STATEMENT OF SIR DAVID TWEEDIE
CHAIRMAN, INTERNATIONAL ACCOUNTING STANDARDS BOARD,
BEFORE THE
SUBCOMMITTEE ON SECURITIES, INSURANCE AND INVESTMENT
OF THE
UNITED STATES SENATE

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Mr Chairman and Members of the Subcommittee

I welcome this opportunity to appear before the Subcommittee to discuss the progress of the International Accounting Standards Board (IASB) and the relevance of International Financial Reporting Standards (IFRSs) to the United States and international capital markets more generally. The hearing is particularly timely. The IASB and the Financial Accounting Standards Board (FASB) just concluded their second joint meeting of the year yesterday, when we had the opportunity to review the progress of our convergence efforts. We at the IASB are also closely following the SEC's deliberations on its Proposed Rule and Concept Release regarding the use of IFRSs in the United States.

I am delighted that Conrad Hewitt, John White, and Bob Herz are here with me today, because the SEC and the FASB have been important partners in the effort to develop a single set of high quality international standards. Indeed, the SEC and the FASB were deeply involved in the establishment of the restructured IASB, and the structure, governance and independence of the IASB are largely modelled on the FASB's.

While it is my first time before this particular subcommittee, I have appeared three times previously before the Senate Banking Committee. The IASB greatly appreciates the continued support that the Senate Banking Committee has offered to the cause of convergence of accounting standards and the development of IFRSs. It was in the aftermath of Enron in

February 2002 when the Chairman of the Trustees at that time, Paul Volcker, and I first met the Committee. In the development of the Sarbanes-Oxley Act, the Committee acknowledged the potential benefits of international convergence and principle-based accounting standards. I am pleased to report that much progress has been made in those areas since that first meeting with the Committee.

A long way in a short time

At the time of my first appearance before the Banking Committee in 2002, the IASB had been in existence for less than a year. At our outset, we were established as a private sector, independent accounting standard-setter, based in London and comprising 14 members with a straightforward objective—to develop a set of high quality accounting standards that could be used in the world's capital markets.

Before the IASC Foundation was reconstituted in 2000 from a part-time body to the structure existing today, only a handful of countries throughout the world were using international standards. We have come a long way in a short time.

A lot of attention has been given to the European Union's adoption of IFRSs, and rightly so. The European Union's decision to adopt an internationally recognised set of standards, rather than create a uniquely European accounting system, provided the necessary encouragement for other countries to adopt a similar approach. The rationale behind the EU's decision was simple. Europe wanted to create a common capital market, and there were more than 25 different methods of accounting in today's EU Member States. In a world where business depends on capital from private and institutional investors, the lack of a common, well-respected financial reporting language in Europe was an impediment to economic growth and the development of capital markets to rival other areas of the world.

The movement towards IFRSs is truly global and extends well beyond Europe's borders. More than 100 countries throughout the world—108 according to the latest Deloitte IASPlus survey—require or permit the use of IFRSs. From our discussions with regulators and standard-setters, we expect this number to rise substantially within a relatively short time. As I said, the EU's adoption served as a catalyst. Australia, Hong Kong, New Zealand, and South Africa all joined Europe as early adopters. The major emerging and transition economies of the world—Brazil, China, India, and Russia—are adopting or considering the adoption of IFRSs, not US GAAP, in an effort to become integrated in the world's capital markets and attract the investment necessary to finance their development. Similarly, Canada, Chile, Israel and Korea, economies with significant ties with the United States, have all recently announced their planned abandonment of national standards for IFRSs. Recently, I was in Japan where the Accounting Standards Board of Japan announced its convergence programme with a target date of 2011.

There is clear momentum towards accepting IFRSs as a common financial reporting language throughout the world. But our success is incomplete, and there are a number of countries that are still notably absent from the list of IFRS-applicants, including the United States.

The United States and IFRSs

Wherever I go, I am always asked whether the United States will accept IFRSs. It is understandable that the United States is not among the first wave of IFRS adopters. The United

States has a well-established and respected standard-setting body in the FASB. US GAAP has served US capital markets well and is a system of accounting that provides a high degree of transparency, has been tested over a long period of time, and has had a high degree of acceptance internationally.

However, the world is changing. New centres of international capital formation are emerging, and companies and investors have a broader range of options. The realities of globalisation, the integration of the world's capital markets, and the emergence of IFRSs as a viable and high quality set of international standards are changing the policy equation. A number of studies, including the report commissioned by Senator Schumer and Mayor Bloomberg, have documented these trends.

As members of the Subcommittee know, the US requirement for non-US companies to reconcile to US GAAP has caused resentment among non-US companies forced to go through the reconciliation exercise. The hope of many foreign registrants is that their use of IFRSs will serve as a passport to markets throughout the world, including the United States. At the same time, US companies operating in multiple jurisdictions are now facing the costs associated with complying with both US GAAP and IFRSs in jurisdictions that have local filing requirements.

It is here that I must confess a bias on the topic of IFRS use in the United States. As I mentioned earlier, the objective of the IASB is to have a single set of high quality, principle-based standards used worldwide. Clearly, a system will not be truly global if the United States does not participate. It is for this reason the IASB has placed such high priority on convergence with US GAAP.

Nevertheless, I do not want to pass judgement on the value of the reconciliation or the likelihood of the United States accepting IFRSs as an alternative to US GAAP. I will leave that to the SEC. I will, however, attempt to provide some insights on how I view the convergence process and its potential benefits to the United States and to answer any questions that you may have regarding the IASB's operations.

The benefits for US companies are very similar to those already achieved in Europe. US multinational companies are now complying with different accounting standards in the jurisdictions in which they operate. As the use of IFRSs spreads, the accounts of those foreign subsidiaries are more often based on IFRSs. Permitting the use of IFRSs in the United States would reduce the compliance costs associated with consolidating the accounts of foreign subsidiaries and the potential for error associated with the conversion and consolidation exercise.

US investors are increasingly seeking investment opportunities overseas. A common financial language, applied consistently, will enable investors to compare more easily the financial results of companies operating in different jurisdictions and provide more opportunity for investment and diversification. The removal of a major investment risk—the concern that the nuances of different national accounting regimes have not been fully understood—should open new opportunities for diversification and improved investment returns. This point is particularly relevant at a time when companies, countries and individuals are increasingly dependent upon capital markets to provide a secure retirement for employees.

For auditors, a single set of accounting standards should enable international audit firms to standardise training and provide better assurance of the quality of their work on a global basis. An international approach for accounting should also permit international capital to flow more freely, enabling audit firms and their clients to develop consistent global practice to accounting problems and thus further enhance consistency. Finally, for regulators such as the SEC, the time and cost associated with needing to understand various reporting regimes would be reduced.

It is in this context that I believe that IFRSs and the process of international convergence offer an opportunity for the United States. The risk of any discussion of competition when it gets into regulatory issues is always the potential for a race to the bottom. However, the convergence process is aimed at avoiding such a situation, and early evidence suggests that countries that have adopted IFRSs from existing national standards have benefited.[1] Accounting standard-setting is a field of international co-operation in which the United States, through the FASB and the SEC, is encouraging a 'best of breed' approach to regulation and is improving the development of international capital markets.

Pursuing the joint work programme with the FASB

As I suggested, both the FASB and the SEC have been actively engaged in our work from the very beginning, and the FASB and the IASB have established joint work programmes. At the IASB, irrespective of any SEC decision on the future of the reconciliation requirement or the adoption of IFRS for some companies in the United States, we are committed to continuing working on our joint work programme with the FASB, which was most recently set out in our February 2006 Memorandum of Understanding (MOU).

[1] See Armstrong, Barth, Jagolinzer, and Riedel, "Market Reaction to IFRS Adoption in Europe," January 2007.

Our joint work represents an effort that began five years ago with the Norwalk Agreement. Our goal from the outset has been more ambitious than just eliminating differences in existing standards. Our aim is to improve quality of financial reporting worldwide by developing new solutions to accounting issues when standards have failed to provide sufficient transparency to make informed economic judgements. This strategy has yielded results, and both boards have made changes in their standards, bringing them closer into line.

I believe that our early progress following the Norwalk Agreement gave the SEC confidence in our processes that encouraged it to lay out the ‘roadmap’, which set out steps required to eliminate the need for companies using IFRSs to reconcile to US GAAP by no later than 2009 and is now in the form of a proposed rule.

From the standard-setting standpoint the SEC roadmap was significant. The IASB and the FASB would no longer need to concentrate on a possibly endless series of changes to get the reconciliation removed. In consultation with the SEC and the European Commission, the IASB and the FASB agreed that trying to eliminate differences between two standards that are both in need of significant improvement is not the best use of the FASB’s and the IASB’s resources—instead a new common standard should be developed that improves the financial information reported to investors.

It was in this context that in February 2006 the FASB and the IASB agreed on the new MoU that described their joint work programme for the coming years. (The MoU is attached as an appendix.) The FASB and the IASB agreed that convergence work should proceed on the following two tracks:

- First, the boards will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal is to complete or substantially complete work in those areas by 2008.

- Second, the FASB and the IASB will seek to make continued progress in other areas identified by both boards where accounting practices under US GAAP and IFRSs are regarded as candidates for improvement, culminating in common standards.

The majority of topics in the first area are now either completed or near to completion. The eleven topics on our longer-term joint work programme—the second track of the MoU—include items identified as part of SEC report on off balance sheet items and as part of a recent study by the Committee of European Securities Regulators, such as consolidations, post-retirement benefits, leasing and financial instruments, including dereognition. We also have joint projects on financial statement presentation and the accounting for revenue recognition, fair value measurement, derecognition, and intangible assets. We have just completed a joint project on business combinations.

Importantly, the topics in the second track would have been the ones that both boards would address independently of convergence. They are the challenging conceptual issues of the day. Our joint efforts could therefore signal a double win—improved accounting in important areas and the elimination of differences between US GAAP and IFRSs. It is in these areas that we have the ability to shape the financial reporting landscape to one that can cope with the complexity of today's financial markets.

The result of the convergence process, as outlined by the MoU, should lead to a situation where US GAAP and IFRSs have broadly converged by 2011 or 2012. This time frame makes allowance for the due processes of the IASB and the FASB, which are similar and require extensive public consultation and transparency.

I should say that the convergence programme with the US FASB will not produce totally identical financial statements in the short term. But it will result in close alignment of the accounting for the same transactions and those that are in essence the same.

It is understandable that those affected by the standard-setting process will want to know how the future will look. My hope is that the standards emerging from the FASB-IASB work programme will be very different from the style of many existing IFRSs and US standards. The IASB is firmly wedded to a principle-based approach to standard-setting, and I personally believe that the convergence programme will be useful in driving US GAAP away from the body of prescriptive rules that constituents have requested from the FASB. While it is a misnomer to say that US GAAP is rule-based, few would deny that the level of guidance in its accounting standards and the multiplicity of additional interpretations of that guidance have proliferated under US GAAP.

This is where convergence with IFRSs can help. As part of our MoU work, the FASB and the IASB are seeking another way forward—future joint standards have not only to be principle-based but should contain only a minimum of additional guidance. Going forward, we will demand that a good principle-based standard must pass four tests:

(i) Is the standard written in plain English? (This is also important to allow easy translation of our standards.)

(ii) Can the standard be explained simply in a matter of a minute or so? If not, why does it take longer? (Put another way, can only specialists understand it or can most accountants use it?)

(iii) Does it make intuitive sense?

(iv) Do managements believe that it helps them to understand and describe the underlying economic activity?

The use of principles should eliminate the need for anti-abuse provisions. It is harder to defeat a well-crafted principle than a specific rule that financial engineers can by-pass. A principle followed by an example can defeat the 'tell me where it says I can't do this mentality'. If the example is a rule then the financial engineers can soon structure a way round it. For example, if the rule is that, if A, B and C happens, the answer is X, the experts would restructure the transaction so that it involved events B, C and D and would then claim that the transaction was not covered by the standard.

A principle-based standard relies on judgements. Disclosure of the choices made and the rationale for these choices would be essential. If in doubt about how to deal with a particular issue, preparers and auditors should relate back to the core principles. The basis for conclusions (the rationale underlying a particular standard and published with it) should also include, in particular, the question of whether there is only a single view to tackle the economics of the situation. Often there are competing views—is one regarded as more relevant? If so, the reasons for choosing that particular view should be explained in the basis for conclusions and the reasons for rejecting the others clearly outlined.

All application guidance and examples to understand the principles have to be questioned. Would anything be missed if they were deleted? If guidance is necessary, is the principle sufficiently clearly stated? Does the standard include bright lines and arbitrary limits? Why are these necessary? Does the transition to the new standard follow the normal pattern? If not, why is a change proposed?

This is the vision that I have for the convergence of US GAAP and IFRSs, one that is achievable in a relatively short time.

I know that several commentators have voiced their concern that the elimination of the reconciliation requirement by the SEC would remove an important incentive for future convergence. I disagree. The IASB's objective is to have a single set of accounting standards used through out the world. The strategy laid out in the MoU provides a sensible approach for doing so, and my colleagues and I are committed to continuing these efforts. It is my personal opinion that the elimination of the reconciliation requirement would be a demonstration of the United States' commitment to IFRSs and will help solidify support for our work on the MoU internationally.

Ensuring consistent implementation of IFRSs

As you can tell, I am optimistic about the prospects for convergence and the implementation of IFRSs throughout the world. The implementation of IFRSs in Europe and elsewhere has gone relatively smoothly, and a new wave of countries are now adopting IFRSs. Adding a growing commitment from the United States towards IFRSs is an important element of the IASB's strategy, and the SEC's proposals have caught the imagination of those who doubted the motivations of the United States in the standard-setting process.

Of course, there are a number of challenges before we can state with confidence that a single set of common, high quality accounting standards is being used worldwide. Clearly, the implementation and enforcement of our standards will be important in determining our success. Commentators on the SEC's proposed rule on the reconciliation requirement have rightly understood the need for consistent application of IFRSs. Helping ensure the consistency and protecting the IFRS brand is a leading priority of the organisation. First and foremost, we are encouraging countries to resist the temptation of creating national flavours to IFRSs. As you know, the IASB cannot force anyone to take its standards; they have to be accepted by jurisdictions the world over. It is our job to convince national bodies that our consultation process is robust and that the outcomes merit the respect of the markets. We seek to do so through a rigorous due process. We are also engaging in our work policymakers, such as members of this subcommittee, and those parties affected by accounting standard-setting.

Second, the IASB has an interpretative body, the International Financial Reporting Interpretations Committee (IFRIC), which is similar to the FASB's Emerging Issues Task Force in structure. Overseen by the IASB, the IFRIC should remain the venue to resolve questions regarding the interpretation of standards.

Third, the IASB is working with securities regulators at the International Organization of Securities Commissions (IOSCO) and audit regulators, such as the International Audit and Assurance Standards Board (IAASB), to require clear statements regarding the implementation of IFRSs. We are in the process of proposing an amendment to the existing standards to help clarify such statements. This is not necessarily our preferred approach to the problem, but we wished to raise the profile of the issue. We will continue to be open to input on this important issue.

Lastly, I believe that the enforcement of standards will be an important key to the ultimate success of IFRSs, and securities regulators will therefore play a leading role. This role for the regulator will not go away if the SEC chooses to eliminate the reconciliation requirement, and to some extent the SEC might be better positioned to encourage consistent practices among US foreign registrants using IFRSs, and to co-operate with IOSCO and other regulatory groupings on consistent policy related to IFRS application, if IFRSs were accepted in the United States.

Work to be done

We are at a crucial point in the development of IFRSs. The United States has played an important role in encouraging the adoption of IFRSs throughout the world. More than 100 countries and growing are using IFRSs and are working hard to ensure their consistent application. The world's fastest growing emerging economies are converging with IFRSs.

This is no time for the IASB to rest on its laurels. We are certainly not complacent. The IASB recognises the relevance of its work to the world's economy and the wide range of interests at stake. It is up to us to make sure that we operate in a transparent and accountable manner, engage with and inform the main stakeholders on a timely basis, and develop standards that are of high quality, reflect economic reality, and are broadly respected.

It is understandable that the US policymakers are now considering the options for US markets regarding IFRSs. We appreciate this subcommittee's continued interest in IFRSs and international convergence, and the IASB is committed to working closely with the FASB to complete the work programme described in the MoU. At the same time, the IASB and our oversight Trustees are discussing ways in which we can strengthen our ties with the regulatory community.

We are close to creating a financial reporting infrastructure appropriate for the global modern economy. Let's work together to finish what has been started.

I look forward to hearing your views and answering any questions that you may have.

APPENDIX – Memorandum of Understanding

A Roadmap for Convergence between IFRSs and US GAAP—2006-2008

Memorandum of Understanding between the FASB and the IASB

27 February 2006

After their joint meeting in September 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued their Norwalk Agreement in which they 'each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained.'

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRSs). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard-setters and regulators.

The FASB and the IASB recognise that their contribution to achieving the objective regarding reconciliation requirements is continued and measurable progress on the FASB-IASB convergence programme. Both boards have affirmed their commitment to making such progress. Recent discussions by the FASB and the IASB regarding their approach to the convergence programme indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead, a new common standard should be developed that improves the financial information reported to investors.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards.

Consistently with those guidelines, and after discussions with representatives of the European Commission and the SEC staff, the FASB and the IASB have agreed to work towards the following goals for the IASB-FASB convergence programme by 2008:

Short-term convergence

The goal by 2008 is to reach a conclusion about whether major differences in the following few focused areas should be eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas.

Topics for **short-term convergence** include:

To be examined by the FASB	To be examined by the IASB
Fair value option*	Borrowing costs
Impairment (jointly with the IASB)	Impairment (jointly with the FASB)
Income tax (jointly with the IASB)	Income tax (jointly with the FASB)
Investment properties**	Government grants
Research and development	Joint ventures
Subsequent events	Segment reporting
FASB Note: *On the active agenda at 1 July 2005 ** To be considered by the FASB as part of the fair value option project	*IASB Note:* Topics are part of or to be added to the IASB's short-term convergence project, which is already on the agenda.

Limiting the number of short-term convergence projects enables the boards to focus on major areas for which the current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

Other joint projects

The goal by 2008 is to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

The FASB and the IASB also note that it is impractical, when factoring in the need for research, deliberation, consultation and due process, to complete many of the other **joint projects** by 2008. The two boards understand that during this time frame measurable progress on such projects, rather than their completion, would fulfil their contribution to meeting the objective set forth in the roadmap.

Furthermore, it is noted that the strategy regarding other joint projects and the goals described below should be consistent with one of the IASB's objectives of providing stability of its standards for users and preparers in the near term.

After consultations with representatives of the European Commission and the SEC staff and consistently with existing priorities and resources, the FASB and the IASB have expressed the progress they expect to achieve on their convergence project in the form of a list of 11 areas of focus. It is noted that these projects will occur in the context of the ongoing joint work of the FASB and the IASB on their respective Conceptual Frameworks. As part of their Conceptual Framework project, the FASB and the IASB will be addressing issues relating to the range of measurement attributes (including cost and fair value) to enable a public discussion on these topics to begin in 2006.

After considering the complexity of those topics and consultation requirements, the boards set the following goals for 2008 for convergence topics already on either their active agendas or the research programmes:

Topics already on an Active Agenda			
Convergence topic	Current status on the FASB Agenda	Current status on the IASB Agenda	Progress expected to be achieved by 2008
1. Business combinations	On agenda – deliberations in process	On agenda – deliberations in process	To have issued converged standards (projected for 2007), the contents and effective dates of which to be determined after taking full account of comments received in response to the Exposure Drafts.
2. Consolidations	On agenda – currently inactive	On agenda – no publication yet	To implement work aimed at the completed development of converged standards as a matter of high priority.
3. Fair value measurement guidance	Completed standard expected in the first half of 2006	On agenda – deliberations in process	To have issued converged guidance aimed at providing consistency in the application of existing fair value requirements.[2]
4. Liabilities and equity distinctions	On agenda – no publication yet	On agenda (will follow FASB's lead)	To have issued one or more due process documents relating to a proposed standard.
5. Performance reporting	On agenda – no publication yet	Exposure draft on a first phase	To have issued one or more due process documents on the full range of topics in this project.
6. Post-retirement benefits (including pensions)	On agenda – deliberations underway on the first phase of multi-phase project	Not yet on the agenda	To have issued one or more due process documents relating to a proposed standard.
7. Revenue recognition	On agenda – no publication yet	On agenda – no publication yet	To have issued one or more due process documents relating to a proposed comprehensive standard.

The objective of the goals set out above is to provide a time frame for convergence efforts in the context of both the objective of removing the need for IFRS reconciliation requirements by 2009 and the existing agendas of the FASB and the IASB. The FASB and the IASB will follow their normal due process when adding items to the agenda. Items designated as convergence topics among the existing research programmes of the boards include:

Topics already being researched, but not yet on an Active Agenda			
Convergence topic	Current status on the FASB Agenda	Current status on the IASB Agenda	Progress expected to be achieved by 2008
1. Derecognition	Currently in the pre-agenda research phase	On research agenda	To have issued a due process document relating to the results of staff research efforts.
2. Financial instruments (replacement of existing standards)	On research agenda and working group established	On research agenda and working group established	To have issued one or more due process documents relating to the accounting for financial instruments.

[2] The fair value guidance measurement project will not extend requirements for the use of fair value measurements, and any proposals regarding increasing the use of fair value accounting will be addressed in the context of the Conceptual Framework and other projects on the FASB's and IASB's respective agendas.

3. Intangible assets	Not yet on agenda	On research agenda (led by a national standard-setter)	To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project.
4. Leases	Pre-agenda research underway	On research agenda (led by a national standard-setter)	To have considered and made a decision about the scope and timing of a potential agenda project.

In setting out the projects for both the short-term convergence topics and the major joint topics, the FASB and the IASB recognise that with respect to its foreign registrants the SEC staff will undertake an analysis of their 2005 IFRS financial statements across companies and jurisdictions. This analysis may reveal the need for additional standard-setting actions by one of the boards or both. Furthermore, the FASB and the IASB note that their work programmes are not limited to the items listed above, but remain committed to fulfilling their contribution to meeting the objectives set out by the roadmap.

The FASB and the IASB also recognise the need to undertake this work in a manner that is consistent with their established due process, including consultation with interested parties on their ongoing joint efforts before reaching conclusions.