Hans Hoogervorst, E&Y IFRS seminar—January, 2012

Introduction

This is my first visit to Russia. I have always been fascinated by this country – by its people, by its history and by its culture.

As the sixth largest economy in the world and a member of the so-called 'BRIC' economies currently driving global growth, it is only logical that Russia would like to be home to a major financial centre. This is not yet fully the case.

Many large Russian companies raise capital in London or New York, while few international companies are listed on the Moscow Stock Exchange. I know that this is an area that Russia is now seeking to address, by putting into place the building blocks required to construct an international financial centre.

One of the most important of these building blocks is Russia's commitment to adopt International financial Reporting Standards (IFRSs) in full from 2012. It is important to note that Russia is doing this properly. No amendments to IFRSs. No additions. No omissions. Full IFRSs, as issued by the IASB and required for all publicly listed companies. This really is very impressive. Russia should be congratulated for its full and unambiguous commitment to global accounting standards.

As a result of this commitment, international companies using IFRSs will now be able to raise capital in Russia, while international investors will be entirely familiar with a set of Russian financial statements.

Reflecting this commitment to IFRSs, the IASB is fully committed to working in close cooperation with Russian stakeholders throughout the standard-setting process.

I will now like to turn to the business of today, and in particular the three topics that I will touch upon during my talk with you.

First of all I will bring you up to speed on the IFRS work programme—what's on our plate right now and how we see the future mapped out.

Second, I will offer my outlook on the prospects for global standards.

Third, I will say a few words on what we are doing to address the specific challenges faced by emerging economies such as Russia when applying IFRSs.

IFRS roadmap

Let's 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. 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.

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

The good news is that we appear to be making progress on all of these fronts.

The first of these projects is revenue recognition. Revenue is the top line number and is important to every business. It is all the more important that we get this standard right. Because the 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 we have got the balance about right.

Next is lease accounting. This is a difficult area, but one where improvements are 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.

All we ask is that these transactions are accounted for in a way that is transparent to investors. It seems odd to me that investors must guess what a company's liabilities from leasing are, even though management has this information at its fingertips. These obligations can be substantial.

The boards are finalising the revised proposals and we expect to publish a further exposure draft for public comment shortly. Once again, your input will be important 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 the worst financial crisis in 80 years 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 now have some difficult choices to make, beginning with classification and measurement.

We set out to replace IAS 39 with an entirely new standard.

We completed the first part of this work in less than a year, issuing IFRS 9 at the end of 2009. It is a very good standard. We reduced the complexity associated with IAS 39. We addressed the ‘own credit’ issue.

Our outreach efforts were widely praised. We sought input and revised our proposals in real time.

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 apart.

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 – 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 these changes are going to be limited, but in practice there will undoubtedly be pressure for wider adjustments. Nevertheless, the potential gains are clear. We will proceed with caution and limit any changes to those that are absolutely necessary.

On impairment, after exploring a number of alternative approaches, the IASB and FASB are finally on the same page with a workable model. We have recently agreed on an approach that divides expected loan losses into three categories - referred to by our staff as "The Good, The Bad and The Ugly."

I am hopeful that we are now in a position to move quickly to the exposure draft stage. Again, we need to get this one right.

All being well, the boards should 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 publish on 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 additional 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.

Finally, let me address the insurance project. This is another tough one.

When the IASB began its work in 2001 it knew the industry needed guidance while the Board took the time to develop a new standard. And so, the Board recommended the continued use of local accounting practices for insurance transactions.

As a result, there continues to be a great deal of diversity and complexity in how insurance companies report their numbers.

Investors often talk about insurance accounting being a ‘black box’. This lack of transparency can lead to insurance companies to trade at a discount relative 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. 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?

Well, 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?

There are some obvious candidates for the future agenda.

Everyone is asking us to complete the conceptual framework - the philosophical and methodological underpinning of our work. We will take a serious look at this.

We are also hearing loudly and consistently that we should look at performance reporting and Other Comprehensive Income. However, views on how we should go about this work are mixed.

Some advocate the elimination of Other Comprehensive Income. Others want to retain it, but argue for a stronger underpinning of the concept.

Whether to recycle OCI or not also remains at the top of the list for many people.

Our future agenda consultation recognises that many new jurisdictions such as Russia have their own legitimate requests - including foreign currency translation, business combinations under common control, agriculture and many more. We will have to make a judicious choice here, being mindful that we do not overload our agenda.

The most common request is for a period of calm. In some cases this request 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.

However, 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.

Prospects for global standards

The second topic I would like to discuss is the prospects for global accounting standards.

As I have already observed, we have made remarkable progress in ten years. Before the IASB was established everyone did their own thing, which made international comparability very difficult.

Since then, progress has been truly remarkable. IFRSs are now required or permitted for use by companies in more than 100 countries.

The move towards global accounting standards is seen as an essential part of the global financial reform agenda, providing the transparency on which to build a better, more resilient global financial infrastructure.

The majority of G20 members now require the use of IFRSs. With Russia joining Brazil in fully adopting our standards, the BRICs are more than half-way there. Real progress is also underway in China and India.

China has come a very long way in a very short period of time. Chinese accounting standards are now closely aligned with IFRSs.

To come fully on board, China just has to take some small steps. I am convinced that a country that is used to making great strides forward will make this very small step too.

Indian authorities are in the process of substantially revising their accounting standards. India still has obstacles to overcome on the way to full adoption. However, I was in India last week and I sensed a real desire for them to come fully on board.

Regarding Japan, the IASB and the Accounting Standards Board of Japan (ASBJ) have worked together for many years to bring about convergence of IFRSs and Japanese GAAP.

In recognition of this work, Japan now allows large international Japanese companies to report using IFRSs.

Several Japanese companies have already done so and I believe that many more are planning to follow suit.

Furthermore, Japan is expected to decide this year whether to mandate a national transition from Japanese GAAP to IFRSs, and if so, when. There has been some debate about the transition period if Japan were to decide to fully commit itself to IFRSs, but this is secondary to the actual decision to switch.

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 in public 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 described by the SEC staff's work plan. It is also important to note that the US is committed to supporting global accounting standards. It is SEC policy, it is US Government policy and it is the policy of the G20, in which the US is a key player.

There are many practical challenges facing the SEC in making the decision. I don't 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.

Support for emerging economies

The third and final topic I want to touch upon is what we are doing to support Russia and other emerging economies that have adopted IFRSs.

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, such as Russia, 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.

Consistent with requests from the G20, we have taken a number of steps to ensure that the needs of emerging economies feed into the standard-setting process.

First, we have established an Emerging Economies Group (EEG), of which Russia is a founding member.

The EEG is chaired by the IASB with the secretariat provided by the Chinese Ministry of Finance. The group has met twice and the prospects are encouraging.

Second, the constitution of the IFRS Foundation has been amended to take account of a broad range of stakeholders, both by type and location. As a result, emerging economies have the opportunity to be well represented among the Trustees, on the Board and in our various advisory bodies.

Third, we have significantly expanded the amount of outreach we do outside the established financial centres of London, New York and Tokyo.

This conference, supported by the IFRS Foundation, is a good example of this programme of work. Wayne Upton, our Director of International Activities, continues to prioritise outreach in emerging economies and has visited 16 countries in the last year.

Finally, we consult with emerging economies on IFRS policy matters. In June last year, the IFRS Foundation held its second IFRS International Policy Forum in Indonesia. Representatives from standard-setters, central banks, regulators and governments from more than 20 countries attended the event.

Conclusion

Ladies and gentlemen, I am grateful for your attention. We have a lot on our plate right now. We will complete the remaining convergence projects to a very high standard. At the same time, we will carefully consider our future agenda and play close attention to the needs of our newer members, such as Russia.

We are closer than ever to moving from ‘international’ financial reporting standards to ‘global’ financial reporting standards.

You have committed yourselves to using our standards in full. My commitment to you is that we will support you every step of the way.

Thank you for your time. I wish you a very successful conference.