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IFRS 9 leaves IASB with impaired convergence

by Stephen Bouvier 05 Mar 2014

YOU MIGHT have long suspected it, but now it's official: the IASB and the US Financial Accounting Standards Board have failed to develop a common financial instruments accounting standard. We have no convergence.

The reality about the lack of a single asset impairment model emerged during a 23 January IASB meeting. It leaves preparers playing piggy in the middle between the competing IFRS and US GAAP models.

Speaking at the meeting, Hans Hoogervorst, chairman of the IASB, said the two boards would meet later this year "once the two models are completely clear". Regulators, he explained, have the option of imposing "additional disclosures" in order to bridge the gap.

Hoogervorst, a former Dutch securities regulator and finance minister, added: "But we cannot let the preparers pay the price for the two boards not getting completely converged."

On 20 February there was worse to come. On the parallel effort to finalise the board's approach to classification and measurement, Hoogervorst was forced to concede: "What can we say? A lot of work has been done for nothing, it seems."

IASB member Patrick Finnegan was equally blunt in his assessment: "I would just observe the same thing. I joined this board with a full expectation that there were great aspirations for global convergence in three or four major areas. ... It is a terrible disappointment, in my opinion, for global investors.

"I'm not quite sure what more we can do if the two boards continue to work the problem ... but the FASB has decided not to continue with the current IFRS 9 proposed work plan that we developed, and unfortunately that's the way it is."

The board also voted to fix a new effective date for IFRS 9, Financial Instruments, of 1 January 2018. IASB members were reluctant to delay the standard, or make further changes to it, pending decisions on the linked insurance contracts literature.

Later that same meeting, staff reported that the FASB will almost certainly reject two central features of the IFRS 9 classification and measurement approach - the business model and the contractual cashflow assessments for amortised cost.

So how did it come to this? The IASB embarked on its project to replace IAS 39 in early 2009. It is possible to distill any number of motivations and drivers for the project: to respond to the financial crisis; to reduce complexity; to address the too-much too-late criticism of the IAS39 incurred-loss impairment model.

The project began under the chairmanship of Sir David Tweedie, and glancing back at an official IASB project summary document from 2009, a fully-fledged classification and measurement, impairment and hedging model was supposed to be in place by the final quarter of 2010.

As is now plain to see, the board failed. In 2009, it issued the first completed phase of IFRS 9, which dealt with the classification and measurement of financial assets. It followed this in 2010 with a further module addressing financial liabilities and the fair value option.

In its 2013 iteration, the standard has acquired a new hedging model. This approach to hedging is something of a marmite experience. On the one hand, its supporters claim it will make hedge accounting available in more situations; its critics point to its complexity.

Also in 2013, the board put out proposals to add a new category - fair value through OCI [other comprehensive income] - to IFRS 9. Redeliberation of those proposals is now complete and the IASB has confirmed it will include the FVOCI category alongside fair value and amortised cost.

Since 2009, the standard has also featured a presentational option that allows entities to book gains and losses on fair value holdings of equity investments in OCI. And impairment? Well, the board published its first proposals in November 2009 and followed this with a so-called supplementary document in January 2011. The 2011 document marked the high-water mark of the convergence drive with the FASB.

From that point onwards, what was supposed to be a convergence effort degenerated into a religious war. If the pre-crisis years had been marked out by the clash of fair value and amortised cost, the new battle lines were between 12-months initial loan loss allowance and the FASB's preference for full lifetime expected losses on initial recognition.

And it was here that the convergence effort truly floundered. But as insurmountable though the technical challenges of two competing financial instruments models might appear, there is a much bigger issue: politics.

In recent weeks, the European Parliament has shown an increased willingness to challenge the IASB, even going so far as to propose linking funding for the IASB's activities to specific outcomes.

Separately, the G20 nations have urged the two boards to come up with a single financial instruments model. At some point in time, Hoogervorst is going to have a very awkward conversation with his political masters.