06 March 2013

Hans Hoogervorst, Chairman of the International Accounting Standards Board

This is not my first visit to Indonesia. I first visited your wonderful country in the late nineties, in my then capacity as junior Minister for Social Affairs in the Dutch Government. Visiting this dynamic city of Jakarta, I remember being struck by the huge potential of this country. Indonesia is the fourth most populous nation in the world and has a wealth of natural resources. It was immediately clear to me that Indonesia possessed the raw ingredients to enjoy many decades of strong economic growth.

However, at the time of my visit, Indonesia was not in a very optimistic mood. Indeed, your nation was one of the countries that were most affected by the severe financial crisis that plagued the Asian region at the time. Like many countries around you, Indonesia went through a period of serious economic and political difficulties.

I returned to Indonesia in 2007, this time as a tourist. I thoroughly enjoyed the beauty of your country and the friendliness of your people. As a Dutchman I have been exposed to your culture (and to your food) since I was a child and I was very happy to get even better acquainted with both. Unfortunately my touristic visit to your country was far too short. But it was long enough to see that already in 2007 Indonesia was doing a lot better. Your financial system had been rebuilt. Your economy was moving again.

I am now visiting your country in circumstances that are yet again very different. Again there is a very serious financial and economic crisis. Yet this time, it did not start in Asia, but in the West. This time, Asia had learned the lessons from the crisis in the nineties. Thus far, most Asian countries weathered the storm pretty well.

This time, the West forgot the lessons it had taught Asia in the past. The doctor did not follow the treatment it gave to his patients and now he is getting a taste of his own medicine. This time, it is the Western banking system that is broken and Western public finances that are in disarray. The industrialized world is struggling to show any growth at all.

And what is it that the IMF has to say about Indonesia this time? I quote a report from 2012: "A fundamental reform of the policy framework over the past decade left Indonesia in a strong position when the global economy turned sour after 2007." It continued: "The strong policy framework ensured that Indonesia came out of the 2008 global financial crisis much better that its Asian peers". A ringing endorsement of Indonesia by the IMF, who could have imagined that 15 years ago?

So Indonesia now seems to be well on its way to fulfilling its potential. In 2005, Goldman Sachs included Indonesia in a list of the 'Next 11' economies that would come to serve as the engines of global growth. They forecast that Indonesia will experience outsized growth compared to the rest of the world. By 2050, Goldman Sachs expects the Indonesian economy to be larger than either Germany or indeed the United Kingdom.

Of course, it is difficult to predict what the world will look like in 40 years' time. But what cannot be dismissed is that Indonesia has the potential to achieve that goal. I am here to tell you that I firmly believe IFRS can be an important tool for your country in its quest to fully unlock its potential. I am convinced that full adoption of IFRS can really help Indonesia to sustain its economic development.

But before I explain how Indonesia can benefit from IFRS, let me begin by telling you about how IFRS is close to becoming the global language of financial reporting.

Ten years ago very few countries of the world used IFRSs. Now more than 100 countries require or permit the use of IFRS, including three quarters of the G20. In the America's, almost all of Latin America and Canada are using IFRS. The United States still has to make up its mind, but it allows more than 500 foreign issuers to list using IFRS. All of Europe uses IFRS. In Asia-Oceania countries like Korea, Malaysia, Australia, New Zealand and Hong Kong are full adopters and many others are on the way. China uses standards that are substantially converged and in Japan the number of companies that are using IFRS is expected to increase significantly. Half of all fortune Global 500 companies now report using IFRS. Every year, new jurisdictions decide to adopt IFRSs, most recently Russia and Taiwan.

How could this happen in such a short time? Why have so many jurisdictions, large and small, moved from the familiarity of local accounting standards to IFRS? Well, each jurisdiction has its own reasons.

Europe needed to create a common economic market. For that, it needed a common financial reporting language. At the beginning of the century, the member states of the European Union spoke many different accounting languages. In Germany, the accounting system was very closely aligned to their tax system, while at the other end of the spectrum the UK's accounting system was not dissimilar to the United States. This multitude of accounting dialects was impossible to understand.

In 2002, the EU decided to adopt IFRSs and it completed the task in just three years. In 2005, more than 7,000 companies across 25 countries simultaneously switched to IFRSs. Various reports have concluded that the move to IFRS was a remarkable success. It led to increased transparency and greater comparability. Investors acquired more trust in the numbers and the cost of capital went down. It goes to show that with IFRS, where there is a will, there is a way.

If the introduction of IFRS brought economic benefits to Europe, imagine the benefits that emerging economies can draw from the use of IFRS. In fact, the Asian crisis of the nineties was an important driving factor for the development and spread of IFRS. Too many investors, who had just begun to invest on a global scale, had burned their fingers during the Asian crisis. They wanted to see financial statements that were the same as the statements they saw at home. IFRS provides the global language that investors want. It gives added credibility to your capital market and brings down the cost of capital.

For many emerging economies, adoption of IFRS has become an important statement of ambition – an international commitment to adhere to the highest possible standards of financial reporting. For example, an investor in London, New York or Hong Kong can pick up a Korean set of IFRS-compliant financial statements and be entirely familiar with that company's financial performance.

In a country like Korea the move to IFRS has helped to reduce the so-called 'Korean discount' that international investors would charge, in part due to the unfamiliarity with the previous Korean accounting rules. Today, those same international investors are able to compare and contrast a company with its international peers in more than 100 countries around the world.

It is important to understand that the full benefits of using the IFRS-brand can only be enjoyed if you adopt it fully. For foreign investors it is very difficult for investors to discern small differences from big ones. If a jurisdiction cannot state that it has fully adopted IFRS, investors are likely to think that the differences are much bigger than they really are. If you have gone through all the trouble to adopt 95% of IFRSs, please make sure you also do the last 5%. Otherwise, you have all the pain of transition without the full gain of international recognition of that achievement.

Almost all jurisdictions that adopt our standards experience some challenges with adjusting domestic accounting practices to IFRS. That is to be expected. Often these problems can be resolved, sometimes it is more difficult, such as is the case with the issue of land rights in Indonesia.

Most jurisdictions have concluded that the credibility bonus of full adoption of IFRS outweighs the temptation to tinker with the standard to address local problems. Chances are that other jurisdictions are also having the same problems, so it is much better that we work together, to fix the problem centrally so that all IFRS adopters can benefit from such improvements.

I am delighted to see that Indonesia is well along the path to IFRS adoption. The DSAK has made huge progress under the firm leadership of Rosita Uli Sinaga. At the same time, the road to full adoption still needs to be completed. Completing that transition is an important step in order to convince international investors that Indonesia is serious about unlocking the potential I referred to earlier.

I am here today to offer the full assistance of my organisation. To help you make the small remaining steps in order to reap the large premium that comes with full adoption of IFRS. I am confident that the few remaining obstacles to full adoption can be overcome.

The relationship between the IASB and the DSAK is already very strong. Our respective staffs work very well together. But I also believe that there is an opportunity to further deepen that cooperation.

The IASB has already invested heavily in supporting economies in this important part of the world. We have recently opened an Asia-Oceania office in Tokyo, to better support Indonesia and other important jurisdictions across the region. Our Director of the Asia-Oceania office, my good friend and

colleague Mitsuhiro Takemura, is here with me today, to learn more about Indonesia's plans and to understand better what we can do to help you.

We have also established an Emerging Economies Group, headed by Wayne Upton, Chairman of the IFRS Interpretations Committee. The purpose of this group is to understand better the challenges of applying IFRS in jurisdictions with less developed capital markets. I am glad to see Indonesia participating actively in the Emerging Economies Group.

Furthermore, we continue to work in very close cooperation with the Asia Oceania Standard-Setters Group, or AOSSG, which provides an important mechanism to coordinate views on our work across this diverse region. Rosita is a member of the AOSSG and has used it very effectively to present Indonesian issues in a very eloquent way. The AOSSG is likely to be represented in the Accounting Standards Advisory Forum, or ASAF, that we have created to deepen our cooperation with standard-setters across the world.

All of these initiatives provide wonderful opportunities for strong Indonesian participation in financial reporting. The door is open for you, and there are several ways that you can take advantage of this opportunity – as other jurisdictions continue to do so.

You could help us in the researching of areas of accounting – particularly those where Indonesia has highly relevant experience. I also encourage you to continue acting as a vocal member of the AOSSG. Europe, the United States and other likely members of the ASAF will most likely be highly vocal in our discussions. It is essential that the AOSSG can also express itself clearly, ideally with one voice.

I will now move on to describe our current work programme as well as our plans for the future.

Current programme

Our main priority is to complete the remaining elements of convergence projects with the FASB. We have four major projects awaiting completion. Let me begin with the two standards where we were able to stay completely converged with the United States.

Revenue Recognition

The first of these projects is revenue recognition. Revenue is the top line number and is important to every business. It is also an area that perhaps sees the most divergence in practice. This makes it all the more important that we get this standard right.

We published a revised exposure draft in November 2011 and expect to issue a full standard in the first half of this year. The new standard will replace US requirements that are generally considered to be too detailed and international requirements that are not detailed enough.

The new revenue recognition standard should address some of the concerns regarding the "percentage of completion" method of accounting utilised in IFRS. We are aware that this has been a particular point of concern for the commercial real estate and construction sectors here in Indonesia.

Historically there was some diversity in the way companies recognised revenue from the construction of residential real estate. As a result, the IFRS Interpretations Committee issued IFRIC 15 in 2007. However, in practice, that additional guidance has proved difficult to interpret and apply in some places. In the new revenue recognition standard, the IASB has tried to solve these problems.

The new standard will contain a clear principle as to when revenue should be recognised, namely as goods and services are transferred to the customer. It will also provide supporting guidance that has will provide more clarity as to how to recognize revenue from residential real estate construction contracts. We think the new standard will address most of the current interpretation problems here in Indonesia.

As I mentioned above, Revenue is a key performance indicator for every business and I see this project as being one of the resounding successes of the convergence programme.

Leasing

Second is lease accounting. This is a difficult area, but also one where improvements are needed. The vast majority of lease contracts are not recorded on the balance sheet, even though they usually contain a heavy element of financing. For many companies, such as airlines and railway companies, the off-balance sheet financing numbers can be quite substantial.

What's more, the companies providing the financing are more often than not banks or subsidiaries of banks. If this financing were in the form of a loan to purchase an asset, then it would be recorded. Call it a lease and miraculously it does not show up in your books.

Despite what you may hear, reports that the rule changes will lead to the death of the leasing industry are greatly exaggerated. Leasing provides many important economic benefits to companies and that will not change. All we ask is that these transactions are accounted for in a way that is transparent to investors.

At present, most analysts take an educated guess on what the real but hidden leverage of leasing is by using the basic information that is disclosed and by applying a rule-of-thumb multiple. It seems odd to expect an analyst to guess the liabilities associated with leases when management already has this information at its fingertips.

That is why it is urgent the IASB creates a new standard on leasing and that is exactly what we are doing, in close cooperation with the FASB. The boards are finalising the revised proposals and we expect to publish a final exposure draft for public comment very soon. Your input will be important to achieving a high quality outcome.

Financial Instruments

Phase I: Classification and Measurement

As I'm sure you know, our reform of the accounting rules concerning financial instruments has been conducted in different phases. The first of these is classification and measurement. The IASB and FASB started from two completely different perspectives. The FASB initially favoured a full fair value approach while the IASB chose mixed measurement. I consider it a success that we managed to bring our approaches much closer together.

In early 2012 the IASB and the FASB jointly agreed on amendments to our respective models. For IFRS 9 these included clarifying the amortised cost business model and introducing a Fair Value through Other Comprehensive Income measurement category. At the same time, the FASB has moved to a mixed measurement approach which is very similar to ours. We published our proposals in November 2012 and welcome any comments you might want to make.

Phase II: Impairment

The most challenging part of the revision of IAS 39 has turned out to be impairment. Currently, both IFRS and US GAAP use incurred loss impairment models. Many have voiced concerns that these models result in loan losses being recognised too little and too late. Both boards concluded we had to replace the incurred loss model by an expected loss model.

After several false starts, we will publish our third and hopefully final Exposure Draft in the next few days. We believe our new expected loss model will result in more timely recognition of credit losses. Banks will be required to create a loss allowance for all loans based on a 12-month probability of default. If the credit quality of a loan has significantly deteriorated, banks will have to recognise the full expected lifetime loss.

Our new model is a simplified version of an approach we had developed jointly with the FASB. In July last year, the FASB decided to develop its own model which requires entities recognise full lifetime expected losses on initial recognition of the related assets.

In the coming months, both boards will receive feedback on our respective models. We will keep lines of communication open during the comment period and will consider comments on both models during re-deliberations in 2013. Hopefully we might be able to come to a more converged solution, but this is far from certain.

Phase III: Hedge Accounting

The IASB had received feedback that the hedge accounting requirements in IAS 39 were seen as arbitrary, rules-based and detached from risk management. We therefore proposed a fundamental overhaul of hedge accounting requirements to better reflect risk management activities. Also, we wanted to make hedge accounting more accessible for non-financial institutions. We are almost ready to publish the final standard which we believe to be a vast improvement over current practice.

Insurance

Of the remaining convergence projects, insurance is the one that keeps me awake at night. At this time, we do not have a proper IFRS for insurance and the American standard is in need of updating. As a result, there is huge diversity and complexity in how insurance companies report their numbers under IFRSs. Investors often talk about insurance accounting being a 'black box'. This lack of transparency comes with a corresponding risk premium,

which can lead to insurance companies trading at a discount to their peers in other areas of financial services.

The project is challenging because different financial reporting practices have become embedded in different parts of the world. Many insurance companies are using out-dated assumptions in their measurement. This is particularly concerning because it is very likely that insurance companies are likely to be suffering in the current low-interest environment. Without a proper standard, investors cannot see properly how big these financial risks are.

We have been working with the FASB to develop a model that lifts financial reporting for insurance contracts to a common and improved level. Our standards will not be completely converged, but they will both be based on current measurement. As a result they will vastly improve transparency in the insurance industry. An exposure draft is targeted in the first half of this year.

New Agenda

Clearly there is still some important work to be done in all of these projects, but we have made some substantial progress and are well on the way towards completion. As this chapter in our history draws to a close, we have already begun to put in place arrangements for a new programme of work.

Implementation and maintenance

The IASB is responsible for developing enforceable Standards and will give greater emphasis to addressing implementation concerns. Many respondents to last year's agenda consultation suggested that we should give greater emphasis on maintaining the portfolio of existing IFRS requirements rather than creating new requirements. By maintenance, we mean Interpretations, narrow-scope improvements (including Annual Improvements) and education.

The respondents made a good point. After a period dominated by joint projects focused on convergence, now is the time for the IASB, and the Interpretations Committee, to be more active in addressing matters related to the practical application of IFRS. **Conceptual Framework**

In May 2012, we decided to restart the Conceptual Framework project. This is perhaps the most important work we can undertake and we have widespread support from constituents in addressing it. We know that if we get the underlying concepts right, then we will have sound and consistent reference points for the rest of our standard-setting work.

Our current Framework has definitions of assets and liabilities, but we still do not find them completely satisfactory. While you would expect accountants – of all people- to be able to make a clear distinction between mine and thine, we are still not quite sure how to distinguish equity from liabilities.

Measuring the performance of an entity is also very hard. We measure Net Income, but then there is also Other Comprehensive Income, which keeps on growing without us being entirely clear what it means. These are all the thorny issues that we need to resolve in the next phase of the revision of our Conceptual Framework.

We want to move as quickly as possible to set in place this important framework, which will shape future work. We have therefore set an ambitious target, aiming to finalise the new sections of the Conceptual Framework by September 2015. The first major milestone is a Discussion Paper, which we expect to finalise in June 2013.

Standard Level projects

One of the most common responses we received following the agenda consultation was a call for a period of calm. This is wholly unsurprising given the level of change we have seen in reposting over the last decade. Whilst a period of complete quiet is not quite achievable, consistent with these calls we have made plans to begin work on only a small number of standard level topics.

These include *Agriculture* – where we will pay particular attention to the status of so-called bearer biological Assets. These include cash crops, such as palm oil trees and grape vines, which having reached biological maturity are used to produce grow agricultural produce over several years until the end of their useful lives .

This is of particular importance to countries such as Indonesia with a significant agricultural sector. Under current rules, assets such as palm trees are measured at fair value. Under our new proposals, they will be treated more like property, plant and equipment and measured at cost. The revised standard will be less costly to apply and will remove artificial volatility from net income.

Conclusion

Ladies and gentlemen, I am grateful for your time. I hope that from hearing about these initiatives, you get a sense of our commitment to this region and

to emerging economies such as Indonesia. Although the office of the IASB is located very close to the Tower of London, my organisation itself is certainly not an ivory tower. We have a dynamic, highly motivated staff recruited from all over the world. We are open to views from all over the world. We need you, just as much as you need us. As the world moves to global accounting standards, the G20 has encouraged us to pay special attention to the needs of emerging economies. You have a wonderful opportunity to help shape the future of global financial reporting.

I am here today, to extend the hand of friendship and to encourage you to come fully on board with IFRS. I wish you a very successful conference.