IFRS

IASB® Speech

Current SEC and PCAOB developments

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Introduction

This is the largest gathering of accounting professionals I have addressed since becoming Chair of the IASB earlier this year. The number of people in the audience and watching via video link demonstrates the deep commitment of this country to reliable financial reporting.

Let me begin by taking a few minutes to introduce myself and to describe how I came to this important role.

I have spent the majority of my professional life serving the public interest. As a Minister of Health and Minister of Finance in The Netherlands I served in administrations that concentrated on trimming the bloated Dutch welfare state. My colleagues and I got a lot done and the Dutch government is now one of the few remaining triple-A rated countries in Europe.

In 2007, I left politics and went to chair the Authority for the Financial Markets – the Dutch equivalent of the US Securities and Exchange Commission (SEC). I thought I was entering the relatively ‘rational’ world of finance.

I could not have imagined what lay ahead! Whatever innocence I had left after a decade in politics, I lost very soon.

Shortly after the financial crisis began, I was asked to join Harvey Goldschmid, who is well known to many in the room for his time at the SEC, to co-chair a Financial Crisis Advisory Group.

The group was formed to advise the IASB and FASB on their joint response to the financial crisis. Through the traumatic experience of this crisis, I became convinced more than ever that the best protection available to investors is transparency. Indeed, without transparency there cannot be enduring stability.

For these reasons, I was honoured and deeply motivated to become Chairman of the IASB.

My background gives me a passion for the goals of the IASB: to develop and sustain, first and foremost for investors, a single set of globally accepted and high quality accounting standards. These standards must be set independently and then consistently applied and enforced.

These goals may sound familiar. They are almost identical to those of the FASB. When the IASB was established in 2001, our structures and governance were largely modelled on the FASB.

We are a private sector, independent body. Our mission is clear and investor focused. We have three tiers to our governance structure. A thorough and transparent due process is at the heart of our work. These principles, enshrined in the Financial Accounting Foundation (FAF) and the FASB, are deeply embedded in our processes and standards.

I cannot overstate the important role that the United States has had on our operations. The SEC was a key player in establishing the framework that set up the IASB back in 2001. Paul Volcker was the first Chairman of the Trustees.

The Norwalk Agreement of 2002 committed the IASB and FASB to convergence. Bob Herz, a member of the IASB, became Chair of the FASB.

The US is represented by four IASB Board members and five US Trustees. Mary Schapiro represents the SEC as one of five public capital market authorities comprising the Monitoring Board.

When I was elected Chair of the IASB, I said that I have investor protection in my DNA. Clearly, the US is in the DNA of the IASB.

The Case for Global Standards

High quality financial reporting standards are essential for transparency and for the efficient functioning of capital markets.

When the FASB was founded back in 1973, capital markets looked much different than they are today. Market participants on either side of a transaction were mainly located in the same jurisdiction. Investors and preparers could speak the same financial reporting language.

Since then, and especially in the last 20 years, the world's capital markets have integrated and become more interdependent. US investors seek investment returns and diversify risk on an international basis. US companies seek to raise capital on markets around the world, while US capital markets seek to attract international listings.

The emergence of interconnected financial markets explains the momentum gathering behind the move to global accounting standards. Investors need comparable, reliable financial reporting around the world. For global investor protection, we need a global accounting language.

That is why it is appropriate for the SEC to be asking, as it now is, whether the system in the United States should evolve to reflect the new dynamics of capital markets.

Many other countries have asked the same question. Almost all have concluded that adoption of International Financial Reporting Standards (IFRSs) are in their domestic interests and the best way to protect investors. It has taken less than 10 years for IFRSs to be required or permitted for use by companies in more than 100 countries, including the majority of the G20.

IFRSs are no longer just for Europe. In the last five years we have seen IFRS adoption move at an astonishing pace. In the Americas, almost all countries of Latin America are fully on board. So is Canada to the north and Mexico in 2012 to the south. South Africa and Israel are full adopters. In Asia-Oceania, Australia, Hong Kong, Korea, New Zealand and Singapore are also full adopters. Japan already permits some companies to report using full IFRSs and will decide next year whether to mandate a full transition to IFRSs.

For emerging markets, IFRS has become the de facto financial reporting standard. These markets are attracting vast amounts of inward investment from US fund managers looking to spice-up their investment portfolios. Of the so-called BRIC countries, Brazil already is and Russia very soon will be full adopters, while China is very close.

Of course, the countries that still have to make further and final steps towards full IFRS adoption are looking very carefully at what is happening here in the United States.

US Decision

I recognise the challenges and significant pressures facing the SEC in making its decision. The US is the largest and most liquid national capital market in the world. So, transitional concerns have to be carefully considered. The SEC must believe that this is the right decision for the US. From an investor protection and capital formation standpoint, I believe it is.

US investors now seek and should seek investment returns on a global basis. For example, in its submission to the SEC, CalPERS made the point that they currently invest in 47 markets around world. If the SEC is to protect CalPERS in this international environment it must be an active participant in the development and global enforcement of IFRS. For that to happen, the SEC needs skin in the game.

At our IFRS conference in Boston earlier this year the Controller of Ford Motor Company explained why Ford supported US adoption of IFRS.

His video presentation articulated Ford's support for a single set of high quality standards and IFRSs being the most effective means to accomplish that objective.

Ford is not alone. Archer-Daniel-Midland, Bank of New York Mellon, Kellogg, Chrysler, and Ford Motor Credit all joined with Ford in a recent public letter to the SEC (http://www.sec.gov/comments/4-600/4600-39.pdf) calling for the use of IFRSs by US companies.

Companies like these have been leading the way in terms of consolidating and coordinating their international financial reporting. I think providing a limited number of such US companies with the option to use IFRSs for their US consolidated financial reporting would offer a good test of IFRSs.

I know that there are inevitable concerns about having two GAAPs in the US marketplace. However, if the major competitors of such companies are using IFRSs, comparability will actually increase. Comparability could be further assured if those competitors were foreign private issuers in the US, already subject to SEC review.

From a global perspective, such a limited and early option to use IFRSs would provide a clear signal of a US commitment to IFRSs.

Now I understand that legitimate concerns regarding the introduction of IFRSs in the United States exist. One of these concerns is consistency of application. The SEC Staff recently published a study on this. It looked at how well IFRSs are being applied by Fortune 500 companies.

While the study concluded that the financial statements generally complied with IFRSs, there were inconsistencies observed – mainly due to a lack of disclosure of accounting policies and how individual standards had been applied.

However common such findings about inconsistent application around the world may be, these concerns cannot be dismissed. Standard-setters and securities regulators know that we have to do all we can to improve consistency of application.

Consistency will be improved by working in close cooperation amongst national and regional standard-setting bodies, securities regulators coordinated by IOSCO and the accounting profession.

However, the important point is this. We can only work towards consistent application if we have one single accounting language. If there is no global standard, consistency will always remain an illusion.

By the way, if IFRSs were adopted here in the US, the SEC should and undoubtedly will retain all of the powers that it already has. This includes the area of enforcement. IFRSs pose absolutely no danger of importing different enforcement standards from abroad into the United States. Rather, the example of US enforcement of IFRSs in the US will raise the international bar.

Let me give an IASB perspective on the role of the FASB. The SEC Staff paper rightly addresses the issue of sovereignty in emphasising the FASB's role to endorse IFRSs for use in the US.

Endorsement is the model that is used in most other parts of the world, including Australia, Brazil, Canada, Europe and Korea.

Through this mechanism, the FASB and the SEC retain ultimate responsibility for and control over US accounting standards. It will also ensure a strong role for the FASB in our global system. If we would not have a deep engagement with the FASB, the IASB would obviously run serious risks of non-endorsement.

At the same time, the key to making this model work is setting an appropriately high threshold for non-endorsement. This ensures that any deviations are extremely rare. If we end up with non-endorsements and carve-outs left and right, the gains of adopting IFRSs will remain elusive.

Using full due process, we at the IASB have to make sure that we work in full coordination with national standard-setters, to make sure these deviations do not proliferate.

One way to reduce the temptation to deviate from full IFRS as adopted by the IASB is to engage national and regional standard-setting authorities, including the FASB, in all stages of our work.

The recent FAF comment letter to the SEC (regarding the SEC Staff Paper: Exploring a possible method of incorporation, November 2011) rightly raised the role of national standard-setters. The SEC staff paper sets out a good model for working with such standard-setters. National and regional standard-setting authorities must be the eyes and ears of the IASB. We must consult with them on a very active basis.

Furthermore, I am becoming increasingly convinced that in the future we may have to go beyond pure consultation. A more institutional arrangement for engaging national standard-setters and regional bodies concerned with accounting standards is needed. The FAF comment letter suggested several options that are worth thinking about.

Finally, I would like to make some comments about convergence.

Our convergence history with FASB has been extremely useful in getting us to a point where IFRS and US GAAP are much improved and closer together.

So, it’s tempting to just maintain the status quo. But for the long-term, the status quo is an unstable way of decision making that inevitably leads to diverged solutions or sub-optimal outcomes.

For example, let’s look at just one part of the Financial Instruments project – Offsetting. We began in alignment with the FASB, but we’ve ended up in different places. To investors, the balance sheet of many US banks, which are allowed to net derivatives, will look much smaller than that of Asian and European banks, which have to present them gross.

Through disclosures we will try to bridge the gap, but I doubt that investors in the US or elsewhere will see it as a satisfactory outcome. At the same time, we at the IASB believe that our conclusion is right for investors. I am sure that Leslie would believe the same for the FASB.

The simple truth is that when you have two boards of independently thinking professionals, sometimes they will simply reach different conclusions.

The same would be true if I were to split my Board in two and ask them to consider 10 projects. I doubt each smaller Board would reach identical conclusions on all 10 projects.

I’m sure the SEC realises that the outcome of its decision cannot be convergence by another name. Obviously, it is up to the SEC which decision it wants to make. It will be equally obvious that we at the IASB and stakeholders in the US in support of global standards would like this decision to be a clear and positive one.

Conclusion

I began by stressing the importance to investors of transparency and comparability. In a global economy, investors need a global accounting language and IFRSs are the only candidate. This concept underpins the approach advocated by the FAF in their comment letter that calls for the gradual introduction of IFRSs.

Much of that letter is consistent with the SEC staff paper published earlier this year (SEC Staff Paper: Exploring a possible method of incorporation of IFRS, May 2011 www.sec.gov). Indeed, as suggested before, I think that an endorsement approach makes sense.

At the same time, it is important that any such approach has a couple of key characteristics for us to reach our shared goal of a single set of high quality global standards.

There should be a clear timeline for the completion of the initial 'endorsement process'. There should also be a presumption that - given full due process and extensive involvement of the national standard-setter - non-endorsement would be very rare indeed. Once the initial process of endorsement is completed, US companies should be able to assert compliance with both US GAAP and IFRSs.

Finally, as my own festive season request, I hope that the SEC gives serious consideration to the merits of an early adoption option to use IFRS for a number of US companies.

All of us here today – whether we write accounting standards, prepare financial statements, verify the integrity of financial statements or study the numbers to understand the performance of a commercial enterprise – are part of a global effort that underlies free trade and free-flowing capital. The entire IASB take our responsibilities in this endeavour extremely seriously.

It is important for investor protection in the US and internationally that the SEC remains at the forefront of determining financial reporting policy. This cannot be done from afar. We need the United States to remain on board. We count on your commitment and you can count on ours.

Ladies and gentlemen, thank you for your time. I wish you a very successful conference.