Asia Focus
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Implementing International Financial Reporting Standards in Asia:
Bringing Greater Transparency and Comparability to Asian Banks' Financial Statements

In the wake of the Asia financial crisis of 1997-1998, market participants raised serious concerns about the reliability of reported financial data and the use of lenient or even "creative" accounting practices in Asia. It has been argued that while the lack of transparent, reliable and comparable financial information did not directly cause the financial crisis in East Asia, the magnitude of the crisis might have been diminished had there been more reliable accounting and greater disclosure standards to serve as an early warning sign for the banking institutions and other enterprises[i] . This led to the recommendation that concerted national and international efforts should be made to develop and implement international accounting and reporting standards, compliance with which should be monitored and enforced. This *Asia Focus* reviews the status of the implementation of International Financial Reporting Standards (IFRS) in various Asian economies, discusses the benefits of using one set of internationally accepted accounting principles, and provides some background information on the ongoing reviews of different jurisdictions' accounting practices in connection with the federal banking agencies' supervision of foreign banking organizations (FBOs) that operate in the United States.

IFRS Implementation in Asian Economies

Cognizant of the concerns raised in the international community, and in an effort to conform with internationally accepted standards and best practices, many Asian countries have begun requiring the implementation of IFRS issued by the International Accounting Standards Board[ii] (IASB). Of the Asian economies that have banking operations in the United States, almost all have implemented or are in the process of implementing IFRS (table 1). It should be noted that the IASB is a private organization that does not have any enforcement power. Consequently, the accounting rules could become less relevant if supervisory authorities use their national discretion to make changes to the accounting pronouncements with the intention to dilute certain stringent requirements.

Table 1: IFRS Implementation Schedule for Various Asian Economies

Jurisdiction	Implementation Date
China	January 1, 2007 for publicly listed companies January 1, 2008 for state-owned enterprises January 1, 2009 for large- and medium-sized companies
Hong Kong SAR	January 1, 2005 for publicly listed companies
India	Accounting periods after April 1, 2011 for all listed companies, banks, insurance companies, and large-sized entities. This plan requires government approval
Indonesia	No official implementation date but there are ongoing revisions to current standards to conform with IFRS
Japan	The Accounting Standards Board of Japan and the IASB announced an agreement to accelerate convergence between Japanese GAAP and IFRS, a process that started in March 2005. The two boards will seek to eliminate major differences by 2008, with the remaining differences being removed on or before June 30, 2011.
Korea	January 1, 2011 for all publicly listed companies; early adoption is permitted in 2009 except for banking institutions
Malaysia	January 1, 2006 for all publicly listed entities
Philippines	January 1, 2005 for all entities with "public accountability"
Taiwan	No official implementation date but there are ongoing revisions of current standards to conform with IFRS
Thailand	No official implementation date but there are ongoing revisions to current standards to conform with IFRS
Singapore	The Accounting Standards Council was created in 2007 with the broad policy objective to adopt IFRS

Source: Deloitte and Touche's IAS Plus (www.iasplus.com)

What are the benefits of implementing IFRS?

As the IASB puts it, "a single set of high quality, uniform, globally-applied, and enforced accounting standards is essential for both domestic and cross-border investment and financing decisions." It is desirable to have a uniform set of accounting standards because inconsistency in accounting standards is causing confusion in the investor community.

From a supervisory standpoint, the major advantage of widespread IFRS adoption is that banking supervisors can place greater reliance on the reported financial statements presented by FBOs, knowing that they are prepared in accordance with international standards. Banking supervisors do not have to spend as much time analyzing the key accounting differences between jurisdictions, which, in some cases, involves performing sensitivity analyses to determine the financial condition of the FBO if U.S. accounting standards were used.

It should be noted that there are subtle differences between IFRS and U.S. Generally Accepted Accounting Principles (GAAP); however, the Financial Accounting Standards Board and the IASB signed a Memorandum of Understanding in 2002 called the Norwalk Agreement, pledging to commit to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. In essence, both organizations agreed to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate future work programs to ensure convergence. For example, both organizations have included convergence topics such as business combinations, consolidation accounting, and fair value measurement guidance on their "active agenda" and have sketched out a roadmap for convergence. In addition, to provide greater relief to foreign companies listed on U.S. stock exchanges, the Securities and Exchange Commission (SEC) also issued a proposal in July 2007 that would allow foreign private issuers to file their financial statements using IFRS without reconciliation to U.S. GAAP.

How do U.S. banking regulators consider differences in accounting standards across countries?

In March 1995, the federal banking agencies established the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations (the FBO Supervision Program) and it applies to all FBOs with a banking presence in the United States. In brief, this FBO Supervision Program is a risk-focused framework designed for supervising the U.S. operations of FBOs, particularly those with numerous entities across multiple U.S. supervisory jurisdictions. In carrying out this risk-focused framework, banking supervisors must prepare a total of nine supervisory products, including the home country financial system and accounting practices reports for each country with banking representation in the United States. These reviews provide important reference and background information about an FBO's home country environment and financial reporting practices. These reviews highlight broad issues that are factored into another supervisory product called the Strength of Support Assessment (SOSA) for an FBO. The SOSA assesses the overall financial viability of the FBO by examining the financial strength of its parent company, as well as other external factors such as the strength of management oversight. Supervisory strategy for U.S. operations of FBOs is heavily influenced by reviews of the home country financial and accounting systems, the consolidated financial position of the FBO, and the FBO's financial ability to provide support to its U.S. operations in case of need.

Why is it necessary to review home country accounting practices?

Financial analysts assigned to analyze the consolidated financial condition of FBOs have to understand key accounting differences and their supervisory implications in order to be able to perform a meaningful SOSA for the institution. For example, an FBO's earnings likely are overstated if underwater securities can be valued at cost or the bank's equity position is inflated in jurisdictions where under-funded pension liabilities are not required to be presented on the balance sheet. Simply put, a review of the home country accounting practices is necessary to avoid comparing apples to oranges.

So why are there differences in accounting standards?

Accounting standards are national in origin and, as such, each country follows a set of accounting pronouncements prepared by its accounting professional bodies and regulatory authorities. Furthermore, cultural factors can affect accounting differences. Anglo-Saxon accounting systems, such as those in the United States and United Kingdom, are generally driven by the informational needs of markets and investors and financial statements are intended to present a "true and fair view" of a company's financial position. In some European and Asian countries, accounting policies are designed to conform with local tax laws. This implies that financial statements are prepared to satisfy tax provisions and may not present a "true and fair view" of a company.

Due to these national and cultural differences, financial statements could look drastically different using separate sets of accounting standards. Consider the following example. In 1993, Daimler-Benz was the first German company listed on the New York Stock Exchange. As a result, the company filed a 20-F report with the SEC using U.S. GAAP. Because Daimler-Benz drew on hidden reserves[iii] when there was a recession in Germany in 1993, it managed to report a small net profit for the year (DM 615 million). However, under U.S. reporting standards, it incurred a DM 3.6 billion loss.

Some accounting differences raise supervisory concerns

While reviewing the accounting practices and policies of different Asian countries as part of the FBO supervisory process, financial analysts have noted many differences in accounting practices, some of which have raised supervisory concerns. Until recent years, some Asian FBOs used 180 days past due as the definition for nonperforming loans[iv], compared to the 90-day benchmark employed by U.S. regulators. While "nonperforming loan" is technically a regulatory rather than an accounting concept, it is a very important asset quality indicator for banking supervisors to monitor in order to gauge the quality of an institution's loan portfolio. Further, some supervisory authorities in Asia used their discretion in allowing banking institutions to engage in accommodative accounting practices. For instance, during a stock market downturn in the late 1990s, a supervisory authority permitted its supervised entities to report equity securities values at cost, thereby avoiding write-downs that would affect earnings and potentially cause a decrease in capital ratios below the minimum level stipulated under the 1988 Basel Capital Accord. Other regulatory forbearance measures taken by other supervisory authorities include instructing their supervised banks to amortize certain losses over a period of time as a means to smooth out earnings instead of taking a major hit in earnings in one year. This measure was taken even with the knowledge that external auditors would be required to issue qualified opinions on the banks' financial statements. These examples further explain how critical it is to understand the accounting differences in connection with analyzing the consolidated financial conditions of FBOs when carrying out supervisory responsibilities.

Conclusion

For many years, accounting professionals, regulators, financial analysts and investors have called for heightening efforts to harmonize accounting standards across countries. With the rapid development of global markets, an increasing number of companies are seeking listings in different countries; as a result, investors are demanding more comparable accounting standards to avoid confusion. For companies listed on multiple exchanges, a common set of accounting principles can save them time and resources in producing multiple financial reports.

From a regulatory perspective, using a set of internationally accepted accounting standards is important in the cross-border supervisory process. A convergence of regulatory, accounting, and financial reporting standards is bringing greater transparency and accountability to banks' financial statements. Gradually, the financial statements presented by supervised FBOs will be based on relatively comparable financial reporting standards and this will greatly enhance the effectiveness of the FBO supervisory process.

[i] *"The Role of Accounting in the East Asian Financial Crisis: Lessons Learned"* - United Nations Conference on Trade and Development Study: Accounting and Asian Financial Crisis, December 1998

[ii] The International Accounting Standards Board is an independent, private-sector body that develops and approves International Financial Reporting Standards. The IASB operates under the oversight of the International Accounting Standards Committee Foundation and it was established in 2001 to replace the International Accounting Standards Committee.

[iii] The IASB's view on hidden reserves: "the exercise of prudence does not allow the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability."

[iv] In the United States, nonperforming loans are defined as those loans that are in nonaccrual status or past due more than 90 days and still accruing interest income.

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