completion of that phase of the project, we were responding to the request, expressed most strongly in Europe generally and by this body, that the new standard should be available for 2009 financial statements. The new standard on classification and measurement also addresses the call of the G20 Leaders to ‘reduce the complexity of accounting standards for financial instruments’.

A number of countries, including Japan, Brazil, China (including Hong Kong), South Africa, and Australia, have taken steps to permit or even require the use of the new IFRS 9. Similarly, EU stakeholder groups, including some major banking institutions in Europe, organisations representing the investment community across Europe and elsewhere, and national standard-setters, have called for the endorsement of IFRS 9.

At the same time, the IASB understands that, despite the earlier request for speed in completing this phase of the project, the European Commission now wishes to follow the normal endorsement procedure for IFRS 9. We also recognise that you wish to understand better how the remaining phases of the project that address liabilities, provisions and hedging fit with the first phase of the IAS 39 reform.

We also know that a number of EU policymakers, including the European Commission, the European Central Bank, and members of the Basel Committee, have raised issues regarding specific elements of the new standard. I would like to address some of the issues that have been raised subsequent to the consultation on and the publication of IFRS 9.

First, some have expressed the concern that IFRS 9 will result in an increase in the use of fair value. The IASB did not seek to increase or decrease the use of fair value accounting when overhauling the accounting for financial instruments. Our aim was to find the right balance and establish appropriate criteria for determining whether to use cost or fair value. The decision depends upon whether cost or fair value provides the most useful information about likely future cash flows. This is consistent with the business model approach advocated by the European Commission and the Basel Committee.

Except in the narrow circumstances agreed previously with the ECB where the fair value option is selected by the institution, cost based measurement is required when a financial asset has predictable cash flows and if the objective of the holder is to collect principal and interest over the life of the asset rather than to collect cash proceeds from sale. For a traditional bank, being one that takes deposits and lends money to customers that it holds to collect principal and interest, we expect IFRS 9 to result in fewer rather than more items being measured at fair value.

Those concerned about the “expansion” of fair value seem to be concerned primarily about the potential treatment of financial liabilities. At the suggestion of the European Commission and EU stakeholders, we removed the treatment of liabilities from IFRS 9. I can tell you that the decisions that the IASB has made to date for financial liabilities post the publication of IFRS 9 in fact would *not* result in an increase in the use of fair value in the measurement of financial liabilities.

Second, and related to concern about financial liabilities, EU institutions have raised concerns regarding our decision to prohibit the bifurcation of certain embedded derivatives on the asset side of the balance sheet. We did so with the support of the great majority of stakeholders, who viewed the bifurcation as unduly costly and complex.

We also know that if we made the same decision on the liability side, it may increase the use of fair value, particularly as it relates to deposit instruments. In February, the IASB voted unanimously to retain the bifurcation of embedded derivatives for liabilities. The IASB also did this to address the contentious issue of the effects of changes in a company's own credit standing.

Third, the new standard does not allow for recycling of realised gains and losses relating to strategic investments when an entity chooses to recognise changes in fair value in Other Comprehensive Income. Both the ECB and the Basel Committee would have preferred the IASB to permit these gains and losses to be recycled to the profit and loss account.

We decided not to allow recycling for two main reasons. First, recycling distorts current year profits. If you have held an investment for 30 years, is it right to recognise a one-off gain in year 30 just because the investment has been sold at that time? Economically the gain was amassed over the 30 year period. Secondly, this approach would have meant that we needed to reintroduce the concept of impairment for equity investments. Problems with recycling and impairment accounting under IAS 39 were the catalyst for the IASB's overhauling accounting for financial instruments on an expedited basis.

Fourth, the ECB and the Basel Committee have called for further guidance for our reclassification requirement. In response, the IASB will monitor the need for further guidance supporting the reclassification requirement.

Finally, we appreciate the concern of this Council and other stakeholders internationally that we and the FASB may arrive at different conclusions when financial instruments should be measured at fair value. Both the FASB and the IASB have agreed common principles to help us to achieve a common standard. That is our objective. At the same time, the IASB is conscious of the strongly held view of investors and other stakeholders internationally that a combination of cost-based and fair-value accounting remains appropriate for financial instruments.

Next steps on financial instruments reform

The publication of IFRS 9 marked the completion of the first phase of our IAS 39 reform. We are now tackling the important issues of provisions and hedging, as well as financial liabilities to which I alluded before.

In particular, we are committed to pursuing a more forward looking provisioning model. In November 2009, the IASB published a discussion document for an expected cash flow approach for provisions.

We know that we have not completed our work on provisioning. In issuing our proposals, we stressed the need to gather further input on issues regarding complexity, cost, and operationality, as we seek to develop a workable expected loss model. We have established an Expert Advisory Panel, comprising the relevant regulatory and practical expertise, to ensure operational issues are addressed. We expect these consultations to lead to a final standard for provisions by the end of the year.

We recognise that in addition to an improved expected loss model, prudential supervisors may seek more discretion to have banks hold back more capital for unexpected losses. It is for this reason that the IASB is discussing the possibility of providing regulators with additional information to meet their prudential objectives—without compromising transparency. Specifically, we have suggested to the Basel Accounting Task Force that an additional Regulatory Income Statement could be required. The exact content would be agreed between the IASB and prudential regulators. The statement adjusts reported Net Profit after Tax for items relevant to regulators.

Within such a statement it would be possible to include a ‘through the cycle provision’ for regulated entities. Such a ‘provision’ could be used by prudential regulators to ensure a counter cyclical approach by making regulated entities build up an undistributable capital reserve during the good times to be used during the bad times. Similarly, adjustments could be made to remove gains resulting from modelled estimates (the level three gains) from regulatory income.

Providing such a statement would enable us to meet our primary objective of providing transparency to a wide range of users of financial statements (as reflected in Net Profit after Tax). At the same time, we recognise the needs of regulators and thus the statement would provide them with information that they require to meet their financial stability objectives. Prudential supervisors could use this statement as a basis for imposing relevant restrictions on distributions or compensation.

The IASB is also working to publish a hedging proposal in the middle of this year. Our objective is to establish a more principles-based approach that better reflects the economics of hedging transactions. To reflect the views of stakeholders in the proposals, IASB members and staff have undertaken numerous outreach visits with financial institutions, non-financial companies, and other interested parties. We are now working to ensure issues identified are addressed to the fullest extent possible.

Finally, we are addressing a number of other issues related to financial instrument accounting that the G20, this Council, the Financial Stability Board, and the Basel Committee have raised. These include the recognition of gains and losses on changes in own credit risk and netting of derivative positions. On own credit, we are working to eliminate any gains or losses associated with changes in own credit from net income, unless they result from trading activities and can be monetised. On netting, we have begun discussing this issue with the FASB with a view to harmonising accounting requirements.

We at the IASB fully recognise the importance that the G20 and the European Union have placed on our work to achieve common global standards and reform financial reporting where necessary. I trust that my report demonstrates that the IASB is engaging fully with all the issues raised and is on track to achieve resolution in the timeframe set.

The European Union has been the catalyst for the effort to adopt IFRSs globally. With more than 115 countries committed to IFRS and nearly all G20 members on their way to full IFRS adoption, your support for the IASB’s work as an independent but publicly accountable standard-setter is greatly appreciated.

I look forward to answering any questions that you have.