

## SUMMARY RECORD

MEETING OF  
THE ACCOUNTING REGULATORY COMMITTEE  
OF 25 FEBRUARY 2005

M. Delsaux, Acting Director for Company Law & Corporate Governance, DG Internal Market chaired the thirteenth meeting of the Accounting Regulatory Committee.

### 1. VOTES OF THE COMMITTEE

#### VOTE ON A DRAFT REGULATION RELATED TO IFRIC 2

The Chairman mentioned that not all translations were ready but hoped for understanding in this exceptional case. One delegation (France) mentioned that in this one and very exceptional situation it could participate in this vote.

**Result of the vote on a Proposal for a Commission Regulation amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards IFRIC 2.**

**All Member States (= 321 votes) voted in favour of the draft Commission Regulation proposing the endorsement of IFRIC 2.**

### 2. DISCUSSION AT THE MEETING

#### 1. THE CONSTITUTIONAL REVIEW AND FUNDING OF IASCF

Paul Volcker, Chairman of the IASCF, welcomed the opportunity to speak to the Member States. He signalled that the ongoing constitutional review was meant to fine tune existing structures and not an opportunity to change the whole structure.

His statement which was circulated to delegations is annexed.

One Member State found that IASB had improved consultation on the technical details but wondered why IASB did not consult more upstream on some of the major policy issues such as the US GAAP – IAS convergence project.

Volcker recognised that the consultation must be broader.

Another Member State mentioned that its National Parliament would also start to discuss accountability of IASCF and IASB. Lessons should be drawn from the process around IAS 39. An early warning system should be introduced that would allow solving problems much more upstream. The IAS SME-project also deserves higher attention but its importance and impact seem currently to be underestimated by the IASB.

Volcker reminded ARC that the EU could always refuse to endorse standards under its endorsement process. Discussions on the constitutional review have been ongoing for more than a year now. It is now time for the Trustees to decide.

Another Member State criticised IASB/IASCF for not being an international body where the European continent finds itself represented. More priority should be given to the EU as it does not only converge own standards but directly apply IAS. The proposed constitutional review does not meet the European concerns. Another Member State found a qualified majority essential in IASB decision making process.

The chairman thanked Mr. Volcker and invited him to consider that more time is needed to find solutions acceptable from the point of view of the European business community.

## **2. THE CONSTITUTIONAL REVIEW OF IASCF (DOCUMENT ARC/1/2005)**

Delegations discussed a draft comment letter which the Commission intended to send to the IASCF. The Member States made the following comments:

- that the vision of global accounting standards should be the guiding principle;
- it inappropriate that the IASCF Trustees could reappoint themselves and the Commission should come up with concrete alternative ways for appointing Trustees to be discussed at the next ARC-meeting on 25 May;
- that the representation on IASB should reflect better those constituencies applying IAS while at the same time ensuring that board members are competent;
- that a qualified majority of 10 IASB members out of 14 in total would be preferable;
- that there should be a stable funding of international standard setters and the Commission should provide concrete ideas.

## **3. APPROVAL OF MINUTES OF THE ARC-MEETING OF 20 DECEMBER 2004**

Minutes were approved.

## **4. DATE OF APPLICATION OF NEW STANDARDS AND INTERPRETATIONS (WORKING DOCUMENT ARC/2/2005)**

The endorsement procedure starts after a standard is issued by the IASB. It usually takes up to nine months until the publication of a final text in all official languages in the Official Journal.

There are basically two options for date of application:

- the calendar date proposed in a new standard or interpretation (or their adaptation); or
- a future financial year.

Concerning the calendar date proposed in a new standard or interpretation there could be a risk of retrospective application. The other approach would minimise costs for European companies. In comments published by Commission Services in November 2003, it has been stated that a standard, which has not yet been endorsed by the EU, may be used as guidance under certain circumstances. Therefore, earlier application could be permitted.

Choosing the appropriate date of application is an important issue for the future as the endorsement procedure under the IAS Regulation often cannot be completed at the effective date of application indicated in a new standard.

Many Member States warned that retrospective application is difficult in an accounting context.

The chairman concluded that a case by case approach should be applied when adopting the regulations.

## **5. VOTE ON DRAFT REGULATION ON IFRIC 2**

See above. The text was voted on without further discussion.

## **6. IFRIC 3 UPDATE ON STATE OF PLAY**

IFRIC 3 specifies the accounting for companies participating in government schemes aimed at reducing greenhouse gas emissions, especially the European “cap and trade scheme” which is effective from 1 January 2005 onwards. IFRIC 3 requires companies to account for the emission allowances they receive from governments as intangible assets, recorded initially at fair value. It also requires companies, as they produce emissions, to recognise a liability for the obligation to deliver allowances to cover those emissions.

EFRAG had issued a draft endorsement letter recommending not endorsing IFRIC 3 since the accounting models proposed may lead to artificial mismatch in the reported results and a mismatch in values of respectively the allowances and the liability recognised for emissions made in the balance sheet. In addition, the interpretation suppresses an option given by IAS 20 in order to avoid “inappropriate accounting”.

Many Member States recognized EFRAGs arguments and acknowledged that there were problems that should be solved as soon as possible. Member States urged EFRAG and the Commission to approach IFRIC to get a solution quickly.

## **7. UPDATE ON STATE OF PLAY ON IAS 39 (FULL FAIR VALUE OPTION AND INTEREST RATE MARGIN HEDGE)**

The Commission informed Member States about the state of the discussion.

### *Interest Margin Hedge*

There is slow but steady progress. The final timetable depends on a need to issue a new exposure draft. In case the IASB considers that the Interest Rate Margin Hedge model is “only” another application of the Cash Flow Hedge model and no new Exposure Draft (ED) is needed and the final decision can be taken well before the end of 2005.

### *Full Fair Value Option*

On 6 December, the IASB published a “*first preliminary draft of a possible approach*”. This first draft was an improvement in that it proposed a restricted fair value option based on principles. However, while the ECB and Basle Committee in general welcomed this “principles-based approach”, they felt that the proposal by IASB was not sufficiently robust.

On 22 February IASB released a new draft, which seems to solve many of the problems already identified by regulators since: the revised approach is more restrictive; a financial asset or liability may be designated at fair value through profit and loss where it eliminates or significantly reduces an “accounting mismatch” or a group of financial assets and/or financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

In addition the fair value option is also open for the specific case of combined contracts with one or more substantive embedded derivatives. A compromise solution for the role of prudential supervisors has been found. This is now addressed in the basis for conclusions

(which are not endorsed at EU-level) for the standard rather than in the body of the standard itself.

The revised text will be discussed at a public roundtable organised by the IASB on 16 March. There will be three sessions: insurance, banking and others – (the last covering corporates and venture capitalists).

Assuming the roundtable goes well, the draft will be submitted to the IASB Board meeting in the week of 18 April with the possibility for the IASB to adopt the final text as IASB standard by end of June 2005.

## **8. MISCELLANEOUS**

### *IASB SME Accounting Project*

Following agreement with Mr. Paul Pacter, Project Manager of the IASB SME Accounting Project the Commission asked Member States to come forward with candidates, in particular from public authorities, to participate in the Working Group (Former Advisory Group) on the IASB SME (NPAE) Accounting Project.

## **PARTICIPANTS' LIST**

### **Austria**

**Justizministerium**

**Permanent Representation of Austria to the EU**

### **Belgium**

**Fod. Economie**

### **Cyprus**

**Ministry of Finance**

### **Czech**

**Ministry of Finance**

### **Denmark**

**Danish Ministry of Economic and Business Affairs**

**Danish Commerce and Companies Agency**

### **Estonia**

**Estonian Accounting Standards Board**

**Permanent Representation to the EU**

### **France**

**Conseil National de la Comptabilité (CNC)**

**Ministère de l'Economie, des Finances et de l'Industrie (Trésor)**

### **Finland**

**Ministry of Finance**

### **Germany**

**Ministry of Justice**

### **Greece**

**Greek Accounting and Auditing Oversight Board**

**Ministry of Economy and Finance**

### **Hungary**

**Ministry of Finance**

### **Ireland**

**Institute of Chartered Accountants in Ireland**

**Department of Enterprise, Trade and Employment**

### **Italy**

**ISVAP**

**Ministry of Economy and Finance**

**Banca d'Italia**

**Latvia**

**Ministry of Finance**

**Lithuania**

**Ministry of Finance**

**Accounting Institute**

**Luxembourg**

**Commission de Surveillance du Secteur Financier**

**Ministère de la Justice**

**Malta**

**Accountancy Board, Ministry of Finance**

**The Netherlands**

**Ministerie van Justitie**

**Ministry of Finance**

**Poland**

**Ministry of Finance**

**Portugal**

**CMVM**

**CNC**

**Slovakia**

**Ministry of Finance**

**Slovenia**

**Ministry of Finance**

**Spain**

**Banco de España**

**ICAC**

**Sweden**

**Ministry of Justice**

**United Kingdom**

**Department of Trade and Industry**

## **OBSERVERS**

### **Iceland**

**Ministry of Finance**

### **Norway**

**Financial Supervisory Authority**

**Mission of Norway to the EU**

### **European Institutions/Committees**

**European Central Bank (ECB)**

**Committee of European Banking Supervisors (CEBS)**

**Committee of European Securities Regulatory (CESR)**

**Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)**

**European Financial Reporting Advisory Group (EFRAG)**

### **Commission**

**Pierre Delsaux, Director of DG Markt**

**Jürgen Tiedje, Head of Unit "F3: Accounting & Auditing",**

**Mikael Lindroos, Secretary to the ARC/F3**

**Lars Vind Sørensen, Secretary to the ARC/F3**

**Thomas Scholz/F3**

**Arto Leppilähti/F3**

**Mike Thom/F3**

**Manuel Altemir/F3**

**Alistair Wilson**

MAINTAINING PROGRESS TOWARD  
INTERNATIONAL ACCOUNTING STANDARDS

REMARKS BY PAUL A. VOLCKER

Before

THE ACCOUNTING REGULATORY COMMITTEE OF THE EUROPEAN  
COMMISSION

BRUSSELS, FEBRUARY 25, 2005

I am delighted for this opportunity to meet with you this morning. We have a strong common interest in the world of accounting. At the same time, I sense that a number of questions have arisen about our respective roles in the process of achieving a common set of high quality standards that can and will be accepted right around the world.

As you know, the International Accounting Standards Board is specifically charged with developing and encouraging that approach. To that end, it maintains liaison with other standard setters. However, at the end of the day, it reaches its substantive decisions independently, on the basis of the evidence before it and its own judgment. You, in turn, must review those decisions, opining about whether a particular international standard should come into force in Europe.

In that respect, the Member States of the European Union are in a similar position to other nations that adopt international standards. The IASB itself lacks authority to require any nation to adopt international standards in whole or in part. But obviously, if the goal of common international standards is to be achieved, such exceptions will have to be very limited. Consequently, confidence in the procedures and judgment of the IASB is critically important.

The International Accounting Standards Committee Foundation (IASCF), which I chair, has the responsibility, within its own Constitution, for oversight over the decision-making procedures and the modus operandi of the Board. The Committee Trustees are, as you well know, now completing a review of the Constitution, taking account of its experience since its creation. In the process, some differences in emphasis, and, I sense more commonly, some misunderstandings have become evident between certain approaches proposed by the Committee Trustees and views voiced by some in the European Union.

I cannot pretend to reconcile all the opinions that have been expressed. However, I do believe that any real differences that exist should not be exaggerated, and the misinterpretations cleared up.

The underlying reality in my view is that good progress is being made toward achieving a common set of respected accounting standards applicable in all significant markets. That is the grand prize that should not be lost.

The entire rationale of the reconstructed IASCF and its Board is to work toward that end. Quite obviously, the European Union has a large stake in that effort. International standards are mandatory by law and its companies and investors are potentially among the greatest beneficiaries. But Europe is not alone. What is remarkable is the extent to which emerging and transitional economies without established and credible accounting systems – Russia, China, India, much of the rest of Asia and Latin America – are committed by policy or law to the common objective, as is Japan.

At the same time, it's evident that truly international accounting standards cannot be fully effective – cannot come close to their potential -- without encompassing the world's largest capital market, the United States. American equity markets account for close to half of the world's market capitalization, including listing and trading of many of Europe's largest and strongest companies.

For years, the United States passively took the position that international standards would be fine, so long as they were made in the "good old U.S. of A". There can't be any doubt that for a long time U.S. GAAP has, in fact, provided the most developed and broadest set of standards.

But necessarily the best, in every respect?

Any sense of hubris in that respect was, I think, effectively punctured by the succession of accounting and auditing scandals involving United States companies in recent years. There is now a much more receptive attitude towards truly international standards among American regulators, in key Congressional quarters, surely among large U.S. businesses – indeed, even including members of our own Financial Accounting Standards Board (now chaired by a former IASB member) and its own oversight committee.

Is there anything like unanimity among all the U.S. participants in capital markets about particular standards?

Definitely not.

One of the differences is reflected in the continuing battle of a number of companies, especially high-tech firms, to defeat by political action the expensing of stock options. That standard, as you well know, was forced so squarely on the FASB agenda by the earlier action of the International Board.

In that light, the controversy here in Europe about IAS 39, which is partly related to an existing U.S. standard, has a certain symmetrical quality.

I don't want to minimize those concerns on both sides of the Atlantic, but please keep them in perspective. In three years, the IASB has reviewed, modified, or initiated 39 standards, 34 of which (including IAS 39) were inherited from or based upon its predecessor. Only two of those standards – one in the U.S. and one in Europe - have evoked strong (but very far from uniform) opposition. Plainly, there has been a lot of progress toward convergence.

Whatever those accomplishments, the fact remains that both the current controversies and the very large conceptual issues that lie ahead emphasize the simple fact that we need to find convergence in thinking. That is certainly true between Europe and the U.S. as the largest markets but also among other industrialized and developing countries as well. The only way to do that is to achieve a high degree of confidence in the process by which the IASB reaches agreement on internally consistent, effective, realistic and, I hope, simpler standards. In that connection, I should point out that none of the new or revised standards purport to resolve the circumstances under which so-called "fair value accounting" is generally applicable, a key issue for the future.

Those challenges bring me directly to the IASC's Constitutional review. It should be clear that it has not been the Trustees' intent to revisit the entire debate five years ago about

the organization of the International Accounting Standards Board and our Constitution. The central idea that emerged from that debate, and will remain, is to foster the independence of judgment of a highly professional, decision-making Board, appropriately protected from particular national or special interest pleading. Such a Board would need, in American terminology, to “work in the sunshine”, and with extensive “due process” and review procedures. The non-specialized oversight Committee, which I chair, would be designed to reflect a broad spectrum of interests. The Trustees are responsible for appointing members of the Board and for reviewing its procedures and its responsiveness, both matters that help assure the accountability of the Board.

The experience of the Committee with the existing Constitution and its preliminary thinking about changes in that Constitution has now been tested in extensive public hearings, in consultations with its Advisory Council, and by many written comments. My strong sense is that most of those interested and impelled to comment around the world have welcomed the changes proposed. However, I need not tell you that reservations (I suppose some of you would say strong reservations) have been expressed in Europe -- to be more precise, primarily on the continent of Europe.

It is those concerns, as I understand them, to which I want to respond to today.

Most of them do not seem to me to be matters of principle.

On one point made repeatedly, there is no real disagreement. The Trustees accept the need – indeed have already encouraged – the Board to consult more fully with representative groups in the early stages of formulating its ideas in particularly complex and difficult areas.

As I suggested a moment ago, Constitutional requirements and Board practice are already replete with “due process” requirements. But it is often suggested that comment and consultation have come late in the day, when Board ideas are already shaped. Too often there has been a sense on both sides that the process of consultation has involved a lot of “hearing”, but very little real “listening”.

The Committee Trustees, in setting forth their proposals, decided it was not useful to set out in the Constitution a still more extensive, and potentially sterile, “due process” checklist. Rather, the new language that is proposed more clearly recognizes that the Trustees have a responsibility for assuring that, in its totality, the Board in fact consults in a meaningful way, taking account of the practical implications for business of its standards. The IASB is itself implementing a number of added steps regarding its consultation procedures recommended by the European Commission and others. A handbook on these procedures will be reviewed by the Trustees in March.

One reflection of the organization’s new emphasis on early consultation is the creation of three new “ad hoc” working groups to meet regularly with the Board to consider several of the most difficult conceptual and practical problems in accounting.

One important group is concerned with accounting for financial instruments. That is vastly complicated by the explosion of volatile derivatives which until recently have had no reflection on financial statements of many European institutions.

Representatives of the insurance industry have joined a second group to consider the particular problems of that sector. There is a further group drawn from industry and professional investors to consider the appropriate formats for financial statements and performance reporting.

In addition, with the strong sponsorship of Frits Bolkestein, there is a more specifically European-oriented “High Level Consultative group”. Its responsibility is to examine the open issues with respect to IAS 39 and the underlying conceptual issues ahead – including the vexing question of the appropriate use of fair value accounting.

To further reinforce the need to recognize the practical implications of accounting standards, the Trustees are proposing that the revised Constitution clarify that appointments to the Board itself should blend financial experience and practical expertise along with intellectual vigor and “technical” accounting qualifications.

Significantly, the current proposals take a further important step by making quite specific a requirement that the Committee, as a broadly experienced oversight body, explicitly review the agenda of the Board. I confess that review in the past has been perfunctory, in large part out of concern of impinging on the Board’s independence.

That remains a point of sharp debate within the Committee. I must report that a further step of going beyond “discussion” and “review” to “imposing” or “approving” the agenda is broadly felt to be inconsistent with the intent of the Constitution to protect the independent judgment of the Board. For my part, I am entirely convinced that full presentation and discussion of the Board agenda with the Trustees in a public meeting would be constructive and useful, without doubt testing the Board’s thinking and enhancing accountability without impairing its essential independence. The Trustees have scheduled such a session with the Board at the Trustees’ March meeting.

Another area of particular European interest has been the voting arrangements in the Board. Today, a simple majority is required (that is eight of the 14 members) for all decisions, large and small. The European Commission and other have pressed for requiring a super majority of over 70 percent -- 10 of the 14 votes -- for decisions on a final standard. The point would be to assure such important decisions should reflect a broad consensus. Others, citing U.S. experience, have expressed strong concern that “blocking minorities” would make a lengthy decision-making process even more difficult, tending to undermine coherence and consistency in an attempt to satisfy minority members.

In fact, those concerns on either side may be more theoretical than real, judging from the fact that Board decisions on standards have almost always been by large majorities (including those related to the revisions of IAS 39). The tentative approach of the Trustees is to require nine (of 14) votes for a new standard, close to two-thirds. That proposal frankly strikes me not just as a convenient compromise but as a practical and sensible balancing of the concerns that have been expressed on both sides of the issue.

There is one issue pressed by some in Europe that does rise to the level of principle.

The decision of the European Union to enforce International Financial Reporting Standards (IFRS) by law provided bold and constructive leadership toward the concept of international, rather than national or regional, standards. It does not, however, logically lead to a decision to overweight European representation on the Board or the Committee. The “end game”, after all, is the acceptability of international standards right around the world. I have cited the strong momentum in that direction. The clear corollary is that Japan, China, India, other Asian countries, South American nations and others also want their views and experience reflected in Committee and Board discussions.

We have already heard complaints in these areas that too much of the IASB's attention is devoted to European issues. The tentative Trustees proposal to broaden Committee membership from 19 to 22 is designed to provide more flexibility in recognizing the breadth of the constituencies, not to minimize the concerns of Europe – or for that matter the United States, North America, or “Anglo Saxons”.

The importance of the European Union is in fact already strongly reflected in both Board and Committee. Five of the 14 Board members are from Europe, the same as from the United States (and two of those “Americans” happen to carry British passports!). Seven, or more than a third, of the existing 19-member Trustees, are Europeans, more than the number from North America.

The underlying concept and philosophy has been that none of the Board members or Trustees should consider themselves representatives of, or act as delegates from, particular constituencies, national or sectoral. What we do want is broad experience, a practical understanding of business needs in various areas, a diversity of viewpoints, and for the Board technical expertise.

The difference between breadth and diversity of experience and representation may seem subtle, but it is critical to success. The objective is clear – convergence on common and “quality” standards, not differences by area. We will have failed if the two largest and strongest economic areas, the United States and the European Union, cannot both accept international standards. That agreement – convergence on the highest common denominator – will not be possible if the International Board and Committee are viewed as biased toward or dominated by any particular point of view or region.

When the new effort to work toward international standards was agreed five years ago, I think there was an understanding among many that the Trustees' chair would usefully be from the United States, given the past skepticism – even antipathy - by some Americans toward the effort. Substantial American support and close collaboration with U.S. standard setters is now more firmly in place. My term expires this year. To my mind at least, a chairman equally dedicated to the principle of common international standards but drawn from another part of the world – certainly including a continental European – would now be appropriate.

In sum, European political and business figures have raised several important and appropriate questions about the structure and operational approach of the International Accounting Standards Committee Foundation and its Board. A number of those concerns are shared by my fellow committee members and me. What has been disturbing is the extent to which much European comment – obviously colored by the disagreement about one controversial standard – has failed to recognize the extent to which those concerns have already been taken into account. The changes are reflected both in current work of the Board and in the Constitutional modifications proposed by the Trustees – modifications that have been broadly recognized and welcomed by most of those commenting in public hearings or otherwise.

Specifically, some critics seem oblivious to the extent to which the Board is committed to consult with responsible and representative business people on some of the most difficult conceptual and practical issues before even tentative decisions are taken. That approach specifically urged by the European Commission, is a reality. The Committee's intent to exercise closer procedural oversight and to review the Board's agenda, responding to concerns about accountability, should be transparently evident in our proposed Constitutional modifications.

What we do not propose to change is the basic concept of an independent decision-making Board, expert and experienced, aware of, and responsive to, the needs of businesses and investors alike, but protected from national, political or sectoral interests.

That basic approach has brought us a long way in the past five years. No doubt, the implementation can be improved, and that's what we are about. And it is that effort that needs your understanding and cooperation – and that of your counterparts in other countries and other regions – to complete the job.