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on International Financial Reporting Standards (IFRS) and the Governance of the IASB
(2006/2248(INI))

Committee on Economic and Monetary Affairs

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PR_INI

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on International Financial Reporting Standards (IFRS) and the Governance of the IASB (2006/2248(INI))

The European Parliament,

– whereas since January 2005 EU publicly traded companies have been obliged to use international accounting standards for their consolidated financial statements,

– whereas by EU decision (Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards[1]), the IASCF/IASB was in effect given the status of a law-maker,

– having regard to the first report to the European Securities Committee (ESC) and to the European Parliament on convergence between International Financial Reporting Standards (IFRS) and third-country national Generally Accepted Accounting Principles (GAAPs),

– having regard to the Commission working document on the International Accounting Standards Board – Governance and Funding (second report – July 2007),

– having regard to the conclusions of the Economic and Financial Affairs Council of 10 July 2007 on the question of the governance and funding of the International Accounting Standards Board,

– having regard to the ECB's 'Report on the assessment of accounting standards from a financial stability perspective' (19 December 2006),

Transparent, democratic international organisations

1. Points to the experience from recent years that has shown that the IASC Foundation (IASCF) and the IAS Board (IASB) lack transparency and are outside democratic control; acknowledges, however, that the IASCF and IASB have sought to improve transparency and democratic control, for example through twice-yearly meetings at which the IASCF reviews the IASB's work, through impact assessments for new standards, through the introduction of formalised feedback statements for comments received in public consultations, etc.;

2. Takes the view, however, that governance and accountability must be improved through the following measures:

    (a) setting-up of a forum involving all IASCF and IASB stakeholders, but in particular representatives (including legislators) of jurisdictions which have introduced international accounting standards on a mandatory basis;

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[1] OJ L 243, 11.9.2002, p. 1.

(b) such a forum could be responsible for selecting and appointing the trustees; this would help make the appointment procedure more transparent and significantly enhance the legitimacy of the trustees;

(c) a guarantee that, when appointing members of the IASB, the Standards Advisory Council (SAC) and the International Financial Reporting Interpretation Committee (IFRIC), the trustees ensure that the appointment procedure is transparent and due account is taken of the interests of various interest groups;

(d) increased involvement of the trustees in supervising the IASB and its work plan, in particular as regards the way in which the work plan is drawn up and the way in which mandates are granted to the IASB;

(e) the IASCF constitution should ensure that the IASB develops accounting solutions that are not only technically correct but also reflect what is necessary and possible from a user and preparer point of view;

(f) impact assessments for all projects, so as to check the costs and benefits (including those for user firms) of draft texts and, in particular, to highlight the implications for financial stability;

3. Agrees with the Council that the measures decided on to improve the IASB's governance structure must be implemented in accordance with an appropriate work plan; the same applies to the measures proposed by the European Parliament;

4. Takes the view that the funding structure of the IASCF and IASB, currently based exclusively on voluntary contributions e.g. from undertakings and audit firms, may give rise to questions;

5. Takes the view that transparent and stable funding for the IASB and IASCF is of crucial importance for the European Union; calls for the European Union to examine whether it might consider contributing to that funding;

Implementation of IFRS in Europe

6. Agrees with the Council on the point that the conclusions of the 'round table for the consistent application of the IFRS in the EU'[1] must be taken into account to a considerably greater extent in the IASB's work on standards;

7. Notes that there are numerous players involved in the European endorsement procedure; points out, in particular, that the Commission receives input from a number of players whose competences clearly overlap; points out in this connection that this offers potential for enhancing efficiency and transparency;

8. Takes the view that creating a uniform European structure for accounting issues could contribute to simplification and thereby also strengthen the role that the EU should play at world level; calls on the Commission to develop and put forward a proposal to

[1] The 'round table' comprises representatives of the IASB, CESR, EFRAG, FEE, UNICE, auditing firms and the Commission; it discusses key issues without in any way providing interpretations of existing standards.

establish a European structure, in order to ensure uniform application and to constitute an appropriate international partner;

9. Points out that, within the framework of the revised comitology procedure, the European Parliament will be even more involved in the development and endorsement of international accounting standards; notes, however, that Parliament is formally involved only in the last phase of the endorsement procedure; calls for a guarantee, as a time-saving measure, that the European Parliament will already be involved in the procedure when the IASB work programme is drawn up and a draft new accounting standard is considered, in order to avoid a European IFRS variant or the need for subsequent modifications;

10. Asks that an accounting standard should be drawn up only when it has been ensured that there is an urgent need for it;

11. Takes the view that particular attention should be paid to at least the following aspects:

   – IASB framework (conceptual basis of the IASB's work): points out in this connection that financial statements are drawn up not only for capital market investors but also for a range of other players such as creditors, employees, public authorities, owners, customers, etc.;

   – IAS/IFRS branding (presentation of financial statements): points out in this connection that the IASB should bring about solutions that take account of the various jurisdictions which have made IFRS mandatory;

   – IAS 32 and IAS 39: calls on the IASB in this connection rapidly to resolve the remaining problems in this area;

   – business combinations (accounting for acquisition of another business): points out in this connection that the IASB should draw up solutions regarding the scope of application of the fair-value principle;

   – fair-value measurement: takes the view that the IASB should take its decision on the basis of the outcome of the consultations and, given the apparent impact of this, limit the scope of the fair-value principle;

   – service concessions (agreements 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): points out in this connection that balanced solutions must be found; and

   – 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): points out in this connection that balanced solutions must be found;

12. Takes the view that the application of the fair-value principle is very costly for firms, yet results all too often in unrealistic valuations;

13. Notes that IFRS is increasingly being used in connection with tax matters;

14. Calls for the chairmen of the IASCF and the IASB to report to the European Parliament at least once a year on all matters relevant to Parliament (including work programme, staff decisions, funding and controversial standards);

IFRS for small and medium-sized enterprises (SMEs)

15. Points out that there is a widely shared view among SMEs that the standard IFRS proposed by the IASB is far too complicated for SMEs and, in addition, refers in many places to the full IFRS; takes the view that the obligations regarding appendices are too comprehensive and that the effort required is disproportionate in relation to the requirement to provide information; notes that SMEs are also concerned that the IASB intends to change the standard every two years;

16. Takes the view that it is unclear who gave a mandate to the IASB to draw up an IFRS for SMEs and questions whether there was ever any need or demand for such an international standard;

17. Notes that the endorsement procedure applies only to international accounting standards and interpretations for publicly traded companies; notes further that the endorsement procedure may not be used for the recognition of IFRS for SMEs,

18. Takes the view that European SMEs will derive no benefit from a standard developed by an international body that generally considers itself as a standard setter in the interest of capital market investors; points out in this connection that the IASB confirms in its 'basis for conclusions' that SMEs face different requirements to those for capital market investors;

19. Takes the view that promoting (or encouraging) the voluntary use of IFRS would short-circuit the democratic process and cut out legislators; takes the view, furthermore, that, should a few Member States decide to apply the final IFRS for SMEs in the form decided on by the IASB, this could lead to a fragmentation of the internal market and might even prejudice accounting for SMEs across the entire EU;

20. Points out that the Fourth and Seventh Company Law Directives provide the legal framework for the annual accounts of European SMEs and that it still has to be clarified whether the IFRS for SMEs proposed by the IASB breaches those directives or not;

21. Takes the view that the EU should develop its own standard for SMEs; takes the view, furthermore, that such a European standard should be independent and comprehensive, and should fit into the IFRS conceptual framework without obliging SMEs to use the full IFRS; considers, moreover, that the fact that the application of the fair-value principle to financial assets and liabilities does not always produce realistic valuations must be taken into consideration;

22. Takes the view that a European standard for SMEs must be tailored to the needs of users; advises, against this background, that user needs be analysed in detail once again;

23. Points out that accounting rules exert a very strong influence on the whole field of commercial law, and that a new standard will have a wide-ranging effect here, e.g. will have a major impact in practice on national legislation on company taxation;

24. Takes the view that a European standard for SMEs must take into consideration the fact that there are different forms of undertaking in the EU (such as partnerships and cooperatives); believes, therefore, that a European standard must contain a clear definition of own funds that takes account of the particular needs of SMEs;

25. Calls on the Commission to prevent the planned application of the standard IFRS to SMEs;

Road map for convergence and equivalence

26. Recognises that global convergence of accounting standards is proceeding at an ever-increasing pace;

27. Notes that the work on convergence is progressing by and large, and that comprehensive progress could be made by 2008 in the main areas where improvement is required; stresses, however, that convergence is not and should not become an end in itself;

28. Notes that on 20 June 2007 the Securities and Exchange Commission (SEC) submitted a proposal to the effect that financial statements by foreign issuers should be approved without reconciliation being required, provided that they had been prepared on the basis of the English version of IFRS adopted by the IASB; stresses that the IFRS standards incorporated by the European Union into existing law must be recognised by the SEC;

29. Recalls that the EU's determination to require all publicly traded companies to use IFRS in their consolidated financial statements from the beginning of 2005 was a key element in the increased global interest in IFRS;

30. Recalls that on 30 April 2007 the President of the United States of America, the President-in-Office of the European Council and the President of the European Commission signed a declaration on financial reporting that contains the following: '***Financial markets***. *Promote and seek to ensure conditions for the US Generally Accepted Accounting Principles and International Financial Reporting Standards to be recognised in both jurisdictions without the need for reconciliation by 2009 or possibly sooner*';

31. Recalls the outstanding issue of competence between different jurisdictions applying IFRS regarding the definitive interpretation thereof, which harbours the risk of conflicting interpretations; points out that only European authorities and courts may make a definitive interpretation of the European IFRS and calls on the Commission to ensure that this remains the case; the Commission, working together with the Member States and the European Parliament, must develop a system which will guarantee that IFRS is interpreted and applied uniformly within the European Union.

EXPLANATORY STATEMENT

'IFRS tested, IASB failed'

1. Introduction

Since January 2005 publicly traded EU companies have been obliged to use international accounting standards for their consolidated financial statements. These international accounting standards are developed by an independent private organisation (International Accounting Standards Committee Foundation and the International Accounting Standards Board) situated in London. The standards are incorporated into existing EU law by means of an endorsement mechanism.

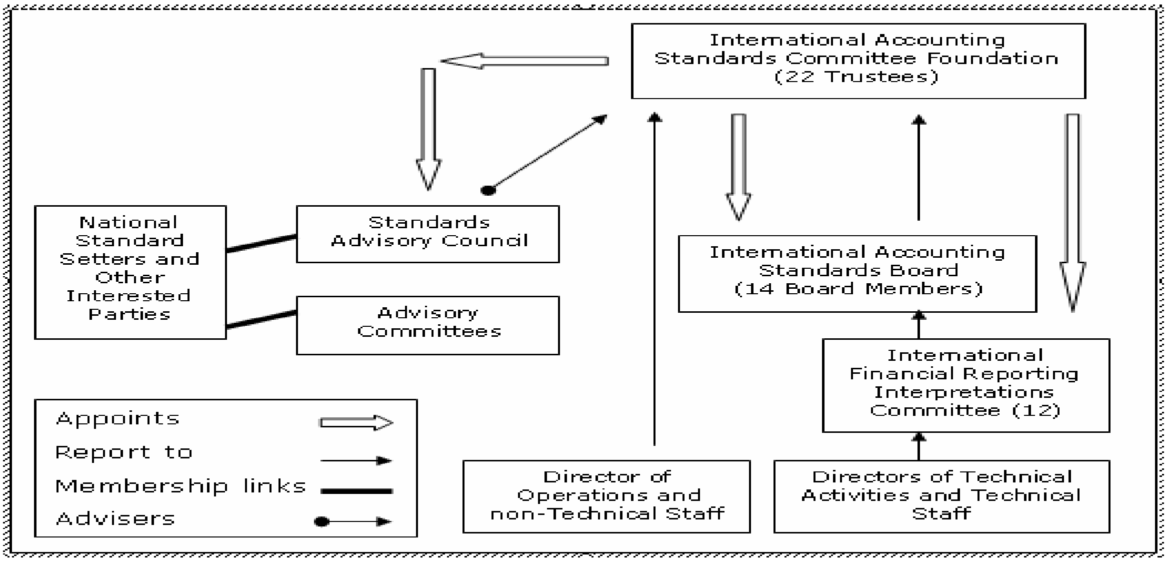
Experience over recent years illustrates that this organisation, governed by private law, is untransparent and outside democratic control. For example, it is not clear how its work plan is developed, how its mandates are formed, how and against which criteria its members are chosen, or how it takes into consideration the interests of 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, the profession and other contributors, which may give rise to questions.

Additionally, the European Commission and the SEC (US Securities and Exchange Commission) have launched a road map towards convergence and equivalence of international accounting standards with US accounting standards. In this context, the London-based IASCF 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 appropriate to analyse further the transparency and democratic control of the London-based organisation; the 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 most serious question in relation to the IFRS process is doubtless the democratic legitimacy of the IASB. This is particularly true in that financial reporting involves highly significant public decision-making powers that have a major impact on many other areas of financial and indeed tax law. Democratic legitimacy must ensure that the interests of all those affected are suitably represented and balanced in a transparent procedure using fair rules.

Up to now, these requirements are not adequately met in the system of the IASCF. The organisation's highest decision-making body, the Board of Trustees, shows particular shortcomings: the trustees are selected mainly on the basis of a criterion designed to ensure proportionate representation for the regions, so that no account is taken of other key interests (such as different sectors of the economy, forms of undertaking, the interests of employees and employers and, in particular, of political leaders).

Even the application of the regional criterion for appointments is not satisfactory in practice: seats that fall vacant are filled by the remaining members of the board without a clearly defined public selection procedure. For the past year, the trustees have formally been supported by an independent committee in the selection of candidates, but the latter can itself refer only to a list of candidates which has been drawn up internally. This does nothing to alter the problem that selection takes place through a self-appointment procedure that does not bestow legitimacy and that hampers the representation of new interests.

This Board of Trustees selects the members of the remaining IASCF bodies. The main such body is the IASB, the qualification criteria for which include professional background as well as proportionate representation for the regions. In order to take greater account of the concerns of stakeholder representatives, the trustees have decided to expand the interpretation body, the IFRIC, from two to 14 members in future. This shows that the IASC Foundation has responded to public calls for improved representation of stakeholders (Commission reports on the governance and funding of the IASB and IASCF of December 2006 and July 2007). On

10 July 2007 the ECOFIN Council adopted conclusions calling on the IASC Foundation to make further efforts in this direction.

From the European Parliament's point of view it should be noted that the system of contribution-based funding is extremely untransparent and the information provided in the annual reports (the sole source of information) has become more and more inadequate. No documents on current funding or plans for the new funding system were submitted to Parliament. However, the Commission's second report on the governance and funding of the IASB and IASCF reveals that, despite the progress made, the goal of stable and sustainable funding has not yet been reached. Parliament should also have been informed of this.

However, the IASCF constitution was recently amended. It is claimed that this was an attempt to strengthen the role of the trustees. But much more must be done. The trustees must for instance be better in overseeing the IASB and its work plan, be more involved in how the work plan is drawn up and how the mandates for the IASB come about, and be much more visible. The criteria for selecting the trustees and IASB members must be changed to ensure that the structure is balanced. In connection with the most recent amendment of the constitution it is to be welcomed that in future all contributions arising from the consultation procedure will be answered by the IASB with opinions, and reasons for comments which are not taken on board will be published.

The EU decision to oblige publicly traded EU companies to use international accounting standards significantly changed the context for the **IASCF/IASB**. The IASCF/IASB used to set voluntary international accounting standards. The EU decision turned the IASCF/IASB into a quasi law-maker. This raises a number of questions that have not yet been addressed by the IASCF/IASB. For instance, should standards not be freely available to all those required to apply them? Is there sufficient democratic control over the IASCF and IASB and do these bodies have a representative membership? Is there an appropriate balance between the bodies? Is it appropriate that the IASCF/IASB only focuses on providing information to capital markets? What about other users of financial statements, e.g. creditors, public authorities, owners, customers and employees?

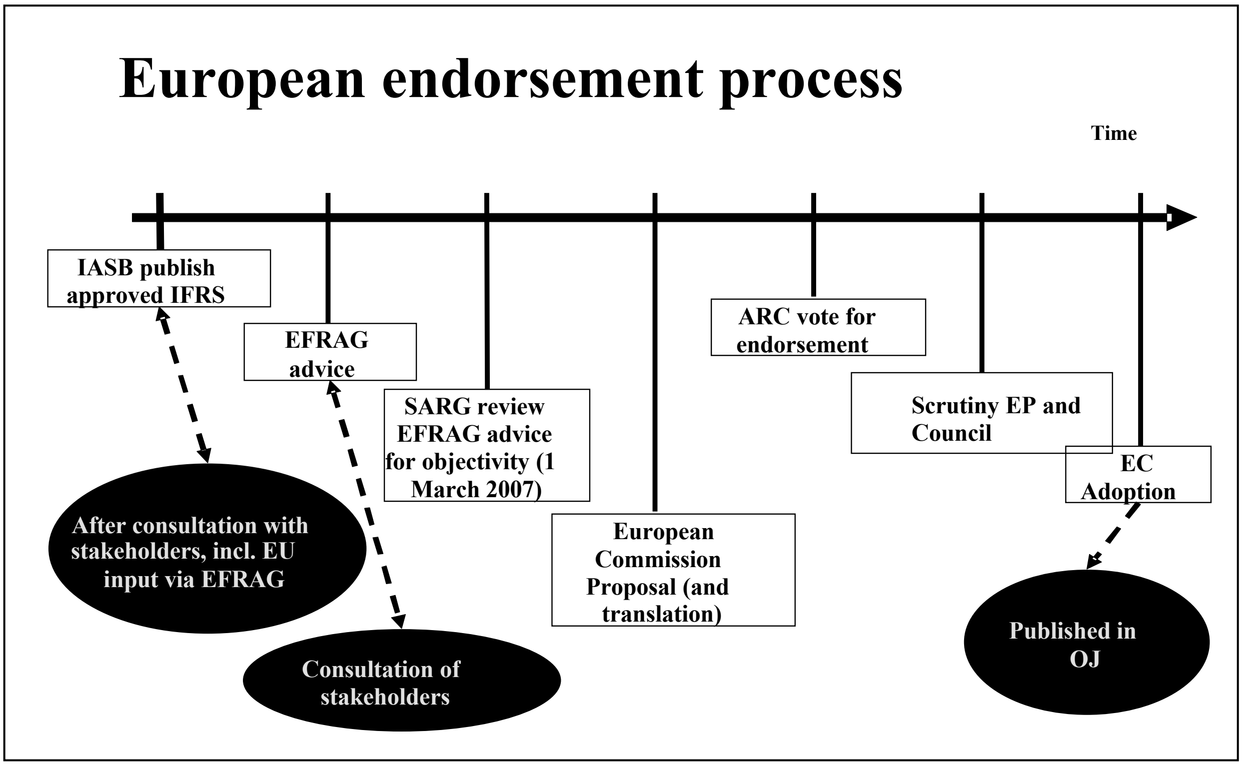
Moreover, any initiator of laws carries out impact assessments, but the IASB currently does not **assess the impact** an accounting project could have on preparers and users. For all projects the IASB should estimate the costs that could be incurred by preparers as well as consider what benefits it might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

Another issue is **funding.** An organisation like the IASCF/IASB must have a transparent and stable funding system. Clearly funding systems can be designed in different ways; for instance, public sources could provide partial funding, or purely private funding could be used. The ECOFIN conclusions stressed the need to secure sustainable funding for the organisation. The funding from contributions hitherto dates back to the early stages of the organisation's current form, and was supposed to have been replaced by 2005 by a long-term system of funding. After it proved impossible to achieve that objective, contribution-based funding was extended for a further two years, and is supposed to continue only until 31 December 2007.

The rapporteur is convinced that the IASCF/IASB is far from being transparent and balanced. The rapporteur is also convinced that democratic control within the organisation must be improved.

3. Implementation of IFRS in Europe

Below the EU endorsement process is illustrated.



The rapporteur points out that the endorsement procedure only applies to international accounting standards for publicly traded companies. **It cannot be used to endorse IFRS for SMEs, since a new legal basis would be needed for this.**

Moreover, there are many bodies involved in the endorsement procedure. Especially the Commission receives input from a number of committees 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 and that, not least in order to save time, the European Parliament needs to be kept informed in a timely manner about how work is progressing.

Given the number of topical accounting issues, 2007 and 2008 could be significant years for the cooperation between the IASCF/IASB, the Commission, the Council and the European Parliament.

4. IFRS for small and medium-sized enterprises (SMEs)

On 15 February 2007 the IASB published the draft financial reporting standard for small and medium-sized enterprises and invited all stakeholders to submit comments on this proposal by 1 October 2007. Given that the European Parliament is involved in implementing this standard in European law, it hereby forwards its initial comments.

In preparation for the own-initiative report, the rapporteur submitted a working document to the competent Committee on Economic and Monetary Affairs on 10 April 2007. This working document sparked a process of discussion that has greatly contributed to this report.

The IASB set itself the aim of bringing together all existing IFRS standards for application in small and medium-sized undertakings and making them available in simplified form.

The intention was to produce a stand-alone document containing all the rules that must be applied by SMEs in a relatively brief overview. The standards were to be presented in a clear and easily understandable way so that they would be easy to apply for small undertakings with relatively limited staff and financial resources for drawing up financial statements. Consistently reducing the comprehensive rules to the circumstances relevant to SMEs and simplifying the rules are central elements for the success of this project.

According to the IASB the **draft IFRS for SMEs** aims at companies with around 50 employees. Firms that do not have public accountability but are required to publish financial statements for external users are to be given accounting guidance, according to which general-purpose financial statements can be published for external users. In the exposure draft the IASB explains that it intends to update the IFRS for SMEs every two years.

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

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 IASCF/IASB has the expertise to develop a simple standard for SMEs which are not publicly traded, so as to take into account e.g. the many different forms that small business may take. 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.

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 uniform accounting for SMEs across the entire EU.

Parliament can at least make an initial assessment, and it is not convinced that SMEs in Europe have called for and need an IFRS for SMEs drawn up by the IASB. It would perhaps be appropriate to offer a European SME standard based e.g. on the opinion of EFRAG (European Financial Reporting Advisory Group) on the IFRS for SMEs. A European SME standard would also make it possible to take specific regional characteristics (e.g. those relating to company law) into account

5. Road map 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 publicly traded 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 GAAPs until 1 January 2007.

The IASB and the FASB (the US accounting standard setter) have published a very full joint work programme. The objective is to achieve progress towards the equivalence of each other's accounting standards by 2009.

On 20 June 2007 the American Securities and Exchange Commission (SEC) submitted a proposal for consultation on the recognition of statements based on the IFRS. This is very welcome news, since the US, in accordance with the agreement signed between the US and the EU on 30 April, is considering measures aimed at waiving the costly reconciliation requirements hitherto applicable for European undertakings listed in the US. However, closer examination reveals that the SEC intends to recognise only financial statements drawn up according to the English version of the standards adopted by the IASB. The Commission wrote to the SEC in the autumn of 2007 calling for the recognition of IFRS, which has the force of EU law.

The existing version of the IAS/IFRS standards, which have the force of law in the EU – the main applier of IFRS – might in future be considered as local variations by the US authority, and thus not binding. The SEC, a national body, is thus giving private proposals from a body outside political control priority over current EU law. For its part, the SEC could submit American interpretations of current IFRS rules, and require European companies which wish to present financial statements in the United States in accordance with IFRS to comply with those, thereby itself creating a US variation on the IFRS. There is also the risk of the SEC becoming the ultimate body interpreting the IFRS.

The Commission must be given fundamental responsibility vis-à-vis the IASB so that EU interests are taken into account in this convergence process on an equal footing with American interests.

In the meantime, questions have also been raised regarding the appropriateness of full convergence between US-GAAP and the IFRS. It must be taken into account that IFRS is also applicable to firms which are listed on several stock exchanges, although this does not apply to the vast majority of firms applying it. Efforts to achieve a single reporting standard by approximating the two dominant standards at world level might prove too great: efforts towards convergence were necessary as long as more standards were in use worldwide than the current two leading standards. An alternative to convergence between these two standards would be the political recognition of equivalence between both standards, which differ in content but are of an equally high quality.

On 12 July 2007 the Commission submitted a first report on the **work timetable** of the authorities responsible for national accounting standards in the US, Japan and Canada for convergence between IFRS and the Generally Accepted Accounting Principles (GAAPs) of those countries. The report also describes 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 discussions on financial conglomerates and the delayed implementation of Basle II. It looks as if the United States were willing to be involved in negotiating agreements on new rules in order to reach a compromise, but will then fail to implement them subsequently itself. The potential recognition of IFRS by the SEC brings with it the urgent question of where the ultimate competence regarding interpretation is to lie. It has to be noted that the European structures are not yet ready for this question.

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