

TRANSCRIPT

FEE Seminar IFRS Convergence and Consistency

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Panel Discussion: Consistent Application of IFRS

- **What is the meaning of consistency?**
- **What are the conditions for achieving consistent application?**
- **What are the limitations and benefits of preclearance**
- **What is the role of enforcement?**

Panel Chairman: Pierre Delsaux, European Commission, Acting Director, DG Internal Market

Panel:

<i>Paul Ebling</i>	<i>EFRAG, Technical Director</i>
<i>Gilbert Gélard</i>	<i>IASB, Member</i>
<i>Philippe Danjou</i>	<i>CESR-Fin, Chairman CESR-Fin Audit Task Force</i>
<i>Mark Vaessen</i>	<i>Head KPMG IFRS Desk</i>
<i>Bill Knight</i>	<i>UK FRRP, Chairman</i>

Pierre Delsaux: The theme of this afternoon is a very important one, the questions of consistent application of IFRS. As you know, it's a fundamental issue because we want IFRS to be applied in a consistent manner everywhere in the Community. Let's be clear, consistent application does not mean having European interpretations. What we want is just to be sure that any application implementation and enforcement are consistent. It's not to substitute existing systems of IASB IFRIC interpretations by a European system.

As a Commission, we have some ideas on these questions. The Commissioner this morning has already highlighted of these ideas but before I move to the Commission's ideas I believe it is always important to listen to all stakeholders and I would like to start by giving the floor to Paul Ebling, EFRAG Technical Director, who I am sure will give a lot of useful explanations of this topic.

Paul Ebling: EFRAG, Technical Director

[NOT EDITED BY SPEAKER]

Perhaps I should start off by explaining that as EFRAG Technical Director, I was what you would call the principal author on the EFRAG paper that was issued in the summer on consistent application of standards. That paper talked a lot about what needs to be done to achieve consistent application of standards but I'll be the first to admit that it didn't really discuss in any great detail what we meant by consistent application. So for that reason I think this session is really well timed.

Perhaps I could start off by making a few statements of the obvious. Financial reporting frameworks can either be principle-based or rules-based. They can either be written at a very high level i.e. with relatively little detail or with lots of detail. The type of financial reporting framework you have, of course, has an impact on the type of accounts you get as a result.

In my view, and I think in the view of many, many people, high level principle-based financial reporting frameworks are the best sort of frameworks. They result in higher quality financial statements but what they also do, and I think we need to understand and admit it and work with it, is that generally speaking, the financial statements that are prepared under those high level principle-based frameworks will not be as consistent as financial statements that are prepared under more detailed frameworks.

The old IASC standards were high level principle-based standards and although the IASB's new standards are much more detailed, I don't think it's stretching the truth to say that they continue to be high level principle-based standards. Europe decided a number of years ago that it wanted its listed companies to prepare their consolidated accounts using international standards. That was a considered decision. It wasn't a decision taken rashly and it meant that at that time Europe was comfortable with the level of inconsistency that is implicit in applying high level principle-based standards.

What we now need to do and what we're faced with, I think what we'll talk about today and what we need to battle with over the coming months and years perhaps, is to find ways of implementing that policy. It's important, I think, for all the players in the financial reporting sphere, whether we are preparers, users, auditors, regulators, whatever, if the policy has been set it is that we are going to use high level principle-based standards, that means a fair degree of inconsistency, let's get on and make it work.

I think when we talk about making it work; my personal view is that at least for the time being we're going to have to rely quite heavily on regulators to help make it work. I think, when you talk to preparers it's very clear that at the moment international standards concern them, they worry about them, they want help. One of the reasons they want help is that simply they don't necessarily understand the requirements fully and that's perfectly reasonable, they're complex standards and for many people they're written in what isn't their first language.

I think, more importantly, another reason why preparers want help is that they can see that IFRS allows flexibility and they want to know how they can use that flexibility without upsetting their regulators. And for that reason it's up to the regulators to give them, in my view, a steer; give them an indication. It's up to the regulators, in my view, to make clear that they accept the degree of inconsistency that is implicit in international standards.

I think at the frontline is, of course, the European regulators, but I think we must also not forget the SEC. It needs, I think, to send the same signal that I am suggesting the European regulators need to send and I think that may be difficult for the SEC. I'm not saying it's difficult and therefore they won't do it but it's difficult and therefore they've got to learn how to do it because I think you'll see in the reports in the press from the beginning of November, I think it was, where the FASB Chairman was saying that although he is a believer in principle-based standards, he doesn't think they'll work in the US environment, at least not for the time being because they don't have a principle-based enforcement system and they don't have a principle-based litigation system. So the challenge really for the SEC is that although it is not used to enforcing principle-based standards in a principle-based way, if it is to be true to the notion of international standards as high level principle-based standards, it has got to get used to the degree of inconsistency that is implicit in that set of standards. And that's difficult. It could well mean that it's used to a higher degree of consistency for US companies but when overseas companies using IFRS file in the US, it's got to accept a greater degree of inconsistency. That's tough for it to learn and it's a message that it has to get across if the SEC is not to become, in many ways, the regulator for the whole of the world.

I think I'll wrap up by just going back to a phrase I've used a couple of times. I thought about the degree of inconsistency implicit in international standards and I think this is part of the key to the debate I think we'll have this afternoon. What degree of inconsistency is actually implicit in international standards? I think there are probably seven reasons, seven opportunities, why inconsistency could arise and I think we have to understand those reasons and reach agreement on those reasons. Are they acceptable, are they unacceptable? I think some of these, perhaps all of these, are obvious. There are explicit options in standards. Those explicit options could be particular provisions where they say you can do this or you can do that, but those explicit options can also take the form of transitional provisions, of course, where grandfathering is either required or permitted. It can also take the form of options to early adopt standards. That again could lead to people implementing international standards in different ways.

I think we have to reach agreement on what we think about those explicit options. If an option is in a standard, is it fair game to use it or are the regulators and should the SEC expect a limit to using those explicit options? There are, of course, implicit options; perhaps the standard is vague or ambiguous in an area. Perhaps there's a degree of estimation or a modelling technique that has to be used. Perhaps it's just that two companies have interpreted the same requirement in different ways. Again, I think we've got to think about those different reasons for inconsistency and decide what we feel about them. An extreme implicit option, of course, are the gaps in international standards and I think exactly the same points exist there.

I think perhaps closer to home another reason for inconsistency will be translation issues. Everybody tries very hard to translate international standards into the languages of the Member States but it must be difficult to capture all the nuances that are in those international standards when you translate them into those languages so it could well be that two companies in two different countries are faced with a requirement that actually looks somewhat different. That's difficulty. Everybody is striving to avoid that and I think to some extent it's inevitable and that's another possible area where inconsistency can arise.

Of course, inconsistency can arise also through incorrect applications but I don't think we would have any doubt that that was an area that the enforcement agencies should, crack down on.

I think also there are two other areas that are perhaps unique to Europe. One is, well, I suppose neither of these are actually unique to Europe but Europe is a prime example. One of them is the carve outs. I was about to say unique to Europe but actually Australia carves out international standards as well although they tend to delete options but it does mean that the international standards you have in one jurisdiction are not necessarily the same as the international standards in another jurisdiction and that can have implications.

Endorsement processes is another example and endorsement processes take time and particularly when you have standards that talk about early adoption, and maybe, from time to time, standards that require fairly immediate implementation and retrospective application. Endorsement processes can have the effect of meaning some companies adopting standards that other companies aren't, and that again is another reason for the possibility of inconsistency.

I'm going to stop there and make four sort of final comments. I think we've all committed ourselves to adopting international standards in the continent. I think having agreed to do it; we need to be committed to it. If we're not committed to it, I think we're messing our companies about and we'll spend lots of money and time implementing standards and I think we're now coming to a point, and not to show that all the bodies within Europe are committed to it, whether it's preparers, users, auditors or the regulators. I think in a sense we're coming to a crossroads and I think if we are committed to it we may have to be prepared to speak with the SEC and help the SEC to learn this new world in which we're operating and the new world we hope they're going to operate in.

Pierre Delsaux: Thank you very much, Paul, for giving us several reasons for differences. Now maybe Gilbert Gélard will explain what can we do? Gilbert has been appointed to the IASB in January, 2001, and will present the view of the Board.

Gilbert Gélard, IASB, Member

The risk when speaking after any speaker is that what we say will be seen too obvious, so I'm glad that what I have to say does not overlap too much with what was said by Paul.

By our constitution, we are supposed to make standards that are enforceable. Fair enough. But what use would be standards that are not be enforceable? We, standard setters, are not in charge of enforcement. This is the role of auditors and regulators but we have to be aware and to be cautious that our standards are enforceable by those people and applicable by the preparers in the first place.

Paul mentioned translation. He was quite right. Translation has been one of my hobbies, and I consider that translation is the first link, and potentially a weak one, in the enforcement chain. Many things may creep up in translation that make a standard deviate from its intent the very first step and this very often comes unnoticed until huge misunderstanding occurs.

It seems that consistency has two dimensions or meanings, to stay in the linguistic area. First, consistency, through time, what we call, in French, permanence, which means that you are supposed to use the same accounting, for the same event, through time, and this is also the view in the US concepts statement; consistency is through time. Of course, it has a second meaning which we have to translate into French in another way, that is consistency in the accounting treatment of transactions and events within entities and between entities at the same time during the same period. This second meaning relates to comparability and is probably the meaning we are more concerned with in this debate. However, whenever we use the word consistency, we should be clear to which of those two exceptions of the word we refer.

Consistency means applying the same accounting treatment to similar events and transactions and by same accounting treatment we mean recognition, measurement and disclosure. This objective is not debatable and indeed is not debated. What is debatable is what similarity means and implies. Do fact patterns have to be exactly the same to warrant the same accounting treatment? Are there such things as strictly identical facts? To what extent do the legal frameworks applicable in various jurisdictions matter? Is substance over form a sufficiently robust principle? These are all questions I have no answer to but I think are relevant to our topic.

If we look for strictly identical facts to be treated in the same way, are we not led to a lot of detailed rules? But, however detailed they are, the rules will never be detailed enough to accommodate all the fact patterns possible. Adherence to the detailed rules may not lead to a fair representation. Also, a culture of engineering around the rules going as far as fraud has been developing as many famous or even infamous examples show.

An overly and excessively detailed framework may lead to apparent comparability which is, in fact, contrived uniformity. Is absolute similarity of facts required, or not required, to warrant the same treatment? Can treatments be derived by analogy? If so, are clear principles enough to exercise sound professional judgement and apply with intelligence the hierarchy in IAS 8? What matters is the need for the user to make difficult economic decisions by being able to compare between entities.

If standards are principle-based, in short, it is possible that two good professionals might come to two different solutions on the same fact pattern. It matters only if the end user is not able to compare the outputs with one another. There, disclosure about the accounting policy arrived at may help to achieve comparability. However, if principles are sufficiently clearly stated, it's unlikely that treatments would be radically different.

It is obvious, though, that principle-based systems need interpretation. In such a system, what should the interpretation be? I forgot, of course, to say that this is my opinion, not that of the Board. I think interpretations must be short and clarify the principles of the standards if need be in a way that adds value to the standard. It must not overlap with normal question solving. There have been many questions so far, many of which are due to the fact that the system was new and that people had to adjust from a previous culture to a new one. The interpretations must be kept to a strict minimum to avoid going to a rules based

system. This means that IFRIC should be selective and give the reasons why it does not take an issue on board.

Several questions have been already asked by Paul. I would just repeat a few of them. One remark: US UITF pronouncements are very often used by preparers when there is a perceived lack of details in IFRS. Caution: the US UITF pronouncements are not necessarily compliant with IFRS. Even if we have fully converged standards, there is a problem because normally if we have converged standards with the US, they would be principle-based as the US are committed to a principle-based system. So not many interpretations would be needed. But I question whether the baggage the US have in their domestic environment will allow them to move quickly enough to principle-based standards. There might also be a need to develop a common understanding of what "principle-based" means.

The role of regulators is key and this was already developed by Paul. They have a need for comparability that may be is not totally satisfied by principle-based standards. They will discuss that for themselves and I am looking forward to hearing them.

There is a fear also of seeing the SEC become the defacto interpreter of IFRS. I think this would be harmful but I am hopeful we can find solutions to keep to principle-based standards without resorting to this unfortunate expedient. This concludes my first remarks on how I view the delicate problem of consistent application.

Pierre Delsaux: Thank you very much for these useful questions and also some answers to what you said. Now we turn to the securities regulator and Philippe Danjou who is working for the AMF.

Philippe Danjou: CESR-Fin, Chairman, CESR-Fin Audit Task Force

I have to start like everyone this morning by making the usual disclaimers. The views do not necessarily represent the views of CESR or the AMF but purely my own.

I think one of the key points that we have to discuss is what we want to achieve, what do we mean with consistency? Until the time when we will have a common agreement on the objective of the exercise, we will spend a lot of meetings and will be going on for months discussing always the same topics, without making good progress. I think it's a difficult issue. Just to remind which is the context of consistency in two sets of situations; Firstly, for issuers of new money – Prospective Directive and Prospectus Regulation – which requires the use of IFRS by EU issuers since July 2005 and from 2007 for the non-EU issuers depending on the Commission's decision on this question. It is also ongoing basis for companies which are already listed – Transparency Directive - which requires that the information be provided under IFRS and this will apply at some point also for non-EU issuers.

Knowing that those elements of legislation have given the authority to the competent authority (namely the securities regulators) to do the enforcement, the question is really what do we want to have, how much consistency and which consistency is desirable and how soon can it happen?

Well, I will try to give a personal definition of what would be the objective of consistency using more or less the same words as Gilbert Gélard is using. For me, the ideal benchmark of consistency is to obtain direct comparability of financial information published by different issuers taken from the investors' perspective and without having to spend days and days on restatement of the information. Otherwise, I don't see what would be the progress and what we would have achieved compared to the previous situation because under the directives, as we know, it was possible to compare but we did have a lot of restatements. Of course, it was not evident but it could be done. The real benefit, the real plus of IFRS, I think we have to move forward and to have more direct comparability for issuers. This is a key point. But, of course, it is not always possible and there are some technical limitations. First, for reasons we know there is a lot of judgment involved in selecting the economic assumptions which are the basis for preparing financial statements and no regulator is going to tell you which useful life you should use for depreciating an intangible asset such as a third generation telephone licence or for discounting rights for your pension liability. This is not our job and I don't think anyone has legitimacy to do it. So management judgment is and will remain important.

Maybe a solution for that is full transparency, disclosing what are the basis for your assumptions and how much sensitivities there are around the use of certain assumptions.

Next point is that direct comparability is limited by the fact that different industries are not directly comparable. Whether we like it or not, there are certain industry practices which can be influenced by other sources of standards. Just take the example of revenue recognition. There is no IFRS on revenue recognition or only a very general one. And for sure, many industries will select from other frameworks, may be US GAAP, certain guidance to be more specific on the revenue recognition. Is that good or is it bad, I leave it to you to decide, but it is a reality.

But against this, investors are entitled to expect within a given industry sector, there would be direct comparability. To me it would be a bit odd if an investor would not be able to compare the performance of Renault and Volkswagen for instance because of different capitalisation criteria for R&D costs or within a very concentrated industry like the pharmaceutical industry.

I think we can expect that there will be sufficient industry coordination or industry guidance so that there will be direct comparability.

Next, the question of applying standards to circumstances. To me, similar transactions should be treated in the same way when the circumstances and the business purpose are the same and the idea that there would be implicit options that would permit to have different treatments for a similar transaction because the judgment would lead to a different conclusion, is a difficult one. Of course, there can be some rare cases where it is uncertain and where the judgment will make the difference.

So you may understand that I don't necessarily agree with some of the previous speakers and I think it's interesting that we have a discussion on that topic.

Against the objective of comparability and I will assume for the rest of my conversation that you agree with my definition of comparability and consistency: What are the risks? Well, we know that there are by nature some options. The first time application standard contains quite a number of options and there are some permanent options on the fact of anticipated application of certain standards. There will be impermanence and a number of differences will remain and it will take time to eliminate them.

We also have the problem with the presentation of financial performance, it is a bit difficult compared to the previous situation where we had very clear indications in Directives as to how to prepare the format. And it is a problem that we have not yet agreement on where to go with Performance Reporting but it will come of course.

Next we have a series of areas which today are not yet properly covered by IFRS. But we should be able in the world of today to have responses to all the questions which are on. For example concession services, we do not have any guidance yet. The application of the purchase method. I could go on with many different examples.

I have not put on my slide, the additional problem created by the "carve-out". I am not against the carve-out, do not misunderstand me, but the fact that we have no precise requirement in Europe on how to deal with macro-hedging means that we have created a lot of flexibility for issuers to apply different methods, which can create problems of comparability and consistency.

I have already mentioned the economic assumptions which are clearly the managements' responsibility under control of auditors. And the fact that we have a number of application questions, sometimes called interpretation even when it isn't the right word, but many questions arise which are due to the fact that the standards are complex, that they are new for many people, and that when applying the standards to unusual circumstances, a lot of judgment is to be applied and people are not totally sure whether their interpretation is OK.

Finally, we have the situation that some standards are not totally clear or some of them really even inconsistent against each other and we have some examples of different standards having some different words which are conflicting and we will have different readings as to which standard takes precedence over all the other ones.

So the question is what solution can we propose? I think that we need to be very practical as there is no magic answer. I think we have to add a number of different elements that together will help to make it a bit better.

First on the list of questions that were proposed by the FEE for the preparation for this Roundtable was a question whether non-GAAP measures could be an alternative. For me, clearly not. Non-GAAP alternative measures of performance are not a solution to accounting imperfections. Why? Because there is no standard definition of non-GAAP performance. They are not reliable. They are not audited generally and they would just add to the complexity and subjectivity if there were not only some problems with the accounting but there are also some additional problems derived from using two ways to explain the performance and CESR has recently taken some position and issued a paper. We have to work on preparing the financial statements as best as is possible and it means that the preparers should have as much help as possible in doing their job. IFRIC should be responsive to the demands and has a role to play. IFRIC should not take a too narrow view of what is its job. I was glad to hear that IFRIC has been given more resources to deal with the number of questions which are in front of them.

Then the importance of doctrine and industry level coordination and I think this is very important that people who are in the same business meet and discuss and try to form a common view to the extent possible, of course within the framework of the standards, it is not their role to go around the standards. Using the same words, to develop a common understanding of standards and I know that many industries have meetings and coordination to find solutions.

The EU informal roundtable has been mentioned. I think it can be helpful provided we have a clear definition of what are the limits of this exercise. It should not lead to EU interpretations. It should not breach on the enforcement responsibilities which are clearly the enforcers and competent authorities responsibilities.

Now we have a job for enforcers because we are just the ones before the courts in making the decisions. We are very aware of the fact that we could help with the consistency but we could also be detrimental to the consistency if we were to take decisions that would be in contradiction with each other.

So this is why we have agreed within CESR on a number of principles, you know that we have published a number of standards on the enforcement, you can find it on the website of CESR. These decisions, especially covering different situations, ex ante, ex post and pre-clearance. I don't want to speak about pre-clearance since there are no official CESR views on that, but you may ask questions. And we would have coordination between us and also with other parties involved, dedicated entities like the financial reporting review panels which have received enforcement delegation and who have a role to play in the coordination.

What are the practical ways to do that? Well, first, I shouldn't be speaking of that too much because it will not be an official paper but you have to be aware that in doing our enforcement role in selecting which filings we will review, will organise, as we say in French "un ordre de bataille", to do that, we will not cover all filings in a year. You should not expect that we will be able to say that we have reviewed the 8000 listed companies in one year. That would just be impossible. So we have designed some risk-based selection criteria to do it best as we can, knowing that we cannot do everything. This has been approved by our Chairman, I am not allowed to tell you more it is a "secret de fabrication".

We have set up a web-based database of enforcement decisions which is just beginning to be filled by the members. Of course it will take some time to have a sufficient number of cases in the database. We are not yet up to many enforcement decisions because enforcement will come after the first set of publications that is in 2006, but at least we have established a system and procedures to deal with this database. And we will publish those enforcement decisions which we believe are important for the market in Europe, at least for every new case where we felt that there is something special, something that is important to be dealt with, and you will be able to see what regulators think.

To conclude on what we can expect. Well, I think we should not fool ourselves, achieving the level of comparability which I put as an objective, will take time and will take, many efforts, and this transition phase, the first two years of the implementation, are very critical. We must get it right the first time otherwise we will have big problems with the market, big expectation gaps, and I think we have promised the market that it will work and we should deliver and probably the SEC as well is watching us. I think we should not overload the companies, issuers with new standards. It is important that that as well as regulatory pause in Europe, we have to have a standard setting pause to be able to digest what we have to do already and also for the market to understand, to adapt. We always think about preparers and analysts which are very clever people. What about the direct shareholders? We need to think about that, help them understand what's going on. If we change the standards every six months, that will be just impossible.

We must have robust and efficient interpretation mechanisms, IFRIC has a role to play. We must have consistency of enforcement decisions, that is our job. We must also see that auditors should do what they have to do and, CESR has an Audit Task Force which has been created in relation to the reporting under IFRS. We must ensure that reporting is consistent and that the auditors have a clear framework for reporting under IFRS.

Next on the list is investor education. It is a big issue. I don't know who is in charge of investor education. In fact, no one or everyone. I think it's very important that preparers, in putting out their accounts, do their best to make it understandable not only for specialists but to everybody to ensure that individual investors are not lost on the journey. That means that notes should be drafted as clearly as possible, that they should be user friendly to the extent that it is possible to make IAS 39 user friendly, but there are different ways to explain, some better than others. In the end, that is something where everyone has a responsibility, it is a shared responsibility, preparers, audit committees, the profession, big firms.

I think it's also important that the big firms are very consistent in what they do. You can expect that within a network or among firms there shouldn't be too many interpretation conflicts, otherwise it can bring further problems.

Finally, it is a dialogue that would involve not only Europe but also other IFRS Jurisdictions and I think it's important against the discussions that we had this morning that we try to clarify with the SEC what is expected of us because if we talk about an acceptable degree of inconsistency, how will they react in 2009 when they assess our performance? Will they be in line with our implicit acceptance of certain levels of inconsistency, it is critical that we know exactly and agree under which criteria we can make success on the roadmap.

Pierre Delsaux: Thank you very much, Philippe. Apparently everybody, is in charge of consistent application in Europe so that leads me to Mark Vaessen who is partner of KPMG IFRS desk, for his views on this question.

Mark Vaessen: Head KPMG IFRS Desk

I am here to present the auditor perspective and fortunately I don't have to put in a disclaimer. What I say are obviously my own views but shared by quite a few, I hope, in the profession.

Consistency is one of the issues that is very close to my heart because for the last seven years I've been involved in this discussion. As many have said already, it's a big challenge for the auditing profession involved and we all should be committed to the process. Certainly as a firm we are very much committed to do our part. I'll come back to that in a moment.

I want to make three points just briefly, because that's what I was asked to do, to be short. We can expand a bit later in the discussions. First, with regard to the meaning of the word consistency. Gilbert has already asked the question and I would just confirm that, certainly in my mind, consistency does not mean an identical interpretation in every case. This is impossible in a principle-based system and so therefore we should look at each case and find an acceptable interpretation for that particular case. This should be the starting point. Not many cases, generally, are the same. Therefore if you look at the drive for consistency, in my mind it's a drive to identify those interpretations that are not acceptable under the standard, rather than saying there's only one possible answer. This should be the mindset and it's often how we actually have these discussions within our firm. People from different cultures participate and come with their views, sometimes we will come up with three or four different interpretations to a particular phrase of the standard. We have to say, well, two of these, no, it's not possible, these are not acceptable ones, but the other two, they are both valid. It's not up to us to say that the implicit options should be limited down to one answer only, if they both are based on sound arguments founded in the words of the standard.

The example that you, Philippe, mentioned on one of your slides is an interesting one to illustrate my point. You mentioned revenue recognition for the software industry and that it would be desirable to have the consistency within an industry. I would agree, but even there, if you take a software company, many would for their IFRS treatment also look at the US GAAP guidance, because IAS 18 on revenue recognition is at a very high level. As a result, you could get consistencies through using the US GAAP guidance but if a company comes to me in Europe and says, well, I don't want to follow the US guidance but I have a revenue recognition policy under IAS 18, as long as it is compliant with IAS 18, I think we accept it, even if it is not exactly the same as others in the industry that use US GAAP. So I think there's a bit of nuance here - as long as you have an acceptable answer under the standards, you are compliant with the standard.

Secondly, a point several people already have made is that we should be realistic in what can be expected. There are a lot of new things we have to deal with so consistency won't happen overnight. Every standard normally takes one to two years to settle down and a change of this magnitude will also need that time. We should allow ourselves the time to let that happen.

I would also like to emphasise that although we are right in focusing on the challenges, we should not lose sight of the fact that we are already making a huge step forward in terms of comparability and that actually the markets will get much better information than they have had in the past. Hopefully, when these 8,000 companies in Europe are going to report in a couple of months' time, we will have all the share options treated as an expense. We will have all SPEs for which the entity bears the majority of risk and benefits on the balance sheet and we will have much more segmented information than many of the companies have given before. We shouldn't lose sight of that, that we are already making a big step forward in terms of comparability, although obviously there is still also work to be done. We as auditors do have an important role to play in helping achieving more consistency. We do realize that and we should in no way be defensive about it.

As firms, we have already come a long way. I've been involved in this for seven years. We do not come unprepared to this job. Within my firm, KPMG, we have been coordinating views on a global basis for many years; even Gilbert was still involved at the time, when he was still within the firm (a long time ago).

Just to mention a few of the measures that we implemented. Indeed, we have global training materials, developed globally, programmes that we roll out on a global basis with national tailoring. We have various levels of mandatory reviews on the financial statements, again at a national level and also, more recently, we do reviews within our network at a cross border level in order to make sure that somebody from, say, the Netherlands looks at a set of financial statements prepared in the UK and says, well, that's strange, there might be a UK bias in here, and vice versa. We also share databases among our technical people. We have produced guidance books both for the benefit of our people and for the benefit of everyone here in the room, so that you can read what our views are. Also that should help to achieve consistency. Most importantly from our perspective, though, is that our people on the ground feel confident to make judgments but, where necessary with the use of our extensive consultation procedures. Where there is a dispute, we have escalation procedures in place.

Within our international network we discuss IFRS application issues within topic teams and within industry groups. In addition, have a central global group that coordinates our network of IFRS specialists around the world, as well as a policy setting group in order to come to final positions. I know that all the other firms do have similar structures in place. So, as I said, we do not come unprepared.

To go back to my first point, it is our task to identify those applications and interpretations that are not in conformity with the standards. That requires a significant effort. We have to understand that there may be good reasons for the differences, difficulties in the translation was mentioned. I would also not underestimate the cultural bias that goes into application of the standards. Often very innocuous, people don't even realise it themselves, they read something coming at it from their own background - and if people have good arguments for a certain treatment, then we have to accept that there is more than one view that is acceptable.

We have these discussions about application issues within our firms but we also do discuss them amongst the firms. This morning Jon Symonds made the comment that there is a responsibility for the large firms. He's right, there is a responsibility there and we do take our responsibility. We speak on a regular basis to compare notes on technical issues that we see emerging. It would, however not be good if we would go and sit down in a room and just try to agree what the answer should be. We are not the standard setters. So that's not what we do. What we do is exchange arguments, to understand each others' positions, and to use that information to make our own decisions. Sometimes you will find that, having listened to each other arguments, there is a consensus on the appropriate treatment, but that's not the objective of our discussion.

Sometimes we might, again, find that we actually have valid differences of opinion. If that is the case we may refer the issue to IFRIC, through the IFRIC Agenda Committee, because that's the legitimate place where issues should be brought, if we know that there are different views on an issue out there in the market.

My main point today is that it will take some time, but that we are actually doing a lot. It's a learning curve that we all need to go on together. A few other points I'd like to make. Market forces also will help us in this respect, peer pressure generally is a good driver for consistency but in 2005, that's not going to happen yet. It's too early but as time goes on, peer pressure will have its effect. When analysts have had a close look at the IFRS numbers, they will also drive more consistency. In addition, the formation of industry groups to discuss IFRS application issues is something that I would very much encourage. It is very helpful if groups of industry players come together to discuss the application issues they face, possibly with the input of their auditors. I know that there are a number of good initiatives in the marketplace already and I would encourage those industries that haven't actually set up a group like that to do so.

My last point is that consistency of application can only be achieved if we can also avoid the differences in how individual countries interpret and enforce the standards. We do have more than one hundred bodies in Europe in terms of securities, banking and insurance regulators in 25 Member States as well as national standard setters and interpretation groups that all can have a say on IFRS, so there is a huge potential for national dialects of IFRS to emerge, through national interpretations. Without a level of effective coordination at the level of the regulators we will not achieve consistency.

So I agree, we all have to work hard, we all need to give our commitment. I can assure you that we, as auditors, are very much committed to this process and do want to get it right.

Pierre Delsaux: Thank you very much, Mark, for this commitment. And now I want to turn Bill Knight, Chairman of the UK Financial Reporting Review Panel.

Bill Knight: UK FRRP, Chairman

We are enforcers. We review up to 300 sets of accounts each year. Most of them are selected for review based on the economy and based on specific factors such as poor corporate governance. Our sample is biased towards the larger FT company market but we also react to complaints and we therefore find ourselves enforcing international standards and UK GAAP.

Everybody agrees that enforcement has an important part to play in ensuring consistent application of IAS but I would like to suggest to you that enforcement has a vital role. Almost my first lesson as a law student was that there is no right without remedy and no duty without enforcement. The true standard is not one that's written down, but it is one that is enforced.

In 1154, Henry II, King of England, had very much the same problem as we do today. He wanted to enforce the Common Law across England and root out local customs. He didn't do it by issuing interpretations or pre-clearance, he did it with the axe.

Every time we apply a standard, we interpret it. Every standard, not even a rule-based standard, is written specifically to apply to that particular case. Therefore every standard requires interpretation before we know whether and how it applies. Some interpretations are easy, everybody agrees on them. Others are more difficult and by choosing a principle-based system, we made the degree of interpretation wider and therefore open to different interpretation. Our approach is that provided the interpretation remains within the boundaries of the principles, they can be considered consistent with the standard. Consistent does not necessarily mean identical application.

Every time an enforcer considers a case, he makes an interpretation in the same way as a referee on the football field. Every time the referee blows his whistle for a foul, he interprets the rules. He doesn't issue official interpretations of the rulebook, but he interprets it nevertheless. So in my view, the question of how to achieve consistent application by IAS becomes the question how do you achieve consistency in enforcement? In practical terms, the day-to-day work of auditors is crucial and in particular the work of international firms. In a recent speech I was pleased to hear John Tiner urge those planning IFRIC's workload to assess emerging issues on a practical basis and to deal first with those which regulators and others have identified as having immediate practical importance rather than those which can be interesting and challenging. The work of CESR in establishing its database of decisions taken by national enforcers is crucial and we fully support it. This database, is created by the people who attend the extended sessions, that includes our panel, the Swedish panel and the German panel. I think the faster we move on that and the more we talk to one another, the better it will be.

Although I have emphasised the role of the enforcer, I am against pre-clearance. It seems to us that the responsibility for the preparation of accounts in accordance with IAS lies with those who prepare them and we don't want to accept the transfer of that responsibility. The fact is that we think that that responsibility should be with the preparers not with the enforcers.

But we in our turn should be prepared to make standards clearer for preparers and auditors and then to accept the exercise of professional judgment within the framework of the standards. That means that identical situations will not be accounted for in an identical way but it does not mean that IAS is inconsistently applied. Pre-clearance also has very practical problems. In our market we do not have the resources that we need to justify any improvement in reporting which might result. Also, if you look at pre-clearance, it shows that in the end you end up with quite a bureaucratic system written submission, written response, written interrogation. Without that you're never quite sure what you did.

Let me finish with an example. Many companies these days sell products at a loss but they go on to make profit on consumables in the after market. One example might be the inkjet printer. We all know that printers are cheap, but the ink is expensive. I'm a photographer and I recently read in a photography magazine that for one particular printer, if you want fresh ink, it's cheaper to buy a new printer in order to get the ink that comes in the box. The same principles apply in complex engines, hospital equipment, all sorts of specialised machinery. In these cases sometimes the right to supply the consumables is contractual, sometimes it just arises because you are the only supplier, sometimes it arises because it you are the best supplier to make the machine work better.

Now, how do you account for all this? A straightforward method, obviously, is to accept the loss when the original equipment is sold or even before if stocks have to be written down to realisable value and then recognise the profit when you sell in the after market, but some companies are setting up intangible assets. They say the assets are the right to the sales in the after market, the cost of the asset is the loss on the sale of the original product. They then amortise the asset over a period. IAS 38 says that an intangible asset needs to be identified but does not need to be separable if it arises because of contractual or legal rights. In the case I am talking about, maybe contractual rights apply or it may be that the company just sells the parts that will do the job. Or there may be other, generic parts but the company's parts may be much better.

I'm not going to tell you whether this accounting treatment is justified. In any case it depends on the facts and when we get a set of accounts like this, we would talk to the directors to see how carefully they'd gone into it, whether their opportunity to supply parts in the aftermarket was so clear as to amount to a right.

So it's a complex, difficult issue. I'm not going to give you the answer but I will say first, it is most unlikely we would compel all companies to use the treatment. If directors told us they didn't want to do it this way, I can't see us saying that they must.

Second, we wouldn't want to pre-clear. It depends on the honesty of the judgment of the directors and those who audit the accounts. Third, I would very much like to discuss issues like that with all national regulators and see how this case works in a practical situation.

My last point, that learning about IFRS needs some time. Rome was not built in a day, neither was the treaty of Rome.

Questions and Answers

[NOT YET EDITED BY MR PAUL EBLING]

Pierre Delsaux: I hope that IFRS will have a long life also. We will now ask for questions from the audience.

Mike Birch, Technical Partner, Central and Eastern Europe, PricewaterhouseCoopers. One of the things that seems to be driving the marketplace at the moment is the fear of regulators in unknown, as it were, of the first time application of IFRS. This fear is creating a demand for rules rather than principles; people want to know how the regulators are going to react. Now, IFRS being applied increasingly around the world, we have different regulators in different jurisdictions, will be, I suspect, penalising companies for failing to comply with IFRS, what is the likelihood of regulators around the world coordinating their efforts to make sure that there is some consistency on the regulators' side and if there is, is that not in some way going to be impinging on the work on the IASB in trying to ensure consistent application of IFRS in the way they understand it?

Philippe Danjou: Coordination among regulators will have a worldwide mechanism similar to that of CESR and will be established by IOSCO. If you look at the website of IOSCO you will find a recent announcement, I think it's in October of this year, that IOSCO intends to create a mechanism to coordinate thoughts and understanding of the standards of Australia, New Zealand, US and all of those who are interested in the application of IFRS. So by this way we can expect not to have divergence between an EU coordination of regulation and the rest of the world which would be another problem.

On rules versus principles, do not plan to enforce IFRS beyond what is written in the text. Only the standard is enforceable, our own positions are not enforceable. We are not going to make an additional layer of standards but we will assess whether in our view, after consultation, discussions and coordination the standard has been properly applied. And if we believe it is not the case we will make this public. Similarly at national level.

Just to be clear, enforcement should not be a way to create new rules, enforcement is just to apply rules which exist and it was being said by Bill, I mean even when you have a rule based system you have also some margin for interpretation. Every rule has some margin for interpretation and when you move from a rule-based system to a principle-based system I would say the margin of interpretation is wider but the approach is not necessarily different and, of course, interpretation should be within the boundaries of the rules or the principles.

Bill Knight: Well, I completely agree with that and I am very sympathetic to what the questioner said. I think that of course I agree we should have international coordination of enforcement but that will take time inevitably and for this year, for next year, for the year after, I think it's very incumbent on national enforcers to behave sensibly and to put at a premium honest and careful judgement in applying the standards. Our approach would be that if we are convinced the issuer and preparer have taken a standard carefully into account, and has applied it honestly and carefully, then that is a great help to us and we are likely to decide on reasonable interpretation within the boundaries of the standard.

Colin Fleming, IFRS Global Office, Deloitte: I think the last discussion may have clarified some of my concerns but I'm assessing or getting mixed messages from some of the regulators expected consistent positions within and among the audit firms and yet, you spoke of legitimate choices within IFRS. Then you tell us that you want us to get it right the first time and yet Mr Knight has just said we're looking at a sort of growing in period of maybe two to three reporting cycles and we have to give time for the market to adapt to this new reporting cycle and Mr Knight saying that within the UK at least he'll be looking to make sure that the facts and circumstances of the transaction match the accounting that has been adopted. I'm just trying to reconcile some of your earlier comments with some of the remarks that were made later.

Philippe Danjou: If we don't set the objectives at a high level, it will not achieve anything and ultimately not achieve consistency.

Mark Vaessen: We are not looking at "anything can go". I think the standard that we are applying is actually much higher than that, but even if you apply that higher standard, you could still end up with two different views. As we heard this morning, when you have 21 people from the board sitting in one room there's a lot of disagreement. I can tell you if you put 18 people from firms in the room with a few regulators, I am sure also you will have some different views and you will have some alternatives that we end up with to say, well, we can see both sides of the argument. To Colin's point, I think you said you would like to get agreement amongst the firms and I think what I tried to say in my remarks is that as much as we put in an effort to understand where each of the firms are in their thinking on an issue and to try to get consensus, it will not always happen and it wouldn't be good. I don't think that anyone will actually accept that to say six of the large firms would put themselves in a room and are forced to stay there until they come out with one answer. There would be a number of questions being asked - whether it's right from a competition perspective or whether it is actually desirable because it could be undercutting IFRIC, undercutting the IASB. In that sense, I understand that in France perhaps you may need this model in specific situations, that the auditors need to agree because you have joint audits. Certainly in those practical cases we will work together in the end to come up with a view that is reconciled but that is not to say that we will always agree on every particular issue.

Philippe Danjou: There is an example of a joint audit in the air industry where the joint auditors did not agree and such situations are confusing to the market and need to be avoided.

Mark Vaessen: I do accept that, we need to try and avoid these situations but I think there are just sometimes generally different beliefs, also among the regulators. I think we've had a few discussions recently where we also saw that on scope of consolidation issues there are different views amongst the regulators. It is quite human that we all have to go together up the learning curve in that respect and there are genuinely held beliefs, there's nothing improper about it.

Bill Knight: I think we all agree that that we expect high standards. I'm simply saying that realistically we expect to get better as we get more experience.

Gilbert Gélard: Having standards without options would kill one of the reasons for diversity because we have too many options in the standards either explicit or implicit by lack of guidance. We should very often go a little more in the guidance even within the principle-based system. But I was puzzled by the discussion. I understood auditors would accept the client view if it was not incompatible or not in contradiction with IFRS. This leads necessarily to diversity. It means that you will not have a firm's position on this particular topic; you would accept there is diversity of solutions. My question is: is not in that case the regulator forced to act as a sort of referee sometimes?

Philippe Danjou: The company calls and comes to see me at AMF with the two audit firms to find a solution. We hear the arguments of both firms and make sure the proposed decision is supported and acceptable. We are not a referee it is a matter for IFRIC, that is the normal procedure.

Matthias Schüppen, Haarmann Hemmelrath & Partner, Germany: We have several times heard that there might be diversity of opinion and there were several times raised the word referee. But we have not heard who finally will be the referee and at least from a German point of view, personally, I am convinced that the referee will be the courts and so I would like to ask the panel to comment on the role of the court in applying IFRS.

Bill Knight: We have never been to court. Our only power is to take a case to court. That is the only power we have and we have been in existence since 1991 and we have never exercised it and the fundamental reason we have never exercised it is that to take a decision to take a major company to court to discuss the validity of accounts has such terrible consequences for the company that they normally find a way to avoid it. The day will come, I expect, when we go to court on a point of principle which a company is simply not prepared to agree to but we try in practice to find a way through. Accounting enforcement in my mind, and I'm a lawyer, is not, in the end, an easy matter for a judge. Therefore, in practice, we avoid it because of the pressures of the marketplace. Imagine an announcement that in nine months' time a court will rule on whether last year's accounts of a major plc were in compliance or not. It is a situation in which you do not want to be.

David Lindsell, Ernst & Young, UK: Actually I think the panel's done a remarkably excellent job. The best job I've ever heard of actually describing the issues involved in consistency, the depth of discussion has been remarkable. My view on the referee issue and actually it goes back to joint audits in France, is that if we can get the process working more efficiently, IFRIC is actually the ultimate, it should be an ultimate referee on this stuff and certainly in at least one case in a joint audit in France had the processes worked more smoothly, and issue would have got to IFRIC about six or nine months earlier than it did. It's this particular capital instrument issue that's been a horrible issue in France. But if this stuff was easy, we'd have answers on concessions, you know. The sorts of questions, and why can't the firms, for example, come up with a straight answer. There are some huge problems to do with the fact that actually international accounting standards are not yet based on a single coherent set of principles. They're based on a mixture of principles and trying to decide which one to apply in a particular set of circumstances can be very difficult. I don't know whether the panel would agree with that.

Gilbert G elard: If I knew the answer, we would do a better job. It is true that our standards have been developed through time. We started in 1973 with the old IASC and there are standards that date back to 1980, which is very old even by my standard. And also the first standards are not well documented. They have no basis for conclusion, which means that some lack of clarity crept into those standards. I think the new ones are better, at least they have bases for conclusions which may enlighten the reader as to what it really meant. When it comes to the old standards, there were very often compromises to get to the vote and I think we don't work like this any longer. We have a debate but we try to have a clear standard. Of course, as you know, we have mixed attributes with all the ring fencing around. I am not criticising the quality of international accounting standards but they have developed over time and they are not perfectly clear, which means that we have sometimes queries as to what they mean and we have to respond to those queries.

Eric Kandler, Deloitte, Austria: Briefly following up on the court because for my own country it's a pretty important situation, and certainly to have 25 courts or panels or even criminal courts providing inconsistent rulings around IFRS is a nightmare to all of us. I was wondering whether the panel might want to comment on are the constituencies that are represented on the panel really to act very quickly to change the rules and apply the rules or the principles for that matter but the IFRS rules, to correct or get court decisions in the proper direction give consistent and manageable answers to the preparers and the auditors to use that. Or, on the other hand, is there a likelihood that there would, and there will be in effect a system at the European level that could act quickly and get across the southern countries and the southern courts in the individual countries to provide a basis for consistent application because I do hear out in the field the first tendency is to say, oh, we'll go to court, we'll get a ruling, and then we'll have several courts giving us inconsistent answers. I think there's two answers. Either move quickly through the chain of preparing or providing IFRS statements, or have a solid base on top that catches those errors.

Pierre Delsaux: First of all, about terminology, when I heard people saying court decisions might not be consistent between themselves. That's not the question. The question is to which extent are they consistent with the standard? Because as we said, I mean, a standard could get different interpretations, different applications, as long as it's different interpretations within the scope of the standard, it's not a problem. That, I would say, the rule of the game, if I can use the word rule of the game in this particular case. Indirectly, you might have different interpretation of the same standard so the question is basically just to avoid that your interpretation application which goes beyond the scope of the standard. That's the first problem.

Now, the second problem, of course it's important that to some extent, because in certain particular cases, for certain standards, certain questions, we might have the problem of just simply to understand how the standards could be applied, could be interpreted and that, of course, very important questions if you want to achieve what we want to achieve.

From this point of view, the position which has been taken by the Commission so far and which will remain, is very clear. We don't want to create interpretation, some kind of binding interpretation, at Community level. If we have to receive interpretation, the body that should deliver this interpretation is IFRIC and, of course, IFRIC should have adequate resources and should respond quickly to these kinds of problems because if we raise an issue and we bring an issue to IFRIC it's because we consider it's an important one and we need to get an answer as soon as possible and a clear answer of course, not an answer which needs another interpretation.

So that's why we have decided, we have not yet decided but we are envisioning to create a round table where basically all stakeholders would be part of it coming from different backgrounds, different constituencies, different Member States, where issues will be discussed, just to try to act as a filter, just to discover what kinds of issues are really so sensitive, so important, that we have a real problem of interpretation which needs to be sent to IFRIC.

I know it will be a difficult task. Having heard the discussion around this table, clearly when you bring auditors, national standard setters, regulators around the same table, there will be, I'm sure, lively discussion; that's important. But again then to act as a filter before bringing cases to IFRIC which should be the body to give interpretation.

Now we have also another step, another phase, that when you have a practical case, when you have a prospectus, for instance, containing certain information, needs to be vetted by a regulator. Of course a regulator when he will, vet the prospectus will have to look also at the content of the IFRS and to make an assessment which is correct. But it's different. That's an application in a concrete case, in one particular situation, of IFRS and just checking as to which extent this application in this particular case has been done correctly but it is the role of regulators, they monitor all other rules which could be part of a prospectus.

Ed Duncan, International Swaps and Derivatives Association, UK: My question relates to the informal round table that you've just raised. I would like to ask the panel's advice really. I guess over the last couple of years our members have focused any of their interpretation issues or concerns on IFRIC and have attempted to persuade IFRIC to hear their concerns and debate the issues that they believe they have. What would you now advise them to do in relation to the Commission's informal round table and how do you propose to avoid duplication with the work of IFRIC and any potential confusion with the conclusions that both IFRIC arrive at and potential conclusions that the round table will arrive at?

Pierre Delsaux: Before I give the floor, to use my privilege as a president, first of all, let's be clear. No firm decision has been taken so far to create this round table. As it was mentioned this morning, that's something we are exploring. It's possible that we will create it but first no decision today has been formally taken on this issue. Now, as I said, the role of this round table is not to deliver interpretations. The round table, if we were to create such a round table, will not be there to create European interpretations of IFRS. It will be there only to act as a filter. What does it mean? Let's suppose that you have a problem of interpretation in Germany and there's a problem in Austria and a similar problem in Spain. The idea for the round table to meet together to identify the nature of the problem, to assess to which extent it's a real problem which deserves to be answered by IFRIC and if it's the case to send the question to IFRIC. And, of course, we expect IFRIC to be efficient and to give us an answer which we can apply, which can be used in the community. That's the role of the round table so it's a role to be there just to supplement or to substitute to IFRIC. That's the way we see it from the Commission point of view. But I have used my privilege and now I give the floor to the other members of the panel.

Gilbert Gélard: I think it is exactly what has to be expected from IFRIC. IFRIC has the task to interpret. For a subject to be valid for interpretation has to be of widespread application, it must not be a straight answer to a question that is a straight question. As I said in my speech, it must add value to the standard. It makes the principle clearer and it gives insight into the solution for a lot of problems that were not explicitly addressed by the standard. If you have a problem in three countries which is the same, clearly, is a problem valid for interpretation because we can suspect it will not be present in these three countries only, it must be somewhere else in the world also, may be under a slightly different form.

Bill Knight: Only to say this is a principle-based discussion. I would like to see some real facts.

Pierre Delsaux: But we have time to see them. Okay, I would like to thank all the panellists for their contribution. I don't know whether we bring light to you but at least we are starting a process which we hope will deliver results in the future.

Hans van Damme: Ladies and gentlemen. We're getting towards the end of the day but we are not yet at the end. We have a challenging discussion and a challenging speech addressed to us by Madam Pervenche Berès as a Member of the European Parliament really interested in this subject and I am confident that she will certainly have some critical words without being too critical, I hope, for the total atmosphere, but I would certainly request you to take the stand and address the audience.