

## SUMMARY RECORD

MEETING OF  
**THE ACCOUNTING REGULATORY COMMITTEE**  
**OF 3 FEBRUARY 2004**

M. David Wright, Director at the Internal Market DG, European Commission, chaired the sixth meeting of the Accounting Regulatory Committee ("ARC"). An implementing measure featured on the agenda of this meeting.

### **IMPLEMENTING MEASURE**

**Proposal for a Commission Regulation adopting IFRS 1 *First time Adoption of International Financial Reporting Standards* in accordance with Regulation (EC) N° 1606/2002 of the European Parliament and of the Council**

The Accounting Regulatory Committee voted unanimously in favour of the draft Commission Regulation proposing the endorsement of **IFRS 1 *First time Adoption of International Financial Reporting Standards*** .

The Chairman underlined the importance of the new standard, which will replace SIC 8 *First time application of IASs*, adopted by the Commission on 29 September 2003. IFRS1 supersedes SIC 8 Interpretation that required first-time adopters of IAS to carry out lengthy and cumbersome accounting retreatments as if the companies had always been under IAS. IFRS 1 represents marked progress for listed companies, which will be applying international accounting standards for the first time for the preparation of their consolidated financial statements from 1 January 2005 onwards.

The Chairman opened the floor for comments or statements. Member States expressed unanimous support of the Commission's proposal.

The Chairman welcomed the decision of the members of the ARC. The Chairman explained that the formal adoption of the Commission proposal was planned for the end of March and publication of the new standard in the Official Journal before June.

### **OTHER AGENDA POINTS**

#### **Agenda point 1 - Approval of the minutes of the previous ARC**

The minutes (ARC/2003-11-21/5) of the ARC meeting of 21 November 2003 were adopted.

#### **Agenda point 2 –Presentation by EFRAG of the provisional final standards of the Improvements Project**

The Chairman invited M. Van Helleman, Chairman of the Technical Expert Group of the EFRAG (the "European Financial Reporting Advisory Group") to provide an overview of the provisional final standards of the Improvements Project. The Improvements Project affects thirteen of the existing thirty four International Accounting Standards and

aims at convergence with US GAAP and the elimination of options. The new standards were released by the IASB on 17 December 2003 and are part of the stable platform of standards to be applied from 1 January 2005 onwards. The Chairman of EFRAG's TEG gave a general overview of the major changes. EFRAG supports the Improvement Project and has recently released its draft endorsement letter on its homepage for discussion.

A discussion took place about specific issues regarding the choice of the presentation currency by companies (IAS 21), the impact of IAS 27 on venture capital firms and the implication of IAS 10 (Events after the balance sheet date) for the accounting treatment of dividends.

### **Agenda point 3- IASB Governance and strengthening of EFRAG**

#### **Strengthening of EFRAG**

The Chairman invited M. Göran Tidström, Chairman of the Supervisory Board of EFRAG to provide an overview of the envisaged reform of EFRAG. Mr. Tidström recalled that the proposed reform had been subject to a public hearing held in Brussels at the beginning of January 2004 and had attracted around 50 comment letters.

Mr. Tidström outlined the main axes of the reform of EFRAG:

1. Expansion of the role of the **Supervisory Board** but not beyond that usually assigned to trustees. The Supervisory Board will in no case interfere in the decision making process of the Technical Expert Group (TEG) of EFRAG.
2. Establishment of an **Advisory Forum** with the objective of providing assessments of the economic impact of IAS in the EU.
3. Intensified **cooperation with National Standard Setters** and the IASB. To facilitate this, the Chairmen of three National Standard Setters will act as permanent observers at Technical Expert Group of EFRAG. EFRAG is already treated by the IASB like a Liaison Standard Setter and has access to working papers. Göran Tidström indicated that a formal recognition of EFRAG as the technical adviser of the Commission was under discussion.
4. Increase of **human resources and funding**. A full-time Chairman is to be appointed from 31 March for the Technical Expert Group of EFRAG. TEG members are expected to increase their availability for TEG work. Ad hoc committees will be established as necessary. More support is also expected from the audit profession in terms of secondment of project managers. Possibilities to better ensure EFRAG's financial independence are under discussion (Community contribution, levy on listed companies).
5. The **decision process** of the Technical Expert Group of EFRAG may be amended to allow for the publication of dissenting views. The voting procedure is under review and the Supervisory Board is considering a potential change from qualified majority to simple majority in respect of negative endorsement advice.

The Chairman of the ARC thanked Mr. Tidström for his presentation and opened the floor for comments.

Member States were appreciative of the work performed by EFRAG, supportive of the reform proposed and called for its rapid implementation.

Concerns were expressed by some Member States about the complexity of EFRAG's new structure and the consequent risk of bureaucracy and duplication of work. A debate took place, in respect of the future Advisory Forum, on the need and merits for EFRAG to carry out economic impact assessments. Whilst some Member States were of the opinion that such analyses would provide the ARC with useful additional information for the endorsement process, some other Member States considered that EFRAG's resources were too limited to allow it to provide sophisticated economic work. For the latter, EFRAG should focus mainly on technical issues, whilst it is up to Member States in the ARC to evaluate new standards in the light of the public good criteria. Two Member States called for earlier consultations between EFRAG and the ARC. Another Member State said that it was difficult to draw a clear distinction between technical and political issues even in technical matters like accounting standard setting. European regulators pleaded for simple organisational structures and for EFRAG to remain focussed on technical issues. Some regulators expressed their interest in being associated to the work of the Advisory Forum.

The request for formal recognition of EFRAG by the European Commission was generally supported. There was also broad agreement on the need to strengthen EFRAG's financial resources but the ARC had no detailed discussions on the way forward. Whilst one Member State was favourable to a public-private funding of EFRAG, another Member State opposed to imposing a levy on listed companies, considering that unlisted companies may in the future apply International Financial Reporting Standards as well.

With regard to a possible change in the voting procedure for a negative endorsement advice, opinions were divergent. Two Member States opposed the idea of changing the procedure, whilst two other Members expressed the view that the vote itself was not as important as the underlying analysis of the views expressed. This view was shared by the regulators.

The Chairman concluded the discussions by stating that there was a need to move forward with the reform of EFRAG. The Chairman indicated that there was a consensus amongst Member States about the need for: (i) the new structure of EFRAG to avoid bureaucratic complexity and proliferation of committees, (ii) a formalisation of the relationship between the Commission and EFRAG, (iii) a strengthening of the financial independence of EFRAG, (iv) EFRAG to become a "breeding ground" for identifying outstanding European candidates for the IASB and (v) more transparency in the work planning of EFRAG. The Chairman noted that there were nuances, if not disagreement, about EFRAG carrying out economic impact assessments. The Chairman said that in the future, the impact assessment of standards should be performed by the IASB as part of its "due process", but that in the meantime, it was important for the ARC to benefit from all relevant information to make its decision on endorsement. EFRAG's Advisory Forum could be of help, provided a distinction is established between fact finding and political appraisal. The Chairman added that the involvement of regulators in the Advisory Forum was appropriate to avoid duplication in carrying out economic analyses.

### **IASB Governance**

The Chairman indicated that the Board of Trustees of the IASC Foundation was currently reviewing the Constitution of the IASB and had launched a public invitation to answer and comment a questionnaire aimed at “identifying issues for the IASC Foundation Constitution Review”. The Chairman confirmed that it was the Commission’s intention to submit by 11 February 2004 a joint contribution of the Commission and of the ARC, adding that a draft paper had been circulated to the Member States to this end. The Chairman regretted that the letter of Commissioner Bolkestein inviting Ministers of Finance to identify high calibre European candidates for future vacancies at the IASCF and at the IASB had attracted so few responses. Urgent action was needed from Member States.

The Chairman invited a Commission representative to present the main thrust of the position of the European Commission. Four key objectives were identified:

- (1) The need for a more balanced European representation on the IAS Board and relaxation of the job specifications to fulfil to become a Board member.
- (2) The need to reform the Standards Advisory Council to become a sounding board for the IASB. This implies that the Chairman of the IASB cannot hold at the same time the Chair of the SAC.
- (3) The need for the IASB to provide robust economic analyses on the likely impact of IAS.
- (4) The need to reform the IASB’s “due process” to bring about transparency and remedy the general perception of a lack of good governance and communication between the IASB and interested parties.

The Chairman opened the floor for comments.

Member States were supportive of the objectives outlined by the Commission as well as of the draft responses to the questionnaire of the IASC Foundation, notably regarding the need to reform the SAC and improve the IASB’s due process. Some nuances emerged in respect of the composition of the Board as to the pre-eminence of competence criterion over the geographic one and the added value of part-time vs. full-time Board members. A few Member States advocated caution in respect of the conduct of economic impact assessments by the IASB, noting in particular that the beneficial component of a standard is often more difficult to appraise than its cost which could lead to improper interpretations. Some other Member States considered that the practical applicability of standards should be an important part of any impact assessment.

The Chairman concluded that the composition of the IAS Board should reflect a larger European presence in the future (though not necessarily on the basis of geographical quotas), that this required finding top class European people and more flexibility in the job specifications of Board members. The Chairman said that the Board should also include people with more practical experience and that the recourse to some more part-time Board members may help in this respect. The Chairman added that the SAC should become more dynamic, more independent, have a broader remit and act as a real sounding board for the IASB. The Chairman stressed that economic impact analyses should be reasonable and proportionate and should enlighten the IASB’s decision process by providing it with factual information.

The Chairman thanked the Member States for the broad support of the Commissions paper that would be revised and circulated to ARC members for approval before being communicated to the IASC Foundation as a joint contribution of the Commission and of Member States through the ARC.

#### **Agenda point 4 – IAS 32 and IAS 39 – State of play**

The Chairman presented the latest state of play, notably the outcome of a dinner hosted on 19 January by Commissioner Bolkestein gathering representatives from the IASB, the banking industry, the Basel Committee, CESR, CEIOPS and the ECB with a view to facilitate the emergence of a solution on IAS 32 and 39. Five key issues were identified.

1. “Macro-hedging”
2. “Core deposits”
3. Application of the “Fair Value Option”
4. Treatment of co-operative shares as liabilities
5. Measurement Mismatch in the insurance industry

Participants at the dinner had agreed to the creation of a High Level Consultative Group to meet on 16 February for the first time. The mandate of the group was (i) to assess which outstanding issues could be solved before March, how and which issues required more work and time and should therefore be isolated from the standard to be published in March and parked for further work, (ii) to carry out the necessary work to design the solutions achievable by March, taking advantage of the bilateral contacts already initiated by the IASB with a number of interested parties and (iii) to determine a timetable (short term and long term) for the work on issues that clearly cannot be solved by March and begin work on these issues. Commissioner Bolkestein reported on the outcome of that meeting to the ECOFIN Council of 20 January 2004.

Member States thanked the Commission for its efforts to find a consensual outcome, but concerns were also expressed with regard to the seriousness of the present situation on IAS 39. The Chairman said that a possible failure and its downside were a source of major concern, adding however that the Commission was looking at all the options and working closely with the IASB. One Member State insisted on the imperative need for further discussions to be carried out between the IASB, industry and all other interested parties.

#### **Agenda point 5 – Miscellaneous**

A representative of the ECB presented the results of a study it has performed on the impact of fair value accounting on the European banking sector in a financial stability perspective. The study involves comparing the current accounting approach, comprising historical costs and mark to market evaluation, with a Full Fair Value Accounting (“FFVA”) scenario. The study examines the effects on the financial stability of an hypothetical bank under different accounting regimes of four stress scenarii (deterioration in credit quality, unexpected changes in interest rates, real estate crisis, sharp adjustment in equity prices).

According to the study, the positive effects of FFVA are that it leads to the recognition at market value of derivatives in the balance sheet; it decreases the incentive for cherry-picking and makes it possible to recognize quite early the deteriorating of asset quality.

The downsides of FFVA are that it can increase volatility in the balance sheet and profit and loss account because of a pro-cyclicality effect and that it is not consistent with current risk management practices of banks. The ECB suggests in its study to disclose fair value information in the notes rather than on balance sheet and to limit the use of FFVA to cases where markets are sufficiently developed for market values to be relevant.

The Chairman opened the floor for comments. A range of views were expressed by Member States about the study and the methodology used. Some Member States had difficulties with the terminology used (full fair value vs. fair value) or the model, considering that modelling IAS 39 would be more relevant than modelling full fair value.

The representative of the ECB noted that the assumptions and the result of the survey were widely accepted by the banking regulators. In respect of a bank, the introduction of FFVA would affect about 95 % of the balance sheet items, both on the asset side and the liability side. He concluded that more research work must be conducted in the future.

The Chairman thanked the ECB representative for an interesting presentation.

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The Chairman announced that the next ARC meeting would take place on 30 April.

**ACCOUNTING REGULATORY COMMITTEE**

**Meeting of 3 February 2004**

**PARTICIPANTS' LIST**

**Austria**

**Bundesministerium für Justiz**

**Finanzministerium**

**Finanzmarktaufsicht**

**Belgium**

**Commission des Normes Comptables**

**Ministère des Affaires Economiques**

**Denmark**

**Danish Financial Supervisory Authority**

**Danish Commerce and Companies Agency**

**Finland**

**Ministry of Transport & Communication**

**Ministry of Finance**

**France**

**Conseil National de la Comptabilité**

**Ministère de l'Economie, des Finances et de l'Industrie (Trésor)**

**Germany**

**Bundesministerium der Justiz**

**Bundesministerium für Wirtschaft und Arbeit**

**Greece**

**Ministry of Economy and Finance**

**S.O.E.L**

**Ireland**

**Institute of Chartered Accounts in Ireland**

**Enterprise, Trade and Employment**

**Italy**

**CONSOB**

**ISVAP**

**Ministry of Economy and Finance**

**Banca d'Italia**

**Luxembourg**

**Commission de Surveillance du Secteur Financier**

**Netherlands**

**Ministerie van Justitie**

**Portugal**

**CMVM**

**CNC**

**Spain**

**Banco de España**

**ICAC**

**Ministeria de Economia**

**Sweden**

**Ministry of Justice**

**United Kingdom**

**Department of Trade and Industry**

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**Ministry of Finance**

### **Estonia**

**Ministry of Finance**

### **Hungary**

**Financial Supervisory Authority**

**Ministry of Finance**

### **Latvia**

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### **Poland**

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### **Slovakia**

**Ministry of Finance**

### **Slovenia**

**Slovenian Institute of Auditors**

### **Iceland**

**Ministry of Finance**

### **Norway**

**Kredittisynet**

**European Central Bank (ECB)**

**Banking Advisory Committee (BAC)**

**Committee of European Securities Regulatory (CESR)**

**Committee of European Insurance and Occupational Pensions  
Supervisors (CEIOPS)**

**European Financial Reporting Advisory Group (EFRAG)**

**Commission**

**David Wright, Chairman of the ARC**

**Karel Van Hulle, Head of Unit "Accounting & Auditing"**

**Philippe Pellé, Secretary to the ARC**

**Mikael Lindroos**

**Thomas Scholz**

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