Accounting SQUARE

The path towards global accounting standards

Chairman of the International Accounting Standards Board
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I am grateful for the opportunity to contribute to the *Accounting Journal*.

In the eight months since becoming Chairman of the International Accounting Standards Board (IASB) I have travelled to Asia more than to any other region. The IASB spent much of its first decade supporting Europe's transition to IFRSs and working with the FASB to improve IFRSs and US GAAP and bring about their convergence. Looking beyond the completion of the remaining elements of the convergence programme, our attention has begun to shift towards supporting those remaining major Asian economies such as China, India and Japan to complete their transition to IFRSs. This region is of great importance to the world economy and it is no coincidence that the IASB has chosen Asia, and more specifically Tokyo, to open its first satellite office outside of London.

We have vital work to do. The G20 has repeatedly supported the work of the IASB and called for a rapid move towards global accounting standards. I will explain why I believe this goal is not only achievable, but inevitable. I will also explain what the IASB is doing at a practical level to turn this vision into a reality.

Before moving on to this subject, as a relative newcomer to the world of financial reporting I would like to introduce myself and the events that led to my appointment as Chairman of the IASB.

My background and interest in financial reporting

I have spent the majority of my professional life serving the public interest. As a minister of Health and minister of Finance for 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 Netherlands is now, once again, one of the stronger economies in Europe.

In 2007, shortly before the financial crisis struck, I became Chairman of the Authority for the Financial Markets (AFM), the Dutch equivalent of the Japanese Financial Services Agency. It was during my time as Chairman of the AFM that I realised how important IFRSs were to the efficient functioning of the global financial system. It became clear that if investors were to be adequately protected, the complexity associated with modern finance required the highest levels of transparency and international comparability. That meant everyone speaking the same, high quality financial reporting language. The G20 Leaders recognised this in calling for a high quality, level playing field in financial reporting. That is the potential of IFRSs.

For this reason, at the request of Sir David Tweedie, the previous Chairman of the IASB, I agreed to co-chair the Financial Crisis Advisory Group (FCAG), formed to advise the IASB and the FASB on their joint response to the financial crisis. I believe that the FCAG was able to bring some welcomed perspective and calmness to the heated discussions about accounting.

Shortly after the FCAG concluded its work, I was invited to become Chairman of the IFRS Foundation Monitoring Board, the body of capital market public authorities that oversees the work of the Trustees, who in turn are responsible for the governance and oversight of the IASB. From here, I was invited to become Chairman of the IASB. The Trustees also appointed Ian Mackintosh to serve as my Vice-Chairman. Ian is a former Chairman of the UK Accounting Standards Board and used to chair meetings of the National Standard-Setters forum.

He is a highly regarded figure in financial reporting circles and we have developed a very effective working relationship.

Progress towards global accounting standards

I would now like to report on progress towards the IASB's goal of developing a single set of high quality, global financial reporting standards.

When the IASB began its work in 2001, few major economies used the International Accounting Standards (IASs) inherited from its predecessor body, the part-time International Accounting Standards Committee (IASC). Each jurisdiction developed and maintained its own set of financial reporting standards—some very good, others less so.

This model of national financial reporting regimes was appropriate at a time when both parties on either side of a transaction were, more often than not, located in the same jurisdiction. Both sides spoke the same financial reporting language.

Today, the financial landscape is very different. Companies have an array of sources of capital, from the new international financial centres in Asia through to sovereign wealth funds. A well-balanced Japanese pension fund will seek investment opportunities and diversification on an international scale. During the early stages of the financial crisis, the way in which losses associated with US subprime debt spread around the world illustrates this point.

Given the interconnected nature of modern financial markets, it makes little sense to account for identical transactions in a variety of different ways, depending on where in the world that transaction occurred. Doing so invites regulatory arbitrage and makes it extraordinarily difficult for securities regulators to protect investors. Even after accounting standards have converged, minor technical differences can have major financial consequences, which can catch out professional investors and regulators alike. Only a single set of standards, applied globally and on a consistent basis, can eliminate these risks.

This has been the impetus behind the move towards establishing IFRSs as not just an international set of financial reporting standards, but a global one.

Progress towards this objective has been rapid. In 2002, Europe's decision to embrace IFRSs from 2005 encouraged many other jurisdictions to join this first wave of IFRS adoption, including Australia, Hong Kong, New Zealand and South Africa. From here on, a second wave of IFRS adoption was led by major economies across Asia and South America. In the last few years Brazil, Canada, Korea, Mexico and Russia and many others have adopted IFRSs in full, and without carve-outs.

The G20 Leaders, of which Japan is an important member, have repeatedly supported the work of the IASB and called for the completion of the move to global accounting standards. With more than 100 countries now requiring or permitting the use of IFRSs, including most of the G20, we are well on the path to achieving this goal.

Furthermore, the remaining large G20 economies of China, India, Japan and the United States are all making significant progress in their preparations to move towards global accounting standards.

Both China and India are making the transition to new sets of accounting standards that are substantially similar to IFRSs, and we maintain strong links and working relationships with these countries. We have very capable Trustees and members of the IASB from both China and India. China will provide the secretariat for the newly-formed IASB Emerging Economies Group. I have just returned from a trip to India and I believe that the prospects for India to come fully on board with IFRSs are encouraging.

In June 2009, Japan moved significantly towards adoption of IFRSs by permitting certain domestic Japanese companies to report using full IFRSs, with a view to deciding in 2012 on a mandatory transition to IFRSs. Japan is unique among the remaining jurisdictions yet to adopt, because it permits three different sets of financial reporting standards to be used in domestic Japanese markets—IFRSs, Japanese GAAP and US GAAP. I believe that there is a strong argument for rationalising this choice in order to improve comparability, and the obvious choice is to standardise on IFRS.

Our organisation has invested significantly in strengthening our connections with Japan in anticipation of a positive decision on IFRSs in Japan. Tsuguoki Fujinuma (former Chairman of the JICPA) and Noriaki Shimazaki (former CFO, Sumitomo Corporation) are Trustees of the IFRS Foundation. Takatsugu Ochi is a member of the IASB. The ASBJ has full-time staff on secondment to the IASB. The IASB and the ASBJ meet twice a year, having recently concluded their 14th joint meeting. The majority of our Asian outreach meetings take place in Tokyo and the ASBJ is a founding member of the Asia Oceania Standard Setters Group, formed to better coordinate dialogue between the IASB and Asian stakeholders. As I have already mentioned, the IASB will open its first office outside of London in Tokyo later this year.

As you see, Japanese interests are well represented at all levels of our organisation. I believe it is in Japan's domestic interests to mandate a transition to IFRSs and the IASB stands ready and willing to assist in this endeavour.

That leaves the United States.

Wherever I go in the world I am asked one question more than any other. Will the US come on board with IFRSs, and if so, when and how?

I have no privileged insight regarding the SEC's internal decision-making. However, the SEC's Chief Accountant said recently that the SEC will make a decision on IFRS in the coming months.

This is not an easy decision to make. The US already has developed a sophisticated set of financial reporting standards over many decades. Transitional concerns have to be carefully considered. That is why I have supported the general approach for the endorsement of IFRSs set out in the SEC staff's work plan. There are many practical challenges facing the SEC in making the decision. I do not deny that they are real. However, both I and my counterpart at the FASB have made it clear that a continued programme of convergence by another name is not an acceptable way forward. I do believe that the US will ultimately come on board. Quite simply, they need us and we need them.

Our role in the transition to global accounting standards

Much of what I have discussed so far relates to the actions of others. I will now explain what the IASB itself is doing, to help turn the vision of high quality, global accounting standards into a reality.

This translates into two streams of work. First, we will complete our current work programme to the highest possible standard while at the same time consulting on our future agenda. Second, we will strengthen our ties with those jurisdictions that have entrusted the IASB with the responsibility of setting financial reporting standards on their behalf.

Work programme

Let me begin with the current work programme, which right now means completing the remaining elements of the convergence programme to the highest possible standard.

The IASB and the FASB set out on the convergence path back in 2002 with the signing of the Norwalk Agreement, a commitment to their decision to work together, in consultation with other national and regional bodies, to remove the major differences between international standards and US GAAP. This programme was further refined in 2006 when the two boards agreed a Memorandum of Understanding (MoU) to improve and align IFRSs and US GAAP.

Accounting standard-setters have a reputation for moving at glacial speed. Yet, in only five years, the boards have completed most of these projects, leaving only three MoU projects to complete: Financial Instruments, Revenue Recognition and Leasing, as well as one project that was not listed in the MoU, Insurance Contracts.

The good news is that we appear to be making progress on most of these projects.

The first of these projects is revenue recognition. Revenue is the top line number and is crucial to every business. It is therefore all the more important that we get this standard right. Because this topic is so important, we have taken a very careful and conservative approach in developing this standard. We have published a second exposure draft and the consultation period runs a full 120 days until March 2012.

The new standard will replace US requirements that are generally considered to be too detailed and international requirements that are not detailed enough. We need your input to make sure that we have got the balance right.

Next is lease accounting. This is another difficult area, but one where improved transparency is needed. For many companies, lease obligations represent their greatest area of off balance sheet financing. Despite what you may hear, we have not set out to kill the leasing industry. Leasing provides many important economic benefits to companies and that will not change.

The existing leasing standard provides a somewhat artificial separation between operating and finance leases. We are looking to replace this with a more principle-based approach that will bring greater clarity to the liabilities that companies acquire when engaged in leasing activities.

The boards are finalising the revised proposals and we expect to publish a further exposure draft for public comment shortly. Once again, I cannot overstate how important your input will be to achieving a high quality outcome.

The final MoU project is financial instruments. This project was always going to be difficult. It took more than 10 years to develop IAS 39, the existing financial instruments standard. Doing it midway through a major financial crisis has made it even harder.

We and the FASB have been pulled in different directions. We've each tried to respond as best we can, but that has made achieving convergence very challenging.

We have some difficult choices to make regarding financial instruments, beginning with classification and measurement.

We set out to replace IAS 39 with an entirely new standard, IFRS 9. We completed the first part of this work in less than a year, issuing the first part of IFRS 9 at the end of 2009. It is a very high quality standard. We reduced the complexity associated with IAS 39. We addressed the 'own credit' issue. Our outreach efforts were widely praised for the way we went about the project. We sought input and revised our proposals in real time. Some countries, including Japan, went ahead and permitted the standard to be used, and since then have invested resources in preparing for its introduction.

Meanwhile, the FASB has been refining its own approach on classification and measurement.

They responded to feedback on their exposure draft and moved from a full fair value approach to a mixed measurement model. There are still differences in our positions, but we're not a million miles away from each other.

At the same time, as our work on the insurance standard progressed, it became increasingly clear that we had problems with its interaction with IFRS 9. We gradually came to the conclusion that we could make a lot of progress on both these issues—insurance and convergence on classification and measurement—by revising IFRS 9 in a limited way. And that is what we have now set out to do.

It is one thing to say that changes are going to be limited, but in practice there will undoubtedly be pressure for wider changes. Nevertheless, the potential gains are clear. We will proceed with caution, recognising the investment in IFRS 9 that has been made in Japan and elsewhere. Our goal is to limit any changes to those that are absolutely necessary.

On impairment, after a series of false dawns the IASB and FASB are finally on the same page with a workable model. We have recently agreed on an approach that divides up expected loan losses into three so-called buckets. I am hopeful that we are, finally, in a position to now move quickly to the exposure draft stage. Again, we need to get this one right and both boards are committed to doing so.

All being well, I hope that the boards will finalise this phase of the project before the end of the year.

On hedging, we have come up with a general model that has been very well received. We will soon share, through our website, a staff draft of our model to make sure, that, in this case as well, we have got everything absolutely right.

It will also give the FASB the time to take a closer look at our proposals. We are convinced that our hedging model gives investors a more reliable view on the economic reality of modern business practices. By redressing accounting mismatches it gives investors a much better view of the way in which companies hedge their economic risks. This work will also establish the underlying principles for macro hedging that will be subject to a separate exposure draft.

That leaves insurance. This is another tough one.

When the IASB began its work in 2001 it knew it had to develop an insurance accounting standard but that the industry needed guidance while the standard was being developed. And so, the Board basically told the insurance industry to carry on as it was.

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 operating in different areas of financial services.

The project is challenging because different financial reporting practices have become embedded in different parts of the world. We are working with the FASB to develop a model that lifts financial reporting for insurance contracts to a common and improved level. We are committed to completing this project in a timely fashion.

That brings you up to date on our current work programme.

But what next?

In July last year we published a consultation document on the IASB's post-convergence agenda. We asked very open questions. What is in urgent need of fixing? How should we best deploy the limited resources at our disposal? The responses were clear and there are some obvious candidates for the future agenda.

Everyone is asking us to complete the conceptual framework, and to firm up the philosophical and methodological underpinning of our work. We are going to have a serious look at doing so. We are also hearing loudly and consistently that we should look at performance reporting and Other Comprehensive Income, also known as OCI. However, views on how we should go about this are mixed. Some people would like us to get rid of OCI. Others want a stronger underpinning for the concept. And whether to recycle OCI remains at the top of the list for many people.

Our future agenda consultation also recognises that many jurisdictions that have recently adopted IFRSs, or are about to adopt IFRSs have their own legitimate requests. The obvious candidates are foreign currency translation, business combinations under common control and agriculture, but there are many more that we could consider.

The most common request is for a period of calm. In some cases this is followed by, 'apart from this one very specific project'. The difficulty is that the 'very specific project' varies in different parts of the world, so difficult choices will have to be made if the period of calm is to become a reality. I suspect that after the somewhat frenetic period of the last few years, a slowing down in the pace of change would be welcomed by most if not all of our constituents.

Adapting to a global constituency

The final topic I will address is what we are doing to strengthen our ties with jurisdictions that have already adopted IFRSs, as well as those that are making plans to do so.

IFRSs are a wonderful example of market-driven global cooperation. The IASB has no ability to force any jurisdiction to adopt its standards. Jurisdictions choose to adopt the standards as they consider it to be in their best interests to do so. This is the basic premise of endorsement mechanisms that are used to incorporate IFRSs into national law around the world.

As a result, the IASB must work harder than almost any other international organisation to demonstrate that it has actively sought input from all jurisdictions, listened to the various arguments presented and clearly explained the rationale for the choices it has made. We are proud that the IASB's standard-setting process, outreach and stakeholder engagement activities have been independently assessed as best practice.

Furthermore, consistent with requests from the G20 and others, we have deepened our cooperation with prudential regulators and other international authorities with responsibility for aspects of the global financial system. The IASB is a committed member of the Financial Stability Board, established to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability.

However, more needs to be done. The preliminary conclusions of the Trustees' strategy review suggests that the IASB, while mindful of its independence, should explore enhanced ways to work in closer cooperation with national and regional accounting standard-setters as well as other public authorities with responsibility for accounting standards. This is important when seeking to develop global standards that can be applied in both developed and emerging market economies. International financial markets may be closely coupled, but not all markets are the same.

In the United States, Japan and many parts of Europe you see mature capital markets that are both deep and highly liquid. In other parts of the world you see markets that are growing at an astounding rate but from a much lower base, so applying market-based pricing, to pick one example, can be challenging. A single set of global accounting standards must be able to be applied, on a consistent basis, across all different types of financial markets within both developed and emerging economies.

Conclusion

The move towards global accounting standards is not the pipedream of accountants. It is an inevitable consequence of having globally interconnected financial markets, and a beneficial one. That is why I believe it is not a question of 'if' we will get there, but 'when' and 'how' we will do so. That is also the conclusion of the leaders of the G20 countries and financial supervisors around the world.

Progress is well advanced, but we also have much to do. My commitment to you is to lead an open, transparent and inclusive IASB—working in close cooperation with Japanese stakeholders—as we complete this transition to global accounting standards.

Hans Hoogervorst
Term begins: July 2011
Term expires: June 2016

Mr Hoogervorst is a former chairman of the executive board, the Netherlands Authority for the Financial Markets (AFM), and a former chairman of the IOSCO technical committee. He was appointed as a co-chair the Financial Crisis Advisory Group, a high level group of business leaders with experience of international markets, to advise the IASB and the FASB on their joint response to the financial crisis. He also served as Chairman of the Monitoring Board of the IFRS Foundation, oversight body of the IASB.

Between 1998 and 2007 Mr Hoogervorst held a number of positions in the Dutch Government, including minister of finance, minister of health, welfare and sport, and state secretary for social affairs. Prior to this Mr Hoogervorst served both as a member and senior policy advisor to the Dutch Parliament and the Ministry of Finance. He also spent three years as a banking officer for the National Bank of Washington in Washington, DC.

Mr Hoogervorst holds a Masters degree in modern history (University of Amsterdam, 1981) and a Master of Arts degree in international relations (Johns Hopkins University school of advanced international relations, majoring in international economics and Latin American studies).