

INTERNATIONAL ACCOUNTING STANDARDS

Summary: There is currently a mixture across EU Member States of acceptable accounting standards. Existing EU Directives have not so far succeeded in creating a harmonized set of accounting rules. Such harmonized rules are needed to create open, transparent European markets. Europe will benefit in terms of lowering the cost of capital. The European Commission proposal to adopt IASC standards is an important step towards this goal.

INTRODUCTION

The importance of International Accounting Standards (IAS) has been highlighted over the last few weeks by specific references in both the Wise Men's interim report and the 3rd progress review of the Financial Services Action Plan:

- "Accounting rules are not yet harmonised. More information on EU companies is often available in the US than in Europe". (Wise Men p.16)
- "The Committee's priorities include, creating open, transparent European Markets; encouraging the use of international accounting standards for all listed companies". (Wise Men p.23)

In the Commission's list of ten priorities for the next six months a "legislative follow up to the EU Accounting Strategy Communication" is shown as the second most important item (p.8 3rd Progress Report).

A 1995 Communication proposed Member States allow the production of consolidated accounts in accordance with IAS. There is currently a mixture across Member States of what is acceptable - IAS, US GAAP (Generally Agreed Accounting Principles) and national rules based on the EU Directives 4th and 7th Company Law 78/660/EEC and 83/349/EEC. The Directives do not cover all issues so that Member States can adopt different approaches on those aspects where the Directives are silent. This results in de facto different regimes being in place across the EU.

The issue of accounting standards will undoubtedly come before the European Parliament before too long. *It is not merely concerned with accounting technicalities but will help create investment across the EU.*

NATURE OF THE ISSUE

The prize to be gained from the international harmonisation of financial reporting is the lowering of the cost of capital. In its turn this will enable companies to invest more so generating increased employment and wider prosperity throughout Europe.

Capital is employed with reference to the expected return for a given risk taken. The more information available about the nature of the risk the better it can be priced. Where uncertainty exists because of a lack of clarity over risks then a premium will be built into the price so increasing the cost of capital to companies which limits their ability to expand their businesses. The greater the transparency the lower the cost of capital.

In countries with financial reporting regimes which allow for obfuscation the cost of capital will be higher. If companies domiciled there wish to raise cheaper funds internationally they will have to produce financial information which is internationally acceptable which adds to costs and could cause delay.

For Europe to create an efficient, deep and liquid securities market it must be underpinned by financial reporting of the highest quality with common standards shared by all.

There are historical reasons for the disparity in accounting standards. In those countries where the majority of shareholdings were in the hands of a few entities such as Government, pension funds and banks, the need for public disclosure was limited because these entities had direct access to the details they required.

Where however there was a tradition of dispersed ownership the need for better information to be made publicly available was more acute.

However, as wider share ownership has increased across Europe, for example with privatisations, shareholder protection has risen up the agenda and changes have been made.

WHAT NEEDS TO BE DONE

The comparability of companies performance across national boundaries needs to be improved if we are to have a single capital market.

There are internationally agreed core standards and the recent debate has centred around whether all countries should follow US GAAP or adopt IASC (International Accounting Standards Committee) standards.

Following US standards would have been to abdicate to an agenda driven by US domestic political imperatives which would have been a far from attractive option.

Instead the EU proposal is to adopt IASC standards. These will be approved by a technical process aimed at producing the highest standards not just what is easily acceptable to all. The adoption of IASC standards by the EU is however subject to a two stage validation process.

First the endorsement of technical standards and second their political acceptability. The stated aim is however to limit changes to the absolute minimum.

WHERE ARE WE NOW

A Communication was issued in June this year and the 3rd review of the FSAP anticipates a legislative proposal that listed companies report financial statements in accordance with International Accounting Standards will be produced before the end of this year.

The longer term aim is to have a directive in place before 2005. The Commission has just adopted the draft legislative proposal.

Briefing notes are prepared by the Industry Advisory Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, members or Secretariat of the Advisory Committee.

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