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**POLICY STATEMENT ON EU ENDORSEMENT AND ENFORCEMENT OF
INTERNATIONAL ACCOUNTING STANDARDS**

A policy statement issued in August 2000 by the Institute of Chartered Accountants in England and Wales on the endorsement and enforcement of international accounting standards.

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Introduction

A communication issued by the European Commission on 13 June proposes that listed companies will be required to use international accounting standards (IASs) rather than national GAAP in their consolidated accounts from 2005 onwards and an endorsement mechanism will be introduced to provide legal status for IASs within Europe. Endorsement will comprise a two tier mechanism, with a political and a technical level. The communication also proposes the development of an enforcement structure to ensure rigorous application of IASs, including the establishment of benchmarks for auditing and a common approach by securities market regulators.

The note that follows sets out the Institute's position in relation to some of the key endorsement and enforcement issues that arise from the communication.

ENDORSEMENT

- **It is important to establish the legitimacy of international accounting standards for use by listed companies within Europe.**

To ensure support for the use of IASs and their proper application, it will be necessary to provide legal backing to rules set by a body in which EU governments do not have an explicit role. The proposed EU mechanism should address questions such as:

- Has the standard been developed having regard to the IASC Framework and business practice within Europe?
- Has the IASC's due process been followed with regard to views expressed by EU respondents and national standard setting bodies?
- Does the standard include an adequate explanation of the basis for its conclusions?

A review of this nature will help to make accounting standards that are developed globally work in individual EU countries.

- **The IASC has a major role to play in ensuring that there is adequate consultation, both in Europe and elsewhere, when international accounting standards are developed.**

The IASC's own actions in consulting on a global basis, setting appropriate timetables for discussion, comment and implementation, and achieving transparency in its decision-making processes will all have a major bearing on the perceived legitimacy of IASs in Europe and the extent of activity of an endorsement mechanism.

- **The endorsement mechanism should provide input to the development of international accounting standards at an early stage.**

Experience in the UK shows that legitimacy of accounting standards is greatly enhanced by effective early consultation. If Europe is to have effective pre-

endorsement involvement in the development of IASs, sufficient resources will be required to ensure that technical input of a high quality can be provided within the necessary timetable. This approach has been used to enable the ASB to be a strong participant in the development of IASs. Other national standard setting bodies also have processes in place to provide such input. Without a similar commitment, input from the endorsement mechanism is unlikely to be effective.

The endorsement mechanism could also play a practical role in recommending future IASC projects or the review of existing pronouncements. For example, it might suggest a review of the IASC Framework for the preparation and presentation of financial statements, since this might be one of the first documents requiring endorsement.

- **The technical level of the endorsement mechanism should comprise a small group of individuals, selected primarily on their technical ability, but with access to a wider consultative panel.**

To achieve legitimacy, the endorsement mechanism needs to be able to act reasonably quickly, whilst commanding the respect of its principal constituencies. This could be achieved by limiting the technical level to a small group, whose members would be chosen primarily on the basis of their technical expertise in financial reporting by EU listed companies.

Members of this technical group should be appointed by the political level of the endorsement mechanism, following a call for nominations from governments, standard setting bodies and the accountancy profession. Nominations should include preparers, auditors, users and standard setters with appropriate expertise. We would expect the UK to play a full role in the technical group. The technical group would also have access to a wider consultative panel on which national accounting groups and other organisations are represented but there should be no obligation to adopt the views of the panel.

- **European support for international accounting standards should be presumed. Whilst the endorsement mechanism should identify areas where additional guidance would be helpful, it should not issue interpretations of international accounting standards.**

Ideally, the endorsement mechanism should undertake a one-off exercise that addresses the whole process of setting IASs. This would be consistent with the fact that an assertion regarding compliance with IASs requires compliance with each applicable standard and interpretation.

We recognise that Europe may not be ready to adopt endorsement of the process and that a separate review of standards on individual topics may be necessary. However, a layer of EU or national rules within Europe must be avoided as this would undermine the credibility of IASs. It would also abrade the benefits of global standards to listed companies and the EU economy. It is therefore important that the endorsement mechanism should require a large majority to carry a vote against an individual standard. There should be a

simple vote in relation to the whole standard; the possibility of modifying part of it should not be an option.

The endorsement of IASs for application in the EU should be directed towards confirming that there are no fundamental reasons not to adopt the standard. We cannot envisage any reason to reject an IAS unless the IASC had failed to follow due process.

Where the endorsement mechanism identifies issues that are not adequately addressed in IASs or that require interpretations to ensure consistent application in the EU, the need for guidance should be communicated to the IASC. Such requests may include a suggested solution but the endorsement mechanism is not a standard setter and should not issue its own interpretations.

- **The endorsement mechanism should provide a channel for making recommendations to the European Commission in respect of any issues where changes in EC directives are needed.**

The mechanism should check whether an IAS has been compared with the EC directives. If necessary, appropriate changes to the directives should be recommended. Incompatibilities are less likely to arise if the directives are confined to high level principles and disclosure, leaving detailed recognition, measurement and disclosure issues to be dealt with in IASs. As we stated in our July 2000 response to the consultation document from the UK Company Law Review Steering Group, we believe that accounting directives should allow formats, accounting principles and valuation rules to be dealt with as far as possible by standard setting bodies.

ENFORCEMENT

- **A global enforcement system should be the ultimate objective but, in the short term, steps should be taken to establish uniform enforcement of international accounting standards across Europe.**

The effectiveness of IASs depends on uniform enforcement, so as to prevent companies seeking to benefit from arbitrage where national enforcement systems or rulings differ. The EC should therefore engage in international discussion that could lead to a global enforcement system. This would need to involve the US SEC although the responsibility for global enforcement could eventually be placed with IOSCO.

In seeking to secure a global solution, the EC should take full advantage of the longer lead time that exists for establishing an enforcement regime compared with that available for setting up an endorsement mechanism.

In the absence of a global solution, enforcement of IASs in Europe should be the responsibility of member states, with an overarching EU body to review the rulings that are made. Such a body would need international legitimacy and any case that fell within the jurisdiction of national enforcement authorities would need to meet defined criteria before being considered by an EU body. Ideally, there should be a requirement for national enforcement authorities to consult with their equivalents in other countries.

- **Enforcement should preferably be based on a referrals procedure rather than offering pre-clearance on the acceptability of a proposed accounting treatment.**

At present, we believe that the UK has a most credible enforcement mechanism, operated through the Financial Reporting Review Panel, which is concerned with enforcing the application of UK law and accounting standards by listed companies. The Panel acts on the basis of referrals and matters attracting public comment. We believe that the UK procedures merit wider examination.

We recognise that there might be occasions, particularly in the case of new listings, when guidance would be helpful on the compatibility of a proposed accounting treatment with the requirements of the law and relevant accounting standards. However, we believe that it would be undesirable for the enforcement agency to provide any form of pre-clearance. This would dilute and even undermine the perceived responsibilities of directors and auditors, as well as encroaching on the standard setter's role by effectively allowing the enforcement agency to issue interpretations of accounting standards.

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