

**Policy Department
Economic and Scientific Policy**

**INTERNATIONAL FINANCIAL
REPORTING STANDARDS / IASB**

WORKSHOP

Brussels, 19 December 2006

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**DIRECTORATE-GENERAL INTERNAL POLICIES OF THE UNION
- DIRECTORATE A -
ECONOMIC AND SCIENTIFIC POLICIES**

**Workshop on IFRS
*Programme***

19 December 2006
European Parliament Brussels
Room ASP 5 G 3
9.00-13.30 (interpretation (EN, FR, DE, IT, ES) till 12.30 only!)

9.00 - 10.30 Session 1

Governance Issues, role of IASB

- Governance: Structure of IASB, how are members of the board elected; what working methods are used; and how does decision making take place?
- How can neutrality/independence be insured in financing IASB?
- Ensuring a role for stakeholders
- Role of IASB in creating EU-wide transparent financial market
- Role of EU institutions; representation and weight of opinions
- Issue of due process – how is a standard developed, who is heard? Is the process transparent and well documented?

Guest speakers:

Jens Roder, PWC DK partner senior adviser to the trustees of IASCF on IFRS adoption in Europe

European Commission, Pierre Delsaux, Acting Director, Company Law, Corporate Governance

Dr. Oliver Roth, LempHirz GmbH, Member of the IASB Working Group on SMEs

Nicolas Véron, Research Fellow at Bruegel (European thinktank on international economics)

10.30 -12.00 Session 2

Specific impact issues for SMEs and Competitiveness

- IASB project for SME's state of play ; valuation of share capital for non listed companies
- Complexity of rules impacting competitiveness SME's
- Consistency across EU

Guest speakers:

John Hegarty, World Bank

Paul Pacter (Deloitte), Project Manager of the IASB SME project

Jose Maria Bove, Chairman FEE SME working Group

Frederic Soudain, ESBA (European Small Business Alliance)

Erhard Gschrey, Verbandsdirektor, stellvertretender Vorstandsvorsitzender des Genossenschaftsverbandes Bayern

12.00-13.30

Session 3

Practical Issues IFRS

- A critical assessment of transatlantic convergence/differences in IASB/FASB (state of play, consistency, compliance)
- How to ensure consistency and comparability without giving rise to volatility of earnings and complexity through too much disclosure, Fair value
- Financial statement presentation and revenue recognition, Automation of systems, IAS 39, progress on 2nd carve out (interest margin hedge)
- problems of joint ventures and multinationals with dual requirements (financial statement presentation issues)
- Benefits or drawbacks in competitiveness, difficulties in implementation
- Role of Regulator in ensuring smooth progression, active or passive?

Guest speakers:

• Philippe Danjou, IASB Member

• Francois Masquelier, Head of Treasury & Corporate Finance RTL Group, member of working group within EACT on financial instruments and IFRS/IAS issues

• Stig Enevoldsen, EFRAG representative

• Noreen Whelan, American Chamber of Commerce



Governance and Role of the IASC Foundation and IASB

Nicolas Véron
Research Fellow at Bruegel
European Parliament Workshop on IFRS, 19 December 2006



IASCF/IASB Governance: General Comments

- **Rise to Public Responsibility**
 - Because Accounting Standards are not neutral
- **Sea Change from Previous Situation**
- **2001 Reform (and 2005 Constitution Review) Have Been Positive Steps**
- **IASCF and IASB Should Not Underestimate Challenges**

'The world today does not have enough international institutions that can confer legitimacy on collective action, and creating new institutions that will better balance the requirements of legitimacy and effectiveness will be the prime task for the coming generation.'

Francis Fukuyama, *America at the Crossroads*, 2006
- **Hiding Behind 'Technical' Role Will Not Be Enough**
 - Step 1: Assume Identity as Institution (→ Name)



IASCF/IASB Governance: Accountability

- **Appointment of Trustees**
 - Current System Lacks Checks
 - Trustee Appointments Advisory Group Does not Solve Accountability Issue
- **Appointment of Board Members**
 - Rebalancing of Board Member Nationalities is Positive
 - Effort Should Be Continued; also Investor-Side Representation
- **Transparency is Insufficient**
 - Identification and Individual Contribution of Each Funder
 - Contributions in Kind (e.g. Secondment of Experts)
 - Compensation of Board Members and Senior Officials



IASCF/IASB Governance: Funding

- **No 'Ideal' Funding Structure**
- **Sustainable Model Must be Built**
- **Some Suggestions for the Debate**
 - High Diversity
 - e.g. 2% Maximum Share of Funding after 2010?
 - Broad Targeting of Overall Balance
 - e.g. Public Entities 25-35%, Issuers 25-35%, Audit Firms 15-25%, Investors 15-25%?
 - Governance Rights for Each Group Separately, or for All Funders Together?
 - Resources from Publications Should be Scaled Down
- **Government Funding Should Not be Taboo if Appropriate Governance Mechanisms in Place**
 - Options for EU Representation?



IASB Role and Process

- **Convergence Should Be Towards Highest Quality**
 - IFRS 8 Not Appropriate, Both in Itself and as Precedent
 - EU Must Not Adopt It
- **Monitoring of Local Implementation**
 - IFRIC Responsiveness
 - Communication with Audit Firms
 - Communication with Public Authorities



Thank You For Your Attention

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European Parliament Workshop

Accounting Standards and SMEs
A World Bank Perspective

Brussels, 19 December 2006

John Hegarty
Manager, Financial Management
Europe and Central Asia Region

THE WORLD BANK

Introduction

The Need for a Strengthened International Financial Architecture

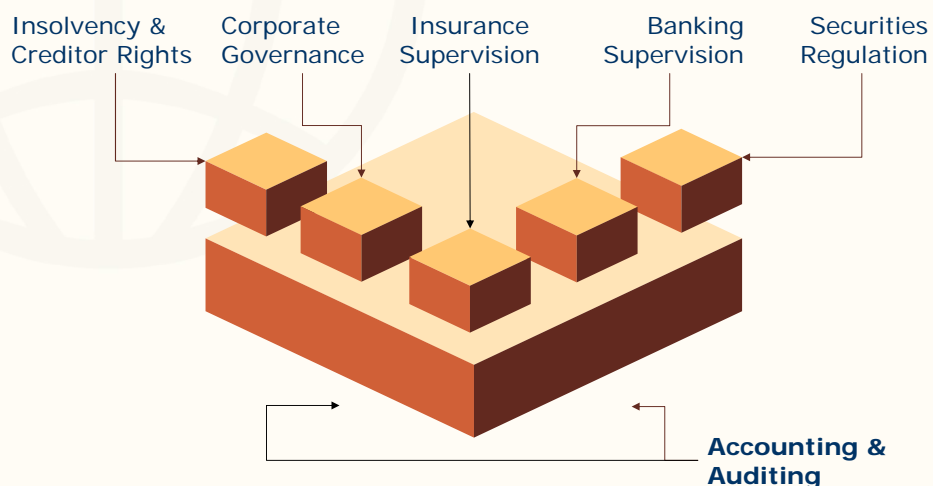
1990s – Emerging Market Crises and contagion effects



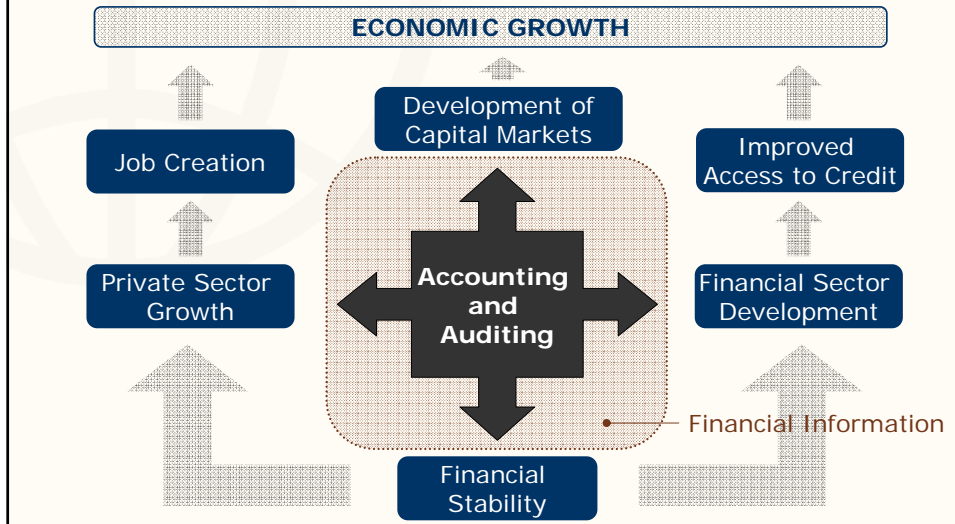
The Need for a Strengthened International Financial Architecture

Shift from ex-post crisis resolution → Ex-ante crisis prevention

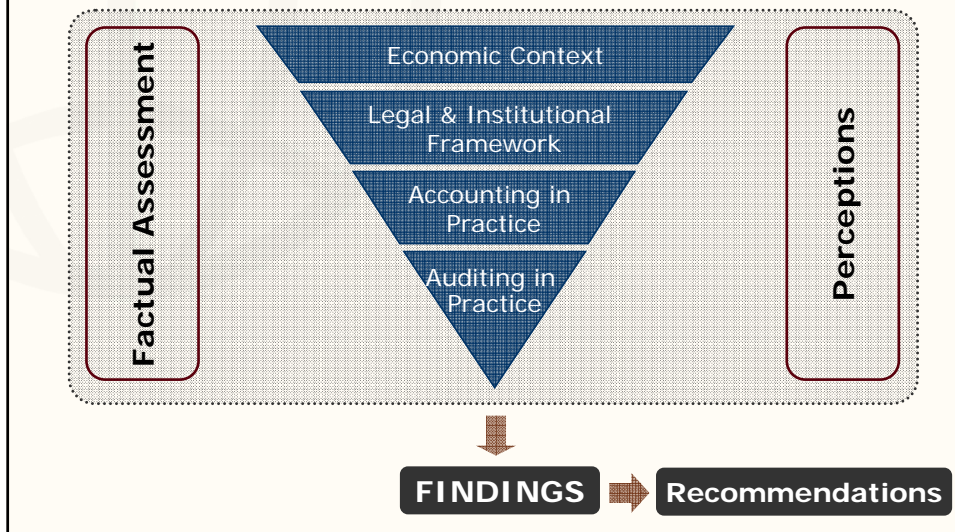
Accounting and Auditing A fundamental pillar



Importance of High Quality Accounting and Auditing



A&A ROSC Assessing the Quality of the A&A Framework



International A&A Regulation Key Benchmarks

Benchmarks:

International Dimension



European Union



Acquis communautaire



CEBS (Banking)

CEIOPS (Insurance)

CESR (Securities Markets)

A&A ROSC Global Coverage

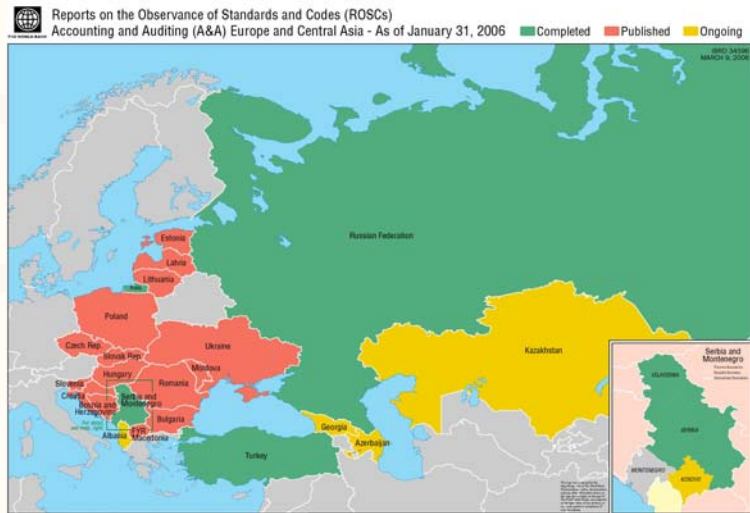


Reports on the Observance of Standards and Codes (ROSCs)
Accounting and Auditing (A&A) Worldwide - As of January 31, 2006

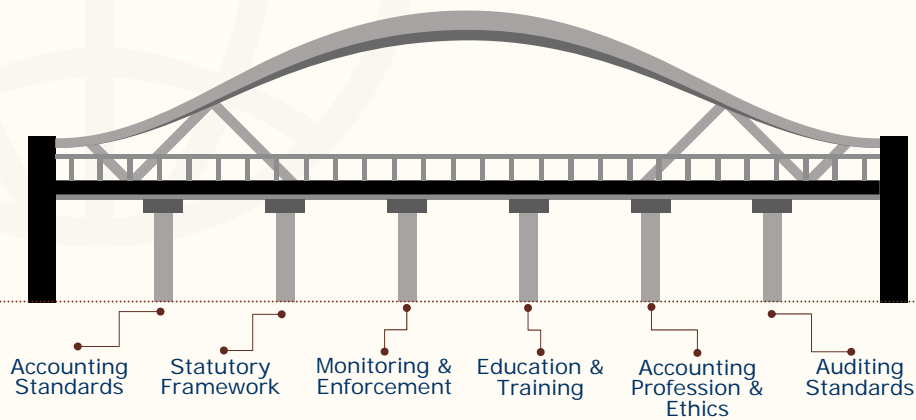
Completed Published Ongoing



A&A ROSC Europe and Central Asia

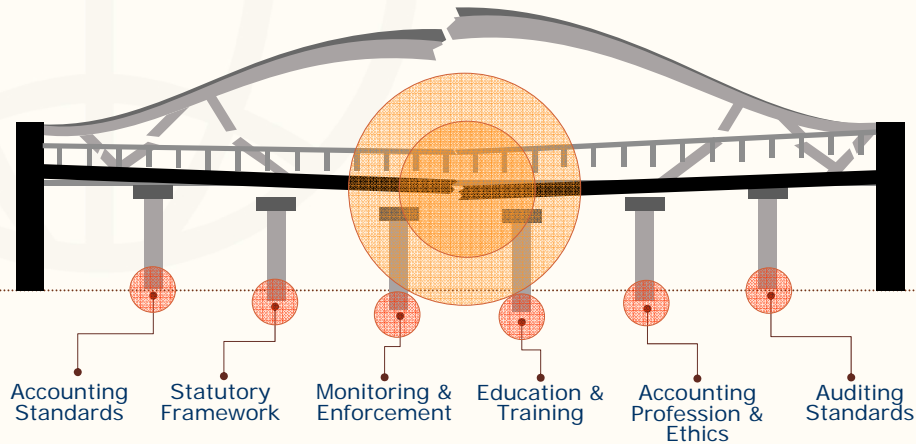


Importance of the **financial reporting infrastructure** not just accounting and auditing standards



Financial Reporting Infrastructure

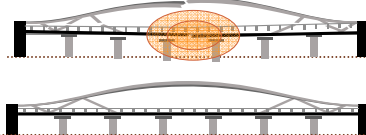
All supporting pillars need to **be strengthened**




From ROSC to Reform

From Diagnostic to Reform

 Country Strategy and Action Plan (CAP)



 Support funding for the CAP, mobilizing financial support from Bank and development partners. For example:

- ▶ Road to Europe – Program of Accounting Reform and Institutional Strengthening, including:
 - ✚ GDLN Program in Accounting and Audit Regulation for South East Europe (28 modules, 14 locations, 8 languages)
 - ✚ Vienna Workshop on Accounting and Audit Regulation (March 14 and 15, 2006)
 - ✚ Multi-donor trust funds to support design and implementation of individual CAPs
 - ✚ Vienna REPARIS secretariat

Critical Success Factor:
Integration with other areas of regulation / standards and codes

Scope of application of international standards

- ❑ Severe risks to the culture of compliance when the scope of application is inappropriate
- ❑ IFRS/IAS not suitable for use by all enterprises
- ❑ Widespread general purpose reporting obligations for enterprises other than “public interest entities”
- ❑ Company law or securities regulation as the legal basis for accounting and auditing requirements
- ❑ Linkages between compliance and capacity: even if user demands don't differ, preparer capacity to comply may do so
- ❑ Importance of cost/benefit considerations in setting public policy
- ❑ Managing the “Big GAAP / Little GAAP(s)” distinction
- ❑ Future of (“Little GAAP(s) Only”) national standard setters
- ❑ At what level should SME accounting standards be set: global, European, or national?

Mechanisms to grant national authority to international standards

- ❑ Without force of law/regulation, “international” standards become “offshore” standards
- ❑ Constraints on granting national public authority to international private standards
- ❑ Backing for the standard-setting process or for individual standards, frequency of change, keeping up to date
- ❑ Timely and complete translation, copyright/royalties, gazetting
- ❑ Role of legislation -v- standards
- ❑ Company law or securities regulation as the legal basis for accounting and auditing requirements
- ❑ Example of EU IAS Regulation / endorsement mechanism for public interest entities, and the Fourth Directive for other entities (including SMEs)

Linkages between general purpose and regulatory reporting

- 📄 Policy objectives of international standards and national regulatory reporting regimes not always aligned
- 📄 Regulatory reporting includes that for taxation and company law purposes, which are often the most important for SMEs
- 📄 Risk of conflicts when international standards adopted through regulatory reporting mechanisms
- 📄 However, specialist regulatory bodies can play a major and positive role in oversight/monitoring/enforcement
- 📄 Avoid completely parallel systems, encourage adoption of a common general purpose reporting platform, keep reconciling items to a minimum, and harness the oversight/monitoring/enforcement capacity of regulators
- 📄 Is the IASB sufficiently attentive to regulatory concerns?

Getting the preconditions right (1/2) International Accounting Standards for SMEs

- 📄 Benefits of international standards
 - Off-the-shelf solutions for capacity-constrained countries
 - Due process
 - High quality
 - International comparability and acceptance
 - World Bank support for IASB SME project
- 📄 Capacity to comply
 - Complexity a threat to preparer responsibility, auditor independence
 - Stability
 - Understandability
 - Self-contained body of standards
 - Availability of easily used measurement benchmarks
 - Education, training and experience of all concerned (preparers, auditors, users, regulators – including taxation authorities)
 - Recognizing the diversity of SMEs – does one size fit all?

Getting the preconditions right (2/2) International Accounting Standards for SMEs

Legitimacy

- Ensuring that the standard-setter is responsive to SME considerations
- Aligning with other relevant public policy objectives, and other regulatory reporting obligations (e.g. taxation)
- Should represent an improvement on existing local standards, including in the medium- to long-term
- Passing the cost/benefit test
- Need for political endorsement

European Parliament Workshop

Accounting Standards and SMEs A World Bank Perspective

Brussels, 19 December 2006

John Hegarty
Manager, Financial Management
Europe and Central Asia Region

THE WORLD BANK



An International Financial Reporting Standard for SMEs

Paul Pacter

IASB Director of Standards for Small and Medium-sized Entities

Workshop on IFRS

European Parliament Committee on Economic and Monetary Affairs

19 December 2006

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1



Why SME Standards Are Needed

- Benefits of global accounting standards for listed companies are obvious in globalised financial markets.
- Even for unlisted SMEs, financial statements that are understandable across borders are needed:
 - Banks make loans across borders and operate multi-nationally.
 - Vendors from other countries.
 - Credit rating agencies.
 - Overseas customers.
 - Foreign venture capital.

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2



Why SME Standards Are Needed

- **Two edged-sword for SMEs:**
 - Good accounting and more disclosure add to SME burdens, not reduce them.
 - SMEs often see greater transparency as 'competitively harmful'.
 - At the same time, good accounting and disclosure give investors confidence to provide capital.
- **Solution: Tailor requirements for SMEs. This is what the IASB SME project is all about.**

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IASB Definition of SME

- **IASB tentative view:**
 - IFRS for SMEs is appropriate for an entity with no public accountability:
 - **not publicly traded; and**
 - **not a financial institution.**
 - An entity whose securities are publicly traded has public accountability.
 - **Need full IFRSs for investor protection.**

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IASB Approach

1. Focus on non-publicly accountable entities that publish general purpose financial statements for external users, including:
 - **Non-manager owners**
 - **Existing and potential lenders and creditors**
 - **Credit rating agencies**
2. Focus on typical SME with about 50 employees in deciding the content of the IFRS for SMEs.

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IASB Approach

3. No quantified "size test". Each jurisdiction should develop guidelines on which entities will use the IFRS for SMEs.
4. Stand-alone document as much as possible.
5. Framework concepts and pervasive principles added, to minimise need for fallback to full IFRSs.

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IASB Approach

6. Material not relevant to typical SME omitted, with cross-references to full IFRSs if needed:

- **Hyperinflation**
- **Equity-settled share-based payment**
- **Agriculture**
- **Extractive industries**
- **Interim reporting**
- **Lessor finance leases**

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IASB Approach

7. Only simpler of options in full IFRS are included. Other(s) cross-referenced. So, only:

- **Cost for investment property.**
- **Cost for PP&E and intangibles.**
- **Expense all borrowing cost.**
- **Indirect operating cash flows.**
- **One method for all grants.**

Jurisdictions could eliminate options.

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IASB Approach

8. Recognition and measurement simplifications, page 1 of 2:

- **Financial instruments:**
 - Two classifications, not four
 - Drop “continuing involvement approach” for derecognition
 - Much simplified hedge accounting
- **Goodwill impairment – indicator approach**
- **Expense all R&D**
- **Cost method for associates and JVs**
- **Income taxes – simplified method**

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IASB Approach

8. Recognition and measurement simplifications, page 2 of 2

- **Less fair value for agriculture – only if “readily determinable” fair value**
- **Defined benefit plans – principle approach, no corridor tests**
- **Share-based payment – intrinsic value**
- **First-time adoption – less prior data**

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IASB Approach

9. SME must try to find answers in SME standard by analogy and by using pervasive principles.
10. But – SME may look to full IFRSs as a “safety net” – if answer cannot be found otherwise.
 - **Expected to be rare for typical SME.**

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Other Issues

- Suitability for micro-SMEs (tiny)
 - **Yes, definitely**
- Usefulness to managers of SMEs
 - **Yes, but not IASB objective**
- Usefulness for tax returns and dividend distribution
 - **Yes, but not IASB objective**

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Rejected Simplifications

- Drop the cash flow statement.
- All leases operating.
- All pension plans defined contribution.
- Completed contract only.
- Fewer provisions.
- Non-recognition of share-based payment.
- Non-recognition of deferred taxes.
- Cost model for all agriculture.
- No consolidation.
- Derivatives at cost.

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The Effort: Due Process

- **Discussion paper on approach.**
 - June 2004. 120 comments received.
- **Recognition and measurement (R&M) questionnaire.**
 - April 2005. 101 responses.
- **Public roundtables on R&M.**
 - October 2005. 45 participants.
- **Working Group**
 - Three meetings
 - January 2006 discussed draft ED two days. 84 recommendations to Board.

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The Effort: Due Process

- **Discussed with World Standard Setters:**
 - 2004, 2005, 2006. Feedback sessions.
- **Discussed with SAC:**
 - 2001, 2003, 2004, 2005, 2006.
- **Board deliberations—public meetings:**
 - 2003 – 4 meetings
 - 2004 – 9 meetings
 - 2005 – 7 meetings
 - 2006 – 9 meetings (so far)

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The Result: Draft Exposure Draft

- **The draft ED now:**
 - About 220 pages
 - **Full IFRSs now 2,400 pages.**
 - Organised by topic
 - 38 sections
 - Developed by considering needs of a company with about 50 employees
 - Model financial statements
 - Disclosure checklist

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The Result: Draft Exposure Draft

- **Board vote Oct 2006:**
 - 11-1 (+1 wait to see final draft) in favour of issuing the ED.
- **Draft posted on IASB website in August 2006 and updated November 2006**
 - Stimulate early thinking.
- **Translations of ED in Spanish, French, German.**

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SME Concern: "Maintenance"

- **SMEs are worried about frequent updating of IFRS for SMEs:**
- **Board decision:**
 - Update the IFRS for SMEs every 2 years.
 - Omnibus Exposure Draft.

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Next Steps

Tentative dates:

- **Exposure Draft –Jan. 2007.**
 - Six month comment period.
- **Field tests and/or visits to SMEs? Roundtables?**
- **Final Standard – 1H 2008.**
- **Effective –2009.**

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Thank you.

EXPRESSIONS OF INDIVIDUAL VIEWS BY MEMBERS OF THE IASB AND ITS STAFF ARE ENCOURAGED. THE VIEWS EXPRESSED IN THIS PRESENTATION ARE THOSE OF DR. PACTER. OFFICIAL POSITIONS OF THE IASB ON ACCOUNTING MATTERS ARE DETERMINED ONLY AFTER EXTENSIVE DUE PROCESS AND DELIBERATION.



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European Parliament Workshop on IFRS

19 December 2006 – Brussels

Session 2 Specific Impact Issues for SMEs
and Competitiveness

José Maria Bové, FEE Vice-President
SME/SMP Matters

1



FEE - European Federation of Accountants

- Representative organisation for the accountancy profession in Europe
- 44 Member organisations in 32 countries
 - ↪ Including all 25 EU countries, 2 candidate countries and 3 EFTA members
- Representing a combined membership of over 500.000 individuals
 - ↪ 45 % in public practice
 - ↪ 55 % industry, commerce, government and education

2



Financial Reporting

- Principles-based
- Transparency
- Communication tool

Different needs for different sizes of companies?

3



Financial Reporting

Over time FEE has been supportive of a separate set of financial reporting standards for SMEs

But need to address:

- Different user and preparer needs
- Practicability
- Cost-benefit considerations
- Voluntary application
- Less Complexity

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Is there a need for comparability?

- Harmonisation of financial reporting for non-listed entities
- 4th and 7th Directive: Not all topics; Options
- Subsidiaries IFRS Group
- Cross border trading

5

But what is an SME?

- A big company in one country can be a small company in another country
- IASB working definition 50 employees: is this too big for small?
- SMEs to be split into three
 - ↳ Medium sized enterprises
 - ↳ Small enterprises
 - ↳ Micro enterprises

Can one standard fit all?

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Financial Reporting

Different standards for different sizes?

- *Micro* enterprises: tax (cash) accounting
- *Small* enterprises: tax accounting/national legislation
 - ↳ Embedded in national environment
 - ↳ Several countries have an SME standard
 - ↳ Limited need for comparability
 - ↳ Need for simple accounting

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Financial Reporting

Different standards for different sizes?

- *Medium* sized non-listed enterprises: IASB Exposure Draft appropriate?
 - ↳ Comparability – Competitiveness
 - ↳ More complex transactions
 - ↳ Need for simplification of measurement and recognition
 - ↳ Sufficient simplification?
 - ↳ Market pressure to apply full IFRS?

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European Commission simplification project:

- To pay attention to Exposure Draft IFRS for SMEs

Other initiatives:

- ISAR/UNCTAD: SMEGA Level 2 and Level 3
- various national SME standards

Positive elements of the proposal

- Simplified framework for SMEs: pervasive principles
- Workable definition of “non public accountable” entity without size test
- Hierarchy for selection of accounting policies favours a “self contained” standard
- Optional application of the standard; left to jurisdiction to decide
- A certain level of simplification achieved for financial instruments, goodwill impairment and defined benefit plans



Financial Reporting

Further simplification needed:

Key issues for FEE:

- No mandatory fall back to full IFRS (hierarchy)
- Stand alone document
- Simplification of measurement and recognition requirements
- No options for measurement and recognition, with exemption of those options that could be of benefit to SMEs
- Historical cost overall principle

Fair value: follow EFRAG criteria

- ↳ Observable market data available
- ↳ Commitment or plan to sell

- Stewardship

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Financial Reporting

Is IFRS for SMEs relevant?

- Yes, if further simplified
- For countries that have no own national SME standards (use IFRS already before 2005)
- Assists in increasing knowledge about IFRS
- Where there is a need for comparability
- Competitiveness
- Help cross-border investment

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Other questions

- Do all European Member States participate in the process of developing IFRS?
- Do we all have the right level of English to understand the process? Are translations going to be available on time?
- Can personnel of standard setters, academics, accountancy profession, etc. follow the process? Training required

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Conclusion

- We are not there yet...
- Good work done so far but further simplification needed
- All to comment on Exposure Draft with a clear indication what we want
- One standard can never fit all sizes!
- FEE ready to support and be involved in further discussion

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FEE

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▶ IAS/IFRS for SME

Erhard Gschrey

Wirtschaftsprüfer/Steuerberater

vice CEO

Co-operative Confederation of Bavaria

IAS/IFRS for SME

1. Definitions
2. Significance of small and medium-sized businesses in Germany
3. Using IAS/IFRS
4. Complexity/Costs
5. Fair Value measurement vs. prudence/historical costs
6. IAS 19
7. IAS 32

1. Definitions

- ▶ SME: „small and medium-sized entities“
- ▶ **IFRS for SME** is intended for use by small and medium-sized entities
SMEs are entities that do not have public accountability
- ▶ An entity has public accountability if:
 - ↳ it has filed, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or
 - ↳ it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, pension fund, investment banking entity
- ▶ **Problem:** co-operative banks and savings banks, per se small and medium-sized entities, couldn't use IFRS for SME!

2. Significance of small and medium-sized businesses in Germany

- ▶ **SME** – the „baseplate“ of the german economy
 - ↳ 3,3 Mio. entities (= 99,7 % of all entities)
 - ↳ 50 % of gross investments
 - ↳ 60 % of gross value added
 - ↳ 70 % of all employees
 - ↳ 83 % of all apprentices

(Zitat: D. Philipp, President - central handcraft confederation of germany)

3. Using IAS/IFRS (1)

- ▶ IAS/IFRS should be aimed
 - for entities which are oriented on capital markets
 and also
 - for entities which are not oriented on capital markets also
- ▶ **Users** of financial statements
 - ↪ entities which are oriented on capital markets:
 - present and potential investors and suppliers
 - ↪ entities which are not oriented on capital markets:
 - owners and owner-managers, creditors, tax authorities

independent from the used accounting rules

3. Using IAS/IFRS (2)

- ▶ IAS/IFRS for SME = appr. 240 – 250 pages
- ▶ Full IFRS = appr. 2.400 pages
- ▶ Decision of IASB = SME standards should include as much accounting options or allowed alternatives as full IFRSs
- ▶ **Disadvantage:** SMEs are required to apply SME standards and – additionally – full IFRS in case of doubt or when no specific rule for SME exists
- ▶ **Proposals:**
 - ↪ IFRS for SME as a single set of standards which will be developed fairly separate from full IFRS?
 - ↪ Separate new SME-Framework?
 - ↪ Accounting options or allowed alternatives should be include!

4. Complexity/Costs

- ▶ IFRS for SME is too **complex**
- ▶ Balance between benefit and cost
- ▶ Information overflow:
additional information depends on the needs of the users
 - ↪ special facilities for small entities are necessary

5. Fair Value measurement vs. prudence/historical costs (1)

- ▶ Fair value measurement should only be applied for instruments if market prices are observable
- ▶ Otherwise financial instruments held by SMEs should be measured at amortised costs
- ▶ Fair Value measurement:
 - ↪ if no market data are available alternative fair value measurement methods are problematic because SMEs usually will not be able to calculate reliable values
 - ↪ Impairment is not reliable
 - ↪ Measurement at amortised costs ensures prudence

5. Fair Value measurement vs. prudence/historical costs (2)

- ▶ anno 1861: Fair Value measurement was already established for Corporations
- ▶ anno 1884: Fair Value measurement was replaced by measurement at amortised costs
 - only in rare cases fair values in the form of market prices exist
 - reported fair values weren't reliable

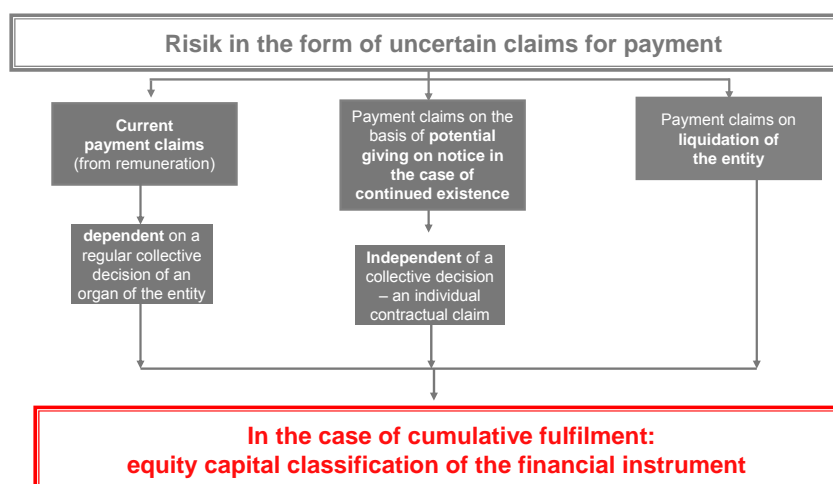
6. IAS 19

- ▶ In principal recognition and measurement methods in IAS 19 concerning accrual for pensions is welcome
- ▶ IAS 19 as a potential guideline for german law
 - ↳ discount rate
 - ↳ future wage or rather salary increases
 - ↳ new biometric principles

7. IAS 32 (1)

- ▶ IAS 32 is especially a considerable barrier for using IFRS for SME
 - ↪ 8.000 co-operatives in Germany
 - ↪ 796.000 limited liability companies
 - ↪ 131.000 limited partnerships
 - ↪ 200.000 business partnerships
- ▶ Interpretation IFRIC 2: no permanent solution
- ▶ IAS 32 must be totally overhaul
 - ↪ Loss absorption has to be the decisive factor for determining the distinction between equity and liability

- ▶ Advisory opinion by Prof. Baetge/Prof. Kirsch (DGRV-paper 2006)



7. IAS 32 (3)

▶ Differentiation between Equity and Liability According to IAS/IFRS

↪ Proposal IASB:

- Ownership Approach added to Settlement Approach (ED Admendments to IAS 32)

↪ Proposed modifications of IAS 32

(cf. advisory opinion Prof. Baetge/Prof. Kirsch)

- Conceptional point of view
 - Which payment obligations has the capital-receiving entity to the investors?
 - To which risks the payment claims of investors are exposed?

Workshop on IFRS
European Parliament – 19 December 2006
Session 3 – Practical issues re IFRS

Philippe DANJOU
Member of IASB

** The views expressed are those of the speaker, not of the IASCF or IASB*

19 December 2006

P. Danjou

1

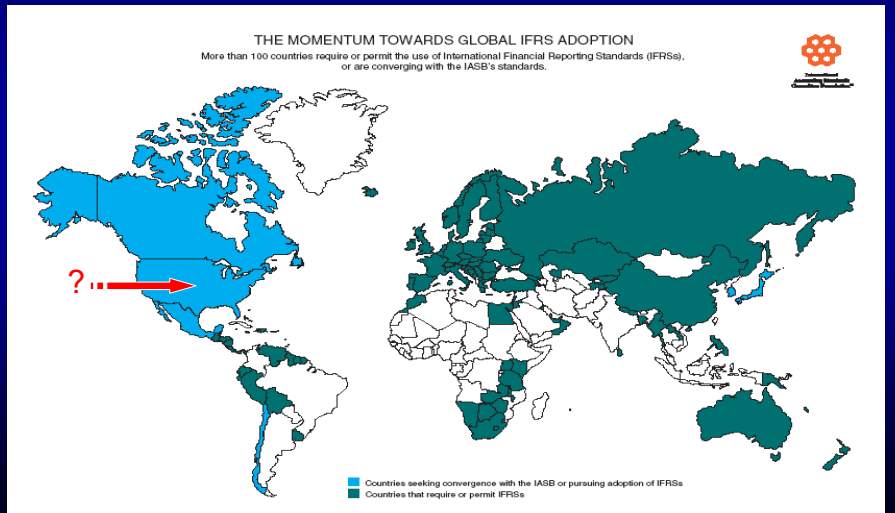
Some key topics on the current agenda

- **IFRS – US Convergence program**
 - Removing the US GAAP reconciliation
- **Convergence with other than US GAAP**
- **New due process policies**
 - Stable Platform 2004-2009
 - Increased public input and consultation
- **Implementation and Consistency : roles of IFRIC, Regulators, Auditors**
- **IFRS beyond the application to listed companies**
- **The IAS 39 “carve out” : what are the next steps ?**
- **Strategic : how can IASB best cope with its “new” role of worldwide standard setter (Trustees and Board) ?**

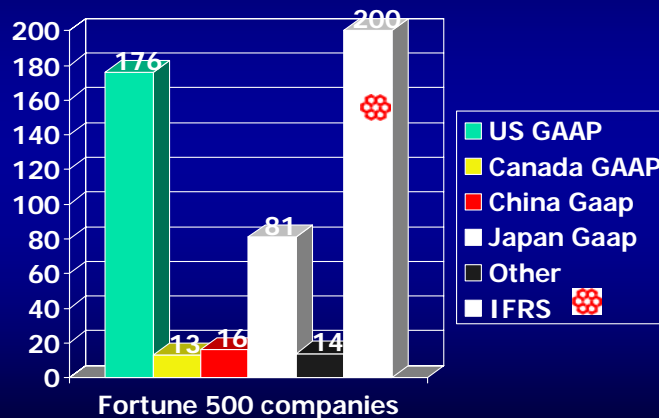
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The World is getting smaller...



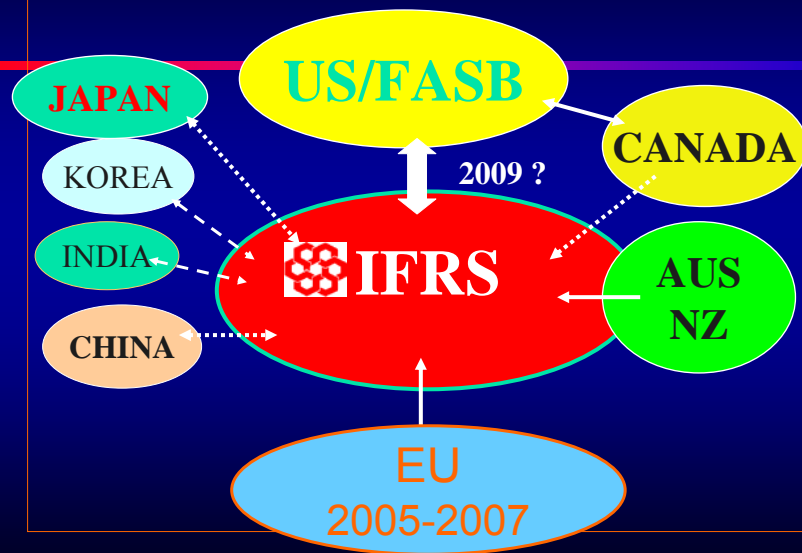
Use of IFRS / US GAAP by world's largest companies (2005)



19 December 2006

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ADOPTION, CONVERGENCE, EQUIVALENCE : A WORLDWIDE TREND



19 December 2006

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IASB' s new role

- De facto became a standard setter for the world
- Mandatory or permitted use
- Scope of application varies
- Endorsement by national authorities

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IFRS – US CONVERGENCE

- September 2002 : Norwalk Agreement
 - 27 February 2006 : MOU IASB-FASB
 - SEC's Roadmap to elimination of the reconciliation in 2009 at the latest
- A process with a few milestones rather than a completed work

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Norwalk agreement

- In 2002 IASB and FASB agreed to:
 - Remove differences
 - Align agendas
- SEC reconciliation should become unnecessary

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FOR IMMEDIATE RELEASE



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27 February 2006

**US FASB and IASB reaffirm commitment
to enhance consistency, comparability and efficiency
in global capital markets**

The US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) today published a Memorandum of Understanding (MOU) that reaffirms the boards' shared objective of developing high quality, common accounting standards for use in the world's capital markets. Both boards believe that a common set of high quality accounting standards will enhance the consistency, comparability and efficiency of financial statements, enabling global markets to move with less friction.

The MOU is a further elaboration of the objectives and principles first described in the boards' Norwalk Agreement published in October 2002. While the document does not represent a change in the boards' convergence work programme, it does, however, reflect the context of the 'roadmap' for the removal of the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It also reflects the work undertaken by the Committee of European Securities Regulators (CESR) to identify areas for improvement of accounting standards.

19 Decem

anjou

Convergence from US to IFRS already achieved

- SFAS 123R Share based payments
- Voluntary changes in accounting policies (converge to IAS 8)
- Inventories pricing – idle capacity
- Earnings per share

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Convergence MOU milestones

- Short term : 2006- 2008 Determine whether major differences should be eliminated and substantially complete work
- Other projects : either converge standard or issue one or more due process document (e.g DP or ED)

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Short term convergence

Examined by FASB

- Fair value option
- Impairments*
- Income tax*
- Investment properties
- R and D
- Subsequent events

Examined by IASB

- Borrowing costs (>)
- Impairments*
- Income tax*
- Government grants
- Joint ventures –
proport. Consolidation
- Segment reporting (>)

* Joint projects

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Other convergence projects

- Business combinations Phase II: IFRS in (H2) 2007
- Consolidations : ED in 2008
- Financial statements presentation
 - Phase A : IFRS in 2007
 - Phase B : DP in 2007, ED in 2008
- Fair value measurement guidance : RT in 2007, ED in 2008
- Revenue Recognition : DP in 2007
- Post retirement benefits : DP in 2007
- Leases : working group just formed; DP in 2008

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Stable platform and due process

- Stable platform 2005 delivered March 2004
- But certain missing blocks :
 - Service concessions = IFRIC 12 (december 2006)
 - Insurance contracts Phase II
- Stability for transition period 2005-2009

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IASB takes steps to assist adoption of IFRS and reinforce consultation – 24/07/2006 press release

- **Regulatory pause 2005-2009 : no new standard to become effective before 2009**
- **Increased lead time : minimum of one year between publication and implementation**
- **Increased opportunities for input from the public on conceptual issues : DP before ED**
- **Increased consultation on key topics : RT on each new significant evolution of standards**
 - **IAS 37 Provisions and Contingent Liabilities**

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IAS 39 second “carve out”

- **Macro hedging of asset / liabilities positions**
- **Public meeting with FBE on 13 Dec.2006**
 - **IRMH is in effect a subset of Cash flow hedge accounting**
 - **Next steps : FBE to highlight those portions of IAS 39 Application guidance that restrain banks from applying CFH provisions of IAS 39**
 - **Board and FIWG to review whether clarifications are needed**

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Other elements of the IASB programme

- **Conceptual Framework (with FASB)**
- **IFRS for SME's**
- **Insurance contracts (DP beginning 2007)**
- **Related-party disclosures**
- **FI : puttable instruments (IAS 32)**
- **Some other research agenda items to be conducted jointly with FASB**

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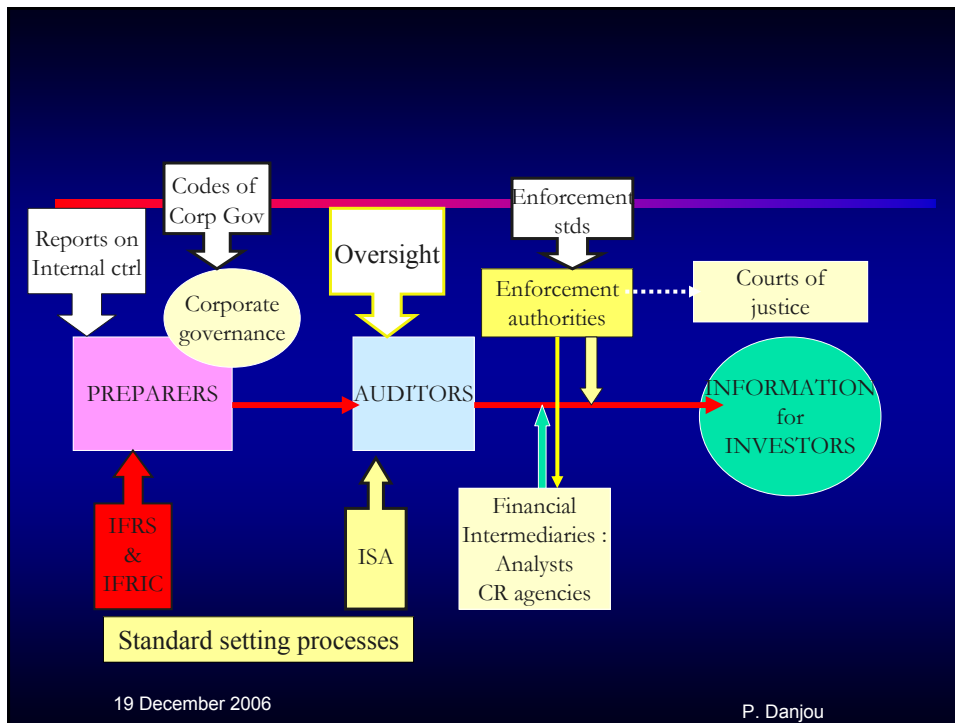
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From standard setting to consistent application

- **A complex chain that involves numerous standards and players**
- **IASB only one of them but aware of the role of the other**
- **IASB – IFRIC work closely with regulators (e.g CESRFin) and IAASB**

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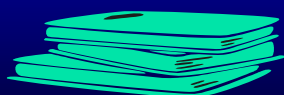
International Financial Reporting Interpretations Committee (IFRIC)

- Due Process Handbook in process of revision
 - Future of Agenda Committee ?
 - Increase Transparency
- More staff assigned

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Principle : Principle based standards



Principles

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Rules

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IFRIC AGENDA DECISIONS

- **Criteria for taking onto the agenda :**
 1. Question has a sufficiently wide application potential
 2. Divergent application of IFRS noted or likely to happen
 3. Question seems able to receive a consensus within IFRIC in a reasonable time frame
 4. The subject matter is not already included in a topic on the Board's agenda
- IFRIC may decide to take the question onboard, to reject it, or to forward it to the Board for improvement of the IFRS

19 December 2006

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EUROPEAN ASSOCIATIONS
OF CORPORATE TREASURERS

EACT and IAS 39



IFRS Workshop - Brussels
December 19th, 2006
F. Masquelier , Honorary Chairman EACT

Part I : What is EACT ?

Part II : IAS 39



EUROPEAN ASSOCIATIONS
OF CORPORATE TREASURERS

2

E.A.C.T.

- Treasurers associations in Europe decided to join their forces and to create EACT
 - Informal meetings from 1998
 - EACT - Euro Associations of Corporate Treasurers – set up in 2002
 - Becomes European Associations of Corporate Treasurers in 2004
- 17 National Treasury Associations (NTAs) – 16 countries



3

E.A.C.T. means "European Associations of Corporate Treasurers"

E.A.C.T

- More than 8.400 members
- +/- 4.700 corporates
- 17 NTA's from major european countries of the EU (ACT, AFTE, AITI, ASSET, ATEB, ATEL, CAT, DACT, FACT, GEFIU, HTC, IACT, ÖPWZ, SAF, SCTA, VDT)

Objectives

- To develop and strengthen relations with European Authorities and Institutions.
- To share experiences, express common points of views, undertake joint actions on financial and treasury matters as well as relationship with financial partners.
- To carry out and publish common surveys and working papers
- To defend all treasury functions



4

Current projects and fields on which E.A.C.T. is acting

- CAST (Corporate Actions on Standards)
- SEPA and European payments standardisation
- Financial Services Action Plan (MiFiD, ...)
- Basel II (McDonough ratios)
- IAS 39
- Education
- Rating processes (CRA)
- STEP (Short Term European Paper)
- Lobbying at international level
- Information to members (NTA)
- Cross-fertilization among associations



5

EACT consists of...

Address :
Its registered office is located in Paris at
AFTE
20, rue d'Athènes
F - 75009 Paris
Tel : 00 33 1 42 81 98 41

Chairman :
M. Pierre Poncet

Email :
secretary@eact-group.com
or
pierre.poncet@aol.com
www.eact-group.com



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www.eact-group.com

6

Couple of examples of EACT activities

The collage illustrates various EACT activities:

- www.eact-group.com**: A screenshot of the EACT website showing a list of member associations.
- JPMorgan survey**: A survey titled "Your views are important to us" from JPMorgan Asset Management.
- Press Releases**: A document titled "Automation of the Financial Supply Chain" and "Corporate Action on E-Funds (CAE) projects".
- TMI**: A magazine cover titled "Enhancing Cash Funds" with the headline "Virgin Flying in the Face of Rising Fuel Costs".
- EU Bodies**: A logo for the European Union.
- International Accounting Standards Board**: A logo for the IASB.

Logos at the bottom include the EACT logo (a stylized Euro symbol) and the International Accounting Standards Board logo.

Part I : What is EACT ?

Part II : IAS 39

The slide features a blue background with a white text box containing the text "Part II : IAS 39". The EACT logo (a stylized Euro symbol) is visible in the bottom left corner.

IAS 39 – E.A.C.T.

- EACT supports the IAS 39 principles of marking positions to market
- EACT considers that hedging of financial price risks by companies is important to them and to financial stability generally.
- The IASB's detailed rules for implementation of the principles of IAS 39, however, have serious potential impact on companies and may make effective hedging much more difficult and considerably more expensive to achieve for many companies.
- Simple changes, wholly consistent with the principles of IAS 39, are available to solve problems, and would bring IAS 39 more closely into line with US GAAP's in certain areas.



9

Working Group on Financial Instruments (WGFI)

Working Group on Financial Instruments Corporate Membership (4)

- ▶ Mark Kirkland – Philips
- ▶ François Masquelier – RTL Group
- ▶ Elisabeth Schmalfluss – Siemens
- ▶ Peter Zegger – Unilever*

* Replaced in July 2006 by M. Kristian Pullola - Nokia

10



WGFI - Objectives

- To take a fresh look at IAS 39 by examining and questioning the fundamentals of the standard within the context of the framework.
- Focus on :
 - Improving
 - Simplifying
 - Ultimately replacing IAS 39
- Possibility of short-term revisions but main focus is long term.



11

Remaining issues for Corporates

Fundamentally, hedge accounting should follow principles of risk management

- a. Treasury Centre Netting
- b. Derivatives hedging combinations of derivatives and non-derivatives
- c. Hedge effectiveness test (including commodities)
- d. Other
 - Managing interest rate risk against benchmark
 - Hedging with options
 - Tender hedging
 - Own-use exemption for commodity / energy companies
 - Short-cut Method



12

Convergence versus short term changes

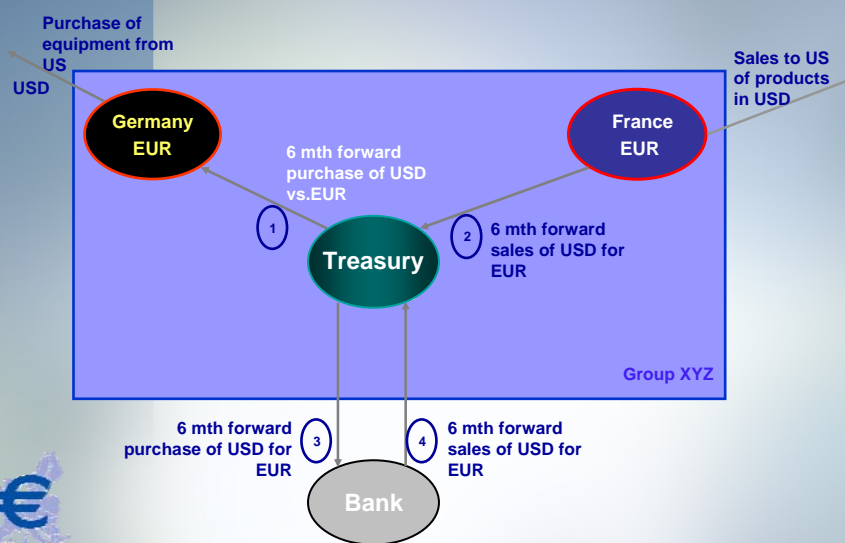
IASB has conflicting priorities

- International convergence (notably with FASB)
- Long term solution to replace IAS 39
- Short term fixes to IAS 39 to align better with risk management policies
- The last of these objectives, whilst critical for many treasurers is not at the top of the IASB's agenda
- Treasurers in the WGFI now looking to influence these priorities



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Treasury Centre Netting



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Example

Assume that XYZ Germany purchases USD 50mm and XYZ France sells USD 25mm 6 months forward

Also assume 1 month later the MTM of both forwards is 10% of the notional

		P&L	OCI	TCI
XYZ Germany		5		
XYZ France		-2.5		
Treasury	Internal	1	-5	
		2	+2.5	
	External	3	+5	
		4	-2.5	
		0	2.5	2.5



15

The current way of working

Advantages	Disadvantages
<p><u>Easy to Audit</u></p> <p>Every transaction deferred can be linked directly to a 3rd party transactions</p>	<p><u>Unnatural way of working</u></p> <p>Not how treasury would work in the absence of IAS 39 or FAS 133. Limited use of netting possible</p>
	<p><u>Expensive</u></p> <p>Larger number of external transactions</p>
	<p><u>Operational risk:</u></p> <p>Increased credit risk and possible errors due to large volumes.</p>



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Clear advantages

- Reduction in number of external hedges
- Clear to audit
- Corporates not wanting to be seen as speculating will ensure financial income & expense is minimized
- Comprehensive Income is not changed even if Treasury retains risks



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2. Hedge accounting for combinations of derivatives & non-derivatives

XYZ finances overseas subsidiaries in two ways – debt or equity

If the overseas entity is financed with debt – the debt is in the functional currency of the recipient. For example, XYZ entities in the US are financed with US Dollar denominated debt.

The holding company, in turn, borrows externally in US Dollar to match assets and liabilities.



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2. Hedge accounting for combinations of derivatives & non-derivatives (cont'd)

There are 2 ways to borrow in USD on a fixed basis

- Issue US Dollar denominated debt (e.g. USD Bond)
- Issue debt in another currency and swap to fixed USD

The second option is sometimes cheaper for XYZ.

But the accounting treatment is different !



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2. Hedge accounting for combinations of derivatives & non-derivatives (cont'd)

The USD bond is evaluated for changes in the FX rate

Alternative is to issue a

- a) EUR denominated bond
- b) Swap fixed EUR to floating EUR
- c) Use a basis swap to swap from floating EUR to floating USD
- d) Swap floating USD to fixed USD

But

- a) Has no revaluations result
- b) Apply fair value hedging
- c) Do not apply hedge accounting – revaluation offsets revaluation of USD intercompany loans
- d) No hedge accounting allowed ! Results in the P&L



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3. The 80 – 125% effectiveness requirements (commodity hedging)

- In some businesses, hedges are used which have a large basis to the underlying
e.g. chocolate manufacturer uses cocoa futures to hedge physical purchases OR Arabica to hedge Columbia coffee
- Over the life, the corporate knows there could be ineffectiveness but has deemed that hedging is better than doing nothing.
- Why is a 80 – 125% corridor effectiveness test necessary if all ineffectiveness goes to income ?



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4. Others

- Managing interest rates against benchmark
- Hedging with options
- Tender hedging
- Own-use exemption for commodity / energy companies
- Short-cut Method

Fundamentally, hedge accounting should follow principles of risk management



22



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Current work of the Corporates Subgroup of the FIWG

Proposal for simplifying Hedge Accounting

Members of the Corporate Subgroup

- Pauline Wallace – PWC
 - Sebastian di Paola – PWC
 - Bernd Hacker – Siemens
 - Elisabeth Schmalfluss – Siemens
 - Kristian Pullola – Nokia
 - Francois Masquelier – RTL
 - Mark Kirkland – Philips
 - Gary Throup – Philips
- } = Corporates
& Members
of FIWG



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Constraints of the IASB

- All changes should move towards Fair Value
- Any change should simplify the Standard



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Guiding Principles of the Subgroup

- Consistent – Two constructions which have the same economic effect should be accounted for in the same way
- Simple – The day to day working with the Standard should not be bureaucratic
- Transparent – The changes in fair value of all instruments should be seen either in P&L or in OCI
- Reflect Reality – Economic and Accounting considerations should lead to the same outcome.



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Proposal I

- Changes in the Fair Value of bonds, loans and deposits due to interest rate may be reflected either in P&L or OCI, and can be changed at any time
- Changes in the Fair Value of bonds, loans and deposits due to FX must be reflected in P&L
- Changes in the Fair Value of own bonds, loans and deposits due to changes in credit are reflected in OCI.
Therefore the changes in fair value of all debt instruments is shown in either P&L or OCI.



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Board Reaction

- How do you measure our credit?
- Why do you need the option to book in OCI or P&L? Why not all through P&L?



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Proposal II

- Eliminate “Fair Value Hedge Accounting” leaving only ‘Cash Flow Hedge Accounting’ and ‘Net Investment Hedge Accounting’ therefore the change in fair value of all derivatives is either in P&L or OCI.

The need to use Fair Value Hedge Accounting is eliminated for interest rate hedging by first proposal.



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Proposal III

- The hedged item can be a portfolio of items or a portfolio of items and derivatives

This ensures that the treatment of issuing in fixed USD for a EUR company is the same if they borrow fixed USD or borrow fixed EUR and swap to fixed USD.



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Board Remarks : to Proposal III

- How can effectiveness / ineffectiveness be traced?
- Does this create the need for complicated tracing of transactions



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Proposal IV

- In order to apply hedge accounting a business must show that the hedge is expected to reduce the risk of the portfolio (can be qualitative)
- At reporting dates, ineffectiveness is released to the P&L for all hedges with no requirement for a 80-125% test

This ensures that businesses that hedge commodities where the basis is very volatile can still apply hedge accounting even though the hedge may not always be highly effective.



32

Board Reaction

- Did not like the term “reduce risk”. Preferred a name like “offset test”
- Support for elimination of 80 – 125% test



33

Next Steps

- Meeting with IASB in July 2006
- Clarify the issues raised by the Board
- Include a corporate with large commodity exposure in discussions to ensure their views are captured (i.e. Nestlé)
- Circulate next draft to EACT members for comment (January 2007)
- Extend consultation to include rest of Big 4.



34

Thanks !

François Masquelier
Chairman of ATEL (*Association des Trésoriers du Luxembourg*)
Honorary Chairman EACT (*European Associations of Corporate Treasurers*)
Chairman of the Board IGTA (*International Group of Treasury Associations*)

Senior Vice President
Head of Treasury, Corporate Finance & ERM at RTL Group
francois.masquelier@rtlgroup.com
GSM +352 621 278094



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IFRS-IASB Workshop

European Parliament - Brussels

December 19, 2006

Noreen Whelan
General Electric Company
Global Controller – International Financial Reporting
Email: noreen.whelan@ge.com



Agenda

- **GE in EMEA**
- **Europe - Financial Reporting**
- **Simplification**

2



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19/12/06



GE Multinational Substantial Presence Throughout EMEA

95,000 GE employees today

\$39 billion sales in 2005 (up from \$3 billion in 1987)

GE's International headquarters in Brussels... GE Healthcare & GE - Oil & Gas: global headquarters near London & Florence

Business European headquarters in Amsterdam, Brussels, Budapest, Dublin, London, Paris

Global Research Centre in Munich

Growth In Emerging Economies... served from EMEA

– Strong business focus in Russia, Eastern Europe, Middle-East

3



imagination at work

IFRS-IASB Workshop
19/12/06

Europe – Financial Reporting



imagination at work



IFRS Convergence Overview - GE Has/Will Be Adopting IFRS

EC survey on extended use of IFRSs

Use of IFRSs in the separate company financial statements of listed companies:

- 13 countries will permit: DK*, FI, DE**, IE, LU, NL, PT***, UK, NO, IS, LI, HU**, PL
*required after 2009; **statutory accounts that conform to national GAAP are also required; ***except banks
- 9 countries will require: GR, IT*, CZ, CY, EE, LT, MT, SQ, SI
*except insurance
- 5 countries will prohibit: AT, FR, ES, SE, LV
- 1 country undecided: BE

Use of IFRSs in the consolidated statements of unlisted companies:

- 24 countries will permit: AT, BE, DK, FI, FR, DE, GR, IT*, IE, LU, NL, PT, ES, SE, UK, NO, IS, LI, CZ, CY, EE, HU, PL, SI
*except small
- 6 countries will require: LV*, LT*, MT, PL*, SQ, SI*
*for banks only
- 2 countries will prohibit: LV*, LT*
*for other than banks

Key							
AT Austria	FR France	IE Ireland	ES Spain	IS Iceland	EE Estonia	MT Malta	
BE Belgium	DE Germany	LU Luxembourg	SE Sweden	LI Liechtenstein	HU Hungary	SQ Slovakia	
DK Denmark	GR Greece	NL Netherlands	UK United Kingdom	CZ Czech Rep	PL Poland		
FI Finland	IT Italy	PT Portugal	NO Norway	CY Cyprus	SI Slovenia		

source: European Commission

5



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GE Complex Financial Reporting Requirements in Europe

- > 2,000 Legal Entities
- Generally, legally required to file audited financial statements at legal entity level (legal filings)
- Regulated business filings
- + US reporting requirements
- Rigorous local and US GE financial reporting policies and procedures in place
- 2005 for 3rd year running GE # 1 for Corporate Governance (*Financial Times* survey)

6



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Simplification



Why Simplification? Efficient Operations and Sustainable Controllershship

- **Integrity of financial statements**
- Build repeatable financial reporting processes, eliminate redundancy, consolidate IT platforms
- Customer focused, data driven approach (Six Sigma), we measure eg. # legal entities, late filings, days-to-close
 - > Improvements directly correlated with lower costs for customers and better financial performance for shareholders
 - > Allows European employees focus on business...risks and organic growth

8



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IFRS Provides a Significant Opportunity to Reduce Complexity

- Allows standardisation of financial reporting processes, polices, training and IT platforms
- **Integrity of financial statements = more efficient capital markets**
- Fully engaged.... Representative on IFRIC and IASB's Staff Fellowship Programme
- But.... benefit of filing audited financial statements at legal entity level? Significant cost, duplication of effort and filed information in each country across Europe

9



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Benefit of Filing at Legal Entity Level for Shareholders, Customers and Employees of Multinationals?

- Huge burden on financial systems, processes and European finance staff
- Significant cost: > €30 million for GE '05
- Benefits?
- Should approach be more business risk based?
- **We are ready to provide input and engage**

10



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