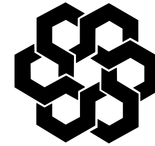

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International Accounting Standards Committee Foundation

This document is provided as a convenience to observers at IASCF meetings, to assist them in following the discussion.

INFORMATION FOR OBSERVERS

AP6A

Chairman's Report to the Trustees

As Trustees are aware the Board has three main strategic objectives at the present time:

- Encouraging more countries to switch to IFRS rather than use national standards.
- Convergence of IFRS and US GAAP
- Development of a standard for SMEs

Growing International Acceptance of IFRS

The last year has seen many countries moving towards IFRS. This year Chinese companies have started using standards which were designed to give the same results as IFRS. Canada has expressed its intention to change to international standards in 2011. Brazil intends to move in 2010 while India, Korea and Japan have expressed their intentions to converge by 2011. Next year Israel switches to IFRS followed by Chile in 2009. In all, according to Deloitte, 107 countries now permit or require the use of IFRSs – we expect that within five years this number will have risen to 150.

The spreading acceptance of international standards has placed an even heavier workload on the Board with numerous requests for speeches and visits to discuss implementation issues with government ministers throughout the world.

In addition, we have also expanded our education outreach. We held our second 2007 IFRS Conference in late August in Singapore. This was the first IFRS Conference that we have held in Asia. It followed a successful conference in May in Zurich, and included plenary sessions, smaller breakout group discussions and half-day special interest workshops. All in all a successful and comprehensive technical update on IASC and IFRIC activities.

Next year, with the support of the FEI, we intend to hold our first conference in North America – the beginning of our programme to hold three conferences a year – one each in Asia and Europe in addition to North America.

The spread of IFRS has not been without its problems. We are still trying to solve the "brand" issue. We are aware that several countries have adopted most of our standards but perhaps not adopted or not mandated one or two, or amended some of the standards' provisions. We have been attempting to deal with these issues in two ways:

First, and our least favoured alternative, is to require companies who use the term "IFRS" in their description of the basis of their financial statements to disclose differences if full IFRS has not been adopted. The intention is that auditors would qualify the financial statements if that disclosure were to be omitted. Our favoured alternative, however, is to seek the support of auditors to enforce IAS 1 which requires companies to state that their financial statements comply with IFRS if that is the case. This requirement has been honoured in the breach and very few companies give the disclosure although it is mandatory. It is worth noting that New Zealand and Australia are now requiring auditors to express opinions on both national standards (which are identical to IFRS) and IFRS. This is a pattern we would like to see world wide and we are pressing the securities regulators (IOSCO) for their assistance in persuading jurisdictions to accept this form of report.

Convergence with the United States

It has to be said that a lot of the enthusiasm for switching from national standards to IFRS has been the prospect of accessing the US markets without reconciling to US GAAP. The removal of the reconciliation requirement has been a major goal for the Board for the last few

years and was brought into international prominence by the Memorandum of Understanding between the IASB and the FASB, agreed with the SEC and the EC in February 2006.

Appendix A to this report outlines the progress that has been made on the technical issues set out in that Memorandum which was the 'roadmap' charting a path to when issuers would no longer be required to reconcile financial statements to US GAAP. Earlier this year the SEC issued a draft regulation proposing the removal of the reconciliation and at present is studying the responses to that proposal. Shortly afterwards the SEC issued a second document – a Concept Release – exposing the view that US domestic registrants should be given the opportunity to use IFRS rather than US GAAP if they so wished. Since then there have been several supportive speeches by SEC Commissioners. One by SEC Commissioner, Paul Atkins, proposed that regulators should choose a single worldwide accounting framework and only last month, the FASB Chairman, Bob Herz, called for a national plan with clear milestones and target dates to move towards adopting international accounting standards in the United States.

The Board is committed to meet its obligations under the Memorandum of Understanding and to work with the FASB to bring IFRS and US GAAP ever closer together so that any change in the US to IFRS would not involve a violent switch in corporate accounting policies.

Principles versus Rules

As part of our work with the FASB, both Boards have agreed that future standards should be principle based. Both IFRS and US GAAP are principle based but the demands for interpretation and additional guidance in the US have led US standards traditionally to be more detailed than IFRSs. It is clear that the world in general does not want to follow the US path and both Boards are now trying to write new standards that will avoid a great deal of detail.

The intention is that the standards would follow a core principle with sub-principles related to the core principle in a tree like structure. Ideally the standards would contain no exceptions and would give just minimum guidance. Preparers and auditors would, obviously, have to use judgement in areas not covered by the standard but would do so by reference to the over-arching principles.

To test whether such a standard was feasible, the Board drafted a mock standard based on a ten year old publication on lease accounting and sent it to the major accounting firms to ascertain whether or not such a standard was auditable. While the firms made several suggestions for improvement and perhaps wished for more guidance than we had given, the overall reaction was positive. We intend now to share the results of this experiment with the FASB and then together seek meetings with regulators to ensure that they can regulate on a principle based system and by accepting preparers' and auditors' judgements.

Risks

While a summary of our activities indicates growing support for IFRS there are still risks to the goal of a single set of global standards.

The current credit crisis did lead to articles in the press questioning the role our accounting standards may have played in the crisis and in particular the role of fair value. Seasoned observers, however, realised that bad lending decisions had caused the crisis - even under the pure historical cost system bad loans had to be written down to the amount expected to be recovered in the future ie the loan's value.

Of greater concern, is the difficulty of valuing investments in illiquid (or less liquid) markets. The Board has been actively working with the Financial Stability Forum to deal with what in essence is a practice issue rather than a regulatory one. At the time of writing the Financial Stability Forum is holding meetings with regulators, representatives of the Board and the accounting firms to try to develop a common policy for the 2007 financial reporting season. (See Appendix B)

Our standards have held up well in the crisis. However, while we have existing standards on derecognition (securitisation) and on special purpose entities we intend, in the New Year, to publish a discussion paper on consolidations which will deal in particular with special purpose entities and conduits. A paper on derecognition is expected to be published around the end of the year. All these projects have been underway for some time and are not affected by the current crisis although their importance has clearly been emphasised by the turmoil in the financial markets.

One of the Board's latest standards, IFRS 7, deals with disclosure of liquidity risk and requires companies to disclose the maturity of their liabilities. It is interesting to note in this respect such disclosures revealed that three quarters of Northern Rock's liabilities were due within three months. Liquidity risk was discussed in the financial statements of the two failed German banks. They stated that they could fund their long term assets from short term finance regardless of market conditions – clearly a fatal assumption! We shall assess whether further disclosure would be welcomed by the markets.

Another risk, as mentioned above, is the practice of certain national jurisdictions choosing which aspects of IFRSs to omit or to alter while sheltering under the overall umbrella of the IFRS descriptor. This does cause confusion in the markets. We need the help of the regulators and auditors in ensuring the markets understand clearly the basis of the accounting provided to them.

Finally, while many countries are moving towards international standards we still have difficulties with the endorsement process in Europe. We have made several visits to EFRAG (the technical group which advises the European Commission) and to the EU Parliament. While the Commission has generally been supportive of our efforts, it does have trouble in persuading the Parliament that the standards should be endorsed - with a resulting delay in the implementation of the standards in the EU, in particular IFRS 8, *Operating Segments*, the amendments to IAS 23 *Borrowing Costs* and IFRIC 12 *Service Concession Arrangements*. IFRS 3 *Business Combinations* (and its companion standard IAS 27 Consolidated and Separate Financial Statements) which will be published shortly could well be another standard which may encounter difficulties in acceptability in Europe and to that end the Board will be issuing its first Feedback Statement – a short document which will deal with the comments and criticisms raised on the exposure draft of the standard and outline how the Board dealt with these issues and its reasons for those decisions. Given that the Board has agreed that all major new standards will be reviewed two years after their implementation date we believe that we have done as much as we can to try and assuage the fears that commentators are not being listened to and additionally to remove concerns that the standards are set in stone for all time. The 2-year post-implementation review will look at continuing controversial issues and areas where the costs of implementation were greater than

anticipated. While we do not guarantee that changes will be made, it will give commentators an opportunity to discuss issues with which they are particularly unhappy.