SPEECH/06/729

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Rewarding excellence in legibility of accounts: meeting the IFRS challenge

Leinster Society of Chartered Accountants - Published Accounts Awards Ceremony

Dublin, 17 November 2006

Thank you, Cliff, for those kind words of introduction. It is a pleasure to be here today at this prestigious event. When I used to visit you as Minister for Finance, little did I know that I would one day come back here as European Commissioner with responsibility for accounting and auditing.

It has been said that: "Accountants are the witch-doctors of the modern world willing to turn their hands to any kind of magic". I think this was said by a lawyer, so it shouldn't be taken too seriously. But magic aside, I do know that there has not been a dull moment in this area since I took up office. And that the field has become incredibly complex. Things have moved on a little since I qualified in 1973, but I'm glad to see that the subject which was all the rage then, "inflation" accounting, has long since bitten the dust.

The awards to be given today reward excellence in providing investors with clear, intelligible accounts. This is something I wholeheartedly support.

The task of preparers of accounts for quoted companies has been made more challenging this year by the adoption of the new International Financial Reporting Standards (IFRS). IFRS aim to give increased transparency in accounts. But this must not be at the expense of legibility. Preparers have been grappling with the novelties of IFRS. Companies and investors will take some time to absorb and digest them. That is why I have repeatedly said we need a period of relative stability to let the new standards bed down.

I am pleased to see how positively companies have responded so far. The finalists at today's Ceremony have demonstrated that they have been able to take on the challenge of implementing IFRS. Their efforts are to be congratulated. It will be interesting to see whether a serial previous Award winner, such as CRH, has managed to maintain their excellent record in preparing outstanding Annual Reports[1] whilst also implementing IFRS.

I am pleased that, when so much focus is given to limited companies, these Awards are also given to other types of entities, including charities. It is just as important that they receive recognition for their efforts to achieve transparency for their diverse stakeholders.

At the time of a big change, such as the move to IFRS, I think we should pause for a moment and go back to basics. We should remind ourselves of the fundamental purpose of the published accounts in communicating information about the company to investors.

How many people could claim to be able to understand the published accounts and explain them to a third party? This should be the litmus test. Accountants in companies and the auditing community must cut through the esoterics, the gobbledygook, and create the desired level of understanding. Even if numbers are the only universal language, explaining the numbers in published accounts remains a constant challenge.

However I have never accepted – and I doubt if many of you here who work in banking or investment management or research would accept - that numbers, or a particular group of financial ratios, are the key to understanding a company's business or its prospects. The calibre of its management, its market position and the competitive dynamics of its market, the regulatory environment within which it must operate and how it is changing – these are just some of the issues that will you will focus on.

[1] CRH won this award in 2004, 2002, 2001, 2000, 1999, 1998, 1997, 1995.

And as to the numbers, different stakeholders will focus on different ones. Clearly many equity investors look first at the "EPS movement" as the bottom line, the ultimate core financial measure of performance. However, the prospective investor must then decide on which EPS figure to focus. Should it be the underlying growth normally called, I think, the 'adjusted basic EPS'? This often depends on the general standards of an individual accountancy firm. In consequence, many people may look to the brokers' focus, rather than automatically accepting the Company's view on the calculation of the underlying performance. And hence the importance of independent and objective broker research.

The primary focus of debt investors or customers is unlikely to be on EPS but on liquidity, gearing, cashflow and debt servicing capacity.

The world's biggest accounting firms have recently joined forces to call for a radical overhaul of how companies report. They have called, in particular, for two changes. The first is that there should be a move to real-time, internet-based accounting, instead of quarterly statements. The second is that more non-financial information should be provided to give a fuller picture of companies' performance.

The accounting firms are right to provoke a debate. But I wonder whether a flood of information is really the answer. Of course, we must make use of new technological tools. Yet often the real problem in the digital age is how best to sift the mass of information that is available. How to find the needle in the haystack. Too much information may mean many investors will have to rely more heavily on professional analysts. In fact, I have to tell you that I am very glad we didn't go for quarterly reporting in Europe. I am not a fully paid-up member of the Transparency Freaks Club. I happen to believe that quarterly reporting can be more misleading than it is enlightening. And I'll tell you why: because the capacity to manipulate the results over three months is clearly much greater than it is over a year or even over 6 months. This is because of the potentially much greater impact in a 3 month reporting period - at least in proportionate terms - of deferring expenses or accruing them, of stuffing distribution channels or starving them, of boosting marketing spend or depressing it – with consequences that will only become evident in a P&L account after the unfortunate gullible market player has gone long or short on the shares on the back of the manipulated quarterly figures.

And there is another reason as well why I am against quarterly reporting figures. Shareholders want managers to spend their time managing the business, not managing the media. Quarterly reports are preceded by quarterly trading statements. That means you have 8 statements a year – about one every six weeks. This is a honeypot for spindoctors, wordsmiths and slide makers, and a ridiculous distraction for management. So let me assure you Europe will not be getting quarterly reporting during my watch.

After the adoption of IFRS for large listed companies, attention is now moving to unlisted companies, and in particular small and medium sized entities. There are over 23 million SMEs across the EU and they are crucial to the European economy. Their accounting rules must reflect the nature of their activities. SMEs should have straightforward and robust rules. They should not be overburdened with reporting requirements that have no or limited relevance to their business.

The Commission is working to identify areas of EU accounting and company law which can be simplified for SMEs. Important work on SME accounting is also going on at the International Accounting Standards Board (IASB). I have already made clear to that board that if this work is to be useful, it must be kept simple. This is the clear test that I will apply in determining whether it is worthwhile making use of the results of the IASB's work at EU level.

Ladies and Gentleman, to my mind, accounts should be as straightforward, readable and as user friendly as possible. Those who succeed in doing this, in spite of the increasing complexity of the business world, should be rewarded. The Awards to be given today will do just this and I look forward, with you, to hearing the names of the winners.

Thank you.