

## IFRS in Europe and the US: lessons learned and challenges ahead

### Introduction

On 30 September and 1 October 2008, members of the European and North American Audit Committee Leadership Networks met to discuss a range of issues,<sup>1</sup> including International Financial Reporting Standards (IFRS). During the course of the summit, members were joined by Philippe Danjou, member of the International Accounting Standards Board (IASB); Sir Callum McCarthy, immediate past chairman of the UK's Financial Services Authority (FSA); Charlie McCreevy, European Commissioner for the Internal Market and Services; and Ethiopis Tafara, Director of the Office of International Affairs at the US Securities and Exchange Commission (SEC). For further information on the networks, see "About this document," on page 11.<sup>2</sup> For a full list of participants, see Appendix 1, on page 12.

### Executive summary

On 27 August, the SEC agreed, in a unanimous vote, to publish for public comment a Roadmap that could result in all US issuers reporting under IFRS by 2016.<sup>3</sup> The Roadmap includes a provision that would permit US companies within the top 20 in terms of market capitalisation, in those industries in which IFRS is already the dominant standard, to begin filing their statements under IFRS after 15 December 2009. (Approximately 110 companies in about 34 industries would be eligible.)<sup>4</sup> In addition, the Roadmap contains several milestones that must be achieved by 2011 in order for the SEC to require mandatory reporting under IFRS, beginning in 2014 for large accelerated filers.

This decision comes less than one year after the SEC dropped its requirement that foreign private issuers reporting under IFRS reconcile their reporting with US Generally Accepted Accounting Principles (US GAAP) and just three years after the European Union's (EU's) adoption of IFRS. With more than 100 countries around the world currently requiring or permitting over 12,000 companies to report under IFRS, many agree the SEC's Roadmap signals the undeniable convergence of global accounting standards, with IFRS emerging as the global standard.

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<sup>1</sup> Other summit discussions included "Finding a balanced approach to global regulation," and "Enterprise risk: recurring challenges and new considerations for the audit committee." *ViewPoints* on both of these discussions can be found at [http://www.tapestrynetworks.com/networks/net\\_audit\\_summit3.html](http://www.tapestrynetworks.com/networks/net_audit_summit3.html).

<sup>2</sup> *ViewPoints* reflects the use of a modified version of the Chatham House Rule whereby names of members, guests and company affiliations are a matter of public record, but comments made by members before and during meetings are not attributed to individuals or corporations. However, Messrs Danjou, McCarthy, McCreevy and Tafara, who were all speaking in a personal capacity and whose views do not necessarily represent those of their organisations, have given permission for their comments to be attributed. Comments made by participants at the summit are shown in italics.

<sup>3</sup> Securities and Exchange Commission, "SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Financial Information More Easily," press release, 27 August 2008. Available at <http://www.sec.gov/news/press/2008/2008-184.htm>.

<sup>4</sup> Ernst & Young, "SEC proposes roadmap for IFRS adoption in the US," *Hot Topic 20*, 27 August 2008, 2. Available at [http://www.securitization.net/pdf/EY/RoadmapIFRS\\_27Aug08.pdf](http://www.securitization.net/pdf/EY/RoadmapIFRS_27Aug08.pdf)



The summit's discussions on IFRS and accounting standards focused on the following topics:

- **Fair value accounting: weathering the financial crisis?** *(Page 2)*

Fair value accounting, a requirement under both IFRS and US GAAP, has become a topic of considerable debate in the context of the global credit crisis. Audit chairs<sup>5</sup> were interested in hearing how regulators and standards setters are responding to calls for its suspension on both sides of the Atlantic. At the summit, the discussion covered the pros and cons of fair value accounting and the likely outcome of the debate. Regulators and standards setters stressed the dangers of changing standards in the midst of the financial crisis and pointed out that investors are likely to fear companies would use the suspension of fair value to hide still-worse problems.

- **A new timeline and the challenge of accounting standards in flux** *(Page 4)*

The US announcement of a Roadmap for the adoption of IFRS introduces a new and complex timeline for US and European companies. Over the next decade, some of the most important points on the timeline include the end of the IASB moratorium on new standards (2009), the possibility of up to 110 US companies voluntarily reporting under IFRS (2009–10), significant progress on the Financial Accounting Standards Board (FASB) and IASB convergence projects (2011) and the SEC's decision regarding mandatory reporting under IFRS (2011). Audit chairs questioned whether the current crisis will impact this timeline. US audit chairs attending the summit said their companies are unlikely to become early adopters of IFRS due to their focus on the consequences of the financial crisis and the numerous changes that are expected to IFRS as a result of the FASB and IASB convergence projects. European audit chairs offered practical tips for the conversion to IFRS.

- **Challenges ahead: the future of standards setting** *(Page 9)*

With a likely US move to IFRS, audit chairs raised questions regarding the future of standards setting, particularly around the issues of accountability, political influence and responsiveness to users. Mr McCreevy discussed the IASB's establishment of a monitoring group to ensure its accountability to EU member states. Other efforts to increase responsiveness include the IASB's broadening of the membership of the International Financial Reporting Interpretations Committee (IFRIC) and the FASB's creation of the Investors Technical Advisory Committee. Mr Danjou highlighted for audit chairs the inherent tension between users' demands for shortened timeframes for new standards and clarifications from the IASB, and the need to honour the IASB's due process.

## **Fair value accounting: weathering the financial crisis?**

International Accounting Standard (IAS) 39 (Financial Instruments: Recognition and Measurement) requires measuring an instrument at its fair value. One of the main sources of contention with fair value accounting has been the valuation of assets and liabilities for which no market value exists and the consequent use of complex valuation techniques and models. Like many market participants, European audit chairs feel that IAS 39 has, in part, contributed to market instability during the credit crisis. One audit chair recently said, "Clearly the new

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<sup>5</sup> This document uses the term audit chair to include all summit participants who are members of audit committees.

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IFRS standards did not generate [the crisis], but [they] accelerated the financial consequences. [They are] creating a high level of volatility, especially for banks, insurance companies and investors.” Experts argue, however, that the instability was generated by the inherent volatility of the financial instruments that companies were holding, rather than the use of fair value accounting.

In the United States, Financial Accounting Statement (FAS) No. 157 (Fair Value Measurements) was issued by the FASB in 2006 and became effective at the start of the 2008 fiscal year, just as the financial crisis took hold. Similar to the challenges that users of IFRS faced with IAS 39, users of US GAAP have run into difficulties valuing assets and liabilities for which there is no market. Critics of the standard, most often members of Congress and Wall Street executives, say it creates too much volatility and presents a misleading picture of a company’s assets, particularly for thinly traded assets. Some have gone so far as to assert that fair value accounting directly influences value.

A vociferous debate about fair value has ensued, with US congressional leaders from the Democratic and Republican political parties, French President Nicolas Sarkozy and groups such as the Institute for International Finance (IIF) calling for a major reconsideration of its use or, at a minimum, for a mechanism to suspend its application during severe market disruptions.

Standards setters have felt compelled to respond to criticism. The IASB has supported fair value accounting, with its chairman, Sir David Tweedie, stating, “It is undoubtedly difficult to value complex, illiquid, structured credit securities ... My personal view is that showing the changes in values of these securities, even if imperfect, provides much needed transparency and enables markets to adjust in a necessary, even if painful manner.<sup>6</sup> At the summit, Mr Danjou reiterated the IASB’s position: *“Accounting should be neutral [and] report [values] as they are today. We think fair value is the answer when financial instruments are acquired or incurred with a view of trading or otherwise to realize value through their sale.”* However, standards setters have been forced to react to criticism and have undertaken several initiatives to aid market participants in applying fair value accounting. See box on page 4.

Speaking at the summit, Mr McCreevy said there were merits on both sides of the argument, but expressed some concerns about changing the rules in the middle of a crisis: *“I don’t think at the present time you can change it – the markets are so feeble now ... it might make matters worse.”* Mr Tafara commented that *“calls for a suspension reflect one side of the argument. Investors need information to decide on the allocation of their capital. I believe suspending mark-to-market accounting would have a negative impact on market liquidity.”*

Most audit chairs participating in the summit, particularly those who sit on the boards of financial institutions, agreed that despite the difficulties that fair value accounting presents, changing the standards now is risky because of the delicate nature of the current market conditions. One US audit chair stated, *“We need to see where the bottom of the housing market is; otherwise, fooling with [fair value] is nuts. Let’s hit bottom first.”* Audit chairs also agreed with Sir David that fair value provides the transparency investors need in order to re-establish their confidence.

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<sup>6</sup> Sir David Tweedie. Speech to the Empire Club of Canada, Toronto, 25 April 2008, 1. Available at [http://www.iasb.org/NR/rdonlyres/A7987D28-D55C-4A8B-B162-F848406DE2D0/0/Sir\\_David\\_Tweedie\\_Empire\\_Club\\_Speech.pdf](http://www.iasb.org/NR/rdonlyres/A7987D28-D55C-4A8B-B162-F848406DE2D0/0/Sir_David_Tweedie_Empire_Club_Speech.pdf).



## Recent major fair value initiatives by standards setters

- **IASB expert advisory panel.** In June, the IASB convened a panel to identify practices experts use to value financial instruments when markets no longer exist for them. The result was an exposure draft that provides information and guidance, without new requirements, for companies using IFRS or other GAAP. Speaking at the summit, Mr Danjou stated, “[The expert panel] led to a series of best practices that we have published in a [draft] white paper. [Perhaps] regulators will endorse it as a code of conduct.”
- **SEC/FASB guidance.** On 30 September, the SEC Office of the Chief Accountant and the staff at the FASB released clarifications on fair value accounting, followed by additional interpretive guidance from the FASB on 3 October. Subsequently, the IASB released a statement saying that it considered the guidance “consistent with IAS 39 ... The IASB will continue to ensure that any IFRS guidance is consistent with the clarification that has been provided by the US SEC staff and the FASB staff for those companies using US GAAP. This will help ensure comparability across borders.”<sup>7</sup> In order to further reduce differences between IFRS and US GAAP with respect to fair value, the IASB released an amendment to IAS 39 on 13 October. The change allows banks to reclassify certain assets in “rare” circumstances, which is consistent with US GAAP.<sup>8</sup>
- **SEC review.** The Emergency Economic Stabilization Act of 2008 included two provisions on fair value accounting. Section 132 reaffirms the SEC’s authority to suspend FAS 157 “if the Commission determines it necessary or appropriate in the public interest and [for] the protection of investors.”<sup>9</sup> Section 133 requires the SEC to conduct a study, to be completed by 2 January 2009, on whether the standard exacerbated the crisis in the banking sector.

## A new timeline and the challenge of accounting standards in flux

With the US announcement of a Roadmap for the adoption of IFRS, the near-term picture for financial preparers in Europe and the United States is one of great change and complexity. Participants in the summit discussed the timeline for convergence, with a specific focus on:

- 2009: the IASB moratorium on new standards ends
- 2009–10: up to 110 US global companies could voluntarily report under IFRS
- 2011: the FASB and IASB are expected to complete convergence projects
- 2011: the United States will make a decision on mandatory reporting

<sup>7</sup> International Accounting Standards Board, “IASB announces next steps in response to credit crisis,” press release, 3 October 2008. Available at <http://www.iasb.org/News/Press+Releases/IASB+announces+next+steps+in+response+to+credit+crisis.htm>.

<sup>8</sup>International Accounting Standards Board, “IASB amendments permit reclassification of financial instruments,” press release, 13 October 2008. Available at <http://www.iasb.org/NR/rdonlyres/7AF46D80-6867-4D58-9A12-92B931638528/0/PRreclassifications.pdf>.

<sup>9</sup> The complete text of the Emergency Economic Stabilization Act of 2008 is available at <http://financialservices.house.gov/essa>. The text quoted here is from pp. 87–88.

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## Global convergence towards IFRS, 2001–16

	2001–5	2006–10	2011–16
<b>International accounting standards</b>	<p><b>2001</b> – Governing body overhauled: (1) new board created, chairman appointed; (2) renamed IASB.</p> <p><b>2002</b> – "Norwalk agreement" signals convergence with US GAAP.</p>	<p><b>2006</b> – Moratorium on major changes to IFRS begins.</p> <p><b>2006</b> – Announcement of major convergence projects with the FASB.</p> <p><b>2008</b> – Announcement of acceleration of convergence projects, with 2013 set as the date for global adoption of IFRS.</p> <p><b>2009</b> – Moratorium ends. Three changes to be made to IFRS, including: business combinations, financial statement presentation and de-recognition.</p>	<p><b>2011</b> – Expected completion of major convergence projects – with new standards rolled out.</p>
<b>EU</b>	<p><b>2002</b> – Announcement that all EU public companies will use IFRS by 2005.</p>	<p><b>2005</b> – IFRS (with EU "carve-out") adopted</p>	
<b>US</b>	<p><b>2005</b> – Announcement of intention to drop US GAAP reconciliation requirement for foreign filers.</p>	<p><b>2007</b> – Vote to remove requirement that foreign filers reconcile; issuing of concept release on allowing US companies to file under IFRS.</p> <p><b>2008</b> – SEC announces Roadmap for US adoption of IFRS that could lead all US issuers reporting under IFRS by 2016.</p> <p><b>2009–10</b> – First companies could voluntarily report under IFRS; up to 110 US companies in 34 industries (those in which IFRS is dominant standard).</p>	<p><b>2011</b> – SEC decision to be made on mandatory adoption schedule if Roadmap milestones have been achieved: (1) major convergence projects are completed; (2) IASB is self-funded; (3) IFRS is XBRL-compatible; and (4) IFRS education in United States has improved.</p> <p><b>2012–13</b> – Other large companies may be allowed to voluntarily adopt IFRS.</p> <p><b>2014–16</b> – If SEC decides to go forward on mandatory adoption, it would begin in 2014 over three years, phased in by the size of companies.</p>
<b>Rest of world</b>	<p><b>2003</b> – Other economies, including Australia, Hong Kong and New Zealand, commit to adopting IFRS.</p>	<p><b>2007</b> – China adopts standards based on IFRS.</p>	<p><b>2011</b> – Canada, India and Korea to adopt IFRS. Japan to remove major differences between Japanese GAAP and IFRS.</p>

### 2009: the IASB moratorium on new standards ends

Just after the EU's move to IFRS, the IASB agreed not to require the application of any new IFRS or major amendments to existing IFRS until after 1 January 2009. The moratorium on changes came into effect in July 2006 as a result of pressure from users still struggling with the implementation of the initial standards. Prior to the summit, European audit chairs raised questions regarding what would emerge from the IASB with the moratorium ending in 2009. Expectations had developed in the market for an IFRS "Version 2.0." Speaking at the summit, Mr Danjou clarified the situation: *"Except for two standards and a change in presentation, all we have done is make minor, technical changes in wording or application guidance; there are no philosophical*

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*changes, so the [phrase 'Version 2.0'] is not valid ... We have a [memorandum of understanding] between IASB and FASB, and it de facto implies that we will have a stable platform until 2011. We will finalize standards in 2010–2011, and at that point, we will have a Version 2.0.”*

## **2009–10: up to 110 US global companies could voluntarily report under IFRS**

The SEC's Roadmap proposes that US companies meeting two specific criteria may begin filing statements under IFRS on or after 15 December 2009. In order to qualify for this limited early use, companies must be (1) one of the top 20 in their industry, according to global market capitalisation and (2) in an industry in which IFRS is the dominant accounting standard.<sup>10</sup> Based on a preliminary assessment by the SEC, approximately 110 companies across 34 industries could qualify for this provision.

Companies that meet these criteria will need to consider the pros and cons of such a move, especially given that the SEC will not make a final decision on whether to require reporting under IFRS until 2011. For eligible US companies with significant foreign subsidiaries already reporting locally under IFRS, the decision may be easier: moving the whole company to IFRS removes the need for internal reconciliation from IFRS to US GAAP for the purpose of their consolidated financial statements, thereby reducing costs and removing a potential source of error.

However, few US audit chairs voiced interest in early adoption at the summit. One audit chair commented, *“We've looked at this over the past year and decided we don't want to be an early adopter. We are waiting to see where this goes in the next six months.”* Other audit chairs noted that possible changes to IFRS in 2011 as result of convergence may be a deterrent to early adoption. Mr Danjou pointed out, however, that although *“there will be some major changes, for example in business combination accounting ... these will change with FASB too ... Most current projects are joint projects and they are all significant ... Even if you are not an early adopter, you will have the same degree of change within US GAAP.”*

## **2011: the FASB and IASB are expected to complete convergence projects**

On 11 September 2008, the FASB and IASB published a revised memorandum of understanding stating the goal of having all major joint convergence projects completed by 2011. Danita Ostling, a partner and Americas IFRS leader at Ernst & Young, said in an interview with *CFO.com*, *“The more similar the standards are, the fewer differences there are and the less work it will be for US companies when it comes time to convert.”*<sup>11</sup> At the summit, one participant noted that *“in reality, the difference [between US GAAP and IFRS] is quite minimal, and convergence continues.”*

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<sup>10</sup> Out for public comment is the additional requirement for these companies to report previous years' financial statements under IFRS, with two options currently being explored: (a) a one-year reconciliation of the issuer's financial statements from IFRS to US GAAP or (b) an unaudited three-year reconciliation of the issuer's financial statements from IFRS to US GAAP, until the use of IFRS becomes mandatory. See Ernst & Young, “SEC proposes roadmap for IFRS adoption in the US,” 2.

<sup>11</sup> Sarah Johnson, “Goodbye GAAP,” *CFO.com*, 1 April 2008. Available at <http://www.cfo.com/article.cfm/10919122>.



## 2011: the United States will make a decision on mandatory reporting

There are several milestones that must be met by 2011 in order to proceed with a decision on the mandatory use of IFRS for US issuers:

- Improvements in accounting standards, based on the IASB and FASB convergence work
- Accountability and funding of the International Accounting Standards Committee Foundation (IASCF) that would enable it to remain a stand-alone, private-sector organisation
- Increase IFRS usage of interactive data (eXtensible Business Reporting Language, or XBRL<sup>12</sup>)
- Improvements in IFRS education and training
- Successful limited early use of IFRS by qualified US companies.<sup>13</sup>

If the SEC judges these milestones to have been reached by 2011, it will consider proceeding with a phased introduction of IFRS for large accelerated filers beginning in 2014, followed by smaller filers in 2015 and 2016.

At the summit, US audit chairs said they wished to be prepared for a conversion to IFRS, yet they wondered whether the current crisis would delay the US conversion process. Mr Danjou stated, *“It is a good idea to start now, not wait ... The conversion process for [Europe] actually began in 2003. If, as a company, you wait until 2011, you will not have much time. If you act sooner, you have up to six years.”* One US audit chair said, *“What if we get there, and [the SEC] says no [to mandatory reporting under IFRS]?”* A European audit committee chair warned US audit chairs not to delay: *“If we take more time, it won’t help. It will just lead to less interest. If we want one system (and I say we do), the solution is to make the move.”*

Other audit chairs mentioned the strain the conversion will place on finance and accounting staff. One US audit chair stated *“We have a [Sarbanes-Oxley] hangover,”* and said that as a result, a great deal of *“push and pull”* will be required to make a US conversion to IFRS successful. Both before and during the summit, European audit chairs and IFRS experts provided US audit chairs with practical tips on handling the conversion. While not exhaustive, this list provides a starting point for audit committee chairs when considering the conversion process. See also Appendix 2 (page 13) for key questions for audit committees to ask ahead of the conversion.

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<sup>12</sup> The consortium that developed XBRL describes it as “a language for the electronic communication of business and financial data which is revolutionising business reporting around the world ... it is one of a family of ‘XML’ languages which is becoming a standard means of communicating information between businesses and on the internet.” More information is available at the consortium’s website, <http://www.xbrl.org/Home/>.

<sup>13</sup> Ernst & Young, “SEC proposes roadmap for IFRS adoption in the US.”

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## Practical tips for a conversion to IFRS

- **Conduct training.** Most audit chairs agree on the importance of training for everyone involved. One audit chair stated, "Make sure that you have some real on-the-job training for the audit committee ... It is hard to get your head around the real implications of IFRS."
- **Plan ahead.** An audit chair stated, "It is important to be extremely methodical ... we felt quite pressured time-wise." Another said, "I think [US audit committees] take [conversion] far too lightly. I feel they are playing on the long term."
- **Consider the first-mover advantage.** Differing interpretations of the standards are possible. Industry leaders may be interested in getting out in front of competitors. An audit chair stated, "In my personal experience in implementing IFRS, and being one of the largest in the industry [in my country], I would fight to be the first one to make a decision in a grey area ... There is an advantage to being the first leader. I have seen that clearly."
- **Run IFRS and US GAAP side by side for a period.** One audit chair had a bad experience undertaking the conversion in a piece-by-piece way: "It is actually better not to do a piecemeal [approach] over different topics ... but to run a parallel system until you've got it."
- **Conduct a dry run.** An audit chair said, "You almost [surely] get it wrong the first time. After the first adoption, you find you make different decisions than the other people in your industry took."
- **Communicate internally.** Several audit chairs stressed the importance of good internal communication: "Getting your finance community as a whole educated and supporting it is difficult; it's not hard to understand the technical [aspects], but ... getting your accountants in your subsidiaries to really appreciate what IFRS is all about is hard work."
- **Communicate externally.** One audit chair noted, "You should ... take the time to explain why the numbers look different, which sets you up for a better trajectory afterwards. There will be less volatility." At the summit, Mr Danjou said, "*Never underestimate the need to educate the shareholder and clarify the impact. And don't overestimate the analysts' understanding of IFRS.*"
- **Consider the implications for your entire organisation.** Shifting to IFRS has implications throughout a company: "Everyone starts by saying, 'we are not letting a change of accounting change our price of product,' but within two years of time, it changes ... On an accounting basis, it changes the way we design our products, remuneration schemes and our third-party arrangements with suppliers. You don't have to do all this up front, but you need to understand that this will be a key driver of the finance of the organisation."



## Challenges ahead: the future of standards setting

The governance of standards setters is a contentious issue in Europe and the US, in the corporate and investment communities and among politicians. Concerns have grown in recent years as convergence towards global standards moves forward and as accounting changes have become more frequent and pervasive. The fact that the United States will adopt IFRS, if key milestones are achieved, could exacerbate these concerns. See Appendix 3 (page 14) for an overview of key bodies that set, interpret and enforce IFRS and US GAAP.

### Governance and accountability

The entities that set accounting standards are under pressure to ensure they conduct their business free from political influence and, at the same time, to be sufficiently accountable.

In the case of the IASB, international regulators have led the way in calling for enhanced accountability. In a combined statement late last year, the European Commission, Japan's Financial Services Agency, the International Organization of Securities Commissions (IOSCO) and the SEC proposed strengthening the framework of International Accounting Standards Committee (IASC) Foundation (the parent of the IASB). The IASB responded by proposing the creation of a monitoring group of public authorities and international organisations, the expansion of its membership (to 16 from 14) and new guidelines regarding the geographical diversity of its members. The monitoring group would approve the appointment of IASC trustees and potentially have influence over the IASB's budget, funding mechanisms and operations. The IASB's proposal "is aimed at enhancing the transparency and public accountability of the IASC Foundation, while not impairing the independence of the standard-setting process."<sup>14</sup> Speaking at the summit, Mr McCreevy said, *"This represents an improved governance structure and dual recognition. Hopefully it will be a satisfactory [mode of operation]. I recognise [the IASB] needs accountability to [EU] member states."*

Audit chairs foresee that the issue of accountability and political influence will become more important as the US adopts IFRS. In a pre-summit conversation, a European audit chair said, "The SEC could take charge of IFRS, and that would be really bad. Our experience [with the SEC] has never been very good. They are very polite, but you can never change their mind." Similarly, concerns are beginning to emerge in the United States about the IASB setting standards for the US capital markets.

### User influence over standards

Both the IASB and the FASB have been criticised for not listening sufficiently to the views of users of financial statements and for being too theoretical in their approach. As one European audit chair put it in a pre-summit discussion, "[The IASB] is so far away from practitioners that people behind the IASB are looked upon [negatively] ... because [IFRS is] impossible to implement ... There is a gap between IFRS, the IASB and the practitioners. The IASB is adrift of real practice."

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<sup>14</sup> International Accounting Standards Committee Foundation, "Trustees publish proposals on enhancements to accountability and to IASB composition," press release, 21 July 2008. Available at <http://www.iasb.org/News/Press+Releases/Trustees+publish+proposals+on+enhancements+to+public+accountability+and+to+IASB+composition.htm>.

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In recent years, the IASB has been making an effort to increase its use of user input. Last year, for example, it broadened the membership of the International Financial Reporting Interpretations Committee (IFRIC), which provides guidance on interpreting IFRS, to include more practical experience.<sup>15</sup> Even so, European audit chairs continue to be concerned about how slowly IFRIC appears to work.

The IASB has also taken steps to be responsive to users during the credit crisis. At the summit, Mr Danjou stated, *“The current [credit crisis] issues are important to address without delay.”* He also highlighted the inherent tension between the need to be responsive to certain constituents on one side who continually push to shorten the IASB’s timeline for new standards or clarifications, while respecting the need for the IASB’s due process. The day after the summit concluded, the IASB issued a press release addressing *“(1) Consistency of fair value measurement guidance between IFRSs and US GAAP ... (2) ... The possible impact of the US Emergency Economic Stabilization Act of 2008 and other similar programmes internationally on the valuation of assets and liabilities ... (3) ... The ability to reclassify financial instruments ... [and] (4) [The IASB’s] willingness to participate in any study on the impact of accounting in the credit crisis.”*<sup>16</sup>

US standards setters have also made changes. Most recently, the Financial Accounting Foundation, the parent of the FASB, made changes to its decision-making process that incorporate the investor perspective more directly.<sup>17</sup> The FASB has also made efforts to incorporate the views of analysts and investors. In 2003, it created the User Advisory Council; in 2005, it created the Investor Task Force; and, most recently, in 2007, it created the Investors Technical Advisory Committee.<sup>18</sup>

Nonetheless, the issue of user influence remains an important topic as convergence progresses. As the US Council of Institutional Investors (CII) asserted in its response to the SEC’s announcement of the Roadmap, *“The views and needs of investors are paramount to the international standards setter,”* moreover, the CII stressed that *“the international standards setter [should have] significant investor representation.”*<sup>19</sup> No doubt, corporate users share the same desire for influence.

## Conclusion

In any other circumstances, the US announcement of a Roadmap for the adoption of IFRS would have spurred audit committees on both sides of the Atlantic to start exploring the impact of such a move on financial reporting for their industries, their companies and their audit committees. The current financial crisis, however, has pushed other considerations to the sidelines. Audit chairs attending the summit were more interested in the

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<sup>15</sup> International Accounting Standards Board, “IASB Foundation, amends Constitution to expand the practical experience of its Interpretation Committee,” press release, International Accounting Standards Committee Foundation, 20 December 2007. Available at <http://www.iasb.org/News/Press+Releases/IASC+Foundation+amends+Constitution+to+expand+the+practical+experience+of+its+Interpretations+Committee.htm>.

<sup>16</sup> International Accounting Standards Board, “IASB announces next steps in response to the credit crisis,” press release, 3 October 2008. Available at <http://www.iasb.org/NR/rdonlyres/C852569A-8BA6-4636-8C0D-DB7EEB088A26/0/IASBannouncesnextstepsinresponsetothecreditcrisis.pdf>.

<sup>17</sup> Financial Accounting Foundation, “The Financial Accounting Foundation Board of Trustees Approves Changes to Oversight, Structure and Operations of FAF, FASB and GASB,” press release, 26 February 2008. Available at <http://www.fasb.org/faf/nr022608.pdf>.

<sup>18</sup> Financial Accounting Standards Board, “Financial Accounting Standards Boards Establishes Investors Technical Advisory Committee,” press release, 2 January 2007. Available at <http://www.fasb.org/news/nr010207.shtml>.

<sup>19</sup> Council of Institutional Investors, “Council of Institutional Investors Expresses Concerns about SEC Proposal,” press release, 28 August 2008. Available at <http://www.cii.org/UserFiles/file/press%20release%20SEC%20ifis%20proposal%2008-28-08.pdf>.

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current debate on the impact of fair value accounting on the crisis and whether calls for its suspension should be heeded. Even so, some European audit chairs, and Mr Danjou, warned against delaying preparations for a conversion to IFRS, highlighting the need for US audit chairs to take the preparations for a conversion seriously. Indeed, the EU's experience of moving to IFRS makes it clear that much work will have to be completed to ensure that a global implementation of IFRS leads to the ultimate goal of a common, high-quality set of accounting standards.

## About this document

The European Audit Committee Leadership Network (EACLN) and Audit Committee Leadership Network (ACLN) are groups of audit committee chairs drawn from leading European and North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

*ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management and their advisers as they endeavour to fulfil their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* may share it with those in their own network. The more board members, members of management and advisers who become systematically engaged in this dialogue, the more value will be created for all.

*The views expressed in this document represent those of the European or North American Audit Committee Leadership Networks. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young, or Tapestry Networks. Please consult your counsellors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organisation.*

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## Appendix 1: Participants at the Audit Committee Leadership Summit

European and North American Audit Committee Leadership Network members participating in all or part of the summit, who sit on the boards of over 44 large-, mid- and small-cap public companies between them, included:

- Dr Werner Brandt, Audit Committee Member, Lufthansa
- Mr Phil Hodgkinson, Audit Committee Chair, BT
- Mrs Judy Richards Hope, Audit Committee Chair, Union Pacific
- Mr Laban Jackson, Audit Committee Chair, JPMorgan Chase
- Dr DeAnne Julius, Audit Committee Chair, Roche Holding
- Ms Marie Knowles, Audit Committee Chair, McKesson
- Mr Wim Kok, Audit Committee Chair, ING
- Mr Daniel Lebègue, Audit Committee Chair, SCOR
- Mr Oscar Munoz, Audit Committee Chair, Continental Airlines
- Mr Chuck Noski, Audit Committee Chair, Microsoft and Morgan Stanley
- Ms Pam Patsley, Audit Committee Chair, Texas Instruments
- Pierre Rodocanachi, Audit Committee Member, Vivendi
- Ms Guylaine Saucier, Audit Committee Chair, Areva
- Mr Kees Storm, Audit Committee Chair, Unilever and InBev
- Dr Bernd Voss, Audit Committee Chair, ABB
- Steve West, Audit Committee Chair, Cisco Systems
- Chris Williams, Audit Committee Chair, Wal-Mart

Ernst & Young partners participating in all or part of the meeting included:

- Mr Steve Almassy, Americas Assurance Leader
- Mr Steve Howe, Americas Managing Partner
- Mr Tom McGrath, Managing Partner, EMEIA Financial Services
- Mr Christian Mouillon, Deputy Area Managing Partner EMEIA



## Appendix 2: Questions US audit committees can ask to start a dialogue on IFRS<sup>20</sup>

- ? What does our company need to do to prepare for an IFRS conversion? Where is the project plan? How early do we need to start the conversion given a particular date?
- ? What is the opportunity for our company? Should we consider early adoption if the SEC allows it and we meet eligibility criteria?
- ? How many of our subsidiaries are currently using IFRS? Is there a control or process in place to ensure the consistent interpretation of IFRS in each of these locations?
- ? What are the staffing implications? What resources will we need internally? What will we source from outside?
- ? What high-level differences in accounting and disclosure are expected under IFRS? What will the SEC allow us to do in terms of selecting how we apply more-flexible IFRS principles? What is our process for approving critical accounting policies? What is our objective – a painless transition or rewriting policies?
- ? In addition to financial reporting, which other business areas will be affected by the conversion? IT? Legal? Contracts? Covenants? Any others?
- ? What is our external auditor saying about IFRS?
- ? What impact will IFRS conversion have on stakeholders? What should we do to manage the expectations of capital markets? What are our peers doing?

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<sup>20</sup> These questions are drawn from Ernst & Young, “Are You Ready for IFRS? What US Audit Committees Need to Know about IFRS,” *BoardMatters Quarterly*, April 2008.



## Appendix 3: Accounting standards setters in Europe and the United States and the associated oversight bodies, advisers, interpreters and enforcement

	<b>International Financial Reporting Standards (IFRS)</b>	<b>US Generally Accepted Accounting Principles (US GAAP)</b>
Oversight body	<p><i>International Accounting Standards Committee Foundation (IASC Foundation)</i></p> <p>An independent, not-for-profit private sector organisation that is committed to developing a single set of high-quality, international financial reporting standards, through the IASB, for general-purpose financial statements.<sup>21</sup></p> <p>The IASC Foundation has 22 trustees (six from North America, six from Europe, six from Asia/Oceania and four from other areas of the world), who are appointed by their fellow IASC Foundation trustees.<sup>22</sup></p> <p>IASC Foundation funding is from countries, central banks, international organisations and international accounting firms.<sup>23</sup></p>	<p><i>Securities and Exchange Commission (SEC)</i></p> <p>A US government agency responsible for enforcing federal securities laws and regulating the securities industry. Its mission is to protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation. The Office of the Chief Accountant monitors the activities of the accounting profession, particularly the Financial Accounting Standards Board (FASB), that result in the formulation of GAAP.</p> <p>The SEC consists of five presidentially appointed commissioners who serve staggered five-year terms.<sup>24</sup></p>
Standards setters	<p><i>The International Accounting Standards Board (IASB)</i></p> <p>An independent standards-setting body, the IASB consists of 14 board members who are appointed by the trustees of the IASC Foundation, which also provides the IASB with funding and oversight.<sup>25</sup></p>	<p><i>The Financial Accounting Standards Board (FASB)</i></p> <p>An independent, private-sector organisation that establishes standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.<sup>26</sup> Its five board members are selected by the Financial Accounting Foundation (FAF), which also ensures its funding (provided by public companies based on market capitalisation) and provides oversight.</p>

<sup>21</sup> International Accounting Standards Board, "About the IASC Foundation," <http://www.iasb.org/About+Us/About+the+IASC+Foundation/About+the+IASC+Foundation.htm>.

<sup>22</sup> International Accounting Standards Board, *IASC Foundation Constitution* (London: IASB, amended 31 October 2007). Available at <http://www.iasb.org/NR/rdonlyres/1904AEEE-3554-49C6-BD96-A4611A6964BE/0/IASCFoundationConstitution2.pdf>.

<sup>23</sup> International Accounting Standards Board, "Update on Funding for 2008," press release, 4 February 2008. Available at <http://www.iasb.org/News/Press+Releases/Update+on+Funding+for+2008.htm>.

<sup>24</sup> Securities and Exchange Commission, "The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation," <http://www.sec.gov/about/whatwedo.shtml>.

<sup>25</sup> International Accounting Standards Board, "About the IASB," <http://www.iasb.org/About+Us/About+the+IASB/About+the+IASB.htm>.

<sup>26</sup> Financial Accounting Standards Board, "Facts about FASB," <http://www.fasb.org/facts/>.

# ViewPoints

FOR THE AUDIT COMMITTEE  
LEADERSHIP SUMMIT



## International Financial Reporting Standards (IFRS)

## US Generally Accepted Accounting Principles (US GAAP)

Interpreters	<p><i>International Financial Reporting Interpretations Committee (IFRIC)</i></p> <p>The interpretive body of the IASC Foundation that reviews widespread accounting issues that have arisen within the context of the current IFRS and provides authoritative guidance on those issues. Members of the IFRIC are appointed by the IASC Foundation.<sup>27</sup></p>	<p><i>Emerging Issues Task Force (EITF)</i></p> <p>A task force that assists the FASB in improving financial reporting through timely identification, discussion and resolution of financial accounting issues within the framework of existing authoritative literature. The members include auditors, preparers and users of financial statements.<sup>28</sup></p>
Advisers	<p><i>The Standards Advisory Council (SAC)</i></p> <p>A council of preparers, financial analysts, academics, auditors, regulators and representatives from user groups and professional accounting bodies that are affected by and interested in the IASB's work. The Council advises the IASB on a range of issues, including the IASB's agenda and work programme. It also provides advice on single projects, with a particular emphasis on practical application and implementation issues, including matters relating to existing standards that may warrant consideration by the IFRIC.</p> <p>The IASC Foundation oversees membership of the SAC to ensure it represents relevant organisations.</p>	<p><i>Financial Accounting Standards Advisory Council (FASAC)</i></p> <p>A council that advises the FASB on issues relating to projects on the Board's agenda, project priorities, possible new agenda items, procedural matters that may require the attention of the FASB and other matters as requested by the chairman of the FASB. There are currently more than 30 members of FASAC, who include CEOs, CFOs, senior partners of public accounting firms, executive directors of professional organisations and senior members of the academic and analyst communities.<sup>29</sup></p>
Enforcement	<p>Independent national regulators are responsible for the enforcement of accounting standards.</p> <p>Also, in 2001 the European Commission established the Committee of European Securities Regulators (CESR), an independent organisation designed to improve co-ordination between securities regulators, act as an advisory group to assist the Commission and work to ensure more consistent and timely day-to-day implementation of community legislation in the member states.</p>	<p><i>Securities and Exchange Commission (SEC)</i></p> <p>See above.</p>

<sup>27</sup> International Accounting Standards Board, "About the International Financial Reporting Interpretations Committee," <http://www.iasb.org/About+Us/About+the+IFRIC/About+the+IFRIC.htm>.

<sup>28</sup> Financial Accounting Standards Board, "Emerging Issues Task Force (EITF)," [http://www.fasb.org/eitf/about\\_eitf.shtml](http://www.fasb.org/eitf/about_eitf.shtml).

<sup>29</sup> Financial Accounting Standards Board, "Financial Accounting Standards Advisory Council," <http://www.fasb.org/fasac/index.shtml>.