



FEE Conference on Audit Regulation

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MINUTES OF PANEL DISCUSSION ON CONVERGENCE IN THE AREAS OF FINANCIAL REPORTING, AUDITING AND ETHICS

LESSONS LEARNT FROM CONVERGENCE IN FINANCIAL REPORTING FOR CONVERGENCE IN AUDITING AND ETHICS

Hans van Damme, FEE Deputy President, Panel Chairman, opened the first panel about Convergence in the areas of Financial Reporting, Auditing and Ethics addressing in particular whether lessons have been learnt from convergence in financial reporting and provided the audience with three main sets of elements which, in his view, are critical in the process of convergence:

1. International standard setters issue global standards but they may be “localised” by endorsement or otherwise for reasons of political acceptability;
2. How quickly can standard setters change to market circumstances;
3. The question whether convergence can lead to global standards.

Hans van Damme introduced the three panellists.

Stig Enevoldsen, Chairman of the European Financial Reporting advisory Group (EFRAG) presented his views on the highlights and key questions on convergence in the accounting area by looking into where we were and where we are now.

Prior to 2005, one could say “each language had its accounting language”. With IFRS, some convergence has been achieved in financial reporting in many countries in Europe and worldwide. Now convergence of IFRS and US GAAP is being considered. The Norwalk agreement was a key step in achieving convergence in the short term by adjusting existing standards and in the long term by having joint projects that look for the same global solutions and effectively one accounting solution. Other initiatives have been undertaken worldwide towards achieving the same goal, for instance the Tokyo agreement (between the ASBJ and the IASB).

The removal of the US SEC reconciliation requirement in 2007 was a real achievement. Moreover, the US SEC has just issued a proposal release on whether to allow or require US companies to use IFRS. This is a step forward but it is still uncertain whether the US will move to IFRS. In addition, the debate on rules versus principles remains open. Key questions arising include whether IFRS will be accepted in the US and will work in a very litigious environment, as well as how the US (potential) adoption will affect the global architecture. For example, how much influence should each part of the world have? The IASB is working closely with FASB.

When discussing global accounting, EU influence and US influence, one should also be thinking of other parties joining in and bringing their influence too (for example China, Japan and others). It is expected that Japan, like the US, will issue a roadmap with a proposal to move to IFRS.



Other key questions to consider are whether full convergence can be achieved and what the next steps are.

Jerry Edwards, Senior Advisor on Accounting and Auditing Policy at the Financial Stability Forum (FSF) provided an insight into the recent developments in relation to the global market crisis and convergence with an outline of the implementation activities undertaken by the FSF to promote convergence and to deal with the global crisis. In this context, the FSF seeks to mitigate risks to financial stability and one of its key roles is the support for sound international standards and practices, including standards for accounting and auditing.

Worldwide leaders have called on the FSF for coordinated actions. In particular, with the G7 request, the FSF was asked to come up with an analysis, recommendations and efforts to address the global market turmoil. In its April 2008 report to the G7, the FSF presented recommendations in the following five key areas (the G7 strongly endorsed the FSF report):

- Strengthening prudential oversight of capital, liquidity and risk management
- Enhancing transparency and valuation
- Changes in the role and uses of credit ratings
- Strengthening authorities' responsiveness to risks
- Robust arrangements for dealing with stress in the financial system

The IASB has undertaken various actions in the areas of valuation, off-balance sheet entities and disclosures to implement the FSF recommendations; it has enhanced its guidance on valuing financial instruments when markets are no longer active and established the IASB Expert Advisory Panel and the High Level Group, as well as strengthened standards for disclosures about valuations and is developing enhancements to off-balance sheet treatment and related risk disclosures. Similar actions have been undertaken by the FASB. In practice, there is already some improvement for example in the area of valuation and off-balance sheet treatments.

The IAASB is enhancing audit guidance based on lessons learned in the turmoil; it issued a Staff Audit Practice Alert in October 2008 and met with key audit firms.

The turmoil has highlighted the importance for market confidence of reliable valuations and useful disclosures of the risks associated with structured credit products and off-balance sheet entities, by ensuring sound standards and practices. Convergence also emerged as extremely important during this period, in particular on valuation, off-balance sheet treatments and risk disclosure. There is encouragement to continue to work towards convergence but one should be careful to continue to respect standards setters' independence.

Regaining market confidence is crucial. The Action Plan from the recent G20 Summit Declaration includes convergence activities and it reflects many of the FSF efforts in this area, for example that key global accounting standards bodies should work intensively toward the objective of creating a single high-quality global standard. These aspects show continued support for high-quality, converged standards and practices and the inclusion of these actions will give a basis for leaders around the world to explore a number of opportunities, which should also be reviewed by standard setter and regulators.

Richard George, Chairman of the International Ethics Standards Board for Accountants (IESBA), presented three main areas for prospects on convergence, namely an overview of Ethics Convergence, Convergence of Independence Standards and the IESBA's Action Plan.



Auditor's independence is one of the distinguishing features of the profession. There is a high level of acceptance of the profession across the world and although different styles and languages may be used, overall the profession is highly harmonised except for one area: Auditor's independence. Convergence of auditor's independence standards is therefore a current and hot topic.

The main reason for the diversity in current standards on auditor's independence is that the responsibility for auditor regulation has moved from accountancy institutes to statutory regulators. Despite the fact that current independence standards are addressing the same topics, they differ in the detail. This can result in an inconsistent understanding among auditors, investors, preparers, and regulators. In addition, the complexity of detail can lead to higher risk of minor violations and higher costs to auditors, preparers, and regulators. Finally, this may create somewhat reduced auditors choice, in terms of the audit service and choice of firms.

In order to address this, the IESBA is currently working on the convergence of Independence Standards and plans to issue fully revised and clarified Independence Standards in June 2009. It is hoped that this will serve as a benchmark for convergence and that it will be produced under a governance model similar to the IAASB. When this is done, focus will not only be on the quality of the standards but also on the political acceptance of the standard setters and the governance model.

We recognise that there are challenges ahead and that these may not necessarily be the same as the ones encountered by the IASB. When the new Code is ready next year, it may be the right time for regulators to focus on convergence issues then, since the credit crisis may be taking up most of their time now.

Questions & Answers

During the **panel discussion and in responding to questions** of the audience, several issues were raised including the question of confidence in the financial statements and whether the financial crisis will lead to the speeding up of the adoption of new clarified ISAs. While the focal point is bringing stability, a broad action plan should be considered going forward of which convergence is an important part. How quickly the adoption of new clarified ISAs is achieved is difficult to say at this point in time.

A question was raised on whether there is more that the profession can do to facilitate convergence. Indeed there is a very important role for the IAASB as detailed in the FSF recommendations. The profession has together with the standard setters an important role to ensure a common understanding about the foundation upon which the standards are based.

Finally, whether the US will move to IFRS is difficult to say but there is a move in the US profession towards becoming more outward looking. Other issues include the procyclicality, the need for standards to be stressed tested, ensuring the long term credibility of standards, and in the context of convergence ensuring that financial reporting and ethics standards are applied but also looking into the governance model to ensure that there is transparency there too. Other factors to consider are the timescale that it takes to produce new requirements and the extensive due process, so a way may need to be found for looking at priority topics. If the US moves to IFRS, one can expect an even more significant US influence within the IASB.

Hans van Damme, Panel Chairman, concluded the discussion and thanked the panellists and audience for their participation.