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REPORT

on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB)
(2006/2248(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Alexander Radwan

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB)
(2006/2248(INI))

The European Parliament,

– whereas since January 2005 EU publicly traded companies have been obliged to use international accounting standards for their consolidated financial statements,

– whereas by Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards[1], the International Accounting Standards Committee Foundation (IASCF)/ International Accounting Standards Board (IASB) was in effect given the status of a law-maker,

– whereas the IFRS concept was set up with the aim of achieving real global financial reporting standards worldwide for publicly traded companies;

– repeats its position as stated in paragraphs 37 to 39 of its resolution of 4 July 2006 on recent developments and prospects in relation to company law[2],

– having regard to the first report of the Commission to the European Securities Committee (ESC) and to the Parliament on convergence between IFRS and third countries' national Generally Accepted Accounting Principles (GAAPs),

– having regard to the Commission services working paper on governance and funding developments in the IASB and IASCF of July 2007,

– having regard to the conclusions of the Economic and Financial Affairs Council of 10 July 2007 on the question of the governance and financing of the IASB and of 11 July 2006 concerning accounting standards and the funding of the IASB,

– having regard to the ECB report of 19 December 2006, entitled "Assessment of accounting standards from a financial stability perspective",

– having regard to the draft opinion of European Financial Reporting Advisory Group (EFRAG) on IFRS for small and medium-sized entities,

– having regard to the letters of 3 October 2007 from the chairperson of its Committee on Economic and Monetary Affairs to the Commission in response to the US Securities and Exchange Commission (SEC) consultation, and to the chairpersons of the corresponding committees in the US Congress,

– having regard to the combined statement of 7 November 2007 of the European Commission, the Financial Services Agency of Japan , the International Organization of

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1 OJ L 243, 11.9.2002, p. 1.
2 OJ C 303 E, 13.12.2006, p. 114.

Securities Commissions (IOSCO) and the US Securities and Exchange Commission on work to enhance the governance of the IASCF,

– having regard to the SEC decision on IFRS for foreign issuers of 21 December 2007;

– having regard to the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies[1] and Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts[2] (Fourth and Seventh Company Law Directives),

- having regard to Rule 45 of its Rules of Procedure,

- having regard to the report of the Committee on Economic and Monetary Affairs and the opinion of the Committee on Legal Affairs (A6-0032/2008),

A. whereas the European Union, since taking on IFRS, has gained insight and expertise that must be used when discussing the further development of the IASCF/IASB; whereas jurisdictions which have not abandoned their own accounting standards but have merely embarked on convergence processes may not have the same expertise and experience,

B. whereas the 17 months which elapsed before the appointment of the new chairperson of the IASCF lead one to wonder about the effectiveness of the current selection and appointment process for members of that body,

C. whereas the European Union should move from a reactive to a proactive attitude in its relations with the IASCF/IASB,

D. whereas the sub-prime crisis of summer 2007 highlighted the importance of accounting standards, and in particular the notions of ‘fair value’ and 'market-to-market’, for financial stability,

Transparent, responsible international organisations

1. Is firmly convinced that the aim must be to develop high-quality global accounting standards;

2. Notes that the IASCF is a private self-regulatory body which has been given the role of lawmaker for the EU by Regulation (EC) No 1606/2002; underlines that the IASCF/IASB lack transparency, legitimacy, accountability and are not under the control of any democratically elected parliament or government, without the EU institutions having established the accompanying procedures and practices of consultation and democratic decision-making that are usual in its own legislative procedures; welcomes, however, that the IASCF/IASB have sought to improve these deficiencies, for example through twice-yearly meetings at which the IASCF reviews the IASB's work, through impact assessments for new standards, through the introduction of formalised feedback statements for comments received in public consultations, etc.;

[1] OJ L 222, 14.8.1978, p. 11.
[2] OJ L 193, 18.7.1983, p. 1.

3. Considers that, lacking satisfactory solutions to the set up and oversight of the IASCF/IASB, a debate should be launched on the conditions for integrating the IASCF/IASB into the system of international governance e.g. the International Monetary Fund, the Organisation for Economic Co-operation and Development (, the World Bank;

4. Stresses the need for more representatives with a European background within the international standard-setting bodies, in order to legitimate a truly international approach and to meet the need for a balanced consideration of the weight of the Community, constituting as it does by far the largest economic area and the area with the most entities applying IFRS; believes that all trustees of the IASB should come from nations that have signed up, or intend to sign up, to IFRS;

5. Notes the increasingly theoretical dimension of IASB projects, the complexity and theoretical nature of which are such that small and medium-sized enterprises (SMEs), in particular, are not always able to follow them;

6. Notes, furthermore, that practical business aspects are not adequately reflected by the IASB; considers that, from a user's perspective, the financial statement presentation for accounting does not always lend itself to other uses, e.g. for the purposes of providing financial information to investors, performance monitoring or financial management;

7. Believes that there should be an open debate about accountancy standards; to this end, believes that the IASB should strengthen its due process as regards stakeholders so that the views of all IFRS users and investors are taken into account;

8. Takes the view, however, that governance and accountability must be improved through the following measures:

   (a) by setting up a public oversight body involving all IASCF/ IASB public stakeholders including in particular legislators and supervisors; and setting up a body allowing representative market participants, including preparers and users from jurisdictions where IFRS is mandatory, to deliver annually a report on the functioning of international accounting standard setting to the governing bodies of the IASCF/IASB;

   (b) such a body could be responsible for selecting and appointing the trustees in a transparent procedure ensuring both the competences of the candidates and a balanced representation of stakeholders; this would help make the appointment procedure more transparent and significantly enhance the legitimacy of the trustees;

   (c) a guarantee that the composition of the IASB, the Standards Advisory Council (SAC) and the International Financial Reporting Interpretations Committee (IFRIC) is improved and that the trustees ensure that the appointment procedure is transparent and due account is taken of the interests of various interest groups;

   (d) increased involvement of the trustees in supervising the IASB and its work plan, in particular as regards the way in which the work plan is drawn up and the way in which mandates are granted to the IASB;

(e) that the IASCF constitution should ensure that the IASB develops accounting solutions that are not only technically correct but also reflect what is necessary and possible from the point of view of all users (investors and supervisors) and preparers;

(f) carrying out impact assessments for all projects, so as to check the costs and benefits (including those for user firms) of draft texts and, in particular, to highlight the implications for financial stability;

9. Notes that in the abovementioned combined statement the Commission seeks – as it did when it concluded a roadmap with the US authorities in April 2006 – to pre-empt solutions where it would be preferable, in the interests of effectiveness and legitimacy, to have an open consultation process and debate, to which this resolution could be a contribution;

10. Urges that improvements to accountability and governance of the IASCF/IASB must not create excessive bureaucracy and ensure that technical issues are not unnecessarily politicised;

11. Considers that the IASB, before embarking on the development of a standard, must take account of actual needs and of the relevant information which users (auditors, investors and supervisors) feel they require;

12. Urges the IASB, before adopting a new standard, to carry out impact studies among all interested parties, taking account of regional diversity and market structures;

13. Considers that, in this field, the Commission's right of initiative should be combined with an appropriate prior consultation process;

14. Agrees with the Council that the measures decided on to improve the IASB governance structure must be implemented in accordance with an appropriate work plan; the same applies to the measures proposed by the Parliament;

15. Considers that the Parliament should be involved in good time in drafting the work plan and in setting the priorities and direction of new standard setting projects; calls in this regard for an early phase consultation of the Parliament;

16. Takes the view that the funding structure of the IASCF/IASB, currently largely based on voluntary contributions e.g. from undertakings and audit firms, gives rise to questions; calls on the IASCF/IASB notably to examine how the funding system can be amended to ensure, firstly, that all user groups are adequately involved in funding and, secondly, that no conflict of interests arises between financers and users and thirdly, that there is better and easier access to the accounting standards; calls for the Community to examine under what conditions and in what form it might consider contributing to that funding;

17. Takes the view that transparent and stable funding for the IASCF/IASB is of crucial importance for the Community; asks the Commission to aim at a uniform funding-method involving publicly traded companies within all Member States, possibly administered by a central agency;

18. Considers it essential that the Community express itself more coherently to ensure it has maximum influence at all stages of the process of drafting, interpreting and implementing accounting standards;

Implementation of IFRS in EU

19. Notes the contribution IFRS has made by making financial statements easier to compare across countries, across competitors within the same industry sector and across industry sectors;

20. Notes the merits of IFRS, which do not just concern technical accounting aspects but also bring benefits to capital markets and to the European Union as a world leader;

21. Notes that the Roundtable for the consistent application of the IFRS in the EU[1] launched by the Commission at the beginning of this legislative period did not live up to expectations surrounding its ability to give clear expression to the Community point of view and interests;

22. Stresses that consistency in adoption and application is essential to the success of the IFRS, but recalls that these are principle-based standards and that, therefore, consistency should not be pursued to the detriment of professional judgement;

23. Agrees with the Council on the point that the conclusions of the abovementioned Roundtable must be taken into account to a much greater extent in the IASB work on standards;

24. Notes that there are numerous players involved in the Community endorsement procedure; points out, in particular, that the Commission receives input from a number of players whose competences clearly overlap; points out that this overlap offers potential for enhancing efficiency and transparency;

25. Considers that the tools the Community has for making its views known (Accounting Regulatory Committee (ARC), EFRAG) do not allow it to deal on an equal footing with states whose structures are founded on the centralised powers of regulators and supervisors (e.g. Financial Accounting Standards Board (FASB) and SEC for the USA, Accounting Standards Board (ASBJ) and Financial Services Authority for Japan);

26. Takes the view that creating a more streamlined EU structure, taking into account national structures for accounting issues could, especially if, where appropriate, some existing bodies were abolished, contribute to simplification and thereby also strengthen the role that the EU should play at global level; calls on the Commission to develop and put forward a proposal, in consultation with the Parliament, the Member States and Committee of European Securities Regulators (CESR) to establish a EU structure constituting a legitimate international partner and guaranteeing uniform interpretation and application of standards;

[1] The Roundtable comprises representatives of the IASB, CESR, EFRAG, Fédération des Experts Comptables Européens (FEE), Businesseurope, auditing firms and the Commission; it discusses key issues without in any way providing interpretations of existing standards.

27. Expresses satisfaction with the way in which it has exercised its authority in this field and points out that, within the framework of the revised comitology procedure, the Parliament will be even more involved in the development and endorsement of international accounting standards; notes, however, that Parliament is formally involved only in the last phase of the endorsement procedure; calls for a guarantee, as a time-saving measure, that the Parliament will already be involved in the procedure when the IASB work programme is drawn up and a draft new accounting standard is considered, in order to avoid a EU version of IFRS or the need for subsequent modifications;

28. Believes it would be to the detriment of EU publicly traded companies if carve-outs from IFRS are used other than as a last resort;

29. Asks that an accounting standard should be drawn up and modified only when it has been ensured that there is a clear and beneficial need for it, and following a proper preliminary consultation process;

30. Takes the view that particular attention should be paid to at least the following aspects:

    (a) IASB framework (conceptual basis of the IASB work): points out in this connection that financial statements are drawn up not only for capital market investors but also for a range of other players such as creditors, employees, public authorities, owners, customers, etc.;

    (b) IAS/IFRS branding (presentation of financial statements): points out in this connection that the IASB should bring about solutions that take account of the needs of the various jurisdictions which have made IFRS mandatory;

    (c) IAS 32 and IAS 39: calls on the IASB in this connection to incorporate in IAS 32 a definition of 'own funds' which will enable all forms of company, including in particular cooperative societies and partnerships, to declare capital provided by shareholders as own funds in the balance-sheet, and to adopt a solution for hedge accounting based on banking organisations' actual risk management practice;

    (d) business combinations (accounting for acquisition of another business): points out in this connection that the IASB should draw up solutions regarding the scope of application of the fair-value principle;

    (e) fair-value measurement: takes the view that the IASB should take its decision on the basis of the outcome of the consultations and, given the apparent impact of this, limit the scope of the fair-value principle;

    (f) service concessions (agreements under which an entity – the concession operator – by contract with a concession provider – usually a government – receives a right and incurs an obligation to provide public services): points out in this connection that balanced solutions must be found; and

    (g) performance reporting (display and presentation of all recognised changes in assets and liabilities from transactions or other events except those related to transactions with owners): points out in this connection that balanced solutions must be found.

31. Takes the view that application of the fair-value principle can be costly for companies and can lead to unrealistic valuations e.g. in the absence of actual markets giving assessment can be less indicative of the true value of companies;

32. Considers, in view of the potential links between IFRS and taxation, that the drafting, entry into force and interpretation of these standards could have an immense impact on the Member States;

33. Welcomes the practice, developed since the beginning of this legislative period by its Committee on Economic and Monetary Affairs, of holding an annual hearing with the Chairperson of the IASB and informal meetings with members of the IASCF, and calls, in future for the chairpersons of the IASCF and the IASB to report to the Parliament at least once a year on all matters relevant to Parliament (including work programme, staff decisions, funding and controversial standards);

34. Expresses concern, while supporting the IASB's intention to improve existing standards, that making continual adjustments, and even small changes, can be costly and result in expensive changes for large companies; believes that any changes should only happen when deemed necessary following a cost-benefit analysis;

35. Notes that the IASB is carrying out broad-based consultation and field tests on its exposure draft on a standard for SMEs; requests that more serious attention be paid to the results obtained from such consultations and field testing than has been the case with this exposure draft; underlines that this is necessary if the EU ever should begin considering taking account of the IFRS for SMEs or adopting EU standards for SMEs with the aim of converging with IFRS for SMEs;

IFRS for SMEs

36. Considers that there is a widely shared view among SMEs that the standard IFRS proposed by the IASB is far too complicated for SMEs and, in addition, refers in many places to the full IFRS; takes the view that the obligations regarding appendices are too comprehensive and that the effort required is disproportionate in relation to the requirement to provide information; is concerned that the draft was designed with relatively large SMEs in mind (over fifty employees) and asserts that most SMEs are smaller in size; notes that SMEs are also concerned that the IASB intends to change the standard every two years; nevertheless, notes it could be a useful optional transition for larger, expanding SMEs, but underlines that this shall not be a waystation for enforced harmonisation;

37. Underlines that no political mandate has been conferred on the IASB to develop IFRS for SMEs; points out that the Community endorsement procedure applies only to international accounting standards for publicly traded companies and is not envisaged with regard to the IFRS for SMEs;

38. Notes that the endorsement procedure applies only to international accounting standards and interpretations for publicly traded companies; notes further that the endorsement procedure may not be used for the recognition of IFRS for SMEs;

39. Would propose to assess first whether EU SMEs will derive any benefits from a standard developed by the IASB; notes that generally the IASB considers itself as a standard setter in the interest of capital market investors; acknowledges that the IASB confirms in its 'basis for conclusions' that SMEs face different requirements to those for capital market investors; questions whether the balance relating to SMEs is currently sufficient in the IASB; acknowledges though that from other parts of the world there may be a request to develop a standard for SMEs and proposes that a more precise assessment of this demand be undertaken; underlines that this is without prejudice to the EU acceptance of a subsequent standard;

40. Takes the view that promoting (or encouraging) the voluntary use of IFRS is not without risks; takes the view that, should a few Member States decide to apply the final IFRS for SMEs in the form decided on by the IASB, this could lead to fragmentation of the internal market and might even prejudice accounting for SMEs across the entire EU;

41. Points out that the Fourth and Seventh Company Law Directives provide the legal framework for the annual accounts of European SMEs and that it still has to be clarified how the IFRS for SMEs proposed by the IASB relates to the Fourth and Seventh Company Law Directives; considers that the Fourth and Seventh Company Law Directives could be the basis for accounting requirements for EU SMEs, including partnerships;

42. Considers that the EU should carefully assess the respective benefits of committing to an IFRS standard for SMEs or developing its own independent and comprehensive solution for SMEs; takes the view, furthermore, that any such EU solution could fit into the IFRS conceptual framework without obliging SMEs to use the full IFRS; considers, moreover, that the fact that the application of the fair-value principle to financial assets and liabilities does not always produce realistic valuations must be taken into consideration;

43. Takes the view that accounting requirements for EU SMEs must be tailored to the needs of users; advises, against this background, that user needs be analysed in detail once again;

44. In the light of the foregoing, encourages the Commission to continue its activities with regard to the simplification of company law, accounting and auditing for SMEs via the relevant legislative acts, in particular the Fourth and Seventh Company Law Directives;

45. Points out that accounting rules exert a very strong influence on the whole field of commercial law, and that a new standard will have a wide-ranging effect here, e.g. will have a major impact in practice on national legislation on company taxation; notes that an international standard based on the fair-value principle is opposed to the principle of capital maintenance which predominates in other jurisdictions, and is not always in the best (tax) interests of SMEs;

46. Takes the view that a standard for SMEs must take into consideration the fact that there are different forms of undertaking in the EU (such as partnerships and cooperatives); believes, therefore, that a standard must contain a clear definition of 'own funds' that takes account of the particular needs of SMEs;

47. Regrets that the draft IFRS for SMEs do not take adequate account of the fact that the addressees of SMEs' accounts are mainly personal shareholders, creditors, business partners and employees rather than anonymous investors as in the case of public companies, and that the addressees of SMEs' accounts are interested in a long-term business relationship rather than a short-term investment;

48. Calls on the Commission to arrange a proper consultation procedure for a EU accounting framework for SMEs along the lines of normal legislative proposals, and to withdraw its commitment to implementing and adopting an IFRS SME standard as well as preventing parallel application in the EU as long as the EU internal process has not been concluded; encourages the Commission to consider the opportunity for reduction of administrative burden for SMEs in the field of accounting and auditing;

49. Acknowledges, however that there is an overall need for simplification of accounting and auditing measures for SMEs, while recalling that SMEs are creators of jobs and a motor of economic growth;

50. Recalls that the ultimate aim of all international stakeholders must be the adoption of IFRS; acknowledges the tension between the intention of achieving maximum convergence and the desire to preserve the EU's full competence to deviate from the consensus that is globally achievable; emphasises that deviations from global standards should be restricted to the minimum necessary both in the EU and in other parts of the world; takes the view that third countries should deal with EU as a whole and not treat the 27 Member States differently and that the ongoing processes of convergence with existing systems can only be accepted as intermediate stages;

Road map for convergence and equivalence

51. Notes the importance and desirability of the establishment of global standards and convergence and recognises that global convergence of accounting standards is proceeding at an ever-increasing pace;

52. Supports the idea of convergence and equivalence; emphasises, however, that convergence with certain third-country standards must be based on a prior assessment of the merits and impact of such a change on EU preparers and users of financial statements and especially on SMEs, and calls on the IASB to bear this in mind when proceeding; believes that convergence would be sufficient if a company's accounts produced in accordance with IFRS could be accepted and recognised under US GAAP without any significant extra cost to companies;

53. Notes that the work on convergence is progressing, and sees a danger that it will be mainly large third countries' economic and company law frameworks which are taken into account in this process while EU frameworks play a lesser role;

54. Notes that on 20 June 2007 the SEC submitted a proposal to the effect that financial statements by foreign issuers should be approved without reconciliation being required, provided that they had been prepared on the basis of the English version of IFRS adopted

by the IASB; stresses that the IFRS standards incorporated by the European Union into existing law must be recognised by the SEC;

55. Welcomes the progress made in the EU-US Accounting Roadmap and the recent announcement from the SEC to allow foreign private issuers to submit financial statements in IFRS without reconciliation to US GAAP; supports the approach outlined by the Commission in its letter to the SEC of 26 September 2007;

56. Recalls that the EU's determination to require all publicly traded companies to use IFRS in their consolidated financial statements from the beginning of 2005 was a key element in the increased global interest in IFRS;

57. Recalls that on 30 April 2007 the President of the United States of America, the President-in-Office of the European Council and the President of the European Commission signed Joint EU-US statement following the annual summit which on the issue of financial reporting contains the following: 'Financial markets. Promote and seek to ensure conditions for the US Generally Accepted Accounting Principles and International Financial Reporting Standards to be recognised in both jurisdictions without the need for reconciliation by 2009 or possibly sooner';

58. Recalls the outstanding issue of competence between different jurisdictions applying IFRS regarding the definitive interpretation thereof, which harbours the risk of conflicting interpretations; points out that only European authorities and courts may make a definitive interpretation of the European IFRS and calls on the Commission to ensure that this remains the case; the Commission, working together with the Member States and the European Parliament, must develop a system which will guarantee that IFRS is interpreted and applied uniformly within the European Union;

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59. Instructs its President to forward this resolution to the Council, the Commission, CESR, the IASCF and IASB.

EXPLANATORY STATEMENT

'IFRS tested, IASB failed'

1. Introduction

Since January 2005 publicly traded EU companies have been obliged to use international accounting standards for their consolidated financial statements. These international accounting standards are developed by an independent private organisation (International Accounting Standards Committee Foundation and the International Accounting Standards Board) situated in London. The standards are incorporated into existing EU law by means of an endorsement mechanism.

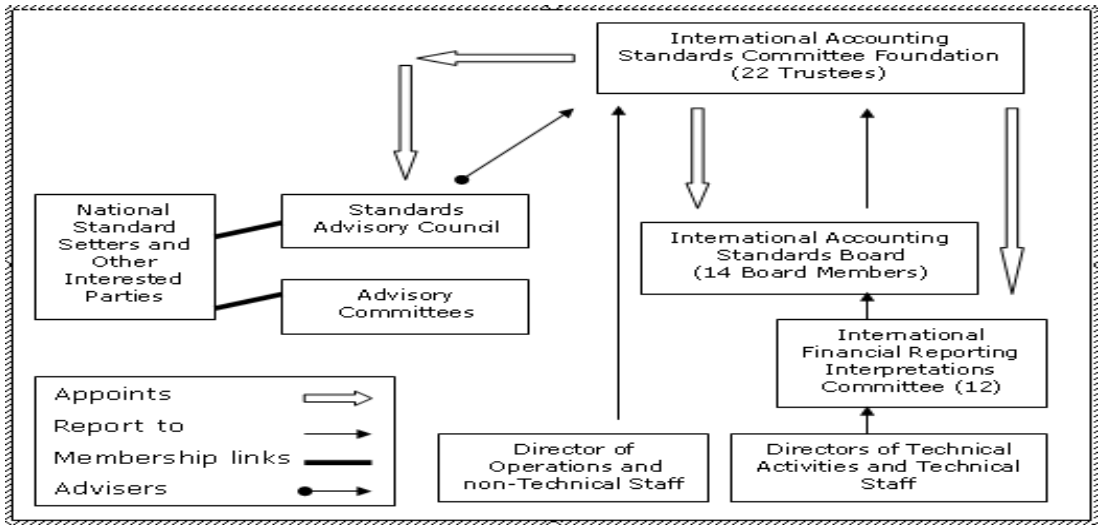
Experience over recent years illustrates that this organisation, governed by private law, is untransparent and outside democratic control. For example, it is not clear how its work plan is developed, how its mandates are formed, how and against which criteria its members are chosen, or how it takes into consideration the interests of stakeholders (including those preparers and users that are required by law to apply international accounting standards).

Moreover, the organisation relies solely on voluntary contributions from companies, the profession and other contributors, which may give rise to questions.

Additionally, the European Commission and the SEC (US Securities and Exchange Commission) have launched a road map towards convergence and equivalence of international accounting standards with US accounting standards. In this context, the London-based IASCF is committed to work with its US counterpart on achieving technical convergence of accounting standards. In parallel, the European Commission is committed to ensure consistent application of international accounting standards in the European Union.

Therefore the rapporteur considers it appropriate to analyse further the transparency and democratic control of the London-based organisation; the implementation of international accounting standards in the EU; the international accounting standard for small and medium-sized enterprises (IFRS for SMEs); and finally EU-US convergence and equivalence of accounting standards.

2. Transparent democratic international organisations



The most serious question in relation to the IFRS process is doubtless the democratic legitimacy of the IASB. This is particularly true in that financial reporting involves highly significant public decision-making powers that have a major impact on many other areas of financial and indeed tax law. Democratic legitimacy must ensure that the interests of all those affected are suitably represented and balanced in a transparent procedure using fair rules.

Up to now, these requirements are not adequately met in the system of the IASCF. The organisation's highest decision-making body, the Board of Trustees, shows particular shortcomings: the trustees are selected mainly on the basis of a criterion designed to ensure proportionate representation for the regions, so that no account is taken of other key interests (such as different sectors of the economy, forms of undertaking, the interests of employees and employers and, in particular, of political leaders).

Even the application of the regional criterion for appointments is not satisfactory in practice: seats that fall vacant are filled by the remaining members of the board without a clearly defined public selection procedure. For the past year, the trustees have formally been supported by an independent committee in the selection of candidates, but the latter can itself refer only to a list of candidates which has been drawn up internally. This does nothing to alter the problem that selection takes place through a self-appointment procedure that does not bestow legitimacy and that hampers the representation of new interests.

This Board of Trustees selects the members of the remaining IASCF bodies. The main such body is the IASB, the qualification criteria for which include professional background as well as proportionate representation for the regions. In order to take greater account of the concerns of stakeholder representatives, the trustees have decided to expand the interpretation body, the IFRIC, from two to 14 members in future. This shows that the IASC Foundation has responded to public calls for improved representation of stakeholders (Commission reports on the governance and funding of the IASB and IASCF of December 2006 and July 2007). On

10 July 2007 the ECOFIN Council adopted conclusions calling on the IASC Foundation to make further efforts in this direction.

From the European Parliament's point of view it should be noted that the system of contribution-based funding is extremely untransparent and the information provided in the annual reports (the sole source of information) has become more and more inadequate. No documents on current funding or plans for the new funding system were submitted to Parliament. However, the Commission's second report on the governance and funding of the IASB and IASCF reveals that, despite the progress made, the goal of stable and sustainable funding has not yet been reached. Parliament should also have been informed of this.

However, the IASCF constitution was recently amended. It is claimed that this was an attempt to strengthen the role of the trustees. But much more must be done. The trustees must for instance be better in overseeing the IASB and its work plan, be more involved in how the work plan is drawn up and how the mandates for the IASB come about, and be much more visible. The criteria for selecting the trustees and IASB members must be changed to ensure that the structure is balanced. In connection with the most recent amendment of the constitution it is to be welcomed that in future all contributions arising from the consultation procedure will be answered by the IASB with opinions, and reasons for comments which are not taken on board will be published.

The EU decision to oblige publicly traded EU companies to use international accounting standards significantly changed the context for the **IASCF/IASB**. The IASCF/IASB used to set voluntary international accounting standards. The EU decision turned the IASCF/IASB into a quasi law-maker. This raises a number of questions that have not yet been addressed by the IASCF/IASB. For instance, should standards not be freely available to all those required to apply them? Is there sufficient democratic control over the IASCF and IASB and do these bodies have a representative membership? Is there an appropriate balance between the bodies? Is it appropriate that the IASCF/IASB only focuses on providing information to capital markets? What about other users of financial statements, e.g. creditors, public authorities, owners, customers and employees?

Moreover, any initiator of laws carries out impact assessments, but the IASB currently does not **assess the impact** an accounting project could have on preparers and users. For all projects the IASB should estimate the costs that could be incurred by preparers as well as consider what benefits it might bring about to those applying the IFRS. Moreover, the IASCF Constitution must ensure that the IASB develops accounting solutions that not only are technically correct but also reflect what would be necessary and possible, seen from a user and preparer point of view.

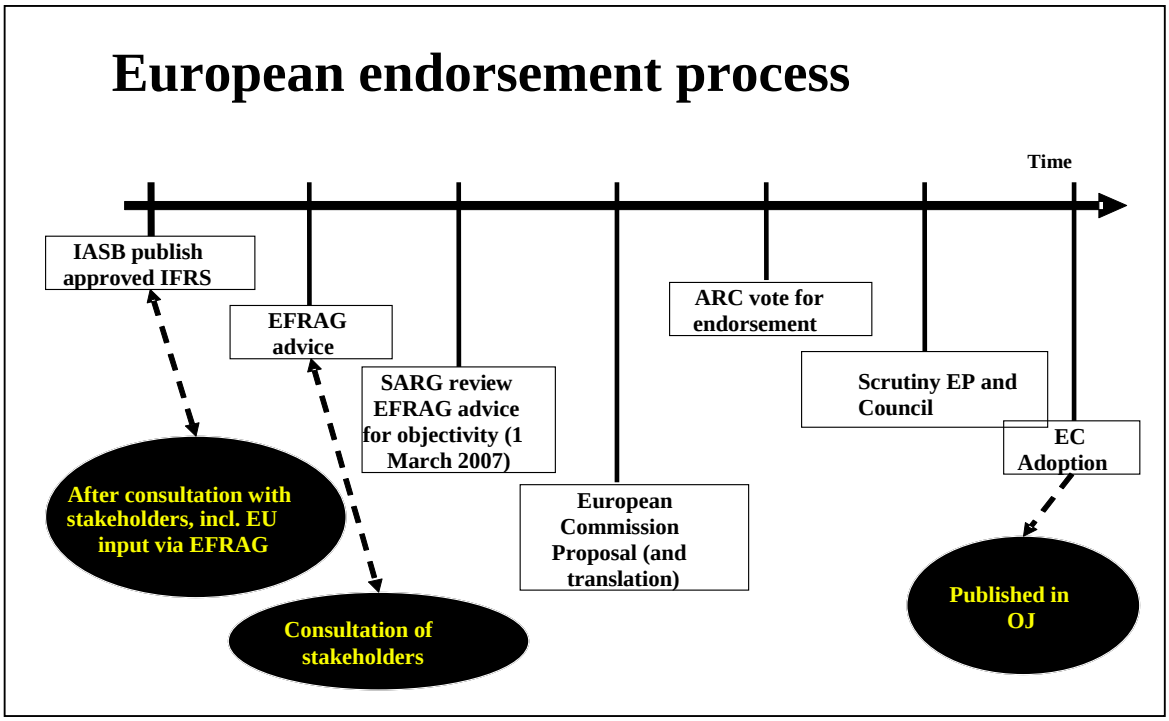
Another issue is **funding.** An organisation like the IASCF/IASB must have a transparent and stable funding system. Clearly funding systems can be designed in different ways; for instance, public sources could provide partial funding, or purely private funding could be used. The ECOFIN conclusions stressed the need to secure sustainable funding for the organisation. The funding from contributions hitherto dates back to the early stages of the organisation's current form, and was supposed to have been replaced by 2005 by a long-term system of funding. After it proved impossible to achieve that objective, contribution-based

funding was extended for a further two years, and is supposed to continue only until 31 December 2007.

The rapporteur is convinced that the IASCF/IASB is far from being transparent and balanced. The rapporteur is also convinced that democratic control within the organisation must be improved.

3. Implementation of IFRS in Europe

Below the EU endorsement process is illustrated.



The rapporteur points out that the endorsement procedure only applies to international accounting standards for publicly traded companies. **It cannot be used to endorse IFRS for SMEs, since a new legal basis would be needed for this.**

Moreover, there are many bodies involved in the endorsement procedure. Especially the Commission receives input from a number of committees that to an extent seem to have overlapping competences.

The rapporteur also stresses that the recent change to the comitology procedure means that the European Parliament will be even more engaged in the development and endorsement of international accounting standards and that, not least in order to save time, the European Parliament needs to be kept informed in a timely manner about how work is progressing.

Given the number of topical accounting issues, 2007 and 2008 could be significant years for the cooperation between the IASCF/IASB, the Commission, the Council and the European Parliament.

4. IFRS for small and medium-sized enterprises (SMEs)

On 15 February 2007 the IASB published the draft financial reporting standard for small and medium-sized enterprises and invited all stakeholders to submit comments on this proposal by 1 October 2007. Given that the European Parliament is involved in implementing this standard in European law, it hereby forwards its initial comments.

In preparation for the own-initiative report, the rapporteur submitted a working document to the competent Committee on Economic and Monetary Affairs on 10 April 2007. This working document sparked a process of discussion that has greatly contributed to this report.

The IASB set itself the aim of bringing together all existing IFRS standards for application in small and medium-sized undertakings and making them available in simplified form.

The intention was to produce a stand-alone document containing all the rules that must be applied by SMEs in a relatively brief overview. The standards were to be presented in a clear and easily understandable way so that they would be easy to apply for small undertakings with relatively limited staff and financial resources for drawing up financial statements. Consistently reducing the comprehensive rules to the circumstances relevant to SMEs and simplifying the rules are central elements for the success of this project.

According to the IASB the **draft IFRS for SMEs** aims at companies with around 50 employees. Firms that do not have public accountability but are required to publish financial statements for external users are to be given accounting guidance, according to which general-purpose financial statements can be published for external users. In the exposure draft the IASB explains that it intends to update the IFRS for SMEs every two years.

It is inappropriate for the IASB to prescribe which companies should or should not be able to use the IFRS for SMEs. It must be left to democratically elected bodies to decide whether they can find any inspiration in the IFRS for SMEs.

SMEs generally find that the IASB should confine itself to developing a simple standard fitting the needs of SMEs and giving them a stable platform. Given the first reactions from SMEs IASB have failed to deliver. SMEs also consider the exposure draft as much too complicated and that its definition of own funds does not meet the particular needs of small and medium-sized businesses. Prospects of the IASB changing the standards every other year also worry SMEs.

More generally it is questionable whether the IASCF/IASB has the expertise to develop a simple standard for SMEs which are not publicly traded, so as to take into account e.g. the many different forms that small business may take. Moreover, it is unclear who gave a mandate to the IASB to suggest such an IFRS for SMEs and it is even questionable whether there ever was a need or a demand for such a standard.

The rapporteur considers that even promoting or encouraging voluntary use of the IFRS for SMEs will short-circuit the democratic process and cut out legislators.

Should a few Member States decide to apply the final IFRS for SMEs this would lead to fragmentation of the internal market and might even prejudice uniform accounting for SMEs across the entire EU.

Parliament can at least make an initial assessment, and it is not convinced that SMEs in Europe have called for and need an IFRS for SMEs drawn up by the IASB. It would perhaps be appropriate to offer a European SME standard based e.g. on the opinion of EFRAG (European Financial Reporting Advisory Group) on the IFRS for SMEs. A European SME standard would also make it possible to take specific regional characteristics (e.g. those relating to company law) into account

5. Road map towards convergence and equivalence

Global **convergence of accounting standards** has proceeded at an ever-increasing pace. At present, almost 100 countries permit or require the use of IFRS. A key element to this increased global interest was the EU's determination to require all its publicly traded companies to use IFRS in their consolidated financial statements from the beginning of 2005. Under the IAS Regulation a small proportion of companies were allowed to use US GAAPs until 1 January 2007.

The IASB and the FASB (the US accounting standard setter) have published a very full joint work programme. The objective is to achieve progress towards the equivalence of each other's accounting standards by 2009.

On 20 June 2007 the American Securities and Exchange Commission (SEC) submitted a proposal for consultation on the recognition of statements based on the IFRS. This is very welcome news, since the US, in accordance with the agreement signed between the US and the EU on 30 April, is considering measures aimed at waiving the costly reconciliation requirements hitherto applicable for European undertakings listed in the US. However, closer examination reveals that the SEC intends to recognise only financial statements drawn up according to the English version of the standards adopted by the IASB. The Commission wrote to the SEC in the autumn of 2007 calling for the recognition of IFRS, which has the force of EU law.

The existing version of the IAS/IFRS standards, which have the force of law in the EU – the main applier of IFRS – might in future be considered as local variations by the US authority, and thus not binding. The SEC, a national body, is thus giving private proposals from a body outside political control priority over current EU law. For its part, the SEC could submit American interpretations of current IFRS rules, and require European companies which wish to present financial statements in the United States in accordance with IFRS to comply with those, thereby itself creating a US variation on the IFRS. There is also the risk of the SEC becoming the ultimate body interpreting the IFRS.

The Commission must be given fundamental responsibility vis-à-vis the IASB so that EU interests are taken into account in this convergence process on an equal footing with American interests.

In the meantime, questions have also been raised regarding the appropriateness of full convergence between US-GAAP and the IFRS. It must be taken into account that IFRS is also applicable to firms which are listed on several stock exchanges, although this does not apply to the vast majority of firms applying it. Efforts to achieve a single reporting standard by approximating the two dominant standards at world level might prove too great: efforts towards convergence were necessary as long as more standards were in use worldwide than the current two leading standards. An alternative to convergence between these two standards would be the political recognition of equivalence between both standards, which differ in content but are of an equally high quality.

On 12 July 2007 the Commission submitted a first report on the **work timetable** of the authorities responsible for national accounting standards in the US, Japan and Canada for convergence between IFRS and the Generally Accepted Accounting Principles (GAAPs) of those countries. The report also describes the amount of progress in the **convergence** between International Financial Reporting Standards and the Generally Accepted Accounting Principles of Canada, Japan and the United States of America and of **progress on the elimination of reconciliation requirements that apply to Community issuers in those countries**.

Certainly the issues concerning convergence and equivalence of accounting standards have some parallels to EU-US discussions on financial conglomerates and the delayed implementation of Basle II. It looks as if the United States were willing to be involved in negotiating agreements on new rules in order to reach a compromise, but will then fail to implement them subsequently itself. The potential recognition of IFRS by the SEC brings with it the urgent question of where the ultimate competence regarding interpretation is to lie. It has to be noted that the European structures are not yet ready for this question.

For other third countries the Commission has committed itself to report to the European Securities Committee and the European Parliament about the development of regulatory discussions and the amount of **progress in the convergence between International Financial Reporting Standards and the Generally Accepted Accounting Principles of third countries** and progress towards the elimination of any reconciliation requirements.

5.10.2007

OPINION OF THE COMMITTEE ON LEGAL AFFAIRS

for the Committee on Economic and Monetary Affairs

on International Financial Reporting Standards (IFRS) and the governance of the IASB (2006/2248(INI))

Draftsman: Klaus-Heiner Lehne

SUGGESTIONS

The Committee on Legal Affairs calls on the Committee on Economic and Monetary Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

1. Repeats Parliament's position as stated in paragraphs 37 to 39 of its resolution of 4 July 2006 on recent developments and prospects in relation to company law[1];

2. Deplores the fact that the International Accounting Standards Board (IASB) lacks democratic control and pluralistic input and thus arrives at decisions that do not adequately reflect the reality of European companies, notably European small and medium-sized enterprises (SMEs);

3. Notes the merits of International Financial Reporting Standards (IFRS), which do not just concern technical accounting aspects but also bring benefits to capital markets and to the European Union as a world leader;

4. Stresses the need for more representatives with a European background within the international standard-setting bodies, in order to legitimate a truly international approach and to meet the need for a balanced consideration of the weight of the European Community, constituting as it does by far the largest economic area and the area with the most entities applying IFRS; believes that all trustees of the IASB should come from nations that have signed up, or intend to sign up, to IFRS;

5. Notes the increasingly theoretical dimension of the IASB's projects, the complexity and theoretical nature of which are such that SMEs, in particular, are not always able to

[1] OJ C 303 E, 13.12.2007, p. 114.

follow them;

6. Notes, furthermore, that practical business aspects are not adequately reflected by the IASB; considers that, from a user's perspective, the financial statement presentation for accounting does not always lend itself to being used for other purposes, e.g. for the purposes of providing financial information to investors, performance monitoring or financial management;

7. Notes the concerns of those who feel that the "decision-usefulness of fair value" approach to accounting, which is increasingly being used by the IASB, can create a disjunction between the picture that is produced by accounts and the actual position of companies, thus reducing the ability of investors to determine the performance of companies;

8. Supports the idea of convergence and equivalence; emphasises, however, that convergence with certain third-country standards must be based on a prior assessment of the merits and impact of such a change on European preparers and users of financial statements and especially on SMEs, and calls on the IASB to bear this in mind when proceeding; believes that convergence would be sufficient if a company's accounts produced in accordance with IFRS could be accepted and recognised under US Generally Accepted Accounting Principles without any significant extra cost to companies;

9. Stresses that consistency in adoption and application is essential to the success of the IFRS, but recalls that these are principle-based standards and that, therefore, consistency should not be pursued to the detriment of professional judgement;

10. Underlines that no political mandate has been conferred on the IASB to develop IFRS for SMEs; points out that the EU endorsement procedure applies only to international accounting standards for listed companies and is not envisaged with regard to the IFRS for SMEs;

11. Questions, moreover, whether the draft IFRS for SMEs appropriately reflect the needs of SMEs and the variety of modes and sizes in which they operate; is concerned that the draft was designed with relatively large SMEs in mind (over fifty employees) and asserts that most SMEs are smaller in size; observes that the IFRS involve very much a 'top-down' approach and queries whether this is appropriate for the diversity that exists among SMEs; is concerned that the draft IFRS for SMEs refer to using the lower of historical cost or fair value approach which implies a double calculation;

12. Regrets that the draft IFRS for SMEs do not take adequate account of the fact that the addressees of SMEs' accounts are mainly personal shareholders, creditors, business partners and employees rather than anonymous investors as in the case of public companies, and that the addressees of SMEs' accounts are interested in a long-term business relationship rather than a short-term investment;

13. Emphasises that the draft IFRS for SMEs should refrain from making references to the IFRS for public companies, since SMEs having a very limited workforce cannot handle the huge IFRS compendium;

14. Acknowledges, however that there is an overall need for simplification of accounting and

auditing measures for SMEs, while recalling that SMEs are creators of jobs and a motor of economic growth;

15. Believes that there should be an open debate about accountancy standards; to this end, believes that the IASB should strengthen its due process as regards stakeholders so that the views of all IFRS users and investors are taken into account;

16. In the light of the foregoing, encourages the Commission to continue its activities with regard to the simplification of company law, accounting and auditing for SMEs via the relevant legislative acts, in particular the Fourth[1] and Seventh[2] Company Law Directives.

17. Asserts that any SME standard must be simple and flexible, avoid a one-size-fits-all model and should apply only to SMEs that are active on a cross-border basis;

18. Expresses concern, while supporting the IASB's intention to improve existing standards, that making continual adjustments, and even small changes, can be costly and result in expensive changes for large companies; believes that any changes should only happen when deemed necessary following a cost-benefit analysis.

[1] Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies (OJ L 222, 14.8.1978, p. 11). Directive as last amended by Directive 2006/46/EC of the European Parliament and of the Council (OJ L 224, 16.8.2006, p. 1).

[2] Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts (OJ L 193, 18.7.1983, p. 1). Directive as last amended by Directive 2006/99/EC (OJ L 363, 20.12.2006, p. 137).

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	4.10.2007
Result of final vote	+: 25 –: 0 0: 0
Members present for the final vote	Carlo Casini, Bert Doorn, Cristian Dumitrescu, Monica Frassoni, Giuseppe Gargani, Lidia Joanna Geringer de Oedenberg, Katalin Lévai, Hans-Peter Mayer, Manuel Medina Ortega, Aloyzas Sakalas, Francesco Enrico Speroni, Gary Titley, Diana Wallis, Rainer Wieland, Jaroslav Zvěřina, Tadeusz Zwiefka
Substitute(s) present for the final vote	Mogens N.J. Camre, Charlotte Cederschiöld, Kurt Lechner, Eva Lichtenberger, Marie Panayotopoulos-Cassiotou, József Szájer, Jacques Toubon
Substitute(s) under Rule 178(2) present for the final vote	Iles Braghetto, Michael Cashman, Genowefa Grabowska, Lily Jacobs

RESULT OF FINAL VOTE IN COMMITTEE

Date adopted	29.1.2007
Result of final vote	+: 38 –: 5 0: 2
Members present for the final vote	Gabriele Albertini, Mariela Velichkova Baeva, Zsolt László Becsey, Pervenche Berès, Slavi Binev, Sebastian Valentin Bodu, Udo Bullmann, Ieke van den Burg, Christian Ehler, Elisa Ferreira, José Manuel García-Margallo y Marfil, Jean-Paul Gauzès, Donata Gottardi, Gunnar Hökmark, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Piia-Noora Kauppi, Wolf Klinz, Guntars Krasts, Astrid Lulling, Hans-Peter Martin, Gay Mitchell, Cristobal Montoro Romero, John Purvis, Alexander Radwan, Bernhard Rapkay, Dariusz Rosati, Heide Rühle, Antolín Sánchez Presedo, Manuel António dos Santos, Olle Schmidt, Peter Skinner, Margarita Starkevičiūtė, Ivo Strejček, Cornelis Visser, Sahra Wagenknecht
Substitute(s) present for the final vote	Katerina Batzeli, Daniel Dăianu, Harald Ettl, Werner Langen, Vladimír Maňka, Bilyana Ilieva Raeva, Margaritis Schinas, Andreas Schwab, Charles Tannock
Substitute(s) under Rule 178(2) present for the final vote	Syed Kamall, Alfonso Andria