



**FINANCIAL REPORTING:
CONVERGENCE, EQUIVALENCE AND
MUTUAL RECOGNITION**

FEE POSITION PAPER

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CONCLUSIONS AND KEY MESSAGES

- **FEE supports robust global principle-based standards. The objective of creating a single set of global standards should ultimately be subordinate to the objective of preserving and improving the quality of principle-based IFRS financial reporting.**
- **FEE welcomes clarification that the convergence process does not necessarily entail full convergence: there is no need for identical sets of standards (IFRS and US GAAP) but a need to progress in a similar direction to allow deeper convergence on a longer term horizon.**
- **Mutual recognition of IFRS and US GAAP, provided they are properly applied, is justifiable today since both US GAAP and IFRS can now be considered as two equivalent high quality sets of standards. Sufficient convergence steps have already taken place in terms of standards to provide comparable financial statements and to enable users to take similar economic decisions in similar situations. Removing the SEC requirement for foreign issuers to reconcile to US GAAP should be delayed only if IFRS implementation by European preparers for the 2005 and 2006 implementation would evidence significant inconsistencies damaging to the international investor community recognising that standards are new and a major change from existing national GAAP. FEE therefore expects the EC and SEC to agree as soon as possible on mutual recognition, that is, as soon as there is positive experience of the implementation of IFRS, hopefully starting in respect of 2005.**
- **FEE calls on IASB, FASB, SEC and EC to be transparent and to communicate on the current plans for short term and long term convergence (Roadmap) and its impact on the IASB work programme and its priorities. The related timetable should be made public as soon as possible. Public consultation needs to be strongly considered, the whole work programme properly explained and comments welcomed as part of due process.**
- **Although FEE remains open to the changes that would be necessary to keep accounting up to date with new business or economic developments and to accommodate some “easy fixes” to eliminate some existing differences between IFRS and US GAAP, FEE supports a stable platform of IFRS in the coming years. Any other adjustments to existing standards and any new standards with immediate application should be justified by reference to an urgent need to correct inconsistencies in the existing IFRS literature. Radical changes need to be studied and exposed as discussion papers without short term implementation objectives in the next few years.**
- **The IASB should continue to work on improvements to standards and new standards, but needs to carefully respect its due process. The feedback received by way of its due process should be reflected in the eventual standards or, if not, explained in a feedback statement. The effective dates of future approved standards, such as those required to meet some short term convergence objectives, can also be designed so as to respect the stable platform.**

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- **FEE emphasises that, in view of the nature of IFRS (more principle-based than US GAAP), consistent application does not mean identical application: it means acceptable by reference to the standards and therefore within the boundaries of IFRS.**
 - **The benefits of consistent application of IFRS go beyond the IFRS – US GAAP convergence process and is of benefit to all investors in companies that prepare their financial statements on the basis of IFRS in order to obtain comparable information. In 2005 IFRS are new and often fundamentally different from national GAAP for many preparers, and also for auditors, regulators and users. The implementation of IFRS is a big step forward in terms of comparability. Capital markets will get better information than they did in the past.**
 - **FEE calls for enhanced coordination between regulators including CESR and SEC to agree on the new enforcement behaviours that IFRS principle-based standards entail in order to minimise regulatory differences that could create inconsistent application.**
 - **Each of the parties involved in the financial reporting chain has to fulfil its role in achieving consistent application of IFRS. The profession is ready to assume its fair share.**

INTRODUCTION AND BACKGROUND

Over the last six months, and before, the issue of convergence of IFRS and US GAAP is high on the political agenda and debated in various fora. Two elements play an important role:

- *What level of convergence is needed for dropping the reconciliation requirement for European companies, which are registered with the SEC using IFRS and reconciling with US GAAP.*
- *Consistent application of IFRS and the issue of interpretations.*

On 1 December 2005, FEE organised a seminar on this theme under the title “IFRS Convergence and Consistency¹” with key senior speakers involved. The seminar focused on questions of political importance with social implications rather than on technical questions². In wrapping up the seminar, FEE President David Devlin concluded:

- *There is strong support for global standards and clear recognition of their benefits.*
- *There is a need for a stable platform of standards: any adjustments to existing IFRSs should be very well justified. This does not mean that one should stop thinking about the route to better standards: accounting should not fall behind economic developments.*
- *IFRIC has a critical function and should be well staffed to perform efficiently, recognising that its due process does take time.*
- *For removal of the reconciliation requirement the SEC does not expect complete or even a particular degree of convergence: a robust process needs to be in place.*
- *Europe needs to perform on the consistency question: what is good enough in Europe should be good enough in the US.*
- *There is appetite to revisit the Conceptual Framework to get some sense of what the rules of the game are.*
- *Due process needs to be reflected in the outcome: IASB might consider introducing a form of feedback statement modelled on the CESR one.*
- *Consistency means acceptable within the boundaries of IFRS standards and IFRIC interpretations.*
- *No interpretations should be considered at European level.*

There is a need to clarify the meaning of convergence: convergence potentially can be understood in different ways. At one extreme, one could argue that convergence means identical standards resulting in the same accounting treatment to be followed in identical cases. This would be a long term and demanding process which will be hampered by clashes in business activity, culture and background and might even be in conflict with the nature of principle-based standards. If the ultimate objective is based on this meaning of convergence, some may require reconciliation statements or disclosures in the meantime to compensate the lack of equivalence of sets of standards.

However, convergence could also mean that two sets of standards should lead to identical, or at least to a great extent, similar investor’s decisions in identical economic situations. Thus, the resulting financial statements should have equivalent high quality information value, but it is not necessary to arrive at identical financial statements. Some degree of co-existence of somewhat different sets of standards may be possible.

¹ Texts of the presentations and other details about the seminar can be found on the FEE website: http://www.fee.be/news/default.asp?library_ref=2&category_ref=214&content_ref=535.

² The key questions addressed on both convergence and consistent application are set out in the Appendices to this position paper.

Each of the parties involved in the financial reporting chain must work within a governance framework which ensures that it assumes its responsibilities and behaves in an ethical matter consistent with the overall objective of ensuring that financial statements provide a fair presentation of the financial position and performance of the company.

This discussion paper aims at providing background to the debate, providing an analysis of the different issues at stake in convergence, while also addressing equivalence and mutual recognition. The paper addresses:

- *What is the meaning of convergence?*
- *What is the right perspective for short-term convergence?*
- *What level of convergence is needed?*
- *How to ensure the success of convergence?*
- *Does convergence lead to unintended consequences and how can these be solved?*
- *How to ensure widespread understanding and support of the convergence process?*
- *Is the ultimate objective mutual recognition without requiring further remedies?*
- *What is the impact on the IASB work programme?*

This paper aims to discuss how to make a success of the new IFRS process in Europe while at the same time pursuing the long term goal of IFRS/US GAAP convergence. What would constitute a robust and balanced convergence process? The paper develops the standpoint of the European accountancy profession in the form of a discussion of the issues and provide some conclusions and key messages.

1. CALL FOR GLOBAL PRINCIPLE-BASED STANDARDS AND CONVERGENCE

FEE is strongly committed to high quality, global, principle-based and neutral financial reporting standards. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness and comparability and for capital raising purposes. FEE therefore supports the IAS Regulation requiring the use of IFRS for listed companies in their consolidated accounts.

The “Norwalk Agreement” between the FASB and IASB aims at a common set of high quality global standards.

European stakeholders support principle-based standards. A principle-based approach to financial reporting means that clear principles are designed to serve the public interest, accompanied by a limited number of rules that show how those principles should be applied in common situations. Such an approach promotes consistency and transparency and helps companies and their advisers to respond appropriately to complex situations and new developments in business practice, in diverse business cultures and diverse legal frameworks. It also prevents the risk of regulatory overload from detailed rules that may be developed in an attempt to cope with all the eventualities that may arise in practice.

This approach of adopting principles which must always be respected, accompanied by appropriate guidance, should be paramount. It is different from an approach where principles guide the development of detailed rules and whereby companies need to obey the detailed rules rather than the underlying principles. The US environment may not yet be sufficiently conducive to principle-based standards given their existing regulatory and legal systems which may result in strong support from preparers and auditors for detailed prescriptive rules. Principle-based accounting is difficult when enforcement is not also fully principle-based or when litigation encourages a prescriptive, rules based approach. Is there therefore a risk that continued convergence could slow down or come to a halt, and if so, how can it be addressed?

2. CONVERGENCE, EQUIVALENCE AND MUTUAL RECOGNITION

High quality financial reporting is the overarching objective of standard setting. Long term convergence of standards is desirable, not only at European but also at worldwide level, where there are conflicts between different sets of accounting standards which impair the comparability of financial information. But convergence must involve an approach of seeking the best solutions for accounting issues. This approach it is generally agreed, must be principles-based as discussed in section 1. Convergence should also demonstrate fully that experience from across the globe has been utilised. However, taking into account cost-benefit, cultural traditions and litigation considerations, the question arises as to what level of convergence can be achieved. Many countries around the globe are converging to IFRS, whether by adopting IFRS, aligning to IFRS or developing their own standards based on IFRS. IASB has also convergence agreements with some countries. This paper focuses however on convergence of IFRS and US GAAP.

The convergence process started with the “Norwalk Agreement” of 2002 between IASB and FASB whereby both pledged to use their best efforts to make their existing standards fully compatible as soon as is practicable and to coordinate their future work programme, aiming ultimately at a common set of high-quality global standards.

The US GAAP environment is fundamentally different from the general European environment. This is due to social and cultural factors, the US tradition of private sector accounting standard setting in contrast to reliance on public law and regulation to specify accounting requirements for all companies in Europe (rather than just listed companies) and the much greater risk of litigation on financial reporting in the US. The greater level of detail in US accounting standards (the so-called primarily “rules based” approach) and the role, authority and practices of the SEC are other factors. Therefore US GAAP and IFRS are also different and the question is how close they can come together without turning IFRS into rule-based standards.

The convergence project is seen as an urgent high-priority issue on both sides of the Atlantic. John Bruton, Ambassador of the European Union to the US, indicated in a recent speech: “The IASB and the FASB are engaged in a process of converging the two standards over time. And the European Commission and the SEC are working with these two institutions to ensure that the convergence programme has a clear timetable, clear objectives and is transparent to all stakeholders. This is urgent.”³

Convergence and the related expected removal of the reconciliation requirement has direct benefits for European companies listed in the US. The benefits for other listed companies are of a longer term nature. However, convergence has positive aspects for all participants in the financial reporting chain: including the possibility of standards for universal use; improved understanding and comparability of financial reporting; and driving for a higher quality of financial reporting with the related economic benefits, such as lower cost of capital. It is important that the positive aspects are not lost sight of in the convergence process when problems are encountered. All participants need to determine what level of convergence is needed and work together to make the convergence process of even more widely accepted benefit to the world. The driving principle should be high quality, robust financial reporting standards that are sufficient to meet the needs of users, including cross-border investors.

³ Speech by John Bruton Ambassador of the European Union to the United States of America at the Irish Financial Services Association Annual Dinner, Four Seasons Hotel, Dublin, Ireland on 1 September 2005.

However, the objective of creating a single set of global standards must ultimately be subordinate to the objective of preserving and improving the quality of principle-based IFRS financial reporting.

The current convergence approach - agreed between the IASB and FASB some time after the political decision to require the use of IFRS in Europe - has given rise to a series of questions⁴, perceived problems and challenges that need to be addressed in order to make the convergence process successful, robust and balanced.

2.1. Speed of change

Many (listed) companies are in the process of transition to IFRS and are experiencing challenges with the first time application of IFRS. Companies and their auditors are calling for a stable platform of IFRS for use in Europe to gain experience, acknowledging that changes to standards may continue to be needed. Any changes must be properly justified. Too much change in the short term could be counter-productive, confusing and difficult. This does not mean that the IASB should stop thinking about the route to better standards as accounting should not fall behind economic developments, but effective dates for implementation need to be carefully considered. Many stakeholders involved have problems with the apparent current speed of change and the apparent radical changes in contemplation. There is doubt whether the convergence process leaves sufficient room for a stable platform of IFRS in Europe.

The question arises as to what is the right perspective for short-term convergence: should it focus on the best of the existing standards aiming at a platform of stable standards? Or should it aim at new standards, in which case: should revision of the Conceptual Framework come first? How long should the stable platform of standards for 2005 be left unchanged? To what extent are the 2005 standards in themselves already a sufficiently high level platform? How much change is desirable, given Europe's (and others) current transition to IFRS?

2.2. Complexity of IFRS

Some complexity in accounting standards is inevitable, reflecting the increasingly complex transactions entered into by many listed companies. However, the current trends regarding the style and level of detail used in IFRS and IFRIC, and IASB concepts supporting new standards, make them very complex to grasp. Standards are perceived as becoming more theoretical, complex and lengthy, which causes not only a very significant education issue within listed enterprises but also within unlisted IFRS users and with auditing firms. Such issues may well increase the risk of preparers and auditors being held liable for the accounting judgements made in good faith. Regulators and other users also face similar issues in dealing with this new and recent complexity. Restatements caused by innocent failure to apply complicated rules also damage public trust in the system that the rules are intended to strengthen. In addition, there is the issue that the standards are often costly to apply.

Comments need to be properly considered and to be reflected in the outcome of standards either in the final standard or in a feedback statement clearly justifying why adverse comments at proposal stage have not been accepted. A true due process must be practised always, and applied with special care to

⁴ Appendix I sets out a series of questions that could be considered in this respect and was provided to the panellists in the FEE 1 December 2005 seminar on IFRS Convergence and Consistency.

more radical proposals, to build up continued support for global standards. Some improvements have been made to the due process and others are announced to come.

Given the concerns expressed, in particular on the wider use of fair value measurement, there is a risk that the European financial reporting community may react adversely to some of the main current convergence items (such as Business Combinations phase 2).

2.3. Impact on IASB work programme

The convergence process resulting from the “Norwalk Agreement”, and the agreed Roadmap towards equivalence between IFRS and US GAAP between SEC and the EC has major implications for the IASB work programme and its prioritising. Priority seems to be given to convergence items instead of to other projects which potentially are more important for Europe (e.g. accounting for SMEs, insurance accounting concessions, emission rights and treatment of shares puttable at fair value). This impact is twofold: to eliminate certain differences through “short term fixes” (6 areas for each standard setter, two being joint) and also eleven areas where significant improvement is deemed necessary, most of them to be finished after 2008. The IASB intends to publish in due course the conditions and priorities of the convergence process in a public document. However, doubts are often expressed whether so far there has been sufficient due process in practice, including involvement of all stakeholders, on the terms for conducting the convergence process and on the IASB work programme. Discussions are taking place between the EC and IASB to ensure proper European influence on the work programme, which is not so far in the public domain and thus has yet to stimulate input from all participants in the process.

Communication and transparency are crucial in relation to the convergence process and the Roadmap, including clearer indications of how US GAAP is expected to move given the serious concerns that continued convergence could stall as the US may be still some way from accepting principles-based standards⁵.

2.4. Conceptual Framework revision

Some commentators believe that several (new) standards and amendments to the existing standards are said to deviate from the IASB Framework published in July 1989, notably in the definition of assets and liabilities and concern is expressed about the enhanced role of fair value accounting without appropriate guidance provided by the Framework. According to these commentators, the convergence process is said to introduce, and to be used as a justification for acceptance of, a further use of fair value accounting. IASB needs to be more transparent about its intentions in respect of the use of fair value. There are strong calls in Europe to make substantial progress in updating the existing Framework before entering into any further development of radical new standards not clearly compatible with that Framework. In the longer run the development of new standards and the Framework should go hand in hand, as the Framework should always be updated and reviewed as new important thinking is established when developing revised standards. A quiet period in standard setting could be used for revisiting the Framework. Similarly, there is a view that agreement on the future direction of the project on performance reporting is necessary before it is possible to assess with any rigour the implications of other proposed new standards. Public consultation should be on the basis of

⁵ For example, interview with Bob Herz, “US not ready for convergence”, Accountancy Age, 3 November 2005.

discussion papers in order to stimulate the public debate and obtain wide support for an agreed direction.

2.5. Consistent application of IFRS as part of convergence and mutual recognition

At present, European listed companies and other companies are in the process of implementing IFRS and experience a series of difficulties and transitional issues with this implementation process. Moreover it should be considered that, in most EU Member States, this is the first year of implementation of IFRS in real life and that little industry peer comparison is available. This inevitably means that companies will have some difficulties with implementing IFRS. Consistent application is a key factor in the adoption of IFRS in Europe in order to have the full benefit for the European and global capital markets.

Achieving the elimination of the IFRS – US GAAP reconciliation requirements “depends on a detailed analysis of the faithfulness and consistency of the application and interpretation of IFRS in financial statements across companies and jurisdictions, and continued progress on the IASB-FASB convergence project⁶.” “Under the roadmap, consistent interpretation, application and enforcement of IFRS around the world is a prerequisite to the Commission’s (i.e. SEC’s) consideration of eliminating the reconciliation requirement.”⁷

Consistency does not mean identical application⁸. In means acceptable by reference to the standards and therefore within the boundaries of IFRS. A certain level of differences is inherent in application of principle-based standards. However, rule-based standards will never be detailed enough to accommodate all fact patterns possible. If the fact-pattern does not fit the rules, there may be a tendency “to do what one wants”. (e.g. “where do the rules say this proposed accounting treatment is forbidden?”). The aim should be comparability of information. It needs to be acknowledged that a certain level of flexibility and inconsistency is acceptable, allowing for reasonable business and professional judgment. Different interpretations are possible for the same issue, as long as they are an acceptable answer to the application of the standards. The drive for consistency should be a drive to identify those alternatives that are not acceptable under the standards. There is a crucial role for enforcement in consistent application. The measures taken by CESR, including the European Enforcers’ Coordination Sessions (EECS) and a public database of enforcement decisions are recognised.

The SEC plans a review in 2006 of the IFRS 2005 financial statements and the reconciliation to US GAAP for SEC registrants. The review will be focused primarily on investor protection. It will be worthwhile considering the SEC’s approach to evaluating and achieving ‘consistent application’ (What degree of divergence in applying principles-based standards will be tolerated by the SEC?; Is there a risk that US interpretations are created that need to be followed in Europe).

International standards should be supported by international interpretations issued by IFRIC. Therefore, it would not be appropriate if organisations in the US were to provide US interpretations of IFRS; neither would it be appropriate if Europe would provide European interpretations. This would profoundly undermine the concept of global standards. A similar difficulty may arise for US

⁶ Press release 2005-62 SEC: Chairman Donaldson Meets with EU Internal Market Commissioner McCreevy.

⁷ Speech of SEC Commissioner Cynthia A. Glassman on SEC Initiatives Affecting Foreign Issuers, Copenhagen, 17 November 2005.

⁸ Appendix II sets out a series of questions that could be considered in this respect and were provided to the panellists in the FEE 1 December seminar on IFRS Convergence and Consistency.

interpretations of converged US GAAP standards that are identical or very similar to the relevant IFRS.

As part of the commitment to consistent application in Europe several measures are considered. In July 2005 the EFRAG Supervisory Board published a “Discussion Paper on Achieving Consistent Application of IFRS in the EU” to assess the need for more IFRIC interpretations and possible European interpretations. The discussions, including those in the Advisory Forum held by EFRAG on 21 September 2005, alluded to the need for some sort of coordination of European views and requests to support IFRIC in its work. There is no support for European interpretations. Commissioner McCreevy⁹ referred in his speech at the FEE 1 December seminar to an idea for an informal Roundtable involving representatives of all relevant stakeholders as a filtering mechanism. He made clear that the Roundtable will not make any interpretations.

⁹ Speech of Commissioner McCreevy, 1 December 2005 “EC Strategy on Financial Reporting: progress on convergence and consistency”.

3. WAY FORWARD

In the press release of 22 April 2005 on the agreement between the EC and the SEC on a “roadmap” toward equivalence between IFRS and US GAAP, Commissioner McCreevy called on standard setters, preparers, issuers, auditors and regulators to deliver the necessary convergence, consistency and enforcement required.

It needs to be decided what level of convergence is needed for mutual recognition without additional remedies such as reconciliation statement requirements. Identical standards are not needed as a pre-condition to arriving at the same economic decisions in similar situations. At the same time, the debate is taking place as to what, if anything, should be requested from foreign companies listed in Europe in order to continue their access to European capital markets. CESR has advised the Commission on possible implementing measures of the Transparency and Prospectuses Directives regarding equivalence of financial reporting standards in Canada, Japan and the US with IFRS (see section 3.3)¹⁰.

3.1. US views held

In the SEC staff statement¹¹, the then Chief Accountant Donald Nicolaisen stated: “When I speak of IFRS/US GAAP convergence, I do not expect the two sets of standards will necessarily produce totally identical financial statements. But I do consider it necessary that convergence result in close alignment of the accounting for the same or essentially the same transactions, generally comparable results in trends and a continued cooperative will to reduce differences over time, as well as the transparent understanding of any significant differences.”

This is confirmed in a more recent speech of SEC Commissioner Paul Atkins: “I am confident that the need for reconciliation will disappear as all of us gain experience with IFRS in practice. Because of differences in culture, legal systems, and especially liability regimes, true “equivalence” – however that term is defined – may be an illusory goal. Thus, I prefer to state our goal as one of mutual recognition. Investors need to know that published financial statements have integrity and have been prepared according to a set of high standards that are applied consistently. If investors know the standards under which the accounts are prepared, then they can make their own, informed investment judgement. We in the US are keenly aware that unnecessary reconciliation only imposes costs on investors on both sides of the Atlantic. For this reason, I am baffled at the suggestion by some that Europeans should begin to require US companies to reconcile their US GAAP financial statements to IFRS. This runs against the direction that we are taking in the United States and undermines our efforts towards mutual recognition. Some may assert that this is a useful bargaining chip to ensure that we Americans will recognise IFRS. But, I believe that it is counter-productive, ignores historical precedent and market practice, and diverts attention and energy from solving the real challenges

¹⁰ The CESR technical advice on equivalence of certain third country GAAP of June 2005 is carried out on the basis that investor’s decision should be unaffected by the use of different accounting standards when assessing their buy, hold, sell investment decision. By analysing and evaluating financial information based on third country GAAP, investors should be able to make similar decisions irrespective of whether they are provided with financial statements based on IFRS or not. It should be noted that CESR explicitly states in its advice that CESR’s assessment of equivalence is based on real world outcome of investor behaviour and is separate from other initiatives such as IASB convergence projects with the three countries considered.

¹¹ Statement by SEC Staff: A Securities Regulator Looks at Convergence, by Donald T. Nicolaisen, April 2005.

before us. IFRS will stand or fall on its own merits. Our efforts should be focused on making sure that it succeeds.”¹²

Ethiopia Tafara, Director, SEC Office of International Affairs¹³, set out at the FEE seminar of 1 December 2005, the milestones towards eliminating the US GAAP reconciliation. He underlined that IFRS differ from US GAAP in that it has little to no history of application and interpretation. In the “Roadmap” the SEC staff are asking for some time to assess the consistency and faithfulness of IFRS interpretation and application. It was made clear that the SEC does not expect full or even a finite degree of convergence before they will be willing to eliminate the reconciliation requirement. What is important for the SEC is that investors in the US be able to understand financial statements prepared under IFRS. However the SEC wishes to see a robust process for converging IFRS and US GAAP in place and active. It is fully realised that in the short term IFRS and US GAAP will not be the same. In his presentation Ethiopia Tafara referred to the underlying assumptions of the Roadmap¹⁴:

1. The overarching philosophy behind the development of IFRS remains the best interest of current and potential investors.
2. The standard setting process of the IASB be fully transparent: in finalising its standards the IASB should make clear what substantive views it has adopted, which it has rejected and why.
3. The IASB be an independent professional accounting standard setter: politically independent, not subject to undue funding pressures; and IASB members chosen on the basis of professional competence.
4. IFRS-US GAAP convergence to continue apace.
5. The current dialogue among financial regulators over IFRS development continues.

3.2. EC views held

Commissioner McCreevy emphasised in a speech on 18 October 2005 “IFRS, No pain, No Gain?” that not much will be gained by seeking short-term conflict: there is a need for durable, long-term solutions.

In a speech on 20 October 2005, Commissioner McCreevy referred to the agreement with the SEC:

“The convergence this will entail must be a two way street and it must not destabilise the IFRS platform in Europe. I would like to stress that convergence is not an invitation to standard setters to try and advance the theoretical frontiers of accounting. I will not take on board any revolutionary new standards. This should be a practical exercise, firmly anchored in business reality, to be undertaken in the interests of users and investors. The main objective is to try and narrow the differences between the existing standards, not to make accounts even more indigestible with a whole set of new standards!”

¹² Speech of SEC Commissioner Paul S. Atkins, Remarks before the European Parliamentary Financial Services Forum, Strasbourg, 26 October 2005.

¹³ Speech of Ethiopia Tafara , 1 December 2005 “Remarks before the Federation of European Accountants: International Financial Reporting Standards and the US Capital Market”.

¹⁴ Summarised in FEE summary document which forms part of the material on the FEE 1 December seminar. See for details the full text of the presentation as referred to in footnote 13.

The Commissioner¹⁵ indicated that the objective of the convergence process is to have an effective process up and running, which will reach a sufficient level of convergence within a reasonable timeframe. “We are not seeking to obtain an absolute level of convergence. This would be unrealistic and the end point would probably be somewhat near to infinity”. “Convergence is a tool, not an end in itself”.

The European Parliament has expressed its concerns about the calendar of the convergence process. Pervenche Berès mentioned on 1 December at the FEE seminar “I believe that the transitory period set up by the SEC Roadmap should be structured in order to minimise turbulence and disturbances aggravating the competitive position of European companies in the US capital market”.¹⁶

Commissioner McCreevy¹³ also announced in his presentation at the FEE 1 December 2005 seminar his personal intention to defer an equivalence decision and prolong the status quo, rather than taking a decision. “This option would align the equivalence agenda on both sides of the Atlantic and allow time for consolidating our experience of working with IFRS in practice”. This issue is still under discussion within the ARC¹⁷.

3.3. FEE proposals

FEE recognises the need for robust, high quality global financial reporting standards and supports the objective of creating a single set of global standards which, however, must ultimately be subordinate to the objective of preserving and improving the quality of principle-based IFRS financial reporting. IFRS already meets these conditions in our view, provided that they are properly applied. Given this, both US GAAP and IFRS can be considered as two equivalent high quality sets of standards. In our opinion an acceptable minimum level of convergence has been reached and a planned programme for short term and long term convergence can soon be put in place to authorise mutual recognition of both sets of standards, without a continued need for reconciliation statements or other forms of disclosure. This is also the way forward FEE has suggested to CESR, allowing foreign companies to list in Europe without having to provide remedies in the form of additional disclosures, with a sunset clause to review the equivalence assessment to ensure that the GAAP concerned has sufficiently converged¹⁸.

Nevertheless there should be strong support for further convergence activities in order to reduce the remaining principal differences between the two sets of standards. These activities should include thorough discussion of the conceptual frameworks and an alignment of both frameworks as a basis for the further revision and development of standards.

At present there is a need for a stable platform of standards, while recognising that justified changes need still to be made. Effective dates for implementation need to be carefully considered. The pause on new standards and amendments to standards could be used for fundamental deliberations on the Conceptual Framework.

¹⁵ Speech of Commissioner McCreevy, 1 December 2005 “EC Strategy on Financial Reporting: progress on convergence and consistency”.

¹⁶ Speech of Pervenche Berès, Chair of the Economic and Monetary Affairs Committee, 1 December 2005 “The need for better involvement of the EU in the IFRS process”.

¹⁷ ARC: European Commission Accounting Regulatory Committee of the Member States.

¹⁸ CESR’s advice to the EC of June 2005 on equivalence of US GAAP, Japanese GAAP and Canadian GAAP with IFRS is that these countries’ GAAPs, each taken as a whole, are equivalent to IFRS with certain exceptions where remedies need to be put in place at company level.

It would be helpful to carry out research on the reconciliation statements of the European companies quoted in the US, to analyse the remaining differences between IFRS and US GAAP as at 31 December 2005.

The convergence process must be transparent, with input from all stakeholders. The speed of change as well as the radical nature of changes to standards should be carefully considered, given the danger that it could undermine widespread support for the convergence process. It might be desirable, for example, to obtain evidence by regular surveys and polls of the support for convergence, its direction and pace. The IASB should arrange for extensive public consultation and debate on its work programme. European interests should arrange for appropriate substantive input to the IASB work programme either directly or through discussion with the SAC¹⁹. Europe should be able to support the converged standards which are the result of the convergence process and the basis for a mutual recognition agreement. Serious attention should be given to the European demand to start with a discussion on the revision of the Conceptual Framework rather than risk creating new radical standards which tend to deviate from the existing Framework.

¹⁹ SAC: IASCF Standards Advisory Council.

APPENDIX I: MAIN QUESTIONS RAISED IN RELATION TO CONVERGENCE DURING THE FEE SEMINAR OF 1 DECEMBER 2005

I: What does convergence mean and how to ensure the success of convergence?

- Does convergence mean identical?
- What is sufficient convergence in the short term? What should the long-term objective be?
- Can there be sufficient convergence between two different systems, the IFRS principles-based system and the US rule-based system?
- How might both traditions be consistently accommodated within principle-based standards?
- How to ensure the success of convergence in Europe and in the US?
- What level of, and momentum towards, convergence is sufficient for mutual recognition of IFRS and US GAAP without requiring additional remedies?
- The benefits of global standards and therefore convergence beyond dropping the reconciliation statements on other remedies between IFRS and US GAAP.

II: Since the signing of the “Norwalk Agreement” in 2002 between the IASB and FASB there is a joint convergence agenda which largely drives the total IASB work programme.

How can it be ensured that convergence is positive for all parties involved and the impact in the IASB work programme is favourable to all?

- What is the right perspective of short-term convergence?
- Does global convergence leave sufficient room for a stable platform of IFRS in Europe to give preparers, auditors and users time to adapt to IFRS in the transitional period?
- Is convergence the proper main driver for the IASB work programme: Does it lead to the right prioritising?
- Is there sufficient due process and involvement of all stakeholders around the convergence process and notably in the IASB work programme?
- What is the best use of the current opportunity to obtain substantial convergence between IFRS and US standards?
- Might there be unintended consequences of convergence and if so, how can they be solved? (Speed and apparent radicalism of some changes in standards; complexity of standards implementation costs etc.)
- What are the convergence and other priorities for IASB in the period to 2007 and beyond?
- How should the availability of options under current IFRS be appreciated?
- How might the European examination of equivalence between IFRS and US GAAP influence the debate?
- Will truly global standards ever evolve and, at what level of detail? If a single set of standards is the aim, will governments agree not to act unilaterally, even in a future crisis or scandal, and be prepared to await the outcomes of the global standard setting due process?

III: What is a sufficiently robust convergence process acceptable to all stakeholders?

- How similar should standards be to be regarded convergent?
 - Close alignment of the accounting for the same transactions
 - Comparable results
 - Transparent understanding of differences
 - Options in standards?
 - Impact of disclosure
- Need for a widely accepted Conceptual Framework:
 - Does the existing Framework need to be revisited?
 - Identical framework or largely the same principles.
- Need for a widely accepted agreed timetable:
 - On what basis is 2007 attainable?
 - Larger issues need a more gradual timetable.
 - What level of proof would be necessary?
- A fully transparent process needs to be demonstrated, with early sounding of ideas in case of substantial changes:
 - Field testing
 - Discussion papers before issuing exposure drafts

IV: How can one secure widespread understanding and support of the convergence process?

- The benefits of consistent global standards
- What are the positive messages that should be strongly conveyed?
- How can the currently perceived problems and some negative reactions be addressed fairly?
- Convergence / mutual recognition– a global opportunity?
- The role of accounting standard setters versus enforcement bodies.

APPENDIX II: MAIN QUESTIONS RAISED IN RELATION TO CONSISTENT APPLICATION DURING THE FEE SEMINAR OF 1 DECEMBER 2005

I: What does consistent application mean?

- “Consistency” is a potentially misleading word.
- Does consistency mean identical?
- Does consistency mean “acceptable by reference to the standards and therefore within the boundaries of IFRS”?
- Does consistency leave room for professional judgement: Can the same type of transaction be treated in different ways by different preparers, reflecting variations in their circumstances and their business purposes of the transaction?
- Will the use of alternative performance measures risk causing confusion to users and others, despite CESR’s recommendation²⁰?

II: The entire financial reporting chain has to play a role in consistent application of IFRS and each of the participants involved has to assume its responsibility:

1. CFOs and management
2. Audit committees and boards
3. Audit firms
4. Investors
5. Investment banks
6. Credit and investor analysts
7. Regulators (as well as enforcement actions)
8. Industry associations
9. Courts

Both auditors and regulators have a role external to the companies in ensuring consistent application of IFRS in specific cases. In some jurisdictions the regulators offer “pre-clearance” facilities.

(a) Do all participants in the entire financial reporting chain assume their responsibilities concerning consistent application?

- Are all participants in the reporting chain sufficiently aware of their responsibilities?
- Do they have the necessary IFRS knowledge and experience in practice?
- How can enforcement decision database-information be disseminated to all interested parties?
- Would case law be universally applicable?

(b) How important is the pre-clearance facility for consistent application of IFRS?

- Does it risk impairing the principles-based approach?
- Advantages, disadvantages, risk and benefits of pre-clearance
- How to achieve that IFRIC is the only body to provide international authoritative interpretations?
- Is there a possible need for national (country) interpretations and if so, under which conditions?
- If pre-clearance is offered to individual preparers, how is consistency to be achieved within a country and cross border as well as transparency to other market participants?

²⁰ CESR Recommendation on Alternative Performance Measures, October 2005.

III: Enforcement

(a): CESR has set up a coordination mechanism (EECS – European Enforcers’ Coordination Sessions) which groups together all European enforcement bodies, also those not being a member of CESR to coordinate enforcers’ decisions throughout Europe. The EECS meetings are focused on discussing decisions taken or to be taken by local enforcers and giving input and feedback to those enforcers in specific cases in order to achieve consistency of enforcement decisions of European Enforcers on (IFRS) financial statements. CESR is maintaining a database of enforcement decisions, including ex ante and ex post decisions.

Can enforcement guarantee consistent application?

- Are all regulators in the EU of the same view on particular positions?
- What are the plans and procedures of CESR and others?
- Will the database suffice?
- Do enforcement decisions risk to become interpretations?
- Transparency of enforcement decisions?

(b) The SEC plans a review of the IFRS 2005 and 2006 financial statements and the reconciliation to US GAAP for SEC registrants. The review will be focused primarily on investor protection. “Application of IFRSs in a manner that is faithful to the standards and consistent across companies will help expedite the SEC staff’s decision to recommend to the Commission the elimination of the required reconciliation from IFRSs to US GAAP.”²¹

How should the SEC condition of faithfulness and consistency be interpreted?

- What are the conditions for achieving consistent application?
- Might it in practice impair the principles-based approach by restricting the range of acceptable judgments within IFRS?
- How might this impact on European preparers, regulators and auditors?
- Might US interpretations, de facto need to be followed in Europe, and not only by European SEC registrants?
- Would consistency across companies be achievable? And if so would it be desirable?

²¹ Statement Donald T. Nicolaisen of 26 April 2005, A securities Regulator looks at convergence.

