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IASB Chairman Outlines Approach for Reconciling Financial Instrument Standards

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International Accounting Standards Board Chairman Sir David Tweedie on Tuesday outlined a possible approach for reconciling the divergent IASB and FASB models for financial instruments accounting.

With FASB's comprehensive exposure draft on financial instruments expected any day, Tweedie said during a *JofA* exclusive interview at the AICPA Council meeting in San Diego that public comments on the boards' proposals will play a key role in getting their two approaches closer together.

Speaking later to the AICPA Governing Council, Tweedie thanked the AICPA for its longstanding support of the IASB even before international standards were popular.

To understand Tweedie's approach to fixing the financial instruments problem requires some background on where the standards setters diverged. As a result of the subprime mortgage collapse, accounting for loans and securities derived from loans was widely criticized. When the financial crisis started in 2008, this project was already on the active agendas of both standard setters, but the crisis put enormous political pressure on the IASB and FASB to improve their standards as soon as possible.

In a move that was not followed by FASB, the IASB split its project to replace IAS 39, *Financial Instruments: Recognition and Measurement*, into three parts to deal separately with classification and measurement; impairment; and hedging. FASB decided to deal with all three aspects of financial instruments in a single project and plans to issue its comprehensive exposure draft by the end of this month.

Despite intense joint deliberations, FASB and the IASB were unable to agree on a common approach for classification and measurement. The IASB published its approach on Nov. 12, 2009, with the release of IFRS 9, *Financial Instruments*. IFRS 9 may be adopted early but is not effective until Jan. 1, 2013.

Under what is expected to be the proposed FASB model:

- Most instruments would be measured on the statement of financial position at fair value with changes in fair value reflected in net income, or net income and other comprehensive income;
- A limited amortized cost option would be available for financial liabilities; and
- No reclassification would be permitted between categories.

Under the IASB model (IFRS 9):

- The scope of the standard is limited to assets only;
- Amortized cost is used when it matches the entity's business model and cash flow characteristics of the asset;
- Fair value is used for equity instruments, most derivatives and some hybrid instruments; and
- Bifurcation of embedded derivatives is not permitted.

Asked directly whether the boards will be able to reach a compromise on their approaches, Tweedie said the divergent approaches were caused by mismatched timing between the boards' work and the inherent problem of having two major standard setters rather than one. To get back on track, he said, the two boards will sit down together this fall following review of constituent feedback on both boards' proposals.

"Say we both stick to our same positions [on classification and measurement], maybe we need to put out something that would say 'if you want to get the same other comprehensive income as FASB, you have to add this on, which would be the fair value'" he said. "FASB would do the opposite. If you want to get the FRS number, you deduct this. There are ways to do it."

On the remaining pieces of the IASB's financial instruments project, Tweedie explained that basically they plan to let the constituents decide which is the best model. The IASB published its exposure draft dealing with impairment on Nov. 5, 2009, with comments due July 5, 2010. The IASB plans to publish a request for views on FASB's model when FASB publishes its ED. The boards plan to jointly consider the comments received on respective proposed models. They will also discuss feedback received from an expert advisory panel that has been established to advise the boards on operational issues on the application of their credit impairment models and how those issues might be resolved.

"We're not wedded to our [impairment] model. If everyone says the FASB model is better, fine, let's adopt it," Tweedie said.

Under what is expected to be the proposed FASB model:

- A credit impairment would be recognized when information is available indicating that there is an adverse change in the expected future cash flows of the financial asset;
- An entity must consider all available information on past events and existing conditions but not future scenarios; and
- Creditors would not be prevented from evaluating losses on a pool or portfolio basis.

The IASB published on Nov. 5, 2009, a proposed impairment model for those financial assets measured at amortized cost. The model uses expected cash flows.

The proposed IASB model requires an entity:

- To determine the expected credit losses on a financial asset when that asset is first obtained;
- To recognize contractual interest revenue, less the initial expected credit losses, over the life of the instrument;
- To build up a provision over the life of the instrument for the expected credit losses; and
- To reassess the expected credit loss each period and to recognize immediately the effects of any changes in credit loss expectations.

The IASB plans to publish an ED on hedging, the third part of its financial instruments project, to coordinate with publication of FASB's ED. "I would think if FASB thinks ours is better, they'll move toward that; if they think, 'no that's gone too far,' we'll come back to where FASB was," Tweedie said.

The key, according to Tweedie, is that "both of us are asking the others' constituents to look at the opposite model. So this fall, we can say the world in balance thinks this is the best approach."

For those concerned about the number of exposure drafts the boards plan to publish in coming months, Tweedie said the boards met last week and discussed issuing no more than three or at the most four major EDs at a time. This would likely require the boards to rework their [schedules](#) for the 11 projects the boards reconfirmed last fall from their 2006 Memorandum of Understanding (see [Countdown to Convergence, JofA, March 2010](#)).

"We're looking at what's really essential," he said.

When asked about what could be holding the SEC back in making a decision on IFRS, Tweedie said he doesn't think "the U.S. is really stuck on the fence," but that the SEC will come through with a plan next year.

For Tweedie, who is starting his last year at the helm of the IASB, bringing U.S. GAAP and IFRS as close

together as possible is his top priority. "The world needs the U.S. to be involved in standard setting," he said.

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