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Accountancy, Accountability and Practice

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Return to the Principles in the IFRS Setting Process

Author: Theodor Dumitru Stolojan, Member of the European Parliament

Thank you very much. First of all I would like to welcome all participants in this workshop organised by the research lab on financial regulation (Labex ReFi).

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Let me brief you about where we are in the European Parliament (EP) in the field of International Financial Reporting Standards (IFRS). Last year, the European Parliament and Council approved a program for financing of three organisations involved in accounting and auditing: Among them IFRS Foundation and the European Financial Reporting Advisory Group (EFRAG). The program is for 2014–2020. For EFRAG, it is only for three years. Because – you know – it was the Maystadt Report¹ regarding EFRAG, how to change EFRAG, to do better its advising role of the European Commission through endorsement process of accounting standards. At that time, there were intense debates in the EP. And we found ourselves, deputies of the EP – of course, not all deputies, but deputies interested in this issue –, we found ourselves in an academic debate, in a professional debate and of course in a political debate regarding accounting standards.

I am sure that my colleague here Mr Syed Kamall will tell you a few things about the substance of this debate, which was linked to the idea that we have today in the EU, a regulation regarding accounting standards, with principles to be followed when we judge if an accounting standard is to be implemented as it is or not in the EU. And it seems that some principles in this regulation are not the same as those principles built into some accounting standards, and even into conceptual frameworks elaborated by the IAS board. However, by the end of this semester, we expect from the European Commission (EC) a report on the ten years assessment of the application of the IFRS in Europe. This report will be a difficult one, because we ask the EC: Do not look only at the experience of the implementation of accounting standards in companies, but also look into the governance of accounting setters. And we are very much interested in seeing this report as soon as possible.

We have to thank Mr Philippe Maystadt, who was appointed special adviser to the former Commission for Internal Markets, and who elaborated a report regarding how to improve EFRAG, our technical advisor. Most of his recommendations are already implemented. However, there are still some recommendations, which we have to think about, how to implement them.

You know that we have a colleague, a former colleague in the EP, Mr Wolf Klinz, who was approved by the EP to become President of EFRAG. Unfortunately, because of personal health problems, he declined to take this position, and therefore we have to take again from the beginning the process of evaluating different potential candidates for this job, which is very important for us.

¹ Maystadt, Philippe (2013) Should IFRS standards be more “European”? Mission to reinforce the EU’s contribution to the development of international accounting standards. URL: http://ec.europa.eu/internal_market/accounting/docs/governance/reform/131112_report_en.pdf

The things are going ahead: IAS board issued – as you know – IFRS-9, a very important accounting standard for the financial sector, and maybe a lot of debate was around this standard.

Thank you.

Asking Questions of Accounting

Author: Syed Kamall, Member of the European Parliament

First of all, thank you very much for inviting me, and also to my colleagues here today.

I am not a technical expert in accounting but I have a technical mind. A few years ago I was working on a dossier on auditing and I met with a number of different UK stakeholders, including a bunch of investors, and I asked them about auditing – and about what was their experience of auditing. We talked about the big issues: Box ticking as opposed to professional scepticism and issues like that. And suddenly I found myself drawn into the subject; never expecting that I would be sitting here at a conference like this!

But all I did was ask questions. I spoke to the investors and they had some reasonable questions. One of the questions they had was: Look, it is not only about auditing and the policy of auditing, you have got to start asking questions about accounting standards. Now, why is it that banks during the crisis were able to build up such big losses without provisioning for these losses? How is that no one honestly knew, because you know if you read books like *The black swan* by Nassim Nicholas Taleb or things like that, there will always be these unexpected events. But how come there was no sort of robustness or what Nassim Nicholas Taleb would say ‘antifragility’ built into the system to deal with this? Why did it come as a complete surprise? Why did we have, as one of the most extreme examples: AIG Financial products exposed to 2.8 trillion US Dollars? Why did alarm bells not go off along the way before we got that situation?

And so, one of the fundamental questions we have arrived at is: What are accounting standards for? What are they trying to achieve? What I found is that there are two camps: One is saying that it is purely about financial information and that is what we need. Many would say that is the American line, and even that is not necessarily black and white. Others will say: Well, actually accountants have traditionally played a bigger role. Look at the UK and a UK store; accounting should traditionally bear a much bigger role determining the approach taken by a director of a company.

So, I have been asked these questions. I have heard from a number of people that accountants are a bit confused as to why politicians in the EP are asking these questions, why they are suddenly very interested in the work of standards, why did we suddenly become interested.

But actually, for me, that is what politicians should be doing. We should be asking these questions. As a politician, I am often contacted by constituents who have a particular question about a particular issue: If I do not know the answer, it is my duty as their member of the EP, to submit a question to the EC or to the relevant government, or to their ambassador, just to find an answer for them. And so, I think we should have a proper debate about what it is we want accounts to do and for whom they are made: Are they for investors? Are they for accounting firms? Are they for regulators?

And we know accounting standards are different according to the environment in which they are developed. Clearly, we should attempt to converge different standards, but what substance that involves is the question.

One of the things that critics of IFRS tell me is that in this rush for international standards we have forgotten some very important principles. Indeed in 1996, the Commission's own records recognise this danger. And this is exactly why IFRS could only be endorsed for years in the EU if they fulfilled the requirements of EU company law, to insure that we are importing problems into our accounting framework. Of course, global markets should benefit from global standards. But surely not to the extent where, as some believe, they are undermine faith in the reliability of these accounts.

So that is – you know – asking questions: What are the accounts for?

Let us look at the extensive body of examples from the EU and UK, which would suggest that they are far more than just one tool for capital markets. And let me be quite clear, all I am doing is asking questions; it is as simple as that. When I get satisfactory answers, then I can go away onto another subject if you like.

I am not against IFRS, I made this quite clear to IFRS Foundation and I am not against global accounting standards. But what I have in common with many central bankers and accountants and investors is that I do believe that there are certain standards such as IFRS-39 that are problematic.

In the context of this forthcoming debate of IFRS-9 I want to be absolutely sure that this standard will help, not hinder, the recovery of the banking sector. We must have absolute clarity about what role the accounts of companies play, and the objectives that we must reach.

Let us have that proper debate about the extent of stewardship. Let us have that proper debate about concepts such as true and fair and prudence. But let us also answer a very simple question that is: If you have a financial instrument

such as Credit default swaps (CDS) or Collateralised debt obligations (CDO), is it acceptable, is it prudent to book the unrealised profit up front? But, not to make provisions for the potential losses?

The question I ask at all times is: What happens when there is a default, when it blows up? Do you have the money somewhere to repay that? That is a very simple question that I am asking.

Or actually, do you continue to assume that you never have to pay out, and that you can book that profit and assume that there is no pay out? And as we saw during the crisis, when we saw CDOs blow up and CDS' blow up, we see that tragedy can occur.

That is all I ask and that is all we are asking in the EP: We are not technical experts, although we have become more technical. We find ourselves arguing about true and fair, we find ourselves arguing about prudence – what does it mean? We find ourselves arguing whether the standards are compatible with EU company law – that is about the level of the debate that we have.

But I think it is a very important question. When investors come to us and continue to tell that they have some very real concerns about the accounts of particularly financial institutions, I think that as politicians we have the responsibility to listen and to continue to ask those questions.

Thank you very much.

The Standard-setting process must be independent, transparent and democratic

Author: Michael Theurer, Member of the European Parliament

Good morning everybody. Sorry for being late but it is quite a busy week today. Thank you very much for the invitation.

I think it is an absolute important topic. As probably some of you know, I was working in the last mandate as President of the Budgetary Control Committee. So from that point of view, accounting measures and the accounting legal framework are very important because accountability is a democratic value. Can we resolve our problems with a better accounting standard for private enterprise and public sector? I think accounting can play a major role in that, but it is not the only instrument to achieve it. Accounting is only delivering a certain kind of picture of real activities. As you probably know better than me – but from my professional background I also know: You can have a very good accounting framework in enterprise but it is not always preventing you from compliance problems or from

real economic problems. The managers cannot only rely on figures but they have also to walk through their enterprises and look to the real world.

Now to the political issue, it is really great that our colleague Mr Theodor Stolojan invites regularly experts on these issues and questions. I am convinced that a well-functioning Markets Union needs a regulated environment. The IFRS revision is important especially in this moment as the EU is trying to rebuild our economic framework. The question we are putting is: How far shall the harmonisation go and which parts shall be included; only big enterprises or also small and medium? What about the tradition in the 28 Member States? Others are saying – are underlining –: Do not repair things that are functioning. So, is it really good to force entities that worked well in a traditional accounting framework into a new one or will it increase, or lead to disruptions we would like to avoid? As you know the EP has played and wants to play in this discussion a key role together with other key players: Especially the EFRAG and the International Accounting Standards Board (IASB).

There is undergoing the IAS regulation proposed by the Commission. And, I think quite soon there is a conference in Riga.² The Latvian presidency is working on that issue – on this dossier – quite intensively. The EP wants to catch up with this discussion. The ECON-coordinators decided to appoint a permanent team on IFRS to enhance the EP's ability to follow the work.

I would like to highlight on some of the questions. We as Members of the European Parliament (MEPs) have approved EU funding of the IASB and on EFRAG. In March 2014, the EP voted to continue Europe's core funding of the IFRS Foundation and EFRAG. But we have tight this preparedness – this willingness – to co-finance to several conditions and I think we have to safeguard that these conditions are fulfilled.

We want to have the standard-setting process to be independent, transparent and democratic. The standard setters should be accountable, the Commission should report annually on the activities of the IASB and EFRAG. EFRAG should analyse whether new and amended standards present a true and fair view, and serve European public interest. And EFRAG should analyse whether they are evidence-based and meet European needs; bearing in mind the diversity of accounting rules and business models in the EU. Our problem is the details of how the endorsement process will work; the future is still unclear. We have the fear that more time might elapse between adoption of standards by IASB and the implementation in EU law. Companies that prepare IFRS-based accounts may be affected by this delay. What I would like to ask for is: How could we safeguard that these points, which are important for the EP, are implemented.

² 'International Conference on Evaluation of the IAS Regulation', 25 June 2015, Riga, Latvia.

Let me just focus on another question which is accounting for the public sector; we hold a conference on that on the last mandate as well. There is the initiative that proposes to transfer the accounting standards of the private sector to the government sector. There are great advantages for that but it also is a huge challenge for the state-sector, especially in those countries that have a multi-levelled organisation. I think we should be careful in this process; we should foster the European toppling accounting sectors by national government. At the moment, implementation remains low and the question is why. Our problem is that if we look at these European public sector accounting standards, they seem to impose a huge bureaucratic burden on the public sector in Member States, in regions and in municipality areas. So I raised a question in the last mandate whether it might be possible by those who have developed this European public sector accounting standards to simplify their proposals; to make it easier for those who have to implement it to get it into work. I am in favour to have an accounting framework for the public sector, but I am afraid that the proposals that are on the table are too detailed and too complicated and are overburdening those who have to implement it.

So, I would like to leave it with that, thank you.

ANC over 10 years of IFRS in Europe

Author: Patrick De Cambourg, President at Autorité des Normes Comptables (ANC)

Good morning, thank you for inviting me.

Since I am the successor to Jérôme, I would like to say a couple of words if I may. To simply tell you that Jérôme is, first of all, remembered as a man of culture. He was passionate about a number of topics and, of course, we know him for his interest in financial regulation and accounting. Jérôme was a man with – as everybody know – forward looking opinions expressed with energy on the evolution of accounting standards in Europe and at a global level too. He was travelling extensively and he was expressing strong views about the future. Some of his ideas are now implemented today. Leah, if I may reassure you, I do not know what Jeremiah will do, but I can tell you that reconciling accounting and poetry is possible. So, he will maybe be able to create the bridge between the two, and we need people with ideas in this area. So we will remember vividly Jérôme for his very strong contribution and qualities.

As regards to this symposium, we live in a fast changing world but we also are at a crucial moment. First of all, the conference in Riga,³ which a number of us will attend, will take place next month. It is absolutely true that we need to draw the lessons of ten years of implementation of IFRS in Europe, following the decision taken in 2002 to implement them in 2005 onwards. It was a brave decision taken by the EU as it was an element of power play in accounting standard setting: Deciding in favour of IASB/IFRS was of course a decision which was not easy, but which probably will be judged as globally beneficial. But we need to take a balanced view and we need also to learn the lessons from the period we have just been through. So the report from the European Commission is very expected and I am sure there will be a lot of discussions around it.

The second point that I would like to raise is the need to succeed in the reform of EFRAG. The endorsement mechanism in Europe was ‘not commendatory to the importance of the topic’ and the decision that was taken to create a new framework for the national standard setters, which now fully participate in the endorsement advise process via the EFRAG’s board, is fundamental. As the chair of the ANC, I am a Board member of EFRAG and I am exploring this new world, which is very interesting and very important. We are also very sad that Mr Wolf Klinz, whom I know, cannot join us as the EFRAG Chairman. During my previous life as an auditor, I also met you Mr Syed Kamall, and I am convinced that endorsement has to be tested and tested positively at institutional level. Mr Wolf Klinz was the perfect bridge between the European public good, perceived by the democratically elected institutions at European level, and the technicality of accounting. This step back in the nomination process of the EFRAG Chairman will unfortunately delay the full implementation of the EFRAG’s reform. Succeeding in the EFRAG’s reform is also making sure that we find the right definition and the right attributes of the European public good.

The third point I would like to address is that the convergence process is at crossroads. First of all, we are currently right in the middle of the transposition of the EU accounting directive and this is not a minor exercise: We are experiencing this in France but also in all other European Member States. This is an important exercise: A proper harmonisation will help having a better playing field. This transposition and the European Commission consultation on Capital Markets Union also raise the question of whether going further in terms of standardisation, in particular for listed SMEs (Small and medium-sized enterprises) is desirable. The ANC considers that we have to be careful in creating another layer of standardisation: On the one hand, we already apply IFRS for the

³ ‘International Conference on Evaluation of the IAS Regulation’, 25 June 2015, Riga, Latvia.

consolidated accounts of public listed companies; and national accounting standards inspired by the directive on the other hand. Therefore, the ANC does not see the need for another layer. However, if the harmonisation was not a success, we would have to consider this point. But in terms of convergence, a key point, in my view, at a more global level, is that the so-called ‘Norwalk’ agreement has come now to an end. The harmonisation between IFRS and the US GAAP is not a full success. It does not mean that there would be no evolution in parallel, but it means that the ideal of a single set of accounting standards at a global level is not going to happen in the short-term. Therefore we need to find the right level of discussion and the right balance in terms of convergence to avoid more divergence and to make sure that the first two economies in the world (the US and Europe) do not follow different rules, which would disrupt the markets.

And last point, we are confronted with two important topics in terms of substance at a standard-setting level. First, we have to finalise at the European level the endorsement of the standards on financial instruments (IFRS-9). And this is not a standard like the other ones, since it is crucial to banks, insurance companies, but also to businesses in general. It is extremely important to link it with the European public good concept, which relates in particular to a long-term vision for investments. The endorsement advice process is currently underway. EFRAG has launched its draft endorsement advice and we are waiting for the contributions of all the stakeholders. Secondly, the IASB has been setting standards with a very old reference in terms of Conceptual Framework: It was going back to the end of the 80’s and it is therefore not fully appropriate anymore and should be revised. So we need to stop and sit to carefully examine the draft of the new Conceptual Framework and we must link all its concepts with the European public good concept. There will be debates, but debates are always very healthy.

Thank you for your attention.

Don’t Break the Speedometer: Independent International Financial Reporting Standards are a Crucial Instrument of Transparency, Integration and Accountability

Author: Olivier Boutellis-Taft, CEO at Accountancy Europe (formerly known as Federation des Experts-comptables européens)

Good morning ladies and gentlemen, and thank you very much for inviting the Federation of European Accountants (now called Accountancy Europe) to this important workshop.

Before offering my remarks, I would like to say that it means a lot to me to be here today personally, because I knew Jérôme and had great regards for him. And honestly when we talked about accounting we did not necessarily always agree, but I think we were in agreement most of the time when we were talking about other matters. And in any case, whenever we were talking about accounting (or any other thing actually), I think we have always had fascinating and very stimulating conversations because of Jérôme's great intellect and enthusiasm. So, I will miss this; but I am sure that I will find an equally great intellectual stimulation with you Mr Patrick de Cambourg as new chair of the French ANC.

It is quite challenging to add something after this distinguished panel of speakers but I think I would like to maybe remind you of a number of points which show that the title of this seminar is especially well chosen. I think many people have become growingly interested in accounting: Regulators, social scientists, academics and non-governmental organisations (NGOs), and as Mr Syed Kamall reminded us, politicians. And I believe this is a good thing – I mean – everybody has or should have an interest in what is an essential tool for transparency and accountability. But accounting – I believe – is first and foremost a matter of practice. And this is how it contributes to the economy and to society. Accounting is for instance essential to manage a business (whatever the size of this business). It is indispensable to assess performance and stewardship, including for instance in a charity. It is critical to invest or lend money; it is useful to assess a business partner, a supplier, a client or an employer. And it offers a basis in many countries to assess tax liabilities i. e. to participate to society. These examples are mostly taken from the private sector but accounting is or should be equally useful to manage a state, to issue or buy sovereign bonds, to ensure the sustainable performance of public services, to assess the impact of public policies, or to anticipate the pension liabilities of the public sector. As Mr Michael Theurer hinted to, there is a cost associated to any change. But in the case of public sector accounting and looking at where we stand today in Europe, I do believe that the benefits would be much greater than the costs. And to partly answer one of Mr Syed Kamall's questions I would like to add that accounting provides information, decision makers on their side remain responsible. I believe it is a good principle not to shoot the messenger. As I said, accounting offers a basis to achieve many goals for the economy and society but it cannot serve all possible purposes. There has been much debate on its impact on financial stability. Accounting is an agreed method to measure what is going on. We put speed limits and cops on roads but we do not twist speedometers in cars. The chair of the supervisory board

of the ECB, Mrs Danièle Nouy, explains very well the difference between financial reporting and regulatory reporting. Financial Reporting is aimed at market participants and helps them to make business decisions; I would add that it helps them do their job i. e. to take risk. On the other hand, regulatory reporting is aimed at supervisors and it helps them assess and limit risk. So accounting was invented by practice because it responds to a need of market players and citizens. In fact, accounting was so useful to society that it was invented long before writing or numbers even existed, some 10,000 years ago, in areas that are today Iran and Iraq. To ensure that accounting continues to serve the public interest it is essential that we learn the lessons from the past. Do not be afraid, I will not go back 10,000 years but I would just like to quickly look back at the ten past years. We have already been reminded that ten years ago we have been starting using IFRS; and the European Commission is currently conducting an evaluation of the IFRS Regulation. Well I believe, like Mr Michael Theurer, that it is right to do an evaluation before deciding whether any change is needed. Do not repair things which are well functioning – reasonably well –, I think this is the spirit of what you said and I would like to be able to quote you on this; I think this is a very wise approach. And indeed the empirical studies we have seen back this assertion. Most studies effectively indicate that IFRS have worked reasonably well. They enhanced the quality of financial statements across Europe and provided much needed greater comparability. More importantly, we should keep in mind that ten years ago, before the EU made this decision, European listed entities were on the verge of going for US accounting standards. Without the decision to adopt IFRS, today in Europe, and in the more than a hundred jurisdictions using IFRS worldwide, the de facto global standard may be using US standards: Is this what we want? Without the adoption of IFRS in Europe, European stock markets would probably be more fragmented than they already are today. And in this respect let us not forget that transparency and compatibility of financial reporting across Europe will be a key enabler of the Capital Markets Union.

Like in any other field, international standards bring value and this value comes precisely from using the same standard. Do you imagine what sending an SMS from Strasbourg to Brussels would be without a common communication standard, or with something like 'SMS as endorsed in the EU' that would be limited to intra-EU communication? I think we would be struggling with our short messages. This is not meant to say that IFRS and the IASB are perfect and beyond any criticism. We at the Federation of European Accountants also criticise the IASB when we find it necessary, but in a constructive manner based on factual evidence and technical arguments, to preserve and enhance the benefits of international standards and increase their quality. We also think that there is a need for more innovation in corporate reporting and we will soon be releasing a discussion paper

on the future of corporate reporting. When Europe starts bashing the IASB, we should ask ourselves whether we have a credible alternative or whether we can produce one. The story of the recently adopted accounting directive provides the answer. After almost seven years, of a sometimes heated debate, the European Parliament and the Council have produced a directive on accounting that contains about a hundred options. In other terms, a hundred signals that Member States and MEPs cannot agree on accounting matters. The directive even contains options to depart from so-called general principles: So for a lawyer in terms of quality of legislation, I think this is horrendous. For a taxpayer in terms of resource efficiency this is uselessly costly and for an SME willing to go cross boarder or for Europeans in terms of a single market I think this is disappointing to say the least. Let me give a practical example of the impact of the directive as it was recently reported to me by an official from a small country that was striving to modernise itself after having spent seventy years as part of the Soviet Union. As a small opened economy this country was keen to benefit from international standards. Therefore it applied IFRS to almost all entities, including SMEs. Nobody complained because IFRS were applied in a proportional manner. This country had developed an online one-stop shop for all reporting requirements: Accounting but also tax and statistical reporting. Apparently it all worked fine. Now this country is transposing and implementing the new accounting directive. The result is that they lose quality and granularity of financial information for the vast majority of their companies, which in majority are small. At micro-level they lose information and the true and fair view, because they are prevented for instance from asking for a cash-flow statement and disclosures of related parties transactions, making access to finance for SMEs more difficult. At macro-level they also lose information on the overall health of their economy. Apparently, they are also losing out on red tape as the directive limits the amount of information that can be required by Member States to small entities, and they cannot apply their one-stop shop anymore. So, there is more, not less administrative burden for companies.

What lessons can be learned to further advance accounting for Europe's economy and society? Well first of all, all politicians are right to take an interest in accounting and they have an important role to play. I would just like to give five examples of where they can make a real difference. First, I think politicians can inform and foster the debate by events such as today and I would really like to congratulate the organisers of today's seminar. Two, I believe politicians should promote transparency and comparability: There is still such a thing as accounting nationalism and protectionism in Europe, and the EP is instrumental to safeguard the collective European interest. Three, I think they should continue deepening the internal market in a pragmatic manner and insuring that Europe remains integrated in global markets. Four,

I think they should recognise that our legislative process is not always fit to deal with accounting and that outsourcing to a trusted third-party, a global standard setter can make sense: The IFRS experience over 10 years provides clear evidence of that. And five, and finally, I think they should ensure that standard setting remains independent, i. e. at arms-length from all stakeholders: From industry, of course; from the different categories of investors, but also from Member States and especially large ones; but also from the accountancy profession; and if I may, I would say from the EP itself as well. It is all about cooperation and influence, not about power and control. And all these lessons – I believe – are equally, if not more important for the public sector, to continue with the analogy of driving a car. I am amazed that we sometimes intend to drive our bigger cars, or maybe I should say our public buses, without any speedometer.

At all levels of governments, I think we need high quality financial information. Public spending often accounts for more than half of the EU GDP and we cannot afford a black hole on this part of the economy. With a single market and a single currency, we also need comparable reporting. Almost half of the Member States have between 50–80 % of their sovereign debt in the hands of non-residents. And finally we need independent standard setting as I have outlined already. In this respect Eurostat has taken an ambitious and welcomed first step; I think they should be supported and encouraged to make rapid progress. I hope this workshop helps us learn the lesson from the past and continue developing further benefits that both private and public sector accounting bring to the economy and the society.

Thank you.

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