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on International Financial Reporting Standards (IFRS) and the governance of the IASB

Committee on Economic and Monetary Affairs

Rapporteur: Alexander Radwan

"IFRS tested, IASB failed"

1. Introduction

Since January 2005 listed EU companies have been obliged to use international accounting standards for their consolidated financial statements. These international accounting standards are developed by a private organisation (International Accounting Standards Committee Foundation/International Accounting Standards Board) situated in London. The standards are through an endorsement mechanism turned into EU law.

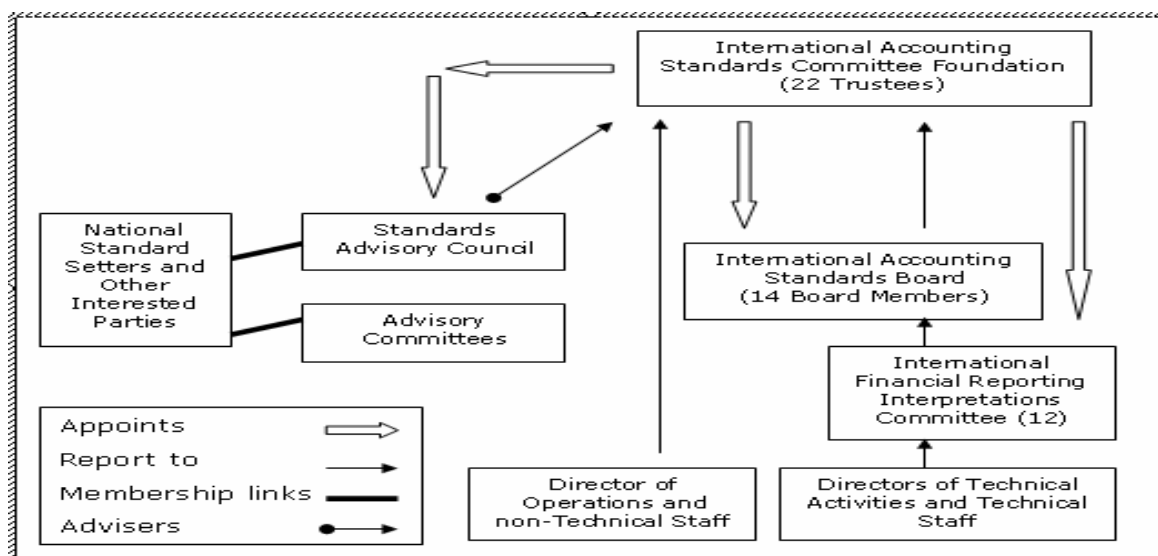
Experience from the past years illustrate that the London-based organisation is intransparent and outside democratic control. E.g. it is not clear how its work plan is developed, how its mandates are formed, how and against which criteria its members are chosen, how it takes into consideration the interests of it's the stakeholders', including those preparers and users that are required by law to apply international accounting standards.

Moreover, the organisation relies solely on voluntary contributions from companies and the profession. This makes the organisation potentially vulnerable.

Additionally, the European Commission and the SEC has launched a road map towards convergence and equivalence of international accounting standards with US accounting standards. In this context, the London-based organisation is committed to work with its US counterpart on achieving technical convergence of accounting standards. In parallel, the European Commission is committed to ensure consistent application of international accounting standards in the European Union.

Therefore the rapporteur considers it relevant to analyse further the transparency and democratic control of the London-based organisation; implementation of international accounting standards in the EU; the international accounting standard for small and medium sized enterprises (IFRS for SMEs); and finally EU - US convergence and equivalence of accounting standards.

2. Transparent democratic international organisations



The IASCF (International Accounting Standards Committee Foundation) consist of 22 Trustees and should oversee the IASB (International Accounting Standards Board), the Standards Advisory Council (SAC) and the International Financial Reporting Interpretations Committee (IFRIC).

Trustees are selected through a self appointment mechanism. Even with the recently adopted formalised election process for Trustees (including advertising of vacant positions, consultation of significant stakeholders and the Trustees Appointments Advisory Group) it is, at the end of the day, the Trustees who appoint themselves. This raises serious questions about the accountability of the IASCF. For instance was the current chairman of the IASCF rolled over for another year without any debate.

Moreover, the Trustees, in principle, appoint IASB, SAC and IFRIC members but without considering that international accounting standards reaches far beyond financial statements. No consideration is given to ensure e.g. adequate representation from different legal systems, from preparers and users obliged to apply IFRS, from different segments of industry, from different sizes of listed companies, from investors etc. On top, the appointment process is in-transparent. Given this it is not surprising that the representation in IASCF and IASB, including associated committees is not balanced.

However, recently the IASCF Constitution was amended. It is claimed that it was an attempt to strengthen the role of Trustees. But much more must be done. Trustees must for instance be better in overseeing the IASB and its work plan, be more involved how the work plan is developed, how the mandates for the IASB come about and be much more visible. The criteria for selecting Trustees and IASB members must be changed to ensure that the structure is balanced.

The EU decision to oblige listed EU companies to use international accounting standard significantly changed the context for **IASCF/IASB**. IASCF/IASB used to set voluntary international accounting standards. The EU decision turned IASCF/IASB into a law maker. This raises a number of questions that have not yet been addressed by the IASCF/IASB. E.g. should standards not be freely available to all stakeholders? Is there

sufficient democratic control with the IASCF and IASB and are they representative? Is there an appropriate balance in the organisations? Is it appropriate that IASCF/IASB only focuses on providing information to capital markets? What about other users of financial statements e.g. creditors and public authorities?

Moreover, any initiator of laws carry out impact assessments but the IASB does currently not **assess the impact** an accounting project could have on preparers and users. For all projects IASB should estimate the costs that could be incurred by preparers as well as consider what benefits it might bring about to users of IFRS. Moreover, the IASCF constitution must ensure that IASB develop accounting solutions that not only are technically correct but also reflect what would be possible and necessary seen from a user and preparer point of view.

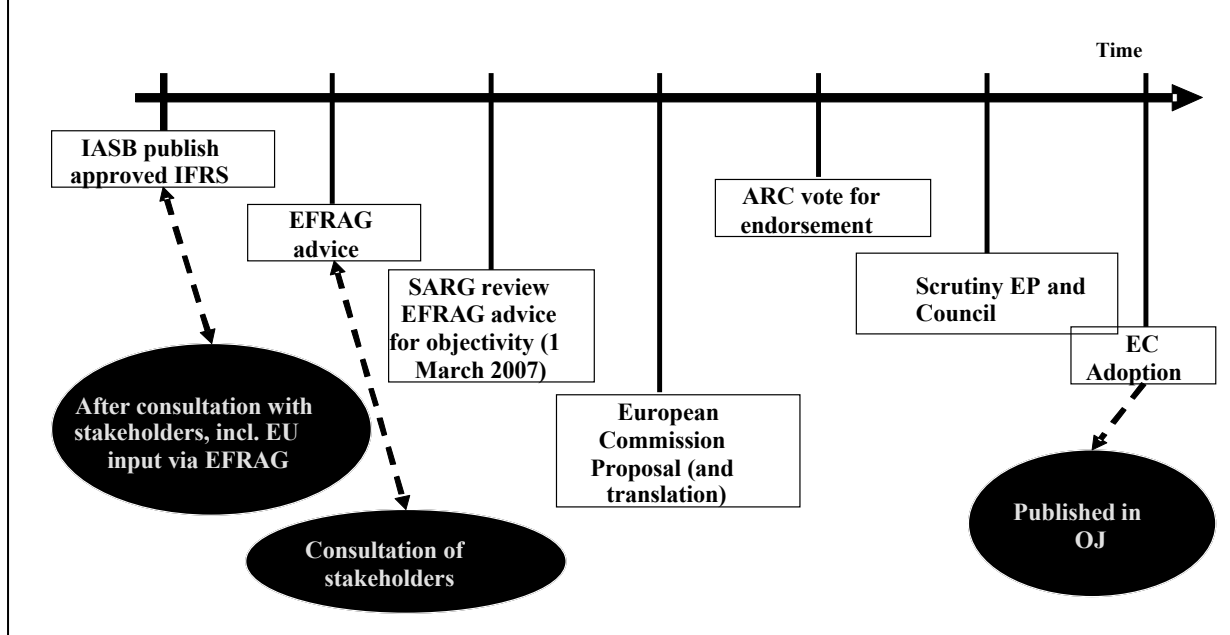
Another issue is **funding**. An organisation like IASCF/IASB must have a transparent and stable funding system. Clearly funding systems can be designed in different ways it can e.g. be based on public sources or user contributions.

The rapporteur is convinced that the IASCF/IASB is far from being transparent and balanced. The rapporteur is also convinced that democratic control with the organisation must be improved. Moreover, the European Parliament is only involved at the very latest stages of the decision making process when the final standard has to be turned into EU law. The rapporteur considers that this is too late. Before an accounting standard is drawn up it must be ensured that there is a need and a demand. Therefore it must be ensured that the European Parliament is involved when work program for the IASB is drawn up and when the accounting standard project is being considered.

3. Implementation of IFRS in Europe

Below the EU endorsement process is illustrated.

European Endorsement Process



The rapporteur underlines that the endorsement procedure only applies to international accounting standards for listed companies. **It cannot be used to endorse the IFRS for SMEs standard.**

Moreover, there are many players involved in the endorsement procedure. Especially the Commission receives input from a number of players that to an extent seem to have overlapping competences.

The rapporteur also stresses that the recent change to the comitology procedure means that the European Parliament will be even more engaged in the development and endorsement of international accounting standards.

The European Parliament will in 2007 pay special attention to at least the following issues:

- IASB Framework (conceptual basis for IASBs work),
- IAS/IFRS branding (presentation of financial statements).
- Borrowing costs - IAS 23
- Business Combinations (accounting for acquisition of another business),
- Fair value measurement
- Service Concessions (arrangements under which an entity (the Concession Operator), by contract with a Concession Provider (usually a government), receives a right and incurs an obligation to provide public services),
- Performance reporting (display and presentation of all recognised changes in assets and liabilities from transactions or other events except those related to transactions with owners as owners); and

- IAS32 and IAS39

Given the number of topical accounting issues 2007 could be decisive years in the cooperation between the London based standard setter, the Commission, the Council and the European Parliament.

4. IFRS for SMEs

The IASB presented in February 2007 an exposure draft of the **IFRS standard for SMEs**. Deadline for comments to the IASB is 1. October 2007. The rapporteur encourages all stakeholders, especially SMEs, to participate in the consultation. The rapporteur also encourages stakeholders to inform the European Parliament of their comments.

According to the IASB the **draft IFRS for SME-standard** aims at companies with around 50 employees. It is intended to provide accounting guidance for those that do not have public accountability; and publish general purpose financial statements for external users. In the exposure draft IASB explains that it intends to update the IFRS for SMEs standard every two years.

It is inappropriate for the IASB to prescribe what companies should or should not be able to use the IFRS for SMEs. It must be left to democratically elected bodies at national or European level to decide whether they can find any inspiration in the IFRS for SMEs standard.

SMEs generally find that the IASB should confine itself to developing a simple standard fitting the needs of SMEs and giving them a stable platform. Given the first reactions from SMEs IASB have failed to deliver. SMEs also consider the exposure draft as much too complicated and that its definition of own funds does not meet the particular needs of small and medium sized businesses. Prospects of the IASB changing the standards every other year also worry SMEs.

More generally it is questionable whether the private based London-based organisation has the expertise to develop a simple standard for non-listed SMEs. Moreover, it is unclear who gave a mandate to the IASB to suggest such an IFRS for SMEs and it is even questionable whether there ever was a need or a demand for such a standard.

The rapporteur considers that even promoting or encouraging voluntary use of the IFRS for SMEs will short circuit the democratic process and cut out legislators.

Moreover, should a few Member States decide to apply the final IFRS for SMEs this would lead to fragmentation of the Internal Market and might even prejudice accounting for SMEs across the entire EU.

5. Roadmap towards convergence and equivalence

Global **convergence of accounting standards** has proceeded at an ever-increasing pace. At present, almost 100 countries permit or require the use of IFRS. A key element to this

increased global interest was the EU's determination to require all its listed companies to use IFRS in their consolidated financial statements from the beginning of 2005. Under the IAS-regulation a small proportion of companies were allowed to use US GAAP until 1. January 2007.

More specifically, the IASB and the FASB (the US accounting standard setter) has published a very full joint work programme. The objective is to achieve progress towards the equivalence of each others accounting standards by 2009.

There is some concern that the technical convergence agenda will not meet its targets before a decision on equivalence (in the EU) and mutual recognition (in the US) has to be taken.

Moreover, it is unclear whether the SEC (Securities and Exchange Commission - US regulator) will accept dropping the very costly reconciliation¹ requirement for EU issuers if the technical convergence agenda has not met its targets by 2009 and if the SEC considers that IFRS are not used consistently across the EU.

From 1 January 2007, all Member States will accept that third country issuers can continue to use e.g. US GAAP in Europe without reconciliation to IFRS. This follows the postponement decision taken under the Transparency Directive and the Prospectus Regulation.

Under the same two Directives the Commission is obliged to develop a **mechanism for judging equivalence** of third country accounting standards before a decision can be taken on equivalence. It is unclear how far the Commission has come in designing such an equivalence mechanism.

Nevertheless, the Commission must by 1 April 2007 present a first report on the **work timetable** of the authorities responsible for national accounting standards in the US, Japan and Canada for the convergence between IFRS and the Generally Accepted Accounting Principles of those countries. The report must also describe the amount of progress in the **convergence** between International Financial Reporting Standards and the Generally Accepted Accounting Principles of Canada, Japan and the United States of America and of **progress on the elimination of reconciliation requirements that apply to Community issuers in those countries**.

Certainly the issues concerning convergence and equivalence of accounting standards have some parallels to EU - US discussion on financial conglomerates and the implementation of Basle II.

For other third countries the Commission has committed itself to report to the European Securities Committee and the European Parliament about the development of regulatory discussions and the amount of **progress in the convergence between International Financial Reporting Standards and the Generally Accepted Accounting Principles**

¹ Reconciliation means that if an EU issuer is listed in the US, the SEC requires that company to adjust parts of its IFRS accounts to the US GAAP equivalents, which can be costly.

of third countries and progress towards the elimination of any reconciliation requirements..