

IFRS Briefing Sheet

G20's roadmap on financial reporting

April 2009, **Issue 131**

This IFRS Briefing Sheet highlights key messages regarding financial reporting from the Group of Twenty (G20) summit in London on 2 April 2009.

Following its London summit the G20 issued a communiqué setting out its plan for stimulating recovery of the global economy; the G20's actions cover a wide range of areas including economic stimulus, enhanced regulation of systemically important entities, and strengthened financial systems.

The Leaders' Communiqué was supplemented by a number of reports from G20 Working Groups and the Financial Stability Forum that provide additional detail.

The G20 will meet before the end of 2009 to review progress on the commitments. Some interim deadlines and bodies responsible for monitoring progress are noted.

In this Briefing Sheet we focus on issues that affect financial reporting. The main themes underlying the recommendations are addressing procyclicality and enhancing the role of supervisors and regulators in standard setting. The three main focal points are:

- loan loss provisions
- fair value measurement
- IASB governance.

KPMG's update on International Financial Reporting Standards (IFRSs)

G20's Leaders' Statement

In the Leaders' Statement, a high-level paper on the main agreements, the G20 called on accounting standard setters – including the International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) – to work urgently with supervisors and regulators to improve standards on valuation guidance and loan loss provisioning and achieve a single set of high-quality global accounting standards.

G20's Declaration on Strengthening the Financial System

More detailed guidance is provided in the G20's Declaration on Strengthening the Financial System (Declaration), dealing with eight topic areas such as, for example, broadening the mandate and resources of the Financial Stability Forum (FSF), which now will be known as the Financial Stability Board (FSB), strengthening international frameworks for prudential regulation, and strengthening principles on compensation structures and measures against tax havens.

The Declaration calls on accounting standard setters to improve standards for the valuation of financial instruments based on their liquidity and investors' holding horizons, while reaffirming the framework of fair value measurement. Accounting standard

setters are asked to take action by the end of 2009 to:

- reduce the complexity of accounting standards for financial instruments
- strengthen accounting recognition of loan loss provisions by incorporating a broader range of credit information
- improve accounting standards for provisioning, off-balance sheet exposures and measurement uncertainty
- achieve clarity and consistency in the application of valuation standards internationally
- make significant progress towards a single set of high-quality global accounting standards
- improve involvement of stakeholders, including prudential regulators and emerging markets, in the independent accounting standard setting process.

The Declaration also welcomed recommendations on procyclicality that address accounting issues. More details regarding these recommendations are included in one of the reports issued by FSF on 2 April.

FSF's Recommendations

The FSF issued three reports on 2 April, covering cross-border cooperation on crisis management, compensation practices and addressing procyclicality in the financial system together with an update on its April 2008 report on enhancing market and institutional resilience. The FSF recommendations regarding financial reporting are found principally in the report addressing procyclicality.

Judgement for Loan Loss Provisioning under Existing Standards (Recommendation 2.1)

The FSF concluded that even though the accounting requirements for loan loss provisioning under U.S. Generally Accepted Accounting Principles (U.S.

GAAP) and International Financial Reporting Standards (IFRSs) are essentially the same, there is a range of practices used by financial institutions and accepted by auditors and regulators.

The FSF calls for the IASB and the FASB to issue a statement by the end of 2009 that reiterates that existing standards require the use of judgement to determine an incurred loss for provisioning of loan losses. The FSF expects that incorporating the impact of changes in current factors into the methodologies used to determine the provisions for loan losses would lead to recognising higher provisions earlier in the credit cycle than approaches that place greater emphasis on historical loss experience.

Analysing Alternative Approaches for Recognising and Measuring Loan Losses (Recommendation 2.2)

The FSF recommends that the FASB and the IASB reconsider loan loss requirements in their joint project on financial instruments. This should be done on an expedited basis while maintaining appropriate due process.

The FSF believes that alternative approaches incorporating a broader range of available credit information should be considered, including a fair value model, an expected loss model and dynamic provisioning. Standard setters should assess whether an alternative approach can be implemented effectively by preparers and whether it provides better information.

The standard setters should establish a resource group to evaluate technical aspects of possible approaches.

Reducing Disincentives for Establishing Appropriate Provisions for Loan Losses (Recommendation 2.3)

The FSF recommends that the Basel Committee on Banking Supervision (BCBS) consider ways to reduce

disincentives for financial institutions to establish appropriate provisions for loan losses.

For example, the manner in which provisions are included in the measure of banks' regulatory capital or the constraint on the amount of provisions that may count as Tier 2 capital should be reconsidered.

BCBS also is called on to analyse whether higher loan loss provisions should be reflected within financial reporting, through adjustments to the prudential framework or a combination of both.

Use of Valuation Reserves When Significant Uncertainty about Fair Values Exists (Recommendation 3.4)

The FSF recommends that standard setters and supervisors explore whether valuation reserves or other adjustments should be established for items that are measured at fair value but are not actively traded.

Such valuation reserves would be intended to avoid possible overstatement of income and could be an incentive to avoid acquiring complex, hard-to-value financial instruments.

The FSF recommends assessing whether these reserves should be part of financial reporting, prudential measures or both.

Other Possible Changes to Relevant Standards to Dampen Adverse Dynamics Potentially Associated with Fair Value Accounting (Recommendation 3.5)

The FSF believes that the extensive use of fair values encouraged market practices in a manner that contributed to excessive risk-taking.

The FSF recommends that standard setters and supervisors consider enhancing the accounting model so that the use of fair value measurement

is examined carefully for financial instruments of credit intermediaries.

The FSF noted the IASB's October 2008 amendments to permit reclassifications between financial asset categories which are similar to the existing requirements under U.S. GAAP. It suggested that further refinements could be considered, particularly to address periods of severe illiquidity.

The FSF also notes that simplifying hedge accounting rules could encourage entities to apply hedge accounting instead of designating items as measured at fair value through profit or loss using the fair value option.

Recommendations of the G20 Working Groups

The G20's work since the November 2008 summit was carried forward largely through four working groups. Reports from each of the working groups also were published on 2 April, and include some comments on financial reporting and related issues. These background papers provide some useful insight into the thinking behind the final text of the Leader's Statement and the Declaration.

The report of Working Group 1 (WG1) underlines the FSF's recommendations on strengthening loan loss provisioning and changes to financial instruments standards. It recommends that a strategic plan be developed by the accounting standard setters and the BCBS (recommendation 13).

WG1 also called for accelerated efforts to reduce the complexity of accounting standards for financial instruments and enhance presentation standards to allow the users of financial statements to better assess the uncertainty surrounding the valuation of financial instruments (recommendation 22). It also recommends that the IASB enhance

its efforts to facilitate the global convergence towards a single set of high-quality accounting standards by sharing the experience of countries that have completed that process and by providing technical assistance to those currently working on convergence (recommendation 23).

WG1 notes that the IASB will examine whether the accounting treatment of fluctuations in exchange rates introduces excessive fluctuations in financial results during periods of high volatility. Its recommendations also call for standard setters to work with prudential supervisors to identify approaches that address both financial sector stability and transparency of financial reporting.

Working Group 2 (WG2) commented on recent changes to the governance of the IASB, in particular the recent formation of a Monitoring Board to oversee the Trustees of the IASB. The Monitoring Board has four securities regulators and the European Commission as its initial members, with the BCBS as an observer. WG2 encourages further enhancements of governance, including expansion in membership and increased representation of a broader range of stakeholder groups and interests.

See *IFRS Briefing Sheet* Issue 123 for a summary of the changes made in January 2009 to the IASB's governance.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

Links to the Documents

- [G20 Leaders' Statement](http://www.g20.org/Documents/g20_communique_020409.pdf)
http://www.g20.org/Documents/g20_communique_020409.pdf
- [G20 Declaration on Strengthening the Financial System](http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf)
http://www.g20.org/Documents/Fin_Deps_Fin_Reg_Annex_020409_-_1615_final.pdf
- [G20 Declaration on Delivering Resources through the International Financial Institutions](http://www.g20.org/Documents/Fin_Deps_IFI_Annex_Draft_02_04_09_-_1615_Clean.pdf)
http://www.g20.org/Documents/Fin_Deps_IFI_Annex_Draft_02_04_09_-_1615_Clean.pdf
- [G20 Progress Report on the Immediate Action Points agreed on at the Washington G20 Summit in November 2008](http://www.g20.org/Documents/FINAL_Annex_on_Action_Plan.pdf)
http://www.g20.org/Documents/FINAL_Annex_on_Action_Plan.pdf
- [G20 Working Group 1 - Report on Enhancing Sound Regulation and Strengthening Transparency](http://www.g20.org/Documents/g20_wg1_010409.pdf)
http://www.g20.org/Documents/g20_wg1_010409.pdf
- [G20 Working Group 2 - Report on Reinforcing International Cooperation and Promoting Integrity in Financial Markets](http://www.g20.org/Documents/g20_wg2_010409.pdf)
http://www.g20.org/Documents/g20_wg2_010409.pdf
- [G20 Working Group 3 - Report on Reform of the IMF](http://www.g20.org/Documents/g20_wg3_010409.pdf)
http://www.g20.org/Documents/g20_wg3_010409.pdf
- [G20 Working Group 4 - Report on The World Bank and Other Multilateral Development Banks](http://www.g20.org/Documents/g20_wg4_010409.pdf)
http://www.g20.org/Documents/g20_wg4_010409.pdf
- [FSF's Report on Addressing Procyclicality in the Financial System](http://www.fsforum.org/publications/r_0904a.pdf)
http://www.fsforum.org/publications/r_0904a.pdf

- FSF's Report on Principles for Cross-border Cooperation on Crisis Management
http://www.fsforum.org/publications/r_0904c.pdf
- FSF's Report on Principles for Sound Compensation Practices
http://www.fsforum.org/publications/r_0904b.pdf
- FSF's Update Report
http://www.fsforum.org/publications/r_0904d.pdf

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