IOSCO endorsement

A European perspective

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1 Introduction

By chance, this paper is in between Paul Leder's and David Tweedie's contribution. This probably makes sense. As a European Commission-representative my message to the SEC would read 'be sufficiently flexible'. In contrast, my message to the ASB would be 'you can not expect us to be flexible to such a degree that nothing is left of the harmonisation'. Thus, I find myself positioned somewhere between the SEC and the ASB.

The IOSCO effort to assess the IASC standards is particularly important to European companies that want to tap the large US equity markets. I believe that the assessment raised a number of issues, which were overlooked earlier, especially in Europe. Some parties thought that after the IASC had established its standards, IOSCO would give the go-ahead signal. Understandably, the IOSCO-assessment process is not going to be as easy as that. Nevertheless, all parties involved have spent considerable effort over the last years reviewing, discussing and examining the IASC proposals. IOSCO should now recognise these efforts and try to complete the assessment process within a short span of time.

Europe has prior experience with harmonisation efforts. The lesson I have drawn from my experience is that there is no chance of success in any international project of the scope IOSCO is embarking on, unless there is political willingness from the parties concerned to compromise. I have seen many of these negotiations fail on 'technical reasons', which is often nothing more than a roundabout way of saying that parties lacked political commitment to reach an agreement. The harmonisation process succeeded in Europe because there was a firm political commitment to achieve the harmonisation goal. The same European inclination to comprise can be found with regard to the international accounting standards project. We expect, however, a similar political signal from the US. Compromises cannot be a one-way street.

2 The accounting scene in Europe

Turning the debate from IOSCO to the European scene, I would like to comment first on the present accounting situation in Europe, and second, on what is in store for the future. 1995 was an important date for accountants in Europe. The Commission adopted its 'New Accounting Strategy'. This policy intended to solve the problems of European multinationals with regard to entering international capital markets, especially in the US. We firmly believed that the best route to proceed was to adopt as many of the IASC standards as possible. Therefore, we advised the EU member states to allow their 'global players' to use international accounting standards in their consolidated financial statements. Two caveats apply, first, application of the international accounting standards should never conflict with the EEC directives on financial reporting, and second, the influence of the EU in

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the international standard setting debate should increase. The Council of Ministers insisted on the latter condition.

We first of all started a joint process with the member states to assess potential areas of conflict between the European accounting framework (and in particular the EEC accounting directives) and the then (1996) existing international accounting standards. The conclusion of this exercise was that by and large only a few conflicts could be identified. One conflict concerned the treatment of negative goodwill. This has now been resolved. A second area of contention dealt with the consolidation of certain subsidiaries. This is no longer a relevant issue in Europe since the practice barely exists currently. Thus, a European company reporting under international accounting standards can do so without being in conflict with the EEC directives. One should recognise the importance of this 1996 conclusion.

Clearly, the IASC has developed a number of new standards since 1996 and the European Commission will speak out on the potential areas of conflict between these new international accounting standards and the EEC directives. In my opinion, there will be only a few. As an example of an area that needs attention, I would like to mention the question of restructuring provisions. The 'conformity-assessment' was critical, it showed that we could use the IASC standards in Europe, 'filling in' any remaining gaps without being in conflict with the EEC directives.

To increase the EU influence within the IASC, we stepped-up the co-ordination between the member states. Thus, we were able to focus the EU input on various IASC exposure drafts. I believe that in this way we influenced the final vote at IASC meetings a number of times. Note that the European Commission representative on the Board has no voting rights.

The New Accounting Strategy also caused some changes in member states. Germany, Italy, France, Belgium, Austria, and Luxembourg now allow multinational companies with cross-border listings to apply international accounting standards in their consolidated financial statements. Somewhat surprisingly, similar changes have not occurred in the Netherlands. It has been suggested to me that the Dutch apply their accounting rules in a rather liberal fashion and that therefore no amendment of the present legislation is necessary! Financial reports prepared in accordance with the existing rules will seldom conflict with international accounting standards, US GAAP, or many other GAAPs. It is also interesting to note that no changes occurred in the UK, although it is at present impossible for companies in the UK to prepare their financial statements under international accounting standards. I have often wondered why the UK took a position markedly different from other European countries in this matter. The reasoning here seems to be that UK GAAP is probably better than IAS and that UK companies should not allow to apply standards which are of lower quality.

Member States, which issued legislation or adopted measures in order to implement the New Accounting Strategy of 1995, encountered three problems. First, some EU companies prepare their financial statements under US GAAP. Actually, the number of companies in Europe that apply US GAAP is surprisingly large. There are some legitimate economic reasons for this practice. For example, EU companies listed on one of the US exchanges want to issue one set of financial statements. In addition, if industry custom dictates that firm performance is evaluated under US GAAP, a company would want to follow such lead. These economic realities have caused some political problems. Member state parliaments, which intervened in this legislative process, insisted that European companies should not apply foreign standards. I believe that an international business environment calls for international solutions. With regard to the application of US GAAP by European companies, we need to evaluate to what extent US GAAP causes conflicts with the EEC directives. Companies might be violating the law by integrally adopting US GAAP.

The second problem that arose with the implementation of the New Accounting Strategy concerns the compliance between IAS and the Accounting Directives. Essentially, the question is who is going to judge on possible conflicts between the EEC directives and the international accounting standards? In Germany, it was decided that this task should be left with the auditors. The German profession, however, indicated that it did not want to bear this responsibility, at least not without additional guidance from the EU. In France, the compliance issue was resolved by setting up a kind of screening device. A committee, the Comité de Réglementation Comptable, was created which will decide which international standards comply with French (and thus EU) law. To complete this task properly, the French Parliament insisted that all international accounting-standards should be translated into French. The same would apply for US GAAP. This is however an impossible task because the translation of the whole package of rules and interpretations which constitutes US GAAP into French is an exercise that will take a man's lifetime to finish.

Thirdly, the question of enforcement needs some attention. There is consensus that something needs to be done about the practice of 'lite accounting' in Europe, which is regrettably not uncommon. Auditing is going to play a major role in any solution of the enforcement question. I believe the European Commission took some appropriate actions in this area. After the publication of a Green Paper on the Role, the Position and the Liability of the Statutory Auditor in the EU, a Conference was organised at the end of 1996 in order to discuss with the profession and the main regulators of the profession possible actions for improving the present state of audit throughout Europe. The wide consultation which took place resulted in the publication by the Commission of a Communication in May 1998 which contains specific proposals for action. These proposals are now discussed within the newly created Committee on Auditing. This Committee is truly committed to making progress in areas such as audit quality insurance, application of International Standards on Auditing and auditor independence. The member states seem to be convinced about the importance of insuring audit quality. All member states have indeed already agreed that a peer review or monitoring system should be put in place.

3 Some observations about the future

What is in store for the future? We learned from our experience that flexibility is required in accounting. For example, it takes time to negotiate EEC directives, as it takes time to implement them. Indeed, it is a problem to ensure that the directives are actually applied in practice. In accounting, this might even be more tricky than in other areas, since the application in practice can potentially be different from what the law intended. Thus, in future, the Commission will look for more flexible legal instruments. We have also learned from the experience in the United States. People sometimes criticise the US for its very regulatory environment. I think, however, that we should applaud the United States for having built its efficient capital market. The US experience taught us that some minimal level of comparability of financial statements is required to ensure the efficiency of capital markets. The standards for such minimum level of comparability might have to be relatively high (certainly higher than the present level of harmonisation within the EU) and they should be accompanied by a strong enforcement mechanism.

In October 1998, the Commission published a Communication called 'Financial Services: Building a Framework for Action'. In this very important document, the Commission takes stock of the present status of financial services legislation in Europe. It also discusses what we need in view of the single European market for financial services and in the context of 'Euroland'. On 1 January 1999, the more progressive member states of the EU will introduce a common currency: the euro. The euro will fundamentally change the way in which Europe operates. It will affect the way in which business is carried out. It will also influence the way in which business is financed. Regulators in the EU are now being asked to ensure as quickly as possible that the existing regulation does not hinder this important development and that all necessary mechanisms are put in place to ensure that an efficient capital market comes about.

From 1999 onwards, large companies in Europe will publish financial statements in euros. This will even be the case in member states, which do not belong to the Euro-block, particularly in Sweden, Denmark and the UK. Thus the impression will be given that accounting practices in Europe have converged. The fact that financial statements will be denominated in euros does not mean, however, that differences in accounting standards are no longer possible under the existing framework. This is going to create problems. An increasing number of people want to invest their money in securities. This trend is stimulated by the uncertainty of continued state funding of pensions. To accommodate this growing demand, a sufficiently mature market must exist. In other words, a market in which the information companies supply is comprehensive, reliable, and properly audited. I can state these requirements in one phrase: we need an efficient capital market.

The European Commission will search for ways (with the member states) to improve the present state of harmonisation in accounting. One of the important elements in this discussion will be whether we can use IAS to fill the gaps in order to provide solutions for the many issues which have not been resolved by the Accounting Directives. Clearly, any reform will primarily be directed towards large and listed companies. We do not believe that IAS provide a suitable framework for financial reporting by the millions of SMEs which are covered by the Accounting Directives. Another question is whether listed companies should not only be allowed but be *required* to use international accounting standards in future. If this were the objective to be pursued, it is clear that the European influence within IASC would then have to be much strengthened. We cannot have the IASC decide on the way our major companies have to report their financial situation without having a say in the development of the standards. Europe will have to prepare itself for this. A truely European influence means putting an end to the practice of sending national representatives to IASC meetings. Europe will have to be represented by a European delegation which can speak on behalf of all member states of the EU.

These future developments will require a number of institutional changes. For one, the national accounting standards boards in Europe must get together. The challenge of a European accounting standards board has become imminent owing to the headway made globally. The same holds true for securities regulators and those involved with the enforcement of (accounting) rules. The decisions reached by national securities commission are known to diverge. This is undesirable. Thus, we will have to focus our attention and effort on forging convergence in Europe in terms of accounting, especially regarding the application of international accounting standards in a European context and in terms of the enforcement of these standards.

These efforts have to be consistent, though, with the agreed-upon harmonisation process. The Accounting Directives should remain sufficiently flexible to accommodate Europe to sign up to the international harmonisation in the field of accounting. The way to proceed here is by adopting a European outlook and shedding national interests to the European advantage. Similar initiatives will also be taken in the field of auditing. The Commission will deal with the issue of independence, quality-assurance and corporate governance.

4 Conclusion

The first priority is to establish an efficient capital market in Europe. Companies from all over the world are welcomed if they want access to the financial market in Europe. This should be possible without any unnecessary burdens. IOSCO endorsement or assessment can be useful. It prevents companies from having to prepare different sets of financial statements and it avoids the need for costly reconciliations. The European Commission therefore supports and will continue to support the IOSCO efforts.

As a natural consequence of the globalisation, the world of tomorrow needs a meeting place, like the IASC, where the main trading blocks can discuss ways and means to improve the quality and comparability of financial reporting. But Europe must also get itself organised. In this respect much can be learned from the US experience and particularly from the important role which the SEC plays in this context, particularly with respect to enforcement. There is too much 'lite reporting' being practised in Europe.

I hope the reforms which we will announce in the next few months will convince particularly the SEC that even outside the United States things can be well organised. Nevertheless, these reforms should primarily serve the interests of Europe. We live in historical times. It is the first time since the Roman Age that we live again in an environment with a common currency in Europe. Future generations would be rightly critical if we were to continue thinking in old strategies and old systems rather than opening us up to the world at large. A world where Europe will have to take the place it deserves.