"Future of IFRS: what purpose(s) do we want annual accounts to serve?"

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REPORT

On 8 May 2013, ACCA (the Association of Chartered Certified Accountants) organised a debate on the "**Future of IFRS: what purpose(s) do we want annual accounts to serve?**" co-hosted **by Dr Syed Kamall (ECR Group, UK), MEP and Theodor Dumitru Stolojan (EPP, Romania), MEP.**

The first panel debated **the relevance of IFRS in today's economic environment** and whether **they are still fit for purpose.** It was moderated by **Richard Martin**, Head of Corporate Reporting, ACCA. The panel was comprised of **Philippe Danjou**, Member of the board, International Accounting Standards Board, Professor **Stella Fearnley**, Bournemouth University, **Danny Van Quaethem**, Financial analyst, Societe Generale Private Banking NV, **Claes Norberg**, Confederation of Swedish Enterprise and BusinessEurope, **Roger Collinge**, Head of Corporate Governance Group, UK Shareholders Association, **Gérard de la Martiniere**, Caisse des Dépôts et Consignations.

The second panel discussion revolved around **what Europe needs to change as IFRS enter its second decade.** It was moderated by **Liesel Knorr**, Chair of the DRSC (Accounting Standards Committee of Germany). Speakers included **Francoise Flores**, Chairman, European Financial Reporting Advisory Group, **Didier Millerot**, Head of the Accounting and Financial Reporting unit, DG MARKT, European Commission, **Roxana Damianov,** Rapporteur Corporate Reporting SC, European Securities and Markets Authority, **Mark Vaessen**, Chairman Corporate Reporting Policy Group, Fédération des Experts-Comptables Européens, **Gordon Kerr**, Cobden Partners.

Main conclusions

Discussions revealed a great diversity of views between panellists, though a consensus on the need for global accounting standards to prevent any new financial crisis seemed to emerge. Most panelists – though not all- agreed that given the global nature of our economy, IFRS are a valuable tool that helps Europe's capital markets in attracting foreign investment in the EU. Today's global economy requires global standards to allow transparency and comparability of financial accounts of listed companies across the world. It was stressed by some that allowing more flexibility in the implementation of IFRS into EU law could run the risk of resulting in different set of regional/local standards and thus potentially undermining the agreed - and reaffirmed by the G20 – objective of pursuing a single set of comparable and transparent financial reporting standards. It was stressed that this might diminish the real added value of the financial statements and reinforce the already negative perception of "fortress Europe".

However, the debate revealed too that serious concerns linked to the conceptual framework of the International Financial Reporting Standards (IFRS) need to be solved, namely the concepts of prudence and stewardship, as well as the issue of quality and reliability of the standards. There is a mounting dissatisfaction among a certain number of people, including users and preparers of financial accounts, on the quality of IFRS linked to their complexity and relevance, as well as their endorsement process in the EU. It was argued that the long-running convergence project with the US has led to a loss of prudence, a concept embedded in the European accounting tradition but not in the US one.

Main highlights

Dr Syed Kamall, **MEP**

- Mentioned that over time he has come to a few conclusions about what we need to learn from the crisis. One is that in the future there should be no more bailouts by tax payers. Secondly, we need to increase liability standards and clarify the company directors' responsibilities. The third issue revolves around accounting standards, where not enough prudence has been exercised.
- We need to discuss what we are trying to achieve with accounts. The European accounting model, which has developed over several centuries, is about far more than simply providing information to the capital markets - unlike the US model - it is also meant to be a driver of better governance. The G20 commitment is to strengthen the global financial system. We have to ask ourselves whether converging around complex, wordy accounting standards is something that will protect us from future crises.

Moderator of the **first panel**, **Richard Martin**, **Head of Corporate Reporting, ACCA**, stressed that:

- There are a certain number of issues linked to the conceptual framework of the IASB such as the issues of prudence, reliability and stewardship, which are being questioned by several stakeholders and need to be included in the forthcoming consultation of the IASB.
- The debate on whether IFRS are fit for purpose in Europe has been tainted by the failings in the financial statements of banks. The IASB's proposed solution is currently out for comment. All parties should be encouraged to respond to IASB and to EFRAG, so that these bodies can judge the strength of opinions on these contentious matters.

Philippe Danjou, **Member of the board, International Accounting Standards Board**,

- Believes that IFRS are still fit for purpose. We live in a global economy. If we do not have global standards, we will have many problems in the transparency of economy. We try to provide the bedrock on which we can build a stronger, more transparent financial system. Financial institutions need global standards and a level playing field. You need to have measurement in order to establish global regulations. Political leaders of the world have been calling for convergence since 2008 in order to work towards a global single set of accounting standards.
- In 2001 no major economies used international standards. In 10 years we have come to a situation where more than hundred countries permit or require IFRS. The regulation of 2005 was the starting point in Europe. And today 2/3 of G20 economies require IFRS. Certain countries are slow in making decisions or are adopting the standards in more complex ways.
- There are different paths of IFRS adoption. For example, China has converged with IFRS and it is very close to our standards. India is still to make a decision. Indonesia is using IFRS since 2009 and is on the way to have full IFRS. In Japan some companies are using IFRS; however it is not mandatory. Saudi Arabia requires IFRS. United States have permitted foreign companies to use IFRS, but a decision is still to be made on whether to require US company to report on IFRS.
- The IASB has become a global organisation. We have governance that has evolved over time. The Monitoring Board is making sure that we fulfil our role in public accountability and interest; trustees of IFRS Foundation are in charge of the governance of the Foundation; the technical board is in charge of developing the standards.
- IFRS are designed to provide investors with maximum transparency, good information to make decisions, both for short and the long term decisions. Long-term investors require point in time, reliable information and unbiased performance measurements.
- We have eliminated the concept of prudence as a top priority, because there was some misunderstanding about the term. Not everyone has the same notion of prudence. We want accounting to be as neutral as possible, that does not mean not prudent.

Professor Stella Fearnley, **Bournemouth University**, argued that:

- Financial statements should reflect the economic substance of a company and have a believable audit report attached. Some comparability of accounting practices and underlying common basic principles across borders can be a good thing, but to try to impose a top-down system which ignores culture context and existing legal frameworks in individual countries will have problems.

- We got it wrong in 2002 by introducing a maximum harmonisation Regulation for IFRS in the EU. This Regulation grants a monopoly in standard setting for our listed companies to the IASB, a body which the EU does not own or control and which has limited accountability. 20% of IASB's funding comes from the Big Four accounting firms.
- IASB standards have been dominated by the US GAAP convergence / comparability project since 2002, which is now on hold. The US standard setter, the FASB is accountable to the SEC which itself is accountable to the US political systemObvious conclusions can be drawn on where the influence on IFRS may come from. There was no public consultation about US GAAP convergence which was announced shortly after the EU Regulation was passed.
- In 2009, the UK Financial Reporting Council (FRC) issued a consultation paper '*Louder than words'* based on its own 2008 research and they listed some items called *opportunities for further action.* These include: valuation of intangibles; capitalisation of research and development; valuation of defined benefit pension schemes; discontinued operations; valuation of embedded derivatives; fair values in the absence of a market; fair value of own debt; financial instruments generally; hedge accounting; segmental reporting; share based payments; and proliferation of guidance. There are criticisms about too many choices which inhibit comparability - the main justification for IFRS, and criticisms specifically about the outputs of fair value accounting which are described as *not always sensible*.
- Since the banking crisis, there has been reluctance on the part of the IASB and the UK accounting establishment to acknowledge that mark to market accounting and the incurred loss provisioning model contributed to the crisis by allowing under provision for loan losses and booking unrealised gains as profits, thus allowing the payment of bonuses and possibly dividends out of capital and inflating share prices in banks. Investors and other key stakeholders in the banks' financial reporting process were not told that the banks' accounting numbers were unreliable, at least until 2012, when the Bank of England reported that some banks' assets are still significantly overvalued and additional capital needs to be raised. In 2009 the G20 asked for changed to be made to IAS 39 by 2011, and this has yet to happen. Generally it is taking political intervention to make the IASB change what it is doing and change takes too long. .
- We need prudence in a conceptual framework, not just written into specific standards. It was taken out of the framework because it was not in US GAAP. The reason put forward is that prudence allows earnings management by tucking profits away to cover downturns in future years. There are views in the UK that this would have been no bad thing recently. Earnings management refers to any forms of gaming within the rules by management to get the results they want. It is the job of the auditor to make sure that earnings' management is not happening as it is impossible to set accounting standards to cover every form of gaming by management. Europe has to take back the control of its accounting standards and not be subsidiary to IASB.

Danny Van Quaethem, **Financial analyst, Societe Generale Private Banking NV**

- He emphasised that speaking of accounting standards in the context of the recent financial crisis, perhaps moral standards are the most important issue.

- In order to get good standards, we need first of all to answer the question - what is a good standard? There is no "one set of standards" at the moment. Many companies use their own measurement of EBITDA and EBIT, calling it REBITDA and REBIT (eg this allows a company to add net profit of their part in a joint venture into the group's REBITDA, instead of only being visible in the "associates line"). Many companies have their own definition of earnings per share called "adjusted EPS" or "core EPS". In the US we have the same problem with GAAP and non-GAAP numbers. No wonder that one finds so many different EBITDA, EBIT and even EPS numbers for one company in different analyst reports. Sometimes analysts add a bit of their own flavour as well. He quoted Peter Elwin, accounting specialist at JP Morgan, who compared IFRS to a language: "*IFRS is a language and like any language it has an impact on the situations it is used to describe and on the thinking of those who use it, but it is a dynamic framework, not a static computer."*
- Second issue – rules are too complex. It is good to have extra information, but we must get relevant information and to separate what is really important. Another problem is that people do not care and do not know about IFRS. Danny Van Quaethem mentioned that there are also some frustrations on technical issues, for example the accounting for Mergers and Acquisitions. People want the system to be reliable and to work. It is absolutely necessary to

have standards, to get markets to be more transparent, as well as to get information on liabilities which are extremely important.

- During the Q&A session Danny Van Quaethem addressed the ‘cookie jar’ concept as a moral case; there is a problem of the dogma against the ‘cookie jar’. Profit is an opinion, cash is a fact. We must refer to moral standards.
- He referred to a comment in the Wall Street Journal 6 May 2013, in which Mary Jo White (SEC president) called "*for the need for international cooperation*": but...: "*The promise of global accounting standards fades if there is not consistency in their application, implementation and enforcement*."

Claes Norberg, **Confederation of Swedish Enterprise and BusinessEurope**

- It is important to have one accounting language accepted in all capital markets, all over the world. IFRS can carry out this role. It is very important that IFRS fulfil some key points: it is a set of principle-based high quality standards; IFRS should facilitate a meaningful communication between preparers and users of financial reporting; it should provide a stable platform for financial reporting, and standards should be practical and workable. He stressed the necessity for the IASB to use an evidence-based approach to standard setting, to pursue a stakeholder dialogue that also takes the views of preparers into account, and to use the results of field testing and effect analysis when adopting standards.
- Regarding the current situation and the impact on IFRS over the last ten years, there are three drivers: 1. Convergence with US GAAP; 2. Views by some American analysts; 3. Financial crises, which have led to the situation where preparers are dissatisfied with the development of IFRS.
- Much of the current work is focused on accounting in banks and insurance companies. There is a spill-over on non-financial entities regarding e.g. disclosures which we feel is not really wanted. A suggestion is that the IASB should maybe try to deal with issues related to financial institutions separately.
- The problem of disclosure overload has been highlighted by the IASB itself, which is encouraging, but it is important to create a model to cut the clutter. We should also be concerned about disclosures in interim financial statements; are they going to get as detailed as annual accounts? There seems to be a tendency to add on new disclosure requirements on a piece-meal basis without any clear guiding principles.
- Most users focus on P/L and cash flows but IFRS standards are based on a balance sheet approach with a taste for fair value reporting, not only for financial instruments. We welcome a discussion about this in the Conceptual Framework project.
- It seems like the IASB and the IFRS Interpretation Committee have taken the view that narrow scope amendments and interpretations should increase in volume. This can be in conflict with the principles based approach in IFRS.
- The speaker expressed his concern about the quality of standard-setting. We must not to rush amendments through the system.
- With some major changes in IFRS coming up, many companies say that it is essential that field tests are performed before adoption of new standards and that the results of field testing and effect analyses are incorporated in the standards.
- We are waiting for the four major projects to be delivered and we expect this to create a significant amount of work for preparers in the forthcoming years. It is therefore of vital importance with a period of calm after the implementation of those standards. E.g. five years with no amendments would be great.
- The Conceptual Framework project will be next big thing for IASB. While it is encouraging that the IASB now is addressing the principles for financial reporting in general, one can wonder if this will trigger a major review of specific IFRSs if the Framework is amended. There is need for discussion how to tackle this. A list of standards that need to be changed would help and also a time-table. There is also a concern that research projects and limited scope amendments will create a stream of amendments in IFRS. It is therefore important to make priorities and focus on real accounting problems. We acknowledge that the IASB has high ambitions but we believe that “less is often more”. There is a need to curb the instinct for achieving the perfect accounting system.
- Preparers are trying to keep up with developments. It´s not just implementing adopted standards, it is all the work of analysing and commenting on proposals, not just from the IASB but also from EFRAG, national standard-setters and others. It is important to work together. Make good use of scarce resources to avoid “proposal fatigue”.

Roger Collinge, **Head of Corporate Governance Group, UK Shareholders Association**

- We all support the idea of international accounting standards so long as they produce the right answer, but we are worried. Accounts should show a true and fair view; be drawn up on a prudent basis and report on the stewardship by the directors of the shareholders' money. When accounts are drawn up this way they can improve economic stability, underpin responsible corporate governance and help to rein in excessive pay and incentivise the longer term view from management.
- The 4th Directive says "*… annual accounts must give a true and fair view of a company's assets and liabilities, financial position and profit or loss ". This is a* concept, which from a UK viewpoint started as long ago as the 1940s. It has never been precisely defined in English law as that law has recognised that how true and fair is arrived at may change. But it is in EU law , supported by a number of cases. It includes the idea of maintaining the capital of the company and ensuring that dividends are only paid out of "*profits made*" [4th Directive]. IFRS, on the other hand, include unrealised profits- and these can be calculated on assumptions only- Mark to model-. IFRS accounts, on the other hand, are not required to show the distributable profits.
- We have become intellectually arrogant, we think we can measure risk, we allow banks to have "risk adjusted capital", but the evidence shows that we cannot measure risk. Virtually no-one foresaw the crisis; nor the interbank market coming to a halt. But it happened and demonstrates that we can never know what the future will bring.
- We need to return to the concept of prudence: not having prudence was in itself a bias to optimism and a bias to the view that we are able to really measure risk. There is also the legal requirement to account on a prudent basis. …*valuation must be made on a prudent basis, and in particular: (aa) only profits made at the balance sheet date may be included,"* (4th Directive). Unfortunately the Conceptual Framework of the IASB has dropped this concept.
- The IASB defines the objective of its standards as being to produce *"information useful to existing and potential investors, lenders and other creditors…"* There is no reference to a true and fair view or to the idea of stewardship. As largely long term investors- there can be few investors with a longer term view than those managing pension savings for example-we want accounts to demonstrate how our money had been used. We call that stewardship.
- We need in the EU to consider whether the current IFRS help or hinder economic stability; now comply with EU requirements as to the showing of a true and fair view , and to ensure that the standards which are endorsed for EU use produce the prudent view that the Directives require.
- We can then hope that the next financial crisis will be flagged up sooner giving chance for action to be taken to minimise or even avoid some of the enormous financial and social consequences of the present crisis which we have seen, and still see across Europe.

Gérard de la Martiniere, **Caisse des Dépôts et Consignations**

- The introduction of IFRS has brought real progress in improving financial reporting and integration of the European financial system. But the crisis raises strong questions about the suitability of a repository too focused on the short term and amplifying market volatility. On one hand we know that the needs for investments are huge; on the other hand we must answer the question - where the money will come from?
- We have the benefits of savings of households in Europe, but they need to be channeled to long term investment and ensure that the channeling is working. It is necessary to restore the channeling circuits of these savings toward LTI through a balance sheet intermediation of the financial institutions, including by cautiously fostering the short term resources transformation in long uses.
- The new prudential regulations are likely to seriously undermine this capacity particularly Solvency II. Until now, the accounting standardization represented by IFRS completely ignored the point. The LTI regime is still to be invented. The investment activity of any economic actor cannot be validly analyzed independently of the structure of its liabilities. The duration of liabilities, whether statistical, contractual, or legal (in terms of taxation), determines the investment horizon.
- The investment horizon determines the optimal assets allocation that must combine safety and performance according to the fiduciary obligation incurred with respect to the principal. The performance evaluation of asset management can only be conceived through the portfolio management.

- Further work is needed in order to develop a fair value concept. The 'mark to market' approach is perfectly adapted to the description of trading activities, to the mutual funds activities and, more generally, adapted to the balance sheets exposed to liquidity risks. But this approach is nonsense for the evaluation of financial statements that have the capacity and the fiduciary duty to invest for the long term.
- It is imperative to further the thinking on accounting in order to develop a new approach on "fair value" projected at maturity of liabilities, which may neither be the "book value" nor the "market value". A long-term investment policy is based on a streamlined expectancy of global cumulative performance forward: the fair value of the assets that I buy today to meet a commitment to be settled in X years is the probabilistic value I withdraw from this asset when I will have to sell it to resolve my commitment. The accounts must strive to track this, using value and its possible variations to measure the performance of management; in parallel, risk measurement can pass through the detection of temporary spreads with instant market values.
- The auditor in charge of the accounts certification will have to decide on the robustness of the evaluation of the projected values, as he already does in other cases and then will justify its added value, which is nonexistent when simply applying the market value.
- The EU lacks growth and must courageously remedy to the excessive indebtedness. But in the same time, the EU must open the path to the economic recovery, which can only come from investment. EU is the first customer of the IFRS and is now released from American control because of the recent decision by the SEC. Europe must require the international accounting setter to accelerate the adoption of a standard appropriate to the reality of the LTI business model. It is necessary to set aside the dogmatic debates that have prevented the standard setter until now to deal seriously with the subject.

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Panel 2, moderated by **Liesel Knorr**, **Chair of the DRSC** (Accounting Standards Committee of Germany), discussed what Europe needs to change as IFRS enter its second decade. She opened the debate by stating that

- Most likely everyone would agree that a strong European voice was needed in a global debate;
- Likely everyone wanted an EU system for IFRS based on accountability, ownership and representation; and
- We should remind ourselves that the Accounting Directives could barely be seen as solid common ground as the national laws derived varied considerably.

Francoise Flores, **Chairman, European Financial Reporting Advisory Group**

- EFRAG has made many recommendations to the IASB including not to change what was not broken. The same apply for Europe, the starting point has to be the analysis of what has been achieved.
- There is a general agreement that IFRS have contributed to improving the quality of financial reporting in Europe. In its first decade of operations, the IASB considered numerous potential changes to IFRS. Whilst some proposals have been quite contentious, most of the controversy has been solved prior to publishing final standards, or abandoned. During this period, EFRAG was expressing two requests: not to change what is not broken; and to give a high priority to the revision of the conceptual framework so that no fundamental change would be made to the IFRS underlying accounting model before a thorough debate would take place.
- These requests have been satisfied by recent IASB decisions. Europe must be confident in outcome of the revision of the conceptual framework, where issues which trigger quite intensive debate - such as prudence and whether fair value measurement contributes to relevant financial reporting - will be thoroughly debated. This is the most important development for Europe for this second IFRS decade, which should also bring further improvement in two other areas: effect analysis and field test - i.e. to ensure that potential new requirements can be implemented in practice at a reasonable cost and provide the intended outcome on a consistent basis- , and education. Issuers need to be supported as well, as the implementation of principle-based standards require skills which were less in demand before IFRS were adopted or even before the latest more principle-based standards were issued.
- We should praise those who imagined how Europe should be organised to exercise proper influence on the development of IFRS, who decided three important features: 1) to adopt a

pan-European structure, consistent with Europe being the relevant level of jurisdiction for IFRS; 2) to separate clearly the responsibilities for the assessment of proposed or issued IFRS from a financial reporting perspective; 3) the technical assessment of potential or issued IFRS should be provided by an independent group. This set-up has been important to ensure that the European Commission would be best informed in its decision-making process and its influence on the IFRS standard-setting process, and that all European stakeholders would be considered on equal footing, that no particular national group would dominate, so that European participation in IFRS' development would be driven by the European public interest.

- Examples of how Europe has been successful in its influence on the development of IFRS are numerous. Thanks to the technical credibility of EFRAG, Europe has become one of the most robust participants worldwide in the development of IFRS. The decision to set the IAS Regulation as it is, i.e. to submit the IFRS to a double test (ie that they give a true and fair view of the financial position and performance of entities, and they are not deemed contrary to the European public good) should be supported.
- Responding to voices in Europe arguing that our hurdle for adoption is too low, and that the IASB is not taking Europe seriously, Francoise Flores said that Europe's threatening non-endorsement would not work. Influence comes with a constructive and technically credible contribution to the IASB, including initiating debates, such as what EFRAG, and EFRAG with National Standard Setters in Europe have done in the past decade. Europe has also been very influential in shaping the IASB current due process and EFRAG, together with European stakeholders, contribute to make it very effective.
- A criterion based on "improvement" is not practicable. What is "improvement" for some is moving backwards for others. There are many different financial reporting solutions. Our assessment should remain based on whether investors and other users can understand the information presented, whether it is sufficiently transparent to them, and whether it can be produced at a reasonable cost.
- The IAS Regulation plays its role as it protects Europe's ultimate sovereignty in referring to the European public good, a criterion that only European institutions can properly apply, and which should not be changed in the endorsement process. Improvement could be achieved if economic policy considerations were considered collectively at an earlier stage in the standard-setting process, and a stronger interrelationship between EFRAG and the ARC took place. The review, undertaken after 11 years of IFRS adoption, is a healthy process, it will capitalise on the existing strengths that the European Commission and EFRAG have built so far for Europe.

Didier Millerot, Head of Accounting and Financial Reporting unit, DG MARKT, European Commission

- The European Commission has launched several major initiatives to address some key questions. It is at the moment in consultation mode.
- Commissioner Michel Barnier has recently appointed Philippe Maystadt to look at the current system of adoption of the international accounting standards in the EU, with the view mainly to enhancing the European contribution in advocating global high quality accounting standards; and also to evaluate current governance of EU bodies. Mr. Maystadt will advise the European Commission on how it should develop the endorsement process.
- This mandate follows the recommendation provided by the ECOFIN Council in November 2012. It pointed out the need for reinforcement of the EU voice in the development of high quality standards. The objective of this mission is to assess whether the cooperation with EFRAG could be reinforced, as well as to identify how other views from international standard setters could be taken into account in the standard setting process.
- Mr. Maystadt will raise a number of questions concerning the elaboration phase of the new standards, the endorsement process in the EU, and the prospective impact of the implementation. These questions will include in particular: how to ensure that the public interest will be taken into account when formulating common technical positions; how to ensure these common positions best reflect views expressed by different constituencies; who and in what stage should we communicate common positions to the IASB; should there be more flexibility regarding the endorsement process?
- He will also examine the questions of the complexity and length of the endorsement process and the potential need to identify improvement. Philippe Maystadt will finish his mandate in November this year and will present recommendations, which will most probably follow by a debate in the ECOFIN Council.

- The European Commission has made a proposal last December to renew the financing of EFRAG, the IFRS Foundation and PIOB for the period of 2014-2020. The EU budget provides substantial financial contribution to these bodies. We need a financing program – ie a proper legal basis to ensure that this contribution can be maintained. If necessary, the European Commission can propose adjustments for this financing framework, but we need to be sure that the system can be operational next year.

Roxana Damianov, Rapporteur Corporate Reporting SC, European Securities and Markets Authority

- The crisis demonstrated the truly global nature of the capital markets and the urgent need for global mechanisms to regulate the markets, including a single set of global accounting standards. Financial reporting plays an integral role in the financial system and it is important that accounting standards are of high quality. It is the only possibility to have financial stability and to support sound economic growth.
- Increasing international trade, capital movements between countries and a number of multinational firms ask for international regulation. If there is one area where we have made tremendous progress in achieving the objective of global regulation, it is accounting standards with the introduction of IFRS. We heard a lot of criticism of IFRS, and probably there are no standards that are completely right, the idea is to try to fix identified problems.
- ESMA believes in international accounting standards and thinks that in the current global markets this is the way forward. While we want to see the EU Single Market as part of the global market, we also believe that concerns raised by Europe should be heard and dealt with as part of the IFRS setting process.
- Accounting standards should imply providing the real picture and not adapting them to minimize the effect of particular events in the market or in the business of an entity or serve short-term interests. Europe should keep its leadership in the IFRS and strengthen its voice in the international environment.
- A lot of countries and markets are using IFRS; others are in the converging process. Europe was among the first and definitely the biggest region with more than 7000 listed entities using those standards. By doing that, Europe had the opportunity to take the lead in creating the practice of the IFRS application. Despite the fact that differences still remain in the application of the IFRS, we must acknowledge that a significant increase in quality and harmonization in the practices has been achieved in the EU since 2005.
- Europe has the right to claim that it is the first contributor to the IASB. With emerging markets moving fast and becoming important players in the IFRS arena, it becomes important that Europe positions itself right in the IFRS arena. The difficulty is to find the balance between having sufficient influence over the IASB Board in order to ensure that European views and concerns are taken into account when standards are developed, and that the IASB remains an independent body. Europe should continue and even further strengthen its influence over the standard setting process, by ensuring that there is more European representation at various IASB institutional levels.
- The national standard setters and EFRAG have contributed a lot since the introduction of IFRS in Europe, but this is not just a technical position, it is also a political act. Therefore, there is a big responsibility for the EU institutions. It is important that in opening this debate on changes needed we do not to lose the dimension of meaningful combination between preparers and users, because we all have a common objective.

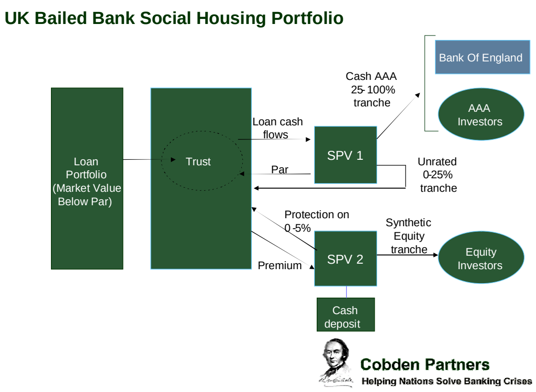
Mark Vaessen, Chairman Corporate Reporting Policy Group, Fédération des Experts-Comptables Européens

- Moving to IFRS was a good thing for Europe. The starting point was that real harmonisation had failed, we had a significant lack of transparency in the European accounts. At the time the largest EU multinationals were increasingly using US GAAP. This left us with a choice – either to accept the US GAAP with no influence on global standards from the EU or to go the alternative roads – either to develop European standards or go back to the international ones.
- At the time, there was no appetite for European standards for the same reasons that are still valid today: markets are global and therefore you need global standards. If you want to stimulate investment, you wonder whether other countries will have the patience with Europe having its own standards…
- We do now have more transparency and comparability among companies, but there are still some issues – complexity has to be addressed.

- Regarding the endorsement mechanism, Mark Vaessen noted that he used to be skeptical. It is important that Europe has a constructive debate with IASB from the early stages on, as the proposals are being developed. We have not been successful in influencing IASB as much as we could have in the past 10 years because of the price we paid for the convergence with the US GAAP. The influence of the US model needs to be recognized. European views on fundamental issues are not always aligned. As long as we do not have strong and coordinated views in Europe, there will be no effectiveness.
- What needs to change in the future? Mark Vaessen is convinced that IFRS are the only game in town, but we need to play it better and continue to bring endorsement mechanism (with technical and political input). High quality of enforcement of financial reporting and coordination in member states is needed. Consistency in the application of the standards across Europe is clearly an important issue. We must work hand in hand with the regulators to achieve this and look into how information is communicated, including innovations, such as integrated reporting. We must embrace that change and look beyond just financial statements. Focus must be put on reducing complexity and keeping the financial reporting relevant.
- He indicated that he is encouraged by the direction taken. Work needs to be done to present a single European voice, which is too often divided. We need to become more influential.

Gordon Kerr, **Cobden Partners, indicated that**

- The system of accounting rules called IFRS was at the core of the sudden and chaotic collapse of the banking system in 2008. You have heard defenders of IFRS here today say that the system is not broken, so why fix it? To demonstrate just how badly broken it is I would make two points:
  a) Firstly I would refer again to Roger Collinge's point, which appears to have gained insufficient attention today. In 2008 Halifax Bank of Scotland (HBOS) provided £300 million against future bad debts. In the next 3 years it wrote off £28 billion. Nobody has been held to account, nor will any charges be brought, because the IFRS rules continue to legitimise underreporting for losses.
  b) Secondly the slide below shows arrangements designed to mask losses under the rules for a major failed and bailed bank in 2010. It demonstrates that the rule changes to both IFRS and Basel post crisis have perversely made it easier for bankers to falsify their profits and capital, and to hide losses.



- The slide is based on a portfolio of loans that should have been marked to market (downwards) by about 10%, because loan spreads for similar social housing UK assets had widened. Instead, the assets are put into a trust to avoid transparency of these arrangements and to keep them on the bank's balance sheet. After tranching, about 75% was eligible for pledging to the Bank of England in return for cheap funding, thus relaxing the funding pressures upon the bank. Of course it used to be the case that these pressures used to signal to the market that a bank was in trouble.
- The second SPV was an entirely separate and unrelated transaction. SPV2 builds up a cash reserve by accumulating excess interest spread on the loan portfolio. This quickly reaches 5% of the total portfolio. At that point SPV2 writes a cash collateralised credit default swap to the bank. Under Basel rules this frees up over £300 million of capital on the £10 billion portfolio, even though of course there is no economic substance to this transaction.
- In conclusion, IFRS has resulted in bankers easily able to present failed investments and loss making transactions as profitable. Large banks are locked in a cycle of bailout/ failure/ bailout,

which will only end when investors, regulators and scrutineers can obtain a reasonably accurate financial healthcheck by reading published accounts. The failure to acknowledge this has resulted in the banking system being stretched again to breaking point, as we meet here today prices of all the heavily criticised alphabet soup instruments (CDOs and CLOs) are at their all time highs. Of equal importance to fundamentally reforming IFRS is auditor rotation. As many UK investors, notably the USS Investment Management team, have emphasised, effective scrutiny does not happen when bank/ auditor relationships are as cosy as they have become in the UK.

Concluding remarks, Theodor Dumitru Stolojan, MEP

- Listening to experts is the traditional way we do our work in the European Parliament. The variety of views expressed today, though very instructive, does not ease his task of rapporteur on the proposal for the co-financing of EFRAG, the IFRS foundation and the PIOB for 2014-2020. The independence and transparency of these organisations must be in place. Public interest must be the center of their work.
- The difficulty lies in striking the right balance between the necessity to preserve the independence of the accounting standard setter while at the same time trying to strengthen the influence of the EU voice. The content of accounting standards is not only a debate between experts and academics, it is also a political debate.
- We are also facing a timing dilemma: while it would make sense to wait for Special Adviser Maystadt's conclusions and recommendations planned for end of November 2013, we as the European Parliament have a political responsibility to ensure that some co-financing for these bodies is in place for 2014.

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