

Europe and IFRSs: six years on

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Robert Bruce, a financial journalist, reports on IFRSs in Europe. His views are his own and may not represent those of the IFRS Foundation or the IASB.



In the ten years since the International Accounting Standards Board (IASB) was established we have moved from a multi-GAAP world to one where a handful of financial reporting languages are morphing in to a single language, namely International Financial Reporting Standards (IFRSs).

Nowhere has this change been more pronounced than in Europe, the first major block to adopt IFRSs when in 2005 more than 8000 listed companies in 25 countries simultaneously switched to IFRSs. Quite an achievement and one that has faced many challenges, one of which has been the need for the IASB, as an international standard-setter, and the European institutions, constitutionally required to act in Europe's best interests, to adapt to a new way of working together.

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This has not always been easy, and in some ways the reasons for this are relatively straightforward. Historically, there are many strands pulling in different directions. It was the European Union (EU) which provided the impetus to make the IASB what it has become. And it was the subsequent success of the IASB which meant that its remit moved to a global

stage, inevitably diluting the influence of the EU. Keeping all these possible tensions in some kind of harmony has not always been easy.

‘It is a complicated relationship’, says Jeroen Hooijer, Head of the Unit on International Accounting, at the European Commission (EC), DG Internal Market and Services. Back in 2002 the EU effectively elected the IASB as its standard-setting body. That happened at a very early stage in the IASB’s history. By making the decision in 2002 to have all listed European companies use IFRSs by 2005 in such a decisive manner, the EU determined the success of the IASB as an international standard-setter. ‘When we decided to make IFRSs mandatory we were leading the field’, says Hooijer. ‘We were the first mover and other countries followed so the EC became the main advocate of IFRSs globally’. Without the EU move, the extraordinary success and take-up of IFRSs by so many countries around the world would have been much more difficult to achieve.

The principles behind the decision were bold. Standard-setting could, in theory, have been brought about through the European directive system. However, that system had proved to be broadly unsuccessful over decades to create the level of harmonisation of financial reporting that the integration of European capital markets required.

The creation of a formula to effectively elect an external body and delegate powers to it, subject to validation of the standards, was the winning one. ‘I still feel Europe took a brave decision to move to IASB and IFRSs’, says Hans van Damme, immediate past-president of European accounting body, FEE. ‘It didn’t really have an alternative’. ‘Ten years ago the IASB was an adventure more than anything, and Europe had a strategic decision to make in terms of its accounting policy and it chose the IASB’, says Jerome Haas, Chairman of the French standard-setter, ANC. ‘That transformed the IASB from an adventure into an institution – it must now live up to that role, focus on its public interest duties and make the necessary governance changes accordingly’. ‘The EU’s decision was a leap of faith’, says Dr Nigel Sleigh-Johnson, Head of the Financial Reporting Faculty at the ICAEW, ‘and inevitably you have some tensions. Relations between the IASB and the EU will always remain of pivotal importance’.

The real difficulties came about just before and immediately after the 2005 implementation of IFRSs across Europe. ‘There was quite a violent rejection of the IASB in 2005’, says

Françoise Flores, Chairman of EFRAG, the technical advisor body to the European Commission in the endorsement process in Europe. But much of this, with hindsight, even though it didn't feel like it at the time, was simply to do with change. 'We support IFRS in Europe', says Pierre Delsaux, Director of Company Law at the European Commission. 'Talking to industry and investors in Europe now no one is arguing for anything else but it was not so obvious five years ago. Then it was new and people don't like change. No one was fully aware about how the IASB would work and whether we would have a real influence. We wanted the feeling in Europe that the IASB was listening to us. If you have an explanation of something then you can understand it'. 'As a customer' says Françoise Flores, 'you tend to focus on the glass half empty and not the glass half full'. In the early stages there were suggestions that Europe should claw back the standard-setting responsibilities from the IASB and set up some sort of European standard-setting body. What were seen as anomalies in the thinking behind the standard-setting process exacerbated such unsettling thoughts. The idea that the Board of the IASB had people on it from countries which were not European or were from countries, particularly the US, which had not adopted IFRSs, was seen then as a particular anomaly. "Why are our rules set by others?" came the cry. But a steady process of greater outreach and changes to the governance process has answered much of the criticism. 'Every year it improves', says Françoise Flores. 'Due process has improved dramatically as has communications and transparency. The IASB works at a very high level of transparency. They have adjusted to our criticisms. It is all very much appreciated and valued'. The idea of creating a separate European standard-setting body as an alternative to the IASB has disappeared. 'No one in Europe is disputing the fact that the IASB should be setting standards for Europe and the world', says Pierre Delsaux. 'And that is a great achievement. No one is suggesting we should do anything else. It is not an issue in Europe'. 'Europe hasn't any alternatives', says Hans van Damme. 'No one wants to go back to the old days', says Jeroen Hooijen. 'It is absolutely clear no one wants a European standard-setter'.

But other tensions will grow and have grown. Governance issues, the speed with which much standard-setting has had to be done in the aftermath of the economic crisis, and issues of cost-benefit analysis are still there.

'We did not pay enough attention to governance in the early days', says Jeroen Hooijer. 'We did not think this sufficiently through'. And the legacy of that still, partly, remains. 'I recognise the IASB has done a considerable amount on consultations with stakeholders', he

says. But it is an inevitable part of the maturing of the process. The current reviews of governance being conducted by the Monitoring Board and by the Trustees, the groups which oversee the workings of the IASB, will lead to more clarity. 'Sometimes the users say that new developments are taken on board too rapidly', says Hans van Damme, 'or that the IASB is responding to needs which the users don't think exist'. But the efforts in recent years to make the issues of independence and accountability clearer have helped. 'The governance of the IASB has developed a lot over the last few years', says Nigel Sleight-Johnson. 'It took time for the IASB to adapt but it has shown that it could make changes to its accountability and raise its credibility. It has made great strides in accountability, in listening and in outreach'. 'It is a really difficult discussion', says Jeroen Hooijer. 'Acceptability of standards is linked to governance. Only a good standard bites. And people have to accept this. The better the process the more all the arguments can be taken into account'. 'In recent times, post-crisis, there has been a lot more interest from regulators and politicians, particularly in Europe', says Michael McKersie, Assistant Director, Capital Markets, at the Association of British Insurers (ABI). 'It is a challenge and it needs to be met and the IASB had demonstrated an ability to respond appropriately to legitimate concerns of a public interest point of view'.

All this has helped the endorsement procedure of the standards in Europe which is carried out by the European Financial Reporting Advisory Group (EFRAG). And that has to do with understanding and acceptability. 'Where we are now a lot of Europeans are ready to have standards which are not necessarily their preferred accounting treatments', says Françoise Flores, Chairman of EFRAG. 'It is part of sharing the global stage'. 'I know that sometimes people would like us to be in conflict', says Pierre Delsaux. 'But honestly we want to influence and we have endorsed all standards which have been put forward by the IASB except one and that is a matter of it going through our three phases of endorsement. It is not a political decision. We don't love every line, like everyone else. It is inevitable. It is always the same with legislation. It is part of life'. 'Over the last ten years', says Françoise Flores, 'the range of diverse views in Europe has narrowed. It is easier to find a consensus now than it was a few years ago'. 'The IASB has probably arrived on the right ground for consensus', says Michael McKersie, 'particularly on financial instruments'. 'The dialogue between the IASB and Europe', says Jerome Haas, 'has been focussed on substance and sharing a common vision of the role of accounting'.

The future of the relationship between the IASB and the EU will depend on three issues. First the changeover when Sir David Tweedie steps down as Chairman from July 2011 and is succeeded by Hans Hoogervorst as chairman and Ian Mackintosh as vice-chairman. Second the impending decision by the US regulatory body, the SEC, as to when or if US companies will move across to IFRS, and third the question of cost-benefit analysis.

‘There is every chance that the package of the new chairman and deputy chairman will be a good one and will enable the IASB to correctly address the need to produce high quality accounts for users’, says Michael McKersie of the ABI.

‘I think 2011 is a critical year for IFRSs’, says Françoise Flores. ‘There are decisions to be made in Europe as well as the US. If IFRS are to be sustainable in the long run as a single set of standards they need to be adopted by the US. But they must go through the endorsement process with no great difficulty’. Pierre Delsaux agrees. ‘The real challenge is what the US is going to do’, he says. ‘We really want the US to accept IFRS. We need to be clear. We cannot continue to wait for a decision. We hope that it will be adoption’.

With the great age of expansion and acceptance of IFRSs coming to an end, a greater emphasis will need to be placed on the effects of the standards. ‘After a period of very rapid change we need to concentrate on the quality of the standards and post-implementation reviews’, says Nigel Sleigh-Johnson. Leasing is the example people point to. ‘The leasing proposals create complex processes and major changes in the balance sheets of retailers, for example. There may sometimes be a case for the IASB to look in greater detail than they have done at the economic consequences’, he says.

A greater cumulative understanding of both the process and of IFRSs themselves has grown over the past decade. The issues that rapid change brought about have cooled. The focus is now on the challenges ahead amidst a renewed commitment to the objectives. ‘We support the IASB becoming stronger’, says Pierre Delsaux. ‘It needs to grow and become the worldwide standard-setter’.