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# IASB & FASB Convergence: Agenda & Challenges

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## 1. The 2009 Roadmap

### Removing the need for reconciliation between IFRS & US GAAP

- SEC – European Commission commitment (Feb 2006)
- FASB and IASB Convergence program (MoU Feb 2006)
  - ▶ Goal: not to eliminate differences, instead to develop new common standards
  - ▶ “Replacing weaker standards with stronger standards”
  - ▶ Key topics: Business Combinations, Fair Value, Liabilities/Equity, Performance reporting, Revenue recognition
  - ▶ And also longer term: Framework, modified joint project for Insurance
- CESR – SEC Work plan (Aug 2006)
  - ▶ Promote high quality standards and consistent application around the world, especially by international issuers
  - ▶ Avoid conflicting regulatory decisions on the application of IFRS & US GAAP



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## 2. IFRS & US GAAP : Similar but different

- Similar in principles but different in detail
  - ▶ Lead to many adjustments from IFRS to US GAAP – e.g. :
    - Financial instruments IAS 39 / FAS 115 -133,
    - Employee Benefits IAS 19 / FAS 158
  - ▶ Differences to be justified and explained to the SEC
- Principles based IFRS / (*de facto*) rules based US GAAP
- Practical consequence:
  - The SEC might be tempted to interpret the IFRS on the basis of US GAAP literature



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### 3. Convergence: Yes but where to ? (1/2)

- “Replacing weaker standards with stronger standards” (FASB-IASB MoU)
  - ▶ MoU does not explain what weaknesses of US GAAP need to be addressed
  - ▶ IFRS actually used in the real world only since 2005 by listed companies in the EU. Therefore too early to assess their quality.
- FASB – IASB reflection based on pure conceptual/ theoretical approach

#### ▶ Legal approach rather than approach based on relevant economic information:

- Liability only if “enforceable” obligation not taking into consideration “economic compulsion”:
  - e.g. : future discretionary bonuses in insurance or investment contracts with DPF; subordinated debts with step up clauses
- Fair value of financial liabilities:
  - “deposit floor” (value at demand) whatever the statistical behaviour of the credit holders population.

#### ▶ Performance reporting:

- One single comprehensive statement without distinguishing realized and unrealized gains and losses.
- All changes in value of assets and liabilities recognized in the net comprehensive income whatever their duration

#### ▶ Liabilities measurement:

- “exit value” model to market, based on theoretical market data instead of actual preparer’s data (e.g. Insurance contracts)

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### 3. Convergence: Yes but where to ? (2/2)

- Consequences of the FASB – IASB conceptual/ theoretical approach :
  - ▶ Flawed picture of the actual situation and performance of the enterprises, especially for long term business like Insurance.
  - ▶ “Signal to Noise ratio”:
    - Short term volatility of the net comprehensive income not reflecting the long term trend of the business.
    - Core underlying earnings obscured by noise from volatile changes in markets.
- Non GAAP indicators still needed to provide an appropriate faithful representation of the activity and the wealth of the companies
- Convergence: a very long and difficult task, since incompatibility of Principles and Rules based approaches:
  - ▶ 2009 very difficult target to reach
- Beyond convergence between US & Europe, concern for international groups with other countries having implemented IFRS with local flavor (e.g. Australia)
- Risk that one Standard setter shoots first and tries to put an early end to the consultation process:
  - ▶ E.g.: Fair value measurement
    - FAS 157 already issued while IASB still considering a call for comment

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#### 4. An alternative realistic proposal: Mutual recognition

- While convergence should remain a long term goal, mutual recognition seems a more realistic short term target
- Standards are conventions, none could provide the “True” reality but only a more or less faithful picture of the reality

- What is expected from accounting standards:

- ▶ Simple and rigorous principles
- ▶ Close to the basics of the business
- ▶ Well understood by preparers, auditors and users of financial statements
- ▶ Consistently applied by companies across industries, geographies over time.

- Mutual recognition would immediately avoid costs due to need for reconciliation

- ▶ Each company obliged to maintain 2 systems
- ▶ Not really shareholder's interests to have those costs, nor customers' or other stakeholders' interests



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Thank you



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