

## **Speech by Frits Bolkestein**

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# **The European Commission's Strategy on Accounting and Auditing**

*Check Against Delivery*  
*Seul le texte prononcé fait foi*  
*Es gilt das gesprochene Wort*

Address at annual dinner for Institute of Chartered Accountants in England and Wales

**London, 2nd March 2004**

Mr President, My Lords, Ladies and Gentlemen,

It is a great honour and a pleasure to be with you this evening. I paid my first visit to your splendid headquarters in October last year. David Illingworth asked me on that occasion to be the principal guest at your next annual dinner and I was delighted to accept.

When I took up my post as Commissioner with responsibility for the Internal Market, Taxation and Customs in 1999, little did I know that so much of my time was going to be devoted to accounting and auditing issues. I was not aware of Lord Justice Harman's statement that: "Accountants are the witch-doctors of the modern world.....willing to turn their hands to any kind of magic". Accounting was meant to be a dry matter. In fact, there has hardly been a dull moment in this area since I took up office.

On a more serious note, after Enron and Worldcom we now have with Parmalat a corporate scandal in Europe of staggering proportions. It has demonstrated we were right not to be complacent when the US scandals broke. The impact of these scandals on auditors and accountants has, without doubt, been significant. One accounting firm has disappeared. Controls on auditors have been tightened. Only four major firms remain and they audit over 95% of the FTSE 300.

This evening I should like to focus on three issues which are an integral part of this changing environment and which I know are of particular interest to you: firstly, International Financial Reporting Standards or, as they are otherwise known, International Accounting Standards (IAS); secondly, EU measures on statutory audit post-Parmalat; and thirdly, EU/US relations in this area.

Firstly, International Financial Reporting Standards. The Commission has promoted a strategy based on a principles-based approach to financial reporting, designed to reflect economic reality and give a true and fair view of the financial position and the performance of a company. At the heart of our strategy is the application, from 1 January 2005, of International Accounting Standards. I remain firmly committed to this strategy. The necessary laws have been adopted and intensive work is now underway across Europe to translate our vision into reality. As your President has already mentioned, your Institute is actively involved in this and I should like to congratulate you on this. Recent events have confirmed that top quality accounting standards are essential for the health of financial markets. Moreover, the EU's commitment to IAS is helping to achieve global convergence on financial reporting: progress is being made on convergence between IAS and US GAAP. We are working to ensure this is a two-way street. I am waiting to hear from the SEC on the precise details of a road-map for convergence.

Nonetheless, as regards adoption and application of IAS a few stubborn issues remain to be resolved: in particular hedging of core deposits in the context of IAS 39 and the so-called "insurance mismatch". A European Consultative Group was recently set up to address these issues. Personally, I am still convinced that acceptable temporary solutions can be found in the short term, pending longer term work by the IASB. I have urged Sir David Tweedie to continue working in the short term with technical experts -around the clock if necessary- to try to find such appropriate solutions. One of the problems we have, unfortunately, is a lack of trust between the interested parties. Due process has not been optimal so far and must improve in future. The next challenge will be accounting for stock options. This is of great importance: there must be full transparency on the cost of award of stock options and other share-based payments, so that shareholders can have their say on this.

I should also like to say a few words on the tax implications of IAS. Here in the UK a great deal of work is already under-way, indeed your Institute prepared a very useful discussion paper on these implications in August – naturally from an UK perspective. My interest necessarily goes a little wider. I strongly believe that EU companies need a common consolidated tax base for their EU-wide activities. Accounting and taxation are, of course, closely linked, and I therefore think that it is well worth examining how these common accounting standards might help us to create such a common tax base.

I know the issue is complicated – many accountants have already told me how difficult it will be, and if it is difficult for accountants then I'm sure it will be even more difficult for politicians like myself to get to grips with the matter. However, the Internal Market needs a common tax base and with the introduction of common accounting standards we have a golden opportunity to make some progress in this direction.

Let me turn now, secondly, to EU action in the field of auditing and corporate governance post-Parmalat. As I said recently before the European Parliament, scandal upon scandal will gradually weaken financial markets like the corrosive drip of a leaking fuel tank. I also called on captains of industry to stand up and take charge, to clean out the crooks and curb excessive greed. Industry leaders worth their salt know that there are also good economic reasons for companies to shape up: well managed companies with strong corporate governance records outperform their competitors.

It is the task of politicians and regulators to ensure that the right framework legislation and policies are in place. As you know, the Commission was already working on this. We have fine-tuned our corporate governance and statutory audit strategies in the light of recent events. The first proposal to be made in mid-March will concern auditing. This proposal will update existing EU arrangements. It will strengthen controls over the audit profession. It will include: full responsibility of the group auditor for consolidated accounts; obligatory independent audit committees for listed companies; stricter auditor rotation requirements and strengthened sanctions. We are also accelerating work on directors' responsibility for company accounts and disclosure in company accounts of off-shore special purpose vehicles.

Your President mentioned the public duty obligations of auditors and I should like to focus for a moment on ethics. No amount of rules can prevent fraud if those who play a role in control of their application do not act with probity. Lord Justice Harman's comments which I quoted at the outset make clear that accountants and auditors are a rare breed. In my view not because of they magic they work with figures, but because of the very special nature of the role they perform. Robust professional ethics are essential because investors place their well-earned savings on the basis of financial reports. Instilling backbone into accountants must be part and parcel of professional qualifications. The key words are independence and integrity. I hope you will forgive me if, as a Liberal, I quote LLOYD George, who once said of Ramsay MacDonald that he had "sufficient conscience to bother him, but not enough to keep him straight". We need to ensure that auditors are imbued with enough professional conscience to keep them straight. Legislators and professional bodies clearly need to work hand in hand on this.

Finally, a look across the pond. You are all too familiar with the spill-over effects of the Sarbanes-Oxley legislation which led to great concern throughout Europe. I have been rather critical of this legislation which I considered to have been prepared in haste, without proper consideration of conflicts of law. However, I began to see the light at the end of the tunnel when Bill McDonough was appointed as head of the US PCAOB in June last year. I went to Washington in October 2003 and we launched a period of intense consultation and negotiation. His staff and mine have been working to find a solution, based on what we describe as a two-way “co-operative approach”. We must avoid duplication of oversight and our common approach should be based on effective equivalence of regulation and oversight, minimising any conflicts of law. The impact of Parmalat has only confirmed our determination to find workable solutions. I hope Bill McDonough will be in Brussels on 25 March for a Round Table to which national oversight authorities will be invited. I also very much hope that we shall, on that occasion, be able to record that significant progress has been made.

As you will have gathered, Mr President, Ladies and Gentlemen, auditing issues will be to the fore and continue to occupy a good deal of my time in the closing months of this Commission’s mandate. Contacts with your Institute are therefore sure to continue. The door to my office and that of my staff in Brussels is always open to your profession. It has been my pleasure to be with you this evening and I look forward to our continued co-operation over the coming months.

Finally, I should like to propose a toast to the Institute of Chartered Accountants in England and Wales.