THE FUTURE OF HARMONIZATION OF ACCOUNTING STANDARDS WITHIN THE EUROPEAN COMMUNITIES

Conference 17 and 18 January 1990, Brussels

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Foreword

More than ten years have passed since the adoption by the Council of Ministers of the Fourth Directive of 25th July 1978 concerning the annual accounts of limited liability companies. It was time to examine whether the objectives of this Directive have been achieved, i.e. equivalence and comparability of financial information published by limited liability companies.

For this reason, the Commission of the European Communities has organised on the 17th and 18th January 1990 a conference in Brussels on the future of harmonisation of accounting standards within the E.C. This conference was attended by some 130 people representing the various competent national ministries of Member States and the most important organisations of preparers, users and auditors of accounts.

At the conference, an analysis was made of the actual situation following the implementation of the Fourth Directive in national law in order to identify the problems which remain to be solved. In this context the question was raised whether a reduction of the option provided for in the Directives would be desirable at this stage. This analysis was followed by a discussion on the ways and means to be adopted in order to remedy the deficiencies identified and thus improve the comparability of accounting documents disclosed by enterprises organised as limited liability companies.

The objective of the conference was to enable the Commission to define the priorities for future action by the Community.

This brochure contains the full text of the papers presented at the conference and of the interventions made by delegates on the different items of the agenda. Included are also the working documents prepared by the Commission's Services prior to the conference.

By publishing these texts, the Commission hopes to contribute to further progress in the area of harmonisation of accounting standards.

I. COMMUNITY ACCOUNTING LEGISLATION

K. VAN HULLE
EEC Commission (DG XV)

1. Introduction

Mr Chairman, Ladies and Gentlemen,

I have been given the honour - and the difficult task - of opening this conference with a review of the Community's achievements in the field of accounting harmonization. Although the theme of the conference is the future of accounting harmonization in the Community, any serious discussion of the matter must take account of the major achievements which have been accomplished since the Commission took its first initiatives in this field in the early sixties. Those achievements enable experts from the twelve Member States to speak the same accounting language today. The emphasis may of course differ from one Member State to another but we are at least able to understand one another without being obliged to call on the services of an interpreter. Community accounting legislation is still in its early stages but it has had a major influence on the daily lives of several million businesses in the Community. It has also enabled the Community to play an active part in the international discussions aimed at harmonizing accounting rules at world level.
Within the Community, accounting harmonization comes under the programme aimed at harmonizing company law. The object of this programme, which chiefly concerns limited liability companies, is the protection of the interests of members and others through the drawing-up and publication of financial information that is both comparable and equivalent. Further

objectives in the context of the single market include equal conditions of competition for businesses established in different Member States, the promotion of trading relations between Member States, the stimulation of cross-frontier cooperation between businesses, the opening-up of markets with a view to cross-frontier takeovers and mergers, and the development of a European capital market.

2. Harmonization technique

Accounting harmonization within the Community is achieved by means of directives. A directive is a legal instrument addressed to the Member States, which are obliged to incorporate the provisions it contains into national law within a specified period. This harmonization technique, which is employed nowhere else in the world, differs from other such techniques in both its procedure and its effects.

As regards procedure, it is important to stress that all the parties concerned may intervene in the negotiating process. After being proposed by the Commission, the directive is examined by the Economic and Social Committee and Parliament and subsequently adopted by the Council. In this way, the two sides of industry, political forces and national authorities have ample opportunity to express their opinions. Parliament has a more important role to play since the entry into force of the Single Act, accounting Directives being adopted by the Council in collaboration with Parliament in the context of cooperation policy. The accounting profession, represented by the FEE (Fédération des Experts-Comptables Européens), is making a particularly important contribution to the drawing-up of draft Directives. Almost all the accounting Directives were prepared by the FEE. However, contrary to the situation prevailing elsewhere in the world, accounting standardization within the Community is not the exclusive province of the accounting profession.

As for the <u>effects</u> of this harmonization technique, it should be stressed that the provisions of the Directives are translated at national level into legally binding rules. Member States of course have a choice as regards the form of the legal rules. Some have transposed the directives into actual law while others have opted for a more flexible system, incorporating the essential provisions into law and the more specific provisions into implementing decrees. Transposing accounting standards into legally binding rules undoubtedly has the advantage of ensuring that such standards are properly observed. This system has sometimes given rise to problems such as the definition of the relationship between those laws or regulations and professional standards and the familiarization of the legal and accounting professions with the new accounting law.

3. <u>Basic Directives</u>

Accounting harmonization is part of the harmonization of company law. It began with the First Council Directive (on company law) of 9 March 1968 (OJ No L 65 of 14 March 1968), which introduced a uniform system for publishing accounts (lodging with a central register and publication in a national gazette). This system, which initially applied only to public limited companies, was subsequently extended to all limited companies and even to other types of companies covered by later accounting directives. It is important to note that, pursuant to the First Directive, accounting documents must be made available to any interested party, who must be able to obtain copies without having to demonstrate a legitimate interest. This is the only way of achieving transparency of the market.

The Second Council Directive of 13 December 1976 (OJ No L 26 of 31 January 1977) also plays an important role in Community accounting law. This Directive concerns the formation of public limited companies and the maintenance and alteration of their capital. It is aimed at preserving companies' capital, which constitutes the creditors' security, particularly by prohibiting any reduction by wrongful distribution to shareholders and by restricting a company's right to acquire its own shares. There is a direct relationship between those rules and a number of provisions of the Fourth Directive such as those on the entry in the balance sheet of own shares, the inclusion on the assets side of certain items of expenditure, etc.

3.1. Fourth Directive

The Fourth Council Directive of 25 July 1978 (OJ No L 222 of 14 August 1978) is the kingpin of accounting harmonization within the Community. It lays down the rules to be followed by some three million limited companies in drawing up their annual accounts. It also provides the frame of reference for the Seventh Directive on consolidated accounts and for the sectoral directives on the financial information to be published by banks and insurance companies.

The Fourth Directive does not set out to standardize accounting rules across the Community. It rather aims at comparability and equivalence of the financial information to be published by limited companies. To that end, it lays down the minimum conditions to be fulfilled while allowing Member States to go beyond those conditions by imposing additional or more detailed rules. The imperfect nature of this harmonization has often been stressed, attention being drawn to the many options allowed in the Fourth Directive. In order to clarify the debate on this subject we have endeavoured to analyse in detail those different options in a working paper which you will find in your file. The subject will be dealt with tomorrow. In accordance with Article 2(1) of the Fourth Directive, the annual accounts comprise the balance sheet, the profit and loss account and the notes on the accounts. Those documents constitute a composite whole. This is a particularly important aspect of the harmonization process. Since the notes form an integral part of the annual accounts, the Directives can enable companies to apply different valuation rules provided that an explanation is given in the notes. In this way, the accounts remain comparable. This harmonization technique has been applied in particular to value adjustments for tax purposes and to valuation methods based on criteria other than the purchase price.

For most Member States, the Fourth Directive introduced a new concept in the shape of the true and fair view. According to this principle, companies are obliged to go beyond the mere application of legal provisions in order to give the reader a more reliable picture of the financial position of the company. It would no doubt be interesting to investigate more closely to what extent companies apply this principle in order to depart from a rule which they should normally apply.

For some Member States the Directive has introduced a further innovation in imposing a layout for the balance sheet and the profit and loss account. A compulsory layout will obviously enhance the comparability of accounts. Some Member States have also introduced a layout for the notes on the accounts, not prescribed in the Directive, in order to improve comparability.

The valuation rules are set out in Article 31 of the Directive. This Article is particularly important. It combines rigidity and flexibility. Paragraph 2 in fact makes it possible, in exceptional cases, to depart from such general principles as the obligation to carry out valuations on a prudent basis, the presumption that the company is carrying on its business as a going concern, the principle of separate valuation and the obligation to apply consistent methods of valuation from one year to another, provided that such departures are disclosed in the notes on the accounts and the reasons for them are given together with an assessment of their effect on the assets, liabilities, financial position and profit or loss. This possibility of departing from the general valuation principles should provide a solution to a number of problems in cases where the traditional rules do not.

According to Article 32, valuation in the accounts is based on the principle of purchase price or production cost. Member States may, however, allow one or more alternative methods, such as valuation by the replacement method, inflation accounting or revaluation, to be used. Irrespective of the alternative method employed, the same rules apply: the amount of the difference between valuation by that method and valuation according to the purchase price must be entered under "Liabilities" in the revaluation reserve, which may not be distributed; disclosure in the notes on the accounts of any changes in the amount of the reserve; and indication of the purchase price in the notes on the accounts. Those rules are aimed at both maintaining the capital and ensuring the comparability of information. Most Member States have introduced one or more of those methods.

Article 43 sets out the minimum information to be included in the notes on the accounts. Article 46 does likewise for the annual report.

Annual accounts must be audited by a person authorized by national law to audit accounts. Such auditors must fulfil the minimum conditions laid down by the Eighth Directive. The annual accounts, duly approved, and the annual report, together with the auditors' report, must be published in accordance with the First Directive.

The Fourth Directive is the first company law Directive to contain specific exemptions for small and medium-sized companies. Such companies are defined by reference to three criteria (balance sheet total, turnover and number of employees) in order to reflect as accurately as possible the socio-economic significance of the company. The criteria (balance sheet total and net turnover) were first amended in 1984 in order to bring them into line with economic and monetary developments within the Community. The exemptions concern the drawing-up, auditing and publication of annual accounts. Member States are not at present obliged to grant such exemptions to small and medium-sized firms in whole or in part.

The Fourth Directive also set up a Contact Committee under the auspices of the Commission. The function of this Committee is to facilitate harmonized application of the Directive through regular meetings dealing in particular with practical problems arising in connection with its application. It also has the job of advising the Commission, where necessary, on additions or amendments to the Directive. Since it was set up, the Committee has met 19 times, i.e. almost twice a year. The subjects which it has tackled in connection with the Fourth Directive have been listed in a working paper

(XV/263/89 of 26 November 1989). The terms of reference of the Committee have gradually been extended as other accounting Directives have been adopted.

All Member States with the exception of Italy have brought their legislation into line with the Fourth Directive. It has emerged from the study carried out by the FEE that a high degree of harmonization has been achieved in the areas covered by the Directive. There is no doubt that in a number of Member States experience is still in its early stages and that the Directive has had a considerable impact on the quality of the financial information produced by companies.

3.2. Seventh Directive

Whereas the Fourth Directive is confined to the annual accounts of companies taken in isolation (individual accounts), the Seventh Council Directive of 13 June 1983 (OJ No L 193 of 18 July 1983) deals with financial information on groups of companies (consolidated accounts).

During the negotiations on this Directive, much time was spent trying to reach a consensus on the definition of a group. The Directive adopted a pragmatic solution in requiring Member States to make consolidation compulsory in cases where a parent company has the legal power to control one or more subsidiaries and in permitting Member States to make consolidation compulsory in other cases where a parent company actually controls one or more subsidiaries through a minority shareholding. This pragmatic solution is combined with a series of exceptions, i.e. cases in which a company may or may not be excluded from the consolidated accounts.

It is important to note in this respect that it was considered desirable not to apply the principle of a true and fair view to the definition of a group. This principle may be applied to exclude a company from the consolidated accounts only if the activities of that company are so different that their inclusion would be incompatible with the obligation of giving a true and fair view.

The Seventh Directive also makes provision for a number of cases in which a parent company may or must be exempted from the obligation to draw up consolidated accounts. Those are cases where the parent company is a financial holding company or is itself a subsidiary heading a sub-group, or where the group concerned is small. A parent company which is not established in the Community may be exempted from the obligation to draw up consolidated accounts for a sub-group located in the Community provided that it publishes consolidated accounts which are at least equivalent to consolidated accounts drawn up in accordance with the Seventh Directive. Use has been made of this option by most of the Member States which have incorporated this Directive into their national law to date. It is interesting to note that Community accounting legislation does not go so far as to require absolute conformity. The same condition of equivalence is applied to branches.

The Contact Committee has discussed ways of defining the factors to be taken into consideration in interpreting the concept of equivalence. Clarification of this concept at Community level is doubtless necessary in order to assist both companies and the accounting profession and to establish the Community's position with regard to third countries.

For the structure of consolidated accounts and for the valuation rules, the Seventh Directive refers back to the Fourth Directive. In the majority of Member States, consolidated accounts have no direct effects on tax treatment. It is interesting to note that, in those Member States, there is a trend towards a greater separation between accounting rules and tax rules governing consolidated accounts. Accounting rules which would not be permitted in the case of individual accounts are accordingly applied to consolidated accounts in order to give a truer and fairer view of the economic position of the group.

The Seventh Directive also contains provisions concerning the technique of consolidation. It allows Member States to permit or prescribe proportional consolidation and requires the equity method to be applied to associated companies. The list of information to be included in the notes on the accounts is modelled on the provisions of the Fourth Directive.

Additionally, information must be provided on the composition of the group and on the reasons why any companies have been left out of the consolidated accounts.

The consolidated accounts are accompanied by a consolidated annual report. They are audited by a person fulfilling the conditions of the Eighth Directive and then published.

The Seventh Directive is the first accounting directive to set a date for revising the main options with a view to enhanced harmonization at a later stage. It should have been incorporated into Member States' national law by 1 January 1988, although the entry into force of the provisions could be postponed until 1990. Seven Member States (D, F, E, NL, L, GR, UK) have transposed the Directive to date. It is hoped that at least another three (B, DK, I) will do likewise in the course of this year. The importance of the Seventh Directive lies mainly in the fact that, in the majority of Member States, it introduces for the first time a general obligation to draw up consolidated accounts and that it enables the Community to play a more active role in international discussions on accounting harmonization which relate specifically to consolidated accounts.

3.3. Eighth Directive

The next stage in the accounting harmonization process is represented by the Eighth Directive of 10 April 1984 (OJ No L 162 of 12 May 1984), which lays down minimum conditions for the approval of auditors and firms of auditors carrying out audits required by Community law. Those conditions relate to competence and independence. As regards competence, the Directive requires auditors to have attained university entrance level, then completed a course of theoretical instruction, undergone practical training for a period of at least three years and passed an examination of professional competence of university final examination standard organized or recognized by the State. The Directive is less exacting as regards independence. The Commission has, moreover, recognized the incomplete nature of harmonization on this point. Reference should also be made in this connection to the provisions of the proposal for a Fifth Directive on the structure of public limited liability companies, which contains rules on the independence of auditors. We have asked the FEE for guidance on this matter. The study which it has carried out, and the answers provided by the Member States' delegations on the Contact Committee, will give us a clearer insight into this delicate and important subject.

The Eighth Directive is concerned neither with freedom of establishment nor with freedom to provide services in the case of persons responsible for carrying out statutory audits of accounting documents. However, Article 11 permits the authorities of a Member State to approve as auditors persons who have obtained all or part of their qualifications in another Member State provided that their qualifications are deemed equivalent and they furnish proof that they possess the requisite legal knowledge. The position will change with the entry into force of the Council Directive of 21 December 1988 (OJ No L 19 of 24 January 1989) on a general system for the recognition of higher-education diplomas awarded on completion of professional education and training of at least three years' duration. This Directive will oblige Member States to approve professional persons from other Member States. The question arises, however, whether

Member States are entitled to require applicants to complete an adaptation period or take an aptitude test. The Directive on mutual recognition leaves this choice to the Member State in the case of professions whose practice necessitates precise knowledge of national law and in respect of which the provision of advice and/or assistance concerning national law is an essential and constant aspect of the professional activity. Where the choice is not left to the Member State, the applicant may choose between an adaptation period and an aptitude test.

The Eighth Directive should have been incorporated into national law by the Member States by 1 January 1988 although the entry into force of the provisions could be postponed until 1 January 1990.

To date, eight Member States (B, L, D, UK, F, P, GR, E) have transposed the Eighth Directive, which will pave the way for the development of a high-quality accounting profession in all Member States.

With those three basic Directives (the Fourth, Seventh and Eighth), a real body of Community accountancy law has come into being. Gaps remain, however, on two points relating specifically to the statutory audit of accounts. Firstly, the concept of the independence of auditors requires clarification and, secondly, the content of audits and the auditing standards to be applied require further definition. The Fifth Directive partly solves those problems but only in respect of public limited liability companies. It remains to be seen how those gaps can best be closed.

4. Proposed amendments to the basic Directives

Some amendments have been made to the Fourth Directive since it was first adopted in 1978. Those amendments concern the relationship between the Fourth and Seventh Directives (and, in particular, the definition of affiliated company), adjustment of the thresholds for defining small and medium-sized companies to take account of economic and monetary developments, clarification of the scope of the Fourth (and Seventh) Directive for new Member States and, most recently, the contents of the annual report (existence of branches).

Two proposals for Directives aimed at amending the Fourth and Seventh Directives are currently before the Council. The amendments concern:

- the extension of the scope of those Directives to certain partnerships (all of whose unlimited members are constituted as limited liability companies);
- additional exemptions for small companies and greater harmonization of their accounting obligations;
- the possibility of drawing up and publishing accounts in ecus.

The first proposal for a Directive (OJ No C 144 of 11 June 1986) has already been the subject of many discussions within the Council. Under the German presidency (spring 1988), it was decided that further consideration should be postponed so that it could be combined with discussions on another proposal to be submitted by the Commission on accounting exemptions for small and medium-sized companies. The latter proposal was presented by the Commission on 24 October 1988 (OJ No C 287 of 11 November 1988). After consulting the Economic and Social Committee and Parliament, the Commission presented an amended proposal on 4 December 1989 (OJ No C 318 of 20 December 1989).

The key points of this proposal are as follows:

- exclusion of small private companies from the scope of the Fourth Directive;
- mandatory nature of exemptions for small companies;
- new flexibility in the definition of thresholds (50% in the original proposal, 25% in the amended proposal);
- additional exemptions particularly as regards the information to be given in the notes on the accounts and the drawing-up of annual reports by small companies;
- option of omitting the salary of the sole manager from the notes on the accounts;
- introduction of the possibility of making accounting documents available to the public at the company's head office;
- drawing-up and publication of accounts in ecus.

The initial discussions in the Council at the beginning of 1989 showed that it will not be easy to reach a new consensus on the accounting obligations of small and medium-sized companies. It is, however, important to clarify the issues involved. We hope that it will possible for the Council to resume its discussions as soon as possible.

5. Sectoral Directives

In accordance with Article 1(2) of the Fourth Directive, pending subsequent coordination, Member States need not apply the provisions of the Directive to banks and other financial institutions or to insurance companies. Similarly, Article 40 of the Seventh Directive contains transitional provisions for groups comprising banks or insurance companies. The exclusion of banks and insurance companies is justified by the particular nature of the activity of such companies, which requires a specific set of rules. It was considered, however, that the financial information provided by such companies should be at least equivalent to that required of other companies. For that reason, the Fourth and Seventh Directives also form the basis of the rules for banks and insurance companies; derogations from those basic rules have been introduced only in cases where it was really necessary in order to take account of the particular nature of the activity.

Legislation governing banks and other financial institutions has existed since the Council adopted the Directive of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions (OJ No L 372 of 31 December 1986). Since the Directive concerns a specific sector, it was possible for it to prescribe a single layout for the balance sheet and for the profit and loss account (horizontal and vertical layout) and to limit the scope for adjusting the layout. As for the information to be provided, the Directive defines the contents of off-balance sheet items, which are of particular importance in the banking sector. Similarly, the notes on the accounts must contain additional information, such as a breakdown of loans and advances and liabilities on the basis of their remaining maturity, information on the supply of management and agency services to third parties and a statement of the types of unmatured forward transactions outstanding at the balance sheet date.

As for the valuation rules, the Directive contains special rules on the valuation of debt securities including fixed-income securities and on transferable securities which are not held as financial fixed assets. Where such securities are shown in the balance sheet at purchase price, the difference between the purchase price and the higher market value at the balance sheet date must be disclosed in the notes on the accounts. Member States may even require or permit such securities to be shown in the balance sheet at the higher market value provided that the difference between that value and the purchase price is disclosed in the notes on the accounts. This valuation rule departs substantially from the principles of the Fourth Directive.

The subject of hidden reserves played a major role in the negotiations on this Directive. The Directive authorizes hidden reserves in certain circumstances. Where such reserves have been formed, Member States must permit credit institutions to include on the liabilities side a fund for general banking risks. The fund draws on the profit and loss account. It is an open fund comprising the amounts which a credit institution decides to set aside to cover such risks where that is required by the prudence dictated by the particular risks associated with banking.

The Directive also endeavoured to tackle the difficult subject of transactions denominated in foreign currencies. Only partial harmonization has been achieved on this point, which was not dealt with in the Fourth Directive.

Where consolidated accounts are concerned, a few changes have been made to the rules laid down in the Seventh Directive. Those rules apply only where the parent company is a credit institution or a bank holding company. The Directive also requires the drawing-up of an annual report, auditing by an auditor fulfilling the conditions of the Eighth Directive and the publication of accounting documents.

Like the Seventh Directive, the Directive on the annual accounts of banks provides for the main options which it contains to be reviewed within a given period with a view to achieving greater transparency and harmonization.

Member States must incorporate the provisions of the Directive into their national law by 1 January 1991 but may delay the entry into force of the provisions until 1993.

The approach adopted for banks will also be used in the case of insurance companies. On 21 January 1987 the Commission sent the Council a proposal for a Directive on the annual accounts and consolidated accounts of insurance companies (OJ No C 131 of 18 May 1987). The Commission has now presented an amended proposal in the light of the opinions of Parliament and the Economic and Social Committee. In this proposal, which will shortly be discussed within the Council, account has been taken of developments which have taken place since the adoption of the Fourth Directive. It contains some clarifications introduced by the Directive on the annual accounts of banks. Without wishing to examine this proposal in detail, I would like to point out some of the delicate aspects involved: application of the Directive to Lloyd's, gross or net presentation of the profit and loss account, valuation of investments at their current value and valuation of technical provisions.

6. Branches

Accounting harmonization has also been extended to branches which, by definition and unlike subsidiary companies, form an integral part of the company which set them up. The Eleventh Directive, adopted by the Council on 21 December 1989, introduces a disclosure system for branches in accordance with the rules laid down by the First Company Law Directive relating to limited liability companies. Annual accounts as drawn up, audited and published by limited liability companies are the subject of further disclosure at branch level. At the same time, the requirement laid down by the laws of certain Member States that separate branch accounts be published has been abolished. Branches of companies from third countries whose accounting documents are not drawn up in accordance with the Fourth and Seventh Directives or in an equivalent manner may be required by Member States to draw up and publish accounting documents relating to the activities of the branch.

Member States are required to incorporate this Directive into their national law by 1 January 1992 but may delay application of the new provisions until 1993.

Special provisions on the branches of credit institutions and financial institutions were adopted in the Council Directive of 13 February 1989 (OJ No L 44 of 16 February 1989). While this Directive lays down that branches cannot be required to publish annual accounts relating to their own activities, it nevertheless authorizes Member States to prescribe, pending further coordination, that branches disclose certain information on the size of their operations. This option will be reviewed and possibly abolished at a later date. For branches of credit institutions and financial institutions having their head offices in third countries, the Directive makes not only equivalence but also reciprocity a condition for exempting a branch from publishing accounts on its own activities. The Directive entrusts the Contact Committee with the difficult task of assessing the equivalence of accounting documents.
Pending further coordination, the disclosure requirements laid down by the Eleventh Directive do not apply to branches set up by insurance companies. As in the case of banks, special provisions will be drawn up at a later date.

7. <u>Conclusions</u>

It is time to conclude this brief review of achievements in the field of accounting. Those achievements have enabled the Community to play an active role in the discussions currently taking place at international level on accounting harmonization. The Commission has in fact been instructed by the Council to represent the Community in the discussions within the OECD and UN on accounting harmonization. It expresses the Community point of view within those organizations after consulting the Member States.

Those Community achievements have also enabled progress to be made in other fields. For example, it was possible for the Directives on securities to refer to the accounting Directives as regards the financial information to be provided by listed companies and by companies whose transferable securities are offered to the public.

I have tried to show that accounting harmonization has developed since the adoption of the Fourth Directive in 1978. The Directive on the annual accounts of banks, while laying down special rules for the banking sector, clarified certain provisions of the Fourth Directive and introduced more sophisticated rules on the valuation of securities. The same will doubtless be true of the Directive on the annual accounts of insurance undertakings. Similarly, the Seventh Directive clarified certain concepts contained in the Fourth Directive, such as that of the affiliated company and certain valuation methods such as the equity method.

The process is rather like an unfinished symphony. Some parts are missing, there are a few wrong notes and there is sometimes a tendency to forget the score and play another tune. It is then up to the conductor to put things right. The difficulties and gaps which we will be discussing during these two days must not lead us to forget the position from which we started and the enormous progress which has been achieved in the Community as a result of the work carried out on the harmonization of accounting. This field will have to play an even more important role in the development of the internal market. I hope that the discussions during our conference will assist that process.

II. IMPLEMENTATION OF THE ACCOUNTING DIRECTIVES INTO NATIONAL LAW IN THE MEMBER STATES

Contribution by Mr. G. GELDERS
Chairman
Accounting Standards Committee
Belgium

1. Belgium implemented the Fourth and Eighth Directives into national law in 1983. However, it had largely anticipated the application of the Fourth Directive when, in 1976, it incorporated into its national law new rules and regulations relating to annual accounts. The Seventh Directive on consolidated accounts is to be transposed into national law very shortly.

2. While the transposition of these Directives into Belgian law has necessitated many studies and much work, it has been carried out without major political difficulties, although it involves Directives which, of those relating to company law, have by far the greatest impact on businesses generally.

   In our view, the reasons for this are as follows:
   1. The influence of Community directives: without the support of these Directives and their mandatory nature, the Belgian Government would probably not have been able to carry through successfully the revolution which Belgium has undergone in the field of accounting law.
   2. The powers delegated by Parliament to government in the field of accounting law, which has made it possible for the bulk of the work on transposing the Directives into national law to be carried out without recourse to parliamentary procedure.
   3. The agreement which has been sought and actually obtained in the field of accounting law from employers' and trade union organizations, whose support has been crucial.
   4. The setting of the reform of accounting law in a broad perspective of the enterprise - as an economic unit producing goods and services and creating income at various levels - within the overall economy; this is a wider view than that concerned simply with protecting the interests of shareholders and creditors.
   5. Incorporation of the reform of accounting law into an institutional whole, giving it an integrated dimension: harmonization of tax law with the key aspects of accounting law; actual availability of annual accounts; setting up of the Central Balance-Sheet Data Office; compilation of general and sectoral statistics from annual accounts.
   6. The level and significance of the requirements imposed as regards annual accounts; the intention has been to create a rational system which attaches full significance to published accounts in order that those requirements are not felt to be pure formalism. As a result, use has not been

made of many concessions provided for in the directive where they would rob the accounts of much of their significance. A particular example of this is the profit and loss account of small and medium-sized firms.

7. The activities of the Accounting Standards Committee; Parliament did not wish to limit itself to laying down rules; it has set up a body to pilot the reform, to make accounting law live and to contribute to its development. This Committee has acquired definite influence.

3. In transposing the Directives and applying accounting law, however, we have been faced with two major difficulties:
   (a) the late or incorrect transposition of the directives in question by some member States and the Commission's failure to ensure actual compliance with the Directives. It should not be forgotten that the harmonization of accounting standards is covered by the Treaty sections on freedom of establishment and freedom•to provide services and that its aim is to ensure equal conditions of protection and competition. For those Member States which are complying with the Directives and for the companies and citizens of this country, those shortcomings in transposing the Directives into national law are having the effect of undermining the reputation of Community law and the Commission of the European Communities and are seriously distorting competitive conditions.
   (b) The hopes we placed in the Contact Committee have to a large extent been disappointed. While many issues have been examined, they have not really been dealt with in detail and have not led to the publication of findings. Furthermore, some of its proposals, even those adopted by a large majority or indeed unanimously, have been ruled out by the Commission. Finally, it has scarcely held any meetings during the last two years.

4. If asked, as the representative of a body concerned with accounting standards, to offer an opinion concerning Community activities in the field of accounting law, I would make three points:
   (a) The accounting Directives have played, and continue to play, a key role in:
      - developing accounting law in all the Member States;
      - promoting far-reaching harmonization between the twelve Member States, which initially had such widely differing systems and traditions.

      They have definitely had the effect of spreading the influence of Community law beyond the Community itself: many third countries, particularly in Europe and Africa, have used them as a basis for their own laws. Reference is continually made to them by those OECD and UN bodies active in the field of accounting law.

      In addition, they should contribute to the mutual recognition of annual accounts, both within the Community and in relations with third countries.
   (b) However, Community progress in this field came to a halt with the Seventh Directive; it has lost its momentum because of strains created within the Community (mainly in connection with proposals for new or additional directives) and external factors.

(c) I would like to see the Community make a fresh start in the field of accounting law. Above all else, however, it must take steps to safeguard and increase, both internally and externally but without any isolationism, the reputation of Community law and the consistency of the policy pursued by the Community. The Commission has a key role to play in this field; its responsibility to act is proportionate to that key role.

II. IMPLEMENTATION OF THE ACCOUNTING DIRECTIVES INTO NATIONAL LAW IN THE MEMBER STATES

Contribution by Mr. O. HASSELAGER
Assistant Director
Danish Commerce and Companies Agency
Denmark

I should like to present a few words on problems which arose from the implementation of the Fourth Directive in Denmark. As to the 7th directive an implementation bill is in this very moment finalized in the State Council, and should be laid before the Parliament this afternoon ! It should be enacted in May or June this year.

The Fourth Directive presented a few problems to Danish companies at the implementation in 1981.

Publication-wise no great problems arose. All Danish Companies were already provided to publish audited accounts from 1973.

Interwoven with the implementation arose a situation not directly derived from the directive: contingency or deferred taxes.

Danish companies had in the 1970's up to implementation time evolved an increasing distance from accounting according to fiscal/taxation rules. This evolution was capped by the implementation act with the ultimate abolishment of taxation wise accounting, all companies to adhere to business accounting. This called for deferred taxes in financial statements, but no universal practice was evolved at the time and several methods are in use today.

In the years after World War Two an accounting method - the part cost method - were evolved and in general use. Here indirect production cost are not capitalized and the profit/loss-account shows another layout than the directives in art. 23-26, the first item after turnover being the direct costs of sales. The residue is the contribution by the principal ordinary business towards all ordinary business costs - accordingly called the "Contribution method". To my knowledge this method is not practised generally anywhere except in Denmark.

Most companies had some qualms about quitting this method, so lots of layouts did not adhere to the profit/loss layouts of the Directive. Likewise very extensive use was made of art. 35, paragraph 2, litra b in the Directive.

While that practice was a peculiar Danish occurrence, many Danish accountants had taken a great liking for Anglo-Saxon accounting practice in several respects. This meant that a great many companies recognized not only realized gains, but also realizable gains from monetary items, at least were market information were readily available.

The practice grows stronger with the years, especially in the light of the special rule allowing the mark to market method in the Banks Accounting directive.

The practice is also relevant with regard to foreign currency translation, where the want of regulation in the Directive makes room for different methods.

Naturally the novelties of the Fourth Directive regimentation of layouts, although all the layouts of the directive were allowed, and more extensive notes, made difficulties for some accountants, but in general the rules of the directive were accepted by the accounting community in Denmark.

Many Danish accountants believe - however - that the rules of the Directive represented a retrograde movement away from the latest developments in Danish and International accounting practice. It is hoped that the directives will catch up with some of the lacunae in the years to come.

III. SURVEY OF ACCOUNTS PUBLISHED ON THE BASIS OF THE FOURTH DIRECTIVE

Contribution by Mr. C. REGOORT
Vice-President of FEE

INTRODUCTION

The survey of published financial statements in Europe was performed on the basis of financial statements for the year 1987 in which year the Fourth Directive was introduced in all Member States except Italy, Portugal and Spain. The sample has been chosen from large and medium-sized companies and included listed and unlisted companies as well as subsidiaries of companies outside the European Community in the following sectors:

Construction
Pharmaceuticals/Chemicals
Manufacturing
Retailing
Services, in particular computer software

The total number of annual accounts investigated was 193. For each company a questionnaire was completed consisting of several hundred questions. The answers have been analysed by a team of experts in the various countries.

It must be stressed that the conclusions in the report are based upon the published documents only. The possibilities to assess the completeness of certain disclosures were, as a result of that, rather limited. The reasons for not including a certain type of disclosure remained therefore unclear in many cases. For example, the absence of a disclosure with respect to lease contracts could indicate the absence of such contracts in a particular company or an incomplete disclosure. In interpreting the answers, this aspect must be kept in mind.

The main conclusions of the survey are :

1. The Fourth Directive has contributed towards a high level of harmonisation in reporting and presentation according to the structure and layout demanded by the Directive itself.

2. The Fourth Directive has contributed towards greater consistency in the application of accounting principles where such accounting principles are specifically dealt with by the Directive.

3. Areas only partially covered by the Directive show an apparent lack of harmonisation.

These conclusions should be interpreted with considerable care. Firstly it is not possible to distinguish between the contribution that the Fourth Directive has undoubtedly made and the contributions by the IASC and National standards applicable and developed in the various countries. Secondly, lack of harmonisation in areas partially covered by the Directive is not necessarily a sign of disagreement on accounting principles or methods. In a large number of cases, different accounting practices could very well be explained by differences in the underlying legal and economic context, which differs considerably from one company to another and from one Member State to another.

Further harmonisation in the latter areas is subject to a better understanding of the obstacles that hinder harmonisation and to the development of ideas on how to remove the obstacles or how to circumvent the unwanted effects of these obstacles.

OBSTACLES TO HARMONISATION

Previous studies on harmonisation have identified major obstacles that hinder harmonisation of accounting practices. The most important ones are :

IDENTITY OF ACCOUNTING FOR TAX AND FOR REPORTING

In the European Community in a number of countries the annual accounts prepared for tax-purposes must be identical, or nearly identical, to the annual accounts prepared for reporting purposes. Both sets of accounts are closely connected, resulting in a stringent application of accounting rules that are tax oriented and that under circumstances do not reflect economic substance. This is the case in Belgium, France, Germany, Greece and Luxemburg. In the other countries, Denmark, Ireland, Netherlands and the UK the requirement for the annual accounts for tax purposes and for reporting purposes to be identical, does not exist. This is the reason for a different approach in those areas, where the economic substance might be in conflict with the form according to tax rules.

This statement is in particular valid for the statutory (unconsolidated) annual accounts.

The introduction of the Seventh Directive however, has resulted in some countries allowing for accounting rules in consolidated annual accounts, differing from those for the non-consolidated accounts, in particular to reflect the economic substance. Such practice improves the comparability of the consolidated annual accounts internationally. This is in particular the case in France and Germany.

DIFFERENCES IN LEGAL CONTEXT

Other disharmonies result from differences in the legal context in the countries. It is sometimes difficult to distinguish here between differences in the legal context and those resulting from the tax requirements, but the different legal systems in the various countries result in different practices.

The following is an example of a difference in practice resulting from a different context.
In the UK the profit and loss account is regarded as a document that must enable the reader to measure the performance of the management. The document must therefore reflect in the best possible way the results of the transactions concluded under the managements' responsibility. So for example it is required to translate open positions in foreign exchange at the closing rate and the translation differences must be included in the P & L., regardless of whether these differences are gains are losses.

In as far as it concerns gains, it could be argued that these amounts are not realised in the formal sense, as realisation depends on the changes in the rates subsequent to the balance sheet date. However in the UK context these differences are regarded as realised gains.

On the other hand in Germany the P & L is a document that informs the shareholders of the amount of profit in principle available for distribution. In this context the inclusion of translation gains is not possible as the more restrictive definition of realised profits prevents this.

Also here the statement is valid in particular for the statutory (unconsolidated) accounts. In the consolidated accounts such legal constraints do not play a role of the same importance.

DIFFERENCES IN ECONOMIC CONTEXT

The economic context influences the reporting practice in various ways.

The reporting needs of large multinationals are very much the same in every country in Europe. These companies are participants in a worldwide market and there they have an interest in providing information that is comparable and equivalent. Here harmonisation is necessary for the conduct of their business.

The reporting needs of smaller family type operations are less sophisticated. Here harmonisation comes slower. The traditional approach in these companies is often conservative and there is a certain degree of resistance to provide much information in a public report.

Slowly the smaller companies are adapting their reporting practices to those of the large companies. This process of adapting is more advanced in countries with a relatively significant number of larger companies. The accounting practices of smaller companies in these countries tend therefore to be more "internationalized" (harmonized), than elsewhere.

Another influence stems from the different degree of public financing in the various countries. Countries with a high degree of public financing as for example the UK, felt already long before the emergence of the Fourth Directive the need for a proper system of public reporting, and have developed a complete set of rules that is very well implemented.

In other countries, like Belgium for example, the introduction of the Fourth Directive triggered off the development of an accounting doctrine. Before 1976 the reporting needs of the close family-oriented Belgian enterprises were too limited to develop tight rules in respect of reporting.

PROBLEM AREAS

In the section of the survey report dealing with subjects that are not, or only briefly, treated in the Fourth Directive the following subjects are discussed :

* deferred taxation
* pensions and pension commitments
* long term contracts
* leasing
* foreign currency translation

Deferred taxation is negligible in the countries where there is identity of accounting for tax and for reporting purposes. In these countries timing differences do not occur as a general rule. In the countries where deffered taxes are included in the balance sheet, the amount is mostly determined according to the liability method.

Provisions for pensions do appear in the balance sheet in most countries. In some countries, in particular in France and Germany, self-insured pensions are common practice. In other countries pension schemes are mostly insured which explains the absence of provisions for pensions in the balance sheet. Backservice liabilities are commonly provided for in Greece and the Netherlands.

The method of calculation of the obligations shows a certain variety, with present value and the probalistic/actuarial value as the most frequently reported basis.

Long term contracts are treated very differently in the various Member States. In four out of the nine countries no national requirement at all is in force with respect to the valuation of this class of stocks and in three of the remaining countries the choice between the two possible methods completed contract or percentage of completion, is up to the company. Only in Ireland and in the UK does the position seem clearcut.

The results of the survey seem to indicate a European preference for the completed contract method. It is however interesting to note that the percentage of completion method is preferred in those countries where the accounting principles for taxation and those for reporting need not be identical.

Accounting for **leasing** is based on IAS 17 in Denmark, Ireland, the Netherlands and the UK. In Belgium and Germany special regulations are applicable. In these countries financial leases tend to be capitalised. In France capitalisation of finance leases is not allowed, but all lease contracts must be explained extensively in the notes. French companies may however capitalize financial leases in the consolidated financial statements. The definition of financial lease seems to differ between countries, so in spite of the practice of capitalisation of financial leases in many countries harmonisation remains defective.

The translation of foreign currency items in the annual accounts is mentioned only in the Fourth Directive as an element of additional information in the notes. The method applied must be explained, but what method should be used is an open question. Only in France and Greece the national legislation identifies and/or limits the methods to be used. In most other countries specific pronouncements have been issued by professional bodies. These pronouncements differ slightly from one country to another, especially with respect to the recording of translation gains. In most countries translation of balances at closing rates is suggested.

The survey shows a preference for the use of the closing rate for translation of balance sheet items. In the P & L the use of the closing rate seems less popular. Here the average rate is also applied in many cases. In 55 out of the 145 cases it was reported that all translation results were included in the Profit and Loss account. These cases are spread over all countries except Germany. The answers from Germany show that in all cases the translation gains have been deferred; the same applies for 11 out of 12 cases where in France the inclusion of translation results in the profit and loss account was reported.
The results are in line with the requirements in the various countries.

CONCLUSION

The major advantage of the Survey is that it in principle does not reflect the practices of the leading national entreprises only, but, thanks to the inclusion of smaller companies, also the accounting practices of entreprises that are never mentioned in the headlines of the financial press.
The Fourth Directive undoubtedly has influenced the accounting practices in Europe, but apart from some formal arrangements like schedules for the balance sheet and the P & L and a list of required additional information, the precise influence could not be revealed in the survey. This is just the confirmation that the Fourth Directive has acted as a catalyst in the process of development of common accounting principles, a process that probably already started during the period of development of the directive. It is of great importance that the smaller companies continue to benefit from the growing harmonisation internationally as is displayed by the large international companies. The Fourth Directive gives sufficient room for this development.

Harmonisation of accounting rules will never lead to uniform standards. The national traditions will remain for a very long time and these traditions as well as the ever changing economic environment will continue to influence accounting practices. These facts of life are an argument for maintaining a limited number of optional approaches.

Comparability does not require uniformity. Comparability means that annual accounts disclose equivalent information, under circumstances by providing additional disclosures in the notes on the accounts.

The adoption of the Seventh Directive seems to result in a step forward towards the so much desired comparability. In countries like France and Germany where the accounting rules in non-consolidated accounts are influenced by tax and other legal requirements, it is allowed to adopt different accounting rules in the consolidated accounts. The Survey revealed the tendency in these countries to adopt in the consolidated accounts accounting principles that come close to international standards like IAS. It seems likely that harmonisation, also in the problem areas, has a good chance to become reality in the consolidated accounts in the near future.

III. SURVEY OF ACCOUNTS PUBLISHED ON THE BASIS OF THE FOURTH DIRECTIVE

Contribution by Mr. B. MICHA
Central Balance-Sheet Data Office
of the Bank of France

I am speaking on behalf of the European Consultative Committee of Central Balance-Sheet Data Offices (Comité Européen des Centrales de Bilans); these offices were set up mainly by central banks.

The delegation attending this conference is made up of Italy, Germany and France, and I am speaking in place of Mr Paolo Gnes, the Chairman of our Committee.

Our Committee, which was set up in 1986, is made up of members from some ten countries and from the Commission's DG II and DG XV. It has set itself two aims:

- to make international comparisons of annual company accounts on the basis of representative samples; and

- to initiate consultations on methods of financial analysis in order to be able to interpret accounts correctly.

As our work has proceeded, we have become aware and convinced that specific national accounting, financial and tax circumstances necessitate different approaches to financial analysis. However, such diversity is not in itself an obstacle if the sources of the accounting data are of the same kind, i.e. if they provide equivalent accounting information.

It is with reference to this point, namely accounting information, that our Committee would like to express its views to you on the future of harmonization of accounting standards within the European Community.

Our prime concern is to ensure that the financial positions of European companies can be compared, which, in our view, entails, in terms of accounting standards, a higher level of requirement than that necessitated by the conventional concept of a "true and fair view".

It must be emphasized that, for most of our central balance-sheet data offices, the documents summarizing annual accounts as defined by accounts classifications or accounting laws constitute the basis for the analytical methods we use, hence our very close interest in accounting standards.

The majority of the member countries represented on our Committee are in agreement with the following general points:

- the improvements to be made should taken the form of fuller summary documents rather than of additions to the notes on the accounts;

- the notes on the accounts could be redesigned to ensure that the information they contain can be comprehended more easily within a more standardized framework;

- if it is impossible to adopt a single method of treatment, one method should be recommended and any others tolerated;

- under such a system of graded choices, it would be necessary for a company which has not adopted the recommended solution to include in the notes on the accounts information and results concerning the method it has adopted comply with the basic requirement.

In more practical terms, the following are areas where the desired improvements set out above would lead to better comparability of annual accounts at both international and national levels and to improved measurement of performances:

- entry in the accounts of research and development expenditure with a view to the disclosure of intangible investment. The choice between their inclusion under assets or as expenses is not neutral, and it would be necessary to be able to identify research expenditure to measure companies' activities in this area;

- method of valuing participatory certificates and temporary investments. The diversity of possible treatments and lack of information in the notes on the accounts raise problems of comparability;

- method of valuing stocks: the diversity of methods (LIFO, FIFO and weighted average cost) undermines the uniform calculation of results;

- method of recording work in progress on long-term contracts. The method based on progress made should be recommended rather than that based on completion in order to ensure that the figures reflect activity;

- there should be sufficient detail in the profit and loss account for an analysis to be made of items according to their nature and purpose. In particular, a breakdown of turnover into sales of goods (resold as they are) and production sold and also, at the very least, a distinction between purchases of goods and purchases of raw materials and supplies would permit a better analysis of margins (commercial and industrial) and of the profit or loss.

The Fourth Directive could also be supplemented in the following respects:

- conversion of claims and liabilities denominated in foreign currencies: inclusion of conversion discrepancies in the balance sheet and search for a method of treating latent profits and losses by comparison with the profit and loss account;

- leasing transactions: reinclusion in the balance sheet and readjustment of the profit and loss account;

- definition of the ordinary, extraordinary and exceptional items involved in the calculation of the various levels of results;

- a fuller definition, at least in the notes on the accounts, of provisions for risks and liabilities in order to enable them, for the purposes of the analysis of financial independence, to be treated as own capital or as debts for which provision has been made.

Last but not least, further work on the Fourth Directive should:

- cover memorandum items; this would permit better identification of refinancing operations in the broad sense, analysis of the company's debt capacity through disclosure of unutilized fractions of credits and, of course, inclusion of commitments stemming from the new financial instruments;

- lead to proposals for one or more statements of source and application of funds, which would open up the Fourth Directive to financial analysis.

IV. <u>THE HARMONISATION OF ACCOUNTING STANDARDS WITHIN THE EC IN RELATION TO THIRD COUNTRIES</u>

Contribution by Mrs. Lorraine RUFFING
Secretary
United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting

Introduction

The positive relationship between improved information disclosure by enterprises and greater investor confidence has long been agreed by accounting experts. Generally, greater investor confidence increases investment flows, lowers capital costs and contributes to the stability of financial markets. Investors need information which is both sufficient and comparable in order to make efficient decisions.

Thus, efforts have been underway at the international level and regional levels for quite some time to improve the quality and the comparability of information disclosed by enterprises. Before I describe the work at global harmonization at the United Nations and its relation to the work being undertaken in this area in the European community, I would like to make a few points to put our panel session into perspective. As I make this remarks I am sure that I have the support of both Mr. Geiger of OECD and Mr. Barthes of IASC.

Occasionally in some international fora one or two participants seem to derive positive benefit from confusing comparability with uniformity. While everyone can always agree that comparability is desirable, pessimists say it is impossible to attain because they chose to confuse it with uniformity. Some even go so far as to say that harmonization is a dangerous exercise because it strives for mindless uniformity which robs financial statements of any meaning.

The idea that comparability is impossible to achieve because of inevitable differences in national accounting environments or is a dangerous goal thus relieves some people from taking any action to harmonize divergent standards. I would like to state that the work at the United Nations is geared toward achieving comparability rather than uniformity.

I have also heard participants in international meetings state that capital flows are not affected by information disclosure so the quest for comparability is a useless one. While it may be true that short-run investment decisions in financial markets currently seem to be more influenced by speculative motives than by corporate performance, this does not mean that information disclosure is unnecessary. In the long-run investors must allocate their capital efficiently and they can make efficient decisions only with adequate information. Thus, I think the quest for comparability is a valid one.

Work at the United Nations

The United Nations has been involved in the area of corporate accounting and reporting since 1973. I would like to return to some ancient history when I remind you that in July 1972, following the denouncement of ITT for its involvement in the internal affairs of Chile, the representative of the country at the UN Economic and Social Council, proposed a comprehensive study of the effects of transnational corporations. A Group of Eminent Persons was appointed to conduct hearings. In its report the Eminent Persons noted a serious lack of both financial and non-financial information in usable form on the activities of TNCS and the limited comparability of corporate reports. It considered that, in order to remedy these deficiencies, an international, comparable system of standardized accounting and reporting should be formulated, and to this end, it recommended that an expert group be convened under the auspices of the Commission on Transnational Corporations.

The expert group was convened and issued its report in 1977. It found, like the eminent Persons, wide disparities and important gaps in the area of general purpose reporting, and it elaborated a list of minimum items of financial as well as of non-financial information for inclusion in general purpose reports. In May 1979 an intergovernmental Ad Hoc Group was set up to deal with the issues identified by the previous group. Finally, in 1982, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting was created by an ECOSOC resolution. ISAR has three objectives: first, to serve as the international body for the discussion of accounting and reporting issues, second, to make a positive contribution to national and regional standard-setting; third, to take into account the interests of developing countries in the field of information disclosure. Regarding this last objective, ISAR can take up issues which are crucial to developing countries such as accounting for inflation or transfer pricing but are not discussed elsewhere because they are marginal issues. ISAR can also take up new issues which regional groups are not yet ready to tackle and at least get the process of global consensus started--one recent example is ISAR's work on accounting for environmental measures.

The need for corporate accountability grows as transnationalization grows. Thus, the mandate of ISAR is more valid today (1990) than at any point in time since the increasing interdependence of financial markets and the gradual economic unification of Europe (both East and West) will forge a truly global economy. However, it is questionable whether accounting standards will be in place to guide and monitor such a marketplace. In a truly global financial market, investors, creditors and Governments must be protected through adequate disclosure systems based on mutually agreed standards.

Since its first session in 1983 ISAR has dealt with a great number of accounting and reporting issues and arrived at mutually agreed conclusions on these issues. ISAR's conclusions on information disclosure were recently published in comprehensive, systematically structured documents. They provide a basis upon which financial statements can be evaluated. ISAR felt it was also necessary to explain to preparers and users of financial statements the main objectives of such statements and the broad concepts which underlie their preparation. A companion volume to the Conclusions which is titled--"Objectives and concepts underlying financial statements" has been published. These two volumes taken together can serve as a guide to Governments in the process of standard-setting.

Gradually, the Group has seen the need to become more action-oriented. Hence it is devoting more time to activities in the field of education and training. The USSR Ministry of Finance requested the United Nations Centre on Transnational Corporation to hold a Workshop on Accounting for and by East-West Joint Ventures in Centrally Planned Economies. As you all know by the end of 1989 more than 1200 joint ventures agreements have been signed but less than 150 of them are operational. Start-up operations must overcome many hurdles. Western partners face uncertainties regarding the repatriation of profits, access to raw materials, availability of adequately trained local management personnel and an incompatible accounting system. The last of these problems includes the recognition of revenues, expenses and certain liabilities, depreciation methods, valuation of assets and, most important of all, the determination of profits.

In June over 150 Soviet and International accounting experts, as well as joint venture personnel attended the Workshop and identified problems arising from their divergent accounting systems. Once these problems were clearly spelled out through case studies, solutions were explored which would draw both partners closer to internationally accepted practices. Time was devoted to discussing what type of training could best help Soviet accountants to attain a better understanding of international accounting. It was also pointed out that Western accountants and businessmen are woefully under-educated about centrally planned economies and that they should improve their education if we are to arrive at common solutions.

One direct result of the Workshop was the resolution of a number of problems by the Ministry of Finance. For example revenue recognition by joint ventures now complies with the "matching principle". The USSR Ministry of Finance also agreed to set up, together with UNCTC, a Task Force to assist, in a purely advisory manner, in matters related to the country's regulatory framework for accounting. The third outcome of the Workshop was the introduction of international accounting courses at six Soviet institutions of higher learning using the curriculum developed and discussed at the Workshop. There are three types of courses: one for upper-level accounting students; a second for joint venture practitioners and a third for University professors or trainers.

During 1989 the Centre has cooperated with the World Bank and the International Labour Organization in carrying out a survey of accounting needs in Africa. ISAR will consider the results in March 1990 and discuss the elements for an effective technical assistance programme.

The composition of ISAR or the Intergovernmental Working Groups of Experts on International Standards of Accounting Reporting is unique in that representation is geographically balanced. Experts from up to 9 African States, 7 Asian States, 3 Eastern European States, 6 Latin American States and 9 Western European States can participate as equal and official members. Thus the conclusions reached by ISAR on various accounting and reporting issues can represent a global consensus. Other international organisations, while having a worldwide membership in terms of their rank and file, have restricted participation in their governing boards and often some countries, particularly developing countries and now centrally planned economies have been left out of the decision-making process. I would also like to stress that it is an intergovernmental body and not a private one. Its work is reviewed every three years by ECOSOC and at that time its mandate is renewed, amended or withdrawn.

When I began my remarks I fell into the usual trap of speaking about the investors' need for information. In most international and regional bodies devoted to standard-setting there is a preoccupation with responding to the needs of financial markets. There are many other users besides investors such as employees, the local community and home and host Governments. These users should not always be forced to request special purpose reports when they want information concerning normal operations and performance. Their concerns should be addressed in the general-purpose reports. The composition of ISAR allows it to take into consideration the needs of these users who are often ignored.

To be fair I must admit that there are still empty seats in ISAR but I am fully confident that given current trends these will be filled by the end of the year. I will return to this issue of the need for balanced participation in global harmonization when I take up the relevance of the work at the UN to that at the EC.

Evaluation of Efforts at Global Harmonization

The former mayor of New York City, Ed Koch, use to enter a crowded room and scream "How 'am I doing ? The new mayor, Dave Dinkins, has changed the question to "How are we doing? I would like to pose that question to those of us who are involved in the effort to achieve greater transparency in the activities of enterprises as well as increased comparability. The answer after more than a decade of efforts by various international organizations is that the results are mediocre.

What do I mean? As the European community, ISAR recently undertook an international survey of the financial statements of transnational corporations and other enterprises. I have a limited number of copies available with me and I would be happy to send the survey to anyone who gives me their card.

ISAR, after the publication of its agreed Conclusions, found it appropriate to take stock of the current situation regarding the adequacy of accounting and reporting by TNCs. Such an exercise could reveal both the level of corporate compliance with internationally accepted practices and standards, as well as the deficiencies in international requirements. The survey analysed the availability and adequacy of information disclosure relating to 39 accounting items. The accounting items were drawn from the agreed Conclusions but to ensure the comprehensiveness of the survey additional items were added.

194 enterprises from 23 countries in different regions of the world and from different industries were selected in a manner which insured geographic and sectorial balance. The financial statements of 165 enterprises from developed market economies, 26 from developing countries and 3 from centrally planned economies were examined.

The extent to which different accounting items were disclosed in financial statements was divided into four categories: high or more than 80 %; good or between 65-80 %; average or between 50-65 % and low less than 50 %. The over all score for disclosure of all items is only 59 % or in my opinion-mediocre. This result should be a cause for concern among international standard-setters.

However, enterprises report on some items more frequently than others. Enterprises in the survey almost always published consolidated balance sheets and income statements, described their corporate structure and activities, reported sales, operating results and new investments as a whole and their accounting policies. They frequently did not give geographic or sectorial details relating to sales, operating results, new investments, assets and employees. Nor did they inform users about inter-group transactions and pricing, depreciation rates and accounting for inflation. See Table One.

There was a market divergence between enterprises from developed market economies and those from other countries. Those from DMEs scored 61 % while the others scored only 42 %. See Table Two. This indicates that if we believe in a global economy and in global capital markets, efforts at harmonization must be extended outside the OECD area.

The main conclusion of this survey is that harmonization efforts must be accompanied by periodic monitoring and an effective mechanism for insuring compliance. It is worth pointing out that no nation, not even the most sophisticated from among the developed market economies, is likely to use or ask its enterprises to comply with international standards unless it can be assured that other nations have done likewise. No nation would be willing to risk putting its transnational corporations at a competitive disadvantage. Compliance might be attained through international pressure resulting from an international convention on accounting standards. Whatever form such pressure ultimately takes, it should be efficient and politically expedient.

I have compared the results of the survey with others done by Tonkin, OECD and the IASC. Unfortunately, I have not had time to compare them with those reached in the EC survey but maybe Prof. Hopwood will draw some parallels. Tonkin's World Survey of Published Accounts is most similar to ISAR's study since developing countries were included and the sectorial distribution was close.

The results of both studies point roughly to the same strengths and weaknesses (See Table Four). Tonkin's overall assessment is that there has been little improvement in reporting practices over the period from 1980 to 1988 and in some areas there have been definite moves backward (segmented disclosure, omission of subsidiaries from consolidation and inflation accounting). To fulfil their commitment to stability in international capital markets and to reduce risks for investors, Tonkin recommends that enterprises make a number of specific improvements which I cannot elaborate on for lack of time but are contained in the World Survey.

Relation between the Work of ISAR and that of the European Community

Practically speaking, the relationship to date has been one of a positive interchange of ideas and materials. However, I wish to address something more concrete than "relationships". I would like to talk about the impact we can have on each others work which can either be positive or negative. Taking the positive side first. Efforts at regional harmonization within the EC are another force which can promote global harmonization.

I know the President of FEE has expressed fears about the EC becoming an accounting ghetto and these are not unreasonable fears. However, the introduction of the 4th and 7th directive and other directives can diminish the use of fragmented accounting rules which produce radically different results in financial statements throughout the Community. The fact that the Directives become law also improves compliance. To date most of the contents of the 4th and 7th Directives are consistent with generally accepted accounting practices at the international level. I would agree with Sir Geoffrey Fitchew when he stated that the existing EC directives have not invented new standards and that they should make international harmonization easier. That's the good news.

Now for the bad news or potentially bad news. The current process of arriving at a consensus on accounting Directives takes a long time. It is not a process which allows the Community to take up new problems and resolve them quickly. That is what some people mean when they say it lacks flexibility.

Also when positions are worked out over a number of years, they become solidified. This can cause real problems when members of the EC meet the rest of the world at the United Nations or other international fora. I must say I have witnessed quite a lot of banter about entrenched positions. This is because it is unlikely that EC members will agree to an accounting practice or standard which is at variance with a Directive.

In a certain sense they have lost the ability to incorporate the concerns of the rest of the world. For example, I have even heard certain ISAR members express reluctance to take up a new issue because it hasn't been yet worked out among EC members and they don't know what the EC position will be. However, one cannot expect international bodies to wait until all issues have been decided in the EC and then just merely rubber stamp EC decisions. If global harmonization is to succeed we must find a way to broaden the dialogue. Even if the Community remains preoccupied with the needs of financial markets, it is in their interest to consider the needs of the newly developing capital markets.

Since universal membership in the EC isn't possible otherwise we are back to the United Nations formula, then maybe the EC should consider giving consultative status to certain bodies which can inject a world view on a regular basis before final decisions are made. This applies to whatever forum, board, party, committee the EC cares to create or support in the future. The EC should also continue to participate or increase their current participation at the international level.

One development which might ease potential conflicts and standoffs is the elaboration of the objectives and concepts underlying financial statements. This exercise has been undertaken at both the national and international level with very similar results and it has the potential to put the work of harmonization into perspective. A clear enunciation of objectives and concepts allows experts to formulate recommendations for accounting standards which are internally consistent and which best meet the users' needs for information.

I would like to close by returning to my reminder that there are a number of users and their needs are diverse. Participation by the EC at the international level can remedy to some extent its fixation on the needs of financial markets and broaden its perspective and insure that it does not end up in an accounting ghetto.

IV. THE HARMONISATION OF ACCOUNTING STANDARDS WITHIN THE EC IN RELATION TO THIRD COUNTRIES

Contribution from Mr. G. Barthes de Ruyter
President
International Accounting Standards Committee

1. When IASC was founded in 1973, few anticipated the globalization of capital markets and the internationalisation of business. Few expected that different national accounting standards would be seen, for example, as an impediment to multinational securities offerings. Nobody imagined that securities regulators on a worldwide basis would be urging IASC to improve its Standards so that they could be used in prospectuses used for foreign issuings of equity and debt - yet that call has been made at each of the last two annual meetings of the International Organisation of Securities Commissions.

2. By 1990, economic and technological forces have impelled national markets to expand across international boundaries. As a result, capital markets and the business community are increasingly recognising the need for truly international standards of accounting and disclosure. The business community and other preparers of financial statements are tired of differences in accounting that lead to increased costs for those companies that operate and raise capital abroad. These differences also result in an unlevel playing field for those international companies that are competing with one another for business opportunities. As a result, the free flow of capital and business is blocked.

3. Investors, financial analysts, lenders, employees and other users of financial statements also recognise the need for truly international standards of accounting and disclosure. They have considerable difficulty in making decisions based on financial information prepared using different national accounting requirements. Their problem is compounded as investment, lending and employment become more and more international.

International Accounting Standards

4. In all these circumstances, the need for International Accounting Standards has never been greater. In the last sixteen years IASC has done a great deal to meet this need. It has issued twenty nine International Accounting Standards (see page 5), many of which have done a great deal to improve and, to some extent, harmonise financial reporting on a worldwide basis. These Standards deal with the substantial majority of topics that are important in the preparation and presentation of financial statements throughout the world. IASC has also recently issued its conceptual framework, the Framework for the Preparation and Presentation of Financial Statements.

5. International Accounting Standards are an international benchmark for national accounting requirements, whatever their form. Some countries use International Accounting Standards as, or as the basis for, national accounting requirements. Other countries develop more detailed national requirements that conform with International Accounting Standards. Other countries have based national accounting laws on International Accounting Standards; for example, the European Commission used the work of IASC in developing the 7th Community Directive on Consolidated Accounts and some European countries have made further use of International Accounting Standards when implementing both the 4th and 7th Directive. IASC referred extensively to the 7th Directive when developing its new Standard (IAS 27) on Consolidated Financial Statements.

6. Securities regulators such as the CONSOB in Italy require the use International Accounting Standards where there are no equivalent national requirements and Stock Exchanges such as that in London require foreign issuers to present financial statements in conformity with International Accounting Standards.

7. As the 1988 Survey of the Use and Application of International Accounting Standards shows, the financial statements of the substantial majority of major business enterprises around the world conform with the Standards. Few enterprises disclose the fact of such conformity although their number is growing.

8. IASC has achieved all this success because International Accounting Standards have been developed by a truly international organisation and as a result of an extensive international consultative process. As well as its member accountancy bodies in nearly eighty countries, the work of IASC involves the business community, employees, stock exchanges and securities regulators, bankers, lawyers and national standard setting bodies from throughout the world. The United Nations Centre on Transnational Corporations, the OECD and the World Bank send observers to IASC meetings and the European Commission has been invited to participate in a similar way. All twelve member countries of the European Community are members of IASC - and six are represented on its Board.

9. However, all these achievements by IASC are not grounds for complacency. IASC has not yet done enough to ensure that the financial statements of different enterprises from different countries can be readily understood and compared by users throughout the world. IASC must do more, much more, to meet the need for truly international standards of accounting and reporting.

<u>Improvements to International Accounting Standards</u>

10. In order to ensure the comparability of financial statements worldwide, IASC must improve existing International Accounting Standards:
    (a) through the elimination of free choices in accounting treatment for like transactions and events;
    (b) through additional implementation guidance and better disclosure requirements; and
    (c) by filling the gaps in its set of Standards.

Eliminating Choices for Like Transactions and Events

11. E32, Comparability of Financial Statements, was the first step in the improvement process. It was published in January 1989 and sets out the Board's proposals for the removal of free choices of accounting treatment for like transactions and events. The proposals are summarised on pages 6 and 7.

12. IASC has received comments on these proposals from over one hundred and fifty organisations in more than twenty countries. Many responses are the result of considerable consultation within individual countries, accounting bodies, international accounting firms and other organisations with an interest in the improvement and harmonisation of financial reporting. Representatives of IASC have also discussed the proposals with national standard setting bodies, regulatory authorities, the accountancy profession and the business community in over twenty countries and, in the middle of December, with officials at the European Commission.

13. The comment letters and the meetings around the world have revealed substantial agreement on many of the proposals in E32 but also very different opinions on some of the issues. They have also indicated considerable support for what IASC is trying to do - and recognition that it is a difficult task. The responses also proved what we had always thought - that all the problems are here in Europe - virtually all accounting systems known in the world exist alongside one another in Europe. Hence, harmonisation across the world is only a little more complex than it is in Europe.

14. IASC's Comparability Steering Committee met earlier this week to review the comments on E32 and to recommend what changes, if any, should be made to the proposals. The IASC Board will consider these recommendations in March and it plans to commit itself, in June 1990, to proceed with the necessary amendments to individual Standards.

Implementation Guidance

15. There is presently considerable variation in the amount of implementation guidance given in International Accounting Standards. This may lead to a loss of comparability when different enterprises use significantly different interpretations and methods of application when applying the same Standard for like transactions and events.

16. IASC has set up a new steering Committee to review all its existing Standards to ensure that they are sufficiently detailed and complete and contain adequate disclosure requirements. The Board will make all the necessary changes at the same time that it implements the changes resulting from E32; it plans to complete this work by 1993.

Filling the Gaps in International Accounting Standards

17. IASC has issued Exposure Drafts on Joint Ventures and Banks; it hopes to have Standards on both these topics by the end of 1990. New projects have been started on Financial Instruments, Cash Flow Statements and Intangibles. IASC is also likely to tackle a project on Earnings per Share in conjunction with the international financial analyst community. IASC plans to complete these projects by 1993.

The Way Ahead

18. IASC has an extremely ambitious programme for the next five years but it is determined to succeed. It will only succeed, however, if it and other organisations responsible for national and regional accounting requirements work together.

19. IASC has been concerned to hear suggestions of competition between IASC and the European Commission and between International Accounting Standards and possible European Accounting Standards. There should not be competition because both IASC and the Commission (and the Community generally) are working with the same objective in mind and should be working together to seize the opportunities that the globalization of markets and business has created.

V. MUTUAL RECOGNITION OF ACCOUNTS BETWEEN THE EC AND THIRD COUNTRIES

Contribution by Mr. B. D'Illiers
Commission des opérations de Bourse
France

After pointing out that, within the French delegation, it was to him, as a member of the Commission des Opérations de Bourse and delegate to IOSCO, that it fell to talk about the objective of protecting shareholders and other providers of risk capital, Mr d'Illiers said that transparency of financial information was the primary safeguard for providers of capital, especially when they operated in a financial market: the information various security-issuing companies gave about themselves had to be comparable.

Comparability was a situation whereby the information supplied was equivalent both in terms of quantity (disclosure) and in terms of quality (measurement); for there to be comparability - without which a market could not function properly - the accounts of companies from a non-Community country had to give information equivalent to that furnished by companies from the host country. It was not enough for the accounting standards of the two countries to be similar, as the companies might interpret them differently according to the domestic "accounting culture". It was such practical verification, along the lines of Article 54(3)(g) of the Treaty of Rome, and not a theoretical verification of the approximation of accounting laws pursuant to Article 100, that the regulator of a market had to carry out before accepting a foreign company.

Within the EEC, the Seventh Directive expressly provided that a group whose parent company was from outside the Community could be exempted only if the consolidated accounts of that company were found to give information equivalent to that given by accounts drawn up under the Community rules: the scrutiny related to the accounts themselves, and once again it was not enough just to look at the standards in force in the parent company's country. Nevertheless, the risk that the consolidated accounts of the same non-Community company might be dealt with in contradictory ways in two Community countries had to be avoided if at all possible, and the obligation to test for equivalence should be made less onerous through negotiations with the countries in which groups originated, in exchange for which better access might be secured for Community companies to those countries' markets.

To that end, Member States should entrust to the Community executive the task of thus negotiating reciprocity agreements with non-member countries on their behalf. But that could be envisaged only if the Commission were representing a truly homogeneous entity, that is to say if Member States were to share a sufficiently similar conception of the "true and fair view" that had to be given by accounts under the Fourth and Seventh Directives. Was that currently the case?

Unfortunately not, it seemed, judging from the accounts published by listed Community companies. In a recent case in point, the consolidated profit of a company from one of our countries came (in terms of amount per share) to ECU 3 by German standards, ECU 4 by French standards, and ECU 6 by United Kingdom standards. Yet profit was the most useful indicator when it came to informing not only investors but also all the persons Article 54(3)(g) was designed to protect.

Many more examples could be given to show that a sufficient degree of comparability had not yet been achieved between the accounts of companies from our countries for us to be able to work under satisfactory conditions on the approximation of our countries' and non-Community countries' accounting methods, or for it to be possible to apply mutual recognition agreements with non-Community countries under satisfactory conditions.

Since it was necessary, however, to work towards that goal, especially at a time when the process set in motion on the initiative of the IASC afforded an opportunity we could not let slip through our fingers, there was an urgent need for us, the accountancy authorities of the Member States and the Commission, to cooperate so as to bring the accounting practices of our companies more closely into line with each other.

But first, common interpretations had to be sought and adopted for those provisions of the Directives which had proved either ambiguous or too succinct; therein lay the key to a speedy improvement in the equivalence of information and to success in concluding truly watertight mutual recognition agreements with non-member countries and coming to an understanding with the IASC as part of a highly desirable drive to achieve harmonization worldwide.

VI. HARMONIZATION OF ACCOUNTING STANDARDS WITHIN THE EC: A PERSPECTIVE FOR THE FUTURE

Contribution by Mr. A. G. HOPWOOD
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Within a relatively short period of time, the accounting harmonisation endeavours of the European Commission have started to have a distinct impact on the practice and regulation of accounting in the member countries of the Community. Although the project remains incomplete, some real attempts nevertheless have been made to confront and change prevailing patterns of accounting diversity. Differences in technical procedures have started to be subject to some degree of critical examination and assessment. Questions have been asked of distinct national traditions in the accounting area. And although very real differences in accounting practice undoubtedly remain, concrete steps have been taken towards achieving a greater degree of comparability of the form and content of the financial disclosures made by business and commercial organisations within the Community.

Although it is still difficult to analyze the state of European accounting, recent studies such as that undertaken by the Federation des Experts Comptables Europeens (1989) confirm that some measure of harmonisation has been achieved. The form of the annual accounts is now a more standardised one. Anyone interested in a company incorporated in any of the member states should now be able to obtain a director's report, an audited set of accounts and a set of notes to the accounts structured on a comparable basis. Moreover, some of the technical issues subject to the requirements of the Fourth Directive are now more likely to be treated in either a harmonised or at least a comparable manner in these accounts. And although it is still too early to evaluate the full impact of the Seventh Directive, it is already clear that its concern to introduce a requirement for consolidated accounts will have a significant impact on accounting practice in some member countries. The full economic significance of large industrial and commercial groupings is likely to become more apparent.

Other more institutional consequences of accounting harmonisation are also of very real significance. The Fourth Directive provided corporate accounting with a more certain legal basis, something previously self-evident in some member countries but a significant change in the practices of others. Already there are signs that that change might be one that is capable of having quite considerable consequences. In those countries where accounting practice was once a more private endeavour, the state has started to take a more sustained and active interest in questions of accounting policy and the mechanisms for its regulation. That interest is unlikely to diminish. Equally, in some of those countries where the state had a more dominant influence, the ambiguity which the terminology of the "true and fair view" introduced into accounting regulation also might have played a not insignificant role at a time when capital market pressures were starting to impinge more actively on accounting thought and practice. At least the potential for a disturbance was introduced into accounting policy making. The concern with "true and fair" could serve to emphasise both the multiplicity of potential purposes which accounting could be called upon to serve and the judgmental processes which often are needed to resolve the resultant conflicting interests which strive to shape accounting choices. The fact that such an indeterminant language was introduced into the Fourth Directive at a time when capital market influences were becoming more significant might have helped to nurture and sustain the conflicting pressures which both the market place and the community can legitimately place on accounting practice.

The harmonisation initiatives of the community also have helped to forge a new European domain of accounting policy making. Practicising accountants now meet to deliberate shared interests and concerns, and have formed their own organisation at the European level. People now talk of accounting in Europe. Amongst some there is a genuine interest in dialogue and communication. With others, there is an equally strong desire to forge strategies for professional planning and mobilisation at a wider European level. What was earlier little more than an disperate collection of divergent practices is in the process of being forged into a more significant whole. Even those who oppose particular approaches to harmonisation often do so because of their own alternative strategies for influence at the European level. Within a relatively short period of time Europe has changed from being a quiet backwater for accounting policy making into an area where an array of very real forces and tensions are at work.

The European accounting policy agenda nevertheless remains an incomplete one. Considerable degrees of technical diversity still exist. Because accounting is perceived of in very different ways in different member countries, quite different factors and circumstances are perceived as having a legitimate right to influence it. Different economic and institutional roles are attributed to accounting. Different mechanisms exist for its regulation and change. The exercising of accounting discretion is subject to very different influences and constraints. The net effect of these differences is not only that accounting itself remains a diverse phenomenon within the Community, but also that the financial accounts of companies incorporated in different member states still remain difficult to compare in many instances. Investors, employees and their representatives, agencies of national governments, the Commission and other parties interested in industrial and commercial activities, still find it difficult to analyze and interpret statements of financial position and performance in cross-national contexts -the very objective which the accounting harmonising activities of the European Commission sought to address.

So although real progress has been achieved in making the financial accounts of companies from different member countries more comparable, the remaining diversity is both real and significant. Questions therefore arise as to the future of the harmonisation project and the methods that might be most appropriate for its continuing realisation. Adopting a forward looking stance, has sufficient comparability been achieved or is the continuing creation of an internal market within the European Community likely to call for more? And if further comparability might be required, how is this to be achieved? Are the mechanisms of the past still adequate or are different approaches now required? It is to such questions that the present study is addressed.

ACCOUNTING DIVERSITY AND ITS BASES

The reasons for the remaining technical diversity in accounting practice in the European Community are reasonably well understood, residing in both the Directives themselves and the underlying accounting contexts which they seek to address.

The Directives provide for options, the differential exercising of which can impair the comparability of financial accounts. Accounting for goodwill is a topic of some current significance in this respect, as are the different valuation bases allowed for tangible fixed assets. Discretion is also allowed in the treatment of research and development expenditures and pension liabilities. All of these options are important in their own right but their significance is enhanced in an economy that is increasingly more knowledge intensive, subject to merger and acquisition pressures, shifting demographic trends and changing price levels.

The Directives were also of necessity partial. Significant aspects of industrial and commercial accounting practice are not directly subject to their harmonising requirements, either because of the difficulty of agreeing on a standard for desirable practice at the time the Directives were being negotiated or because such aspects of accounting have become more significant with the passage of time. Accounting for foreign currency translation, deferred taxation, and the treatment of leases are all very significant topics that are not dealt with by the Directives.

Moreover, as important as the Directives have undoubtedly been in creating the basis for a new domain of comparable accounting practice within the Community, the diversity which they sought to address is now recognised as being more resilient than initially might have been imagined. Rather than being an isolated and thereby more influenceable technical phenomenon, accounting is now recognised as being something that has been shaped by the cultures, institutional configurations and socio-historical circumstances of the specific societies in which it emerged (Busse Von Colbe, 1983).

Being used as bases for the monitoring of economic performance, for the allocation of corporate surplus between different social interests and for defining patterns of accountability between companies and other significant economic agents, today's accounting procedures are the legacies of the different historical circumstances in which they emerged. They are not merely technical. The meanings and significances which are attributed to them, the roles which they are called upon to serve and the institutional contexts in which they operate are all profoundly shaped by wider economic, social and political forces.

Viewed in such terms, it is important to consider the following factors when comparing accountings in different countries:

- Accounting is only one of the ways in which information can flow from a company to other significant economic agents. Over time different institutional arrangements for both information provision and the management of corporate accountability have developed in different national contexts, some attributing a significant role to accounting based sources of information and others a much more modest one. Such differences do not necessarily imply different degrees of information provision, but only different channels for that provision and potentially different recipients.

- At present there is little or no systematic evidence on the relative effectiveness of such alternative institutional configurations or different levels of investment in accounting information flows.

- Markets and administrative hierarchies are likely to give rise to the emergence of different requirements for accounting. Administrative hierarchies are more likely to result in more highly specified and standardised flows of information than markets. The active trading in information in the latter is more likely to result in a greater tolerance of ambiguity and diversity, albeit subject to a basic guarantee of the underlying integrity of the key components of the information flows. Where accounting regulation emerges in more market oriented settings, it is likely to be concerned with ensuring that that integrity exists, reducing the complexity and costs of information processing and ensuring a more equitable outcome of the market process by increasing the equality of access to information.

- Even in countries where the primary demands for corporate information might be market based, historically many of the pressures for accounting standardisation have emanated from agencies of the state. In part these have reflected concerns to facilitate the operations of the market. They also have sometimes stemmed from concerns to reduce inequalities in access to information. Often, however, such concerns with standardising accounting have resulted from problems encountered by state agencies in using accounting information in economic management and forms of institutional regulation.

- Care therefore needs to be exercised in recognising the diverse origins of accounting and its regulation even in the same national context.

- Over time the different institutional contexts in which accounting is embedded result in different roles and functions being attributed to accounting. The rights of different interest groups vis-a-vis accounting information can be differently recognised. Pressures for accounting elaboration and development thereby start to emerge on different institutional axes. And different institutional arrangements are created for the regulation of accounting, including ones which often allow for very different sources and processes of influence. As such differences develop, accounting practices can become quite deeply implicated in their institutional and socio-economic settings, no longer being instruments for information provision purely in their own right.

- Even though very real differences exist between different national accountings and their institutional settings, care nevertheless has to be exercised in accepting many conventional portrayals of those differences. There is a common tendency to exaggerate and to polarise, often for rhetorical and argumentative reasons. Whilst the accountings of certain countries are more influenced by tax requirements, for example, very few countries have accountings that are not subject to some such influence. Indeed tax has been an important factor mobilising accounting change in countries where there is no direct link between corporate accounting and taxation. Rhetorical statements might often lead one to conclude to the contrary, however. Equally, whilst there are very real differences in the configurations of market, professional and state influences on the development of accounting practice, the significance of accounting is now such that the state is rarely, if ever, absent as a significant influence on accounting change. Even in countries where professional and market influences are celebrated, it is impossible to understand the path of accounting development, including its more recent contours, without appreciating the active if not readily visible role played by agencies of the state.

- Within a setting such as Europe with many shared institutional frameworks and traditions, it is usually more important to look for different

> configurations of influences rather than more extreme differences. The latter are often more likely to emerge from the construction of argumentative stances rather than portrayals of reality. Although we do need to recognise that differences can be very real, simplistic representation of them fail to do justice either to the mass of interrelated influences which together constitute national practices of accounting or the very real possibilities for change which reside within them.

It is the patterns of real underlying differences that nevertheless provide both the rationale for harmonisation and, importantly, in the present context, the constraints upon it. Seen in such terms, accounting cannot meaningfully be detached from its institutional and social setting as a separable technical practice. Any attempt to change accounting must be based on a sensitive appreciation of the other important aspects of its setting that constrain accounting to remain as it is and also influence the extent to which changes can be introduced and their consequences anticipated. Moreover with such constraints on accounting change, it is hardly surprising that the process of harmonisation is a slow and imperfect one. Successful change has to be sensitive to areas where discretion exists, where redundancy and additional provisions can be introduced, and where changes in the accounting context might already be suggestive of new accountings.

For it needs to be remembered that accounting is rarely static. Accounting was not as it now is and in the decades that lie ahead it undoubtedly will continue to become what it was not. Changing institutional forms and changing social and economic priorities can and do put pressures on accounting to change.

The growing economic significance of the state placed new pressures on the role of accounting in the provision of economic intelligence and as an instrument of economic control, something that is still very evident in those countries where the state is trying to further the domain of economic rationality in social affairs.

The recent liberalisation of market forces also has placed considerable pressures on accounting in many member countries. With an increasing significance being attached to open capital markets, the role of accounting as an instrument of both accountability and decision oriented information grows. Pressures emerge for the more frequent and more open disclosure of information, with the information provisions being more orchestrated around significant economic transactions. Such pressures become particularly acute when constraints on the active market in companies, rather than merely the provision of financing to companies, are removed. If companies themselves can be bought and sold, accounting information often assumes a more strategic significance both as a source of information for those interested in corporate acquisitions and as an instrument of defence for those seeking to resist takeover attempts. Indeed it was precisely in such circumstances that more active interests in new modes of regulating accounting arose in several countries, including some within the European Community.

Many such changes are currently under way within the European Community and together they are of vital importance for any informed consideration of accounting policy making in the years that lie ahead. Any careful examination of accounting harmonisation must address not only the forces which have created past patterns of accounting diversity but also the factors that are likely to impose new pressures on accounting to change, not least those that might stem from the continuing development of the European Community itself. For whilst the contingencies of the past might constrain the harmonising initiatives of today, it is the changing pressures and demands placed on accounting now that provide the basis for the policy agendas which the accountings of tomorrow must address.

FACTORS INDUCING CONTINUED ACCOUNTING CHANGE

The Directives initially sought to ensure that differing patterns of corporate disclosure and accounting did not constrain the development of a free internal market within the European Community. Although both circumstances and aspirations have changed in the intervening years, the objective still remains a significant one. Today even more emphasis is placed on the liberalisation of industrial and commercial transactions within the community and on removing the barriers to the free movement of goods and services, capital and labour. Enhancing the comparability of corporate financial statements is still an important part of that process, something that is agreed by even those who disagree on the means through which it is to be achieved. There is quite widespread agreement that more comparable flows of information can play a vital role in forging a more cohesive and integrated economic community.

The maintenance of the integrity and understandability of corporate information is of equal importance to those who emphasise the need for accountability to a range of interests as it is to those who stress the information requirements of markets, particularly the capital market. As an active processor of information, the market requires financial accounts of a reasonable standard of validity, integrity and comparability, something which there is reason to believe does not emerge unproblematically through the operation of the market itself (Bromwich, 1985). Historically both accountability and decision oriented needs have provided the basis for an audit function and national forms of accounting regulation.

Recognising the need for some measure of accounting comparability for the sustenance of cross border trade, investment and financing, the existing Directives have provided at least a basis for ensuring that the more complex information requirements of a wider market are met. Equally, they have started to recognise the even greater difficulties which other social interests experience in tracking trading and financial activities across national boundaries.

Unfortunately, however, even that degree of progress is in danger of being dissipated. Despite the fact that the past few years have witnessed a growing volume of cross border investment and trade, the changing nature of the commercial world and the fragmentation of accounting regulation together are threatening to reduce the harmonisation and comparability that have been achieved so far. With areas of accounting not covered by the Directives becoming more significant, national accounting regulators have been forced to select their own different solutions. A new potential for diversity thereby has been created. Similarly, the exercising of options within the Directives has either confirmed previous national preferences or, where national enabling legislation has permitted the use of all possible options, increased the degree of potential diversity.

Looking into the future, it is also important to recognise that a very considerable potential for accounting change is currently being restrained by constraints in other institutional and policy areas - something that serves to illustrate the dependent nature of accounting practice. Perhaps foremost amongst these are the legal and other barriers to takeovers and mergers both within and between member countries. As has already been pointed out, an active capital market and particularly the development of a market in corporate control is capable of considerably enhancing the strategic potential of accounting information and thereby corporate, investor, governmental and other interests in it. The development of such a market in companies is currently restricted by a complex web of legal and other practices in many member countries. Over time it is difficult to believe that these will not be subject to review with the development of a more open internal market, not least because of the growing significance of crossnational companies. Indeed this is already happening. Other related changes oriented towards enhancing the development of capital markets and increasing the significance of publicly quoted companies in a larger number of member countries also would be likely to increase the significance of accounting.

So despite real achievements in accounting harmonisation, increasing pressures on accounting could easily dissipate what has been gained as responses are made at a national rather than a Community level. If this happened, the paradox would be that it was occurring at the very time when both an interest in and a demand for more comparable corporate information was growing.

The development of the internal market is such that the growing volume of cross border trade, commerce and financing is resulting in increasing crossnational comparisons of accounting information. This is a quite natural and predictable response. Whether it is as a result of the activities of financiers, grantors of credit, customers, regulatory authorities or public interest groups, more and more questions are being raised about the significance of the remaining national accounting differences within the community and the means for their reconciliation.

Even if large sophisticated users of corporate financial information can cope with the complexities of non-comparable, they still have to incur additional costs to do so. Other users and interests may have neither the skills nor the resources to cope with such difficulties, however. Be they creditors, local or regional communities, employees or their representatives, or small shareholders, they will all find non-comparable financial information an increasingly costly and constraining problem in an era where crossnational transactions become more important. Any failure to act on this problem is therefore likely to have distributional consequences as well as ones for efficiency.

Moreover, continuing developments within the Community could be quite capable of reinforcing interests in the enhanced comparability of corporate financial information. Growing interests in the harmonisation of financial regulations would certainly have this effect. The control of public purchasing programmes is another sphere of regulatory activity that could impinge on accounting, as might any longer term developments in employee rights and the creation of a more environmentally oriented economy. Even the slightest interest in the harmonisation of taxation would immediately implicate the accounting. For as has already been stated, accounting is not an independent technical practice. Precedents both within Europe and elsewhere suggest that related developments have had quite pronounced consequences for the development of the practices of accounting and their modes of regulation.

With developments in at least some of these areas being very likely in the foreseeable future, the Community must now address the means by which a greater degree of coherence and comparability in accounting is to be achieved. Although the programme of Directives has provided a useful basis for improving the comparability of corporate financial reporting, a new initiative is now required to consolidate the achievements and provide a more adequate basis for facing the future.

THE INTERNATIONAL CONTEXT OF ACCOUNTING HARMONISATION AND STANDARDISATION

A few years ago the international arena for accounting policy making was weakly developed. Although the International Accounting Standards Committee had been established in 1973, it had been slow to develop a focus and mission, and gain the respect of the international accounting community. Other international agencies also provided bases for discussions on accounting matters but for a variety of reasons did not serve as active agents of change.

In the last few years, however, a strong interest in the wider international standardisation of accounting practice has emerged, not least because of the globalisation of the capital markets. The stock exchanges of different countries are interested in attracting international listings but often do not want to compromise their own requirements for financial and other disclosures. Such concerns are shared by many of the relevant regulatory authorities, not least in respect of those circumstances where different accounting regimes are known to influence corporate decisions on listing and financing. Major multinational firms still wishing to be listed in several financial centres can be faced with the costs of supplying financial information prepared in accordance with different accounting standards. And the diversity of disclosures can, in turn, be confusing to the international investing community.

Concerned with these problems, the International Organisation of Securities Commissions asked the International Accounting Standards Committee to investigate the problem. Receiving the support of its professional sponsors, the multinational audit firms and at least some national governments, the IASC is in the process of responding positively to this challenge. Already it has proposed to reduce the options in existing international accounting standards. Although it is still far too early to evaluate the effectiveness of this exercise, there is reason to believe that it might provide a greater degree of coherence and focus to the activities of the IASC, possibly providing a basis for it to become a more proactive and influential organisation.

A question therefore arises as to the relationship between the IASC and any further harmonisation initiatives of the European Commission. There are those who are legitimately worried about a further multiplication of regulatory endeavours. Whilst real, such worries nevertheless need to be considered with some caution. They can easily attribute too significant a role to the activities of the IASC which for the foreseeable future will remain a body that needs to move relatively slowly, carefully negotiating with major interested parties. It is also extremely unlikely that European initiatives would deliberately seek to go in directions counter to those of the wider international community. Past experience suggests that in an increasingly international world, European decision makers are sensitive to the need to develop accounting standards which do not reduce the possibilities for international trade and cooperation. More positively, however, recognition needs to be given to the role which European harmonisation already has played in a wider international standardisation of accounting. Both at a technical and a human level, Europe has made a very real contribution and some of that stems either directly or indirectly from the harmonising endeavours of the European Community. Indeed, in the future, the Community has the potential to serve as a vital laboratory for accounting change, containing, as it does, many of the major strands of accounting diversity. With a strong commitment to move harmonisation forward as part of the wider creation of an internal market and a sensitive appreciation of the need to maintain a dialogue with bodies such as the IASC, there is every possibility that European initiatives in the area could further rather than restrain a wider process of international change.

There are other positive reasons why members of the European community might wish to have a European forum for accounting affairs, albeit one that would actively seek to liaise with international bodies. In many of the member countries of the Community accounting pronouncements need a legal basis that governments and regulatory authorities would be reluctant to attribute to standards issued by a confederation of professional organisations. Questions of authority and enforcement could legitimately arise. A European forum open to wider influences could therefore provide a way in which international pressures for change could more widely permeate European practices, European developments in the area might also need to recognise a wider range of economic and social interests. And not least in significance, accounting pronouncements need to relate to specific institutional contexts and policy concerns. To realistically do that at the international level is something that might only be achievable in the distant future. In the more immediate future, the process is more likely to illuminate very different approaches to regulation, as between Europe and the USA, for instance. International standards are therefore likely to remain quite general and compatible with the exercising of discretion in very different ways. A closer intermingling of accounting pronouncements and their institutional and policy contexts might be a more realistic objective at a European level.

The new initiatives at the IASC are to be welcomed. They represent an exciting and very relevant development. Every effort should be made to maintain their momentum and to further develop the independence and authority of the IASC itself.

There also are strong reasons for maintaining a concern with harmonisation and comparability within the European Community. It is to the institutional means of achieving this, that we now turn.

ALTERNATIVE INSTITUTIONAL APPROACHES

Directives have served as useful instruments of change in introducing a European dimension into accounting thought and practice. When it was necessary to explore the previously uncharted dimensions of European accounting and to identify the bases for establishing a consensus for change, the procedures associated with a Directive were helpful. They provided a means for carefully listening to a broad range of perspectives and interests, for recognising the legitimate political nature of the process, and for enacting change in a way that highlighted the need to filter Community changes through the differing institution of the member countries. Slow as that process often was, it nevertheless has resulted in a domain of European accounting policy-making and practice.

Increasingly, however, the rather ponderous nature of the Directive process is being questioned, not least in an era when change has been dramatic. It is now recognised that the policy agenda of European accounting changed quite appreciably whilst Directives were still being considered and implemented. New issues and problems arose. The environment of accounting changed. New significances were attached to accounting matters. The regulatory context of accounting shifted quite appreciably, not least given the move towards more global capital markets. Relatively few of these changes were incorporated into the resultant Directives so not only do the accounting provisions of the Directives lag behind the development of policy agendas in the area but there also is a quite natural reluctance to embark on the process of revision when initial implementation has sometimes only just been achieved.

There is now a view that Directives provide a less than adequate means for ensuring that Community requirements for accounting remain in touch with the dynamics of business practice and shifting regulatory stances.

Although there is a broad consensus on both the need for accounting harmonisation to move forward and the difficulties of achieving this through Directives, less consideration has been given to alternative institutional frameworks. In the following discussion three different possibilities are considered. Each is amenable to a number of different ways of ensuring its precise implementation. At this stage of the debate, however, it is more important to focus on the broad distinguishing features of the different options rather than their exact mode of operationalisation.

A European Accounting Forum

Recognising the need for furthering accounting harmonisation within the Community but being conscious of the political, institutional and technical constraints on this, one possibility is to invest in a means for furthering dialogue, debate and cooperative change between national accounting standard setters and the European Commission. Such an organisation might be termed a European Accounting Forum. The Forum would not aim to be a regulator of accounting itself. It would not develop accounting standards or requirements. Rather its functions would be to strive to improve communication between national standard setters and to provide for discussions on accounting issues both within the Community and in international organisations. This would provide the basis from which changes could then be introduced into national accounting regulations such that a greater degree of harmonisation is achieved over time. A central aim of such a forum would be to address the technical and institutional impediments to more comparable corporate reporting so that further accounting comparability might be achieved by action at the national level.

Such a forum should be both an active and a contemplative body. It would carefully select issues for consideration either on the basis of their perceived relevance within the Community or because of their concern to international accounting authorities, such as the International Accounting Standards Committee. Its mode of operation would be based on careful analyses of matters on its agenda, trying to understand why accounting treatments are different, the consequences of these and possible means for minimising such differences should this be considered a desirable course of action. Whilst striving to increase the degree of harmonisation and comparability of accounting within the Community, the Forum should be established in such a way that it would always strive to emphasise the practical possibilities of doing this. Its concern with the future would need to be one that was grounded in an informed awareness of the present and the past.

It would be essential for any such European forum to maintain close relationships with international accounting organisations. An international perspective must infuse its deliberations and debates. Wherever possible, the discussions of the Forum should strive to start from an international rather than a purely European stance, unless there are very good reasons to the contrary.

Although such a forum could be established by the Commission much as the OECD has its Working Group on

Accounting Standards, many of those favouring this option do so on the presumption that the Forum would be independently established by accounting standard setting authorities within the Community, albeit including the Commission in that category. For as is discussed below, many proposals for accounting change are as concerned with the management of the influence structure around accounting as they are with accounting itself - another recognition that accounting is far from being purely a technical phenomenon.

So independently established, a European Accounting Forum would be financed by the standard setters, including the Commission, on some agreed basis. It would be essential that the level of financial support would be sufficient for the technical, research and administrative capacity that such an organisation would need to function in the way envisaged above. This need not be large but it must be sufficient to be compatible with the needs of an organisation whose rationale is posited on the basis of its contribution to investigation, dialogue and carefully considered change.

If widespread commitment to such a forum could be found among the relevant parts of the European accounting standard setting community and if an appropriate level of resourcing could be assured, there is much of value in such an approach to institutional change. It recognises the continuing need for action but it articulates this in a pragmatic manner which emphasises the real constraints imposed by technical and administrative diversity and the nature of the political process in which accounting is embedded. It therefore needs careful consideration.

An assessment of such an approach also needs to be conscious of the possible problems which might be associated with it. These mainly relate to questions of authority and legitimacy. Whilst a forum based on a grouping of national accounting standard setters would certainly have more authority than one which only appealed to professional organisations, a question still arises as to whether it would have both the will and the means to act in a coherent and consistently authoritative manner. Having to liaise with a variety of governmental and private institutions, such issues are of some importance, not least at a time when a growing commercialism in many audit firms and a significant increase in the concentration of their industry most likely themselves necessitate an enhanced authority for accounting authorities. Such problems deserve serious attention.

A European Technical Standard Setting Organisation

Another way of furthering European accounting harmonisation might be through the establishment of a separate organisation for European accounting standards setting. Such a possibility has been mentioned on several occasions. The proposals for the exact mode of implementing it have varied but at times reference has been made to the models of CENELEC and CEN, respectively the European Committee for Electrotechnical Standardisation and the European Committee for Standardisation. Spanning wider than the European Community itself, these bodies are independent of the Commission, although partly financed by it.

An accounting equivalent also could be established independently
of the Commission, possibly in a not dissimilar way than the Financial Accounting Standards Board in the USA is independent of the Securities and Exchange Commission and other governmental agencies. In Europe, however, it would appear that there might be some expectation of substantial, if not complete, financial support for such an organisation by the Commission. In addition to providing resources, the Commission also would be expected to delegate decision making powers to such a body. Itself thereby

necessitating a new Directive, the European accounting standards body would be given the powers to interpret existing and any subsequent accounting directives and to elaborate upon them within some agreed framework. Its modes of operation would need to be appropriate to this significant task and desirably should emphasise open processes of consultation and decision making that are responsive to the broad range of parties having an interest in accounting matters.

Such a proposal is far from being an unproblematic one. The resource implications would be substantial, despite the fact that there is evidence that it is often difficult to fund accounting regulatory structures. A quite specific constellation of forces needs to coalesce before such bodies can be perceived to be in the interest of those with the necessary financial resources, other than governmental authorities. Much more significantly, however, the foundation of the proposal on the presumption that accounting is a purely technical matter is profoundly flawed. A diverse number of parties have interests in accounting, and often ones that society recognises as being fully legitimate. The whole history and development of accounting testifies to its deep implication in wider social and institutional forces. Indeed that is precisely why there is a problem of accounting diversity in Europe today and it is also why numerous parties feel strongly about the institutional options for accounting regulation within the Community. The very strength of their lobbying, numerous experiences with accounting regulation in national settings and the historical process of accounting change all testify to the fact that accounting is not a purely technical phenomenon. That may be something that we do not like to articulate but it is something that we must not forget.

Interestingly political processes develop even within and around bodies like CENELEC which are focusing on more technical matters. Even in such areas the consideration of what is seemingly technical can generate conflicts between competing product areas and manufacturers that go well beyond the purely technical domain, as well as entering into wider discussions of international trade and competition.

It is important to recognise such wider foundations of accounting, even though this may not often be done. For if accounting is more than a purely technical practice, its regulation and change need to stem from legitimate and accepted sources of authority. If that legitimacy and authority is not secure, there can be major implications for both the implementation of change and the very process of regulation.

Questions of authority and legitimacy can provide some insight into why it is often thought that bodies charged with the review and development of accounting are easily prone to regulatory excess. Although such a view ignores the long history of inactivity on the part of many standard setting organisations in the accounting area, it is nevertheless possible to point to opposing examples. From a European perspective, the American Financial Accounting Standards Board is often seen in such terms. Of course some differences in activity reflect differences in the wider regulatory environment. But consideration also needs to be given to the fact that visible and public activity on the part of a standard setting body can sometimes stem from an equivocal institutional positioning and a questionable source of authority. Continued activity in such cases can be used to justify the existence of the organisation. Seen in this way, regulatory excess need not stem from the mere presence of a bureaucratic organisation but rather from the expectations which are placed upon it, the nature and strength of its sources of authority, and its systems of governance which can moderate the ways in which responses are made to expectations and appeals are made to other legitimating bodies.

Such issues would be important in a European setting if an independent accounting standard setting authority were to be established. Unable to appeal to the democratic mandate of the state, the executive authority of an official administrative agency or the traditional respect attributed to most existing national accounting regulators, there is a very real danger that such an organisation would either lapse into inactivity or invest in grandiose appeals to expertise to establish a new basis for action. If the latter possibility prevailed, without care a new and very different regime of accounting regulation might emerge that would have only a tenuous relationship to the problems and possibilities in the name of which the organisation was established.

In any event it is doubtful whether a new organisation is needed to deal with the accounting problems currently being experienced in the Community. Already accounting authorities have had too pronounced a tendency to invest in institutional elaboration at the international level, with numerous bodies being established to counterbalance the influence of others rather than to articulate a positive agenda in their own right. Now is not an appropriate time to further this process.

On substantive grounds, the establishment of an independent accounting standards organisation for the European Community is therefore something that is not needed for the foreseeable future. On procedural grounds, moreover, such a step could be something that would be deeply worrying to those interested in a more cautious and reasoned approach to accounting change.

<u>The Role of the Commission</u>

There is widespread enthusiasm for what has been achieved by the accounting harmonisation programme of the European Commission, although there is little immediate interest in new Directives oriented towards reducing options and extending the scope of harmonisation. That said, there is nevertheless still real and genuine interest in furthering the comparability of corporate accounting within the member states in the context of both the continuing development of the internal market and the wider internationalisation of business and financial activities. But there quite rightly is no interest in doing this through a separate accounting standards setting authority.

It is now quite correctly perceived that a more cautious and subtle approach is needed to further accounting change within the Community. Dialogue will be essential. A very real investment needs to be made in improving our understanding of existing practices within the member countries, the rationales for them and their consequences for business and the community at large. Rather than independently proceeding to enact a new regime of European accounting requirements, those concerned with the future development of accounting in the Community need to liaise closely with existing national accounting standard setters and relevant international agencies. Progress needs to be definite but at the same time carefully thought out and skillfully implemented. It needs to be recognised quite explicitly that change within the Community can and must emanate from a combination of national changes and developments at the level of the Community itself.

Such requirements for the future reinforce the concerns behind the establishment of a European Accounting Forum. That proposal recognises the need for dialogue, research and close liaison with national accounting standard setters, where such authorities exist. But as has already been noted, such an independent and loosely orchestrated forum potentially lacks the authority to be seen as a legitimate stimulus for change in many of the member countries of the Community. The Commission clearly has such authority. Consideration could therefore be given to locating such a means for establishing dialogue and incremental progress within the confines of the Commission, thereby accepting the valid contribution which such a development could make and at the same time endowing it with legitimacy and authority.

Being cautious of the need for any further institutional elaboration within European accounting, if this option were to be pursued every effort should be made to use suitably modified existing organisational arrangements. The Contact Committee established by the Fourth Directive needs to be considered in this context. Meeting but leaving no public accounts of its deliberations, so far the Contract Committee has not utilised its potential to serve as an active agent for accounting development within the Community.

The present composition of the Committee is not suitable for pursuing the careful and inevitably technical discussions which will be needed if at least some of the prevailing inconsistencies and differences in European accounting are to be dealt with. Nor is it structured in such a way as to facilitate more direct contact and liaison with the relevant national accounting standard setters.

To further such aims, a technical subcommittee of the Contact Committee could be established consisting either wholly or largely of senior representatives of national accounting standard setting agencies within the Community. Further consideration would need to be given to whether representatives of other interested parties should be represented on this subcommittee or whether such contacts should be left to a separately constituted consultative committee.

Although such a subcommittee, suitably named, would report to the Contact Committee and be subject to its direction and influence, the subcommittee should be allowed to act within a remit established by the Contact Committee. That remit should stress the need to move forward through the identification of possible ways of modifying national accounting requirements in an agreed and coordinated manner and the more direct actions of the subcommittee and the Contact Committee themselves. Working within the confines of the existing Directives, considerable possibilities exist for clarifying their intentions and meaning. Of necessity, accounting pronouncements are often general, having an ambiguous relationship to the specifics of their institutional settings and changing technical possibilities and policy demands. Perceiving one of their roles as being the guardians of the existing instruments of harmonisation and enhanced comparability, the subcommittee and Contact Committee could usefully further progress by being able to offer carefully considered and authoritative interpretations of existing Directives. A great deal of very real progress could be made in this way, the interpretations providing a way in which existing Directives could keep pace with changing circumstances and requirements. Over time, this most likely would not eliminate the need for new Directives but it could introduce a very considerable and useful element of adaptability into the process.

Although such interpretations might emerge from the discussions and analyses undertaken by the subcommittee, they would need to be grounded in the formal authority of the Contact Committee itself. The provision of such a power of authoritative interpretation would most likely necessitate a new Directive. If this institutional option were to be considered further, this would need further investigation and clarification.

Like the proposal for a European Accounting Forum, this modification of existing institutional arrangements would also envisage a cautious approach to further accounting change and harmonisation based on the necessary research and careful analyses of existing technical practices, their contexts of operation and their consequences. At present the resources of the Commission are woefully inadequate for doing this. Whilst not necessitating any large staffing and resourcing, the adequate functioning of the technical subcommittee and the modified Contact Committee would require the services of two or three additional specialist staff. These must be technically well qualified in accounting matters. The branch of the Commission servicing the Contact Committee and the subcommittee also would need to have available to it adequate funds to commission independent studies and analyses where necessary and to start the process of compiling a resource centre for materials on accounting practices and policies in the member countries. At present it is extremely difficult to locate such materials and yet they are necessary if future change is to be informed by a sound understanding of existing practices and their national circumstances. If the Commission is not able to perform such a resource role itself, it should seek to delegate this to another suitable agency or organisation.

The resolution of accounting problems necessarily impinges on wider interests and parties. Because of this, many of the member countries of the Community have introduced processes of wider consultation and sometimes even representation in the accounting policy making area. A modified Contact Committee and a technical subcommittee should seek to follow this example, establishing a European Accounting Consultative Committee with the appropriate representation of user, preparer and other relevant interests.

Together the technical subcommittee and the Contact Committee could consider the scope of further accounting requirements in the Community. Whilst some developments might necessarily apply to all organisations subject to the existing Directives, others might be more appropriately aimed at major entities, either those being publicly listed on national stock exchanges or those subject to the requirements of the Seventh Directive. It is unlikely that any general principle of demarcation can be stated at this stage which could adequately identify the differing needs of various subsets of organisations, so this might be on issue for early consideration by the technical subcommittee and the Contact Committee.

Obviously such a proposal for modifying existing institutional arrangements within the Commission needs more thought and specification. A number of detailed options and alternatives exist within it. It is nevertheless the view of this analysis that this approach is the most useful of the institutional options considered. It certainly avoids the risks and large resource implications of an independent accounting regulatory body at the European level. Seeking to build on the potential for dialogue and grounded change that a forum for bringing together national accounting standard setters could create the modification of existing Commission arrangements would endow such a forum with the authority and legitimacy which it would need to function adequately in a European setting. The modified Contact Committee and a technical subcommittee also could provide a way for progressing harmonisation within the context of existing Directives by the provision of authoritative interpretations. Taken together, it could serve as a means for careful, considered but nevertheless real and authoritative change.

CONCLUSION

The need for further enhancing the comparability of corporate accounting within the European Community is very real, although there is little interest in any hasty or overly centralised approach to this. With the interests in further progress also being very genuine ones, there is quite widespread recognition that the constraints on further harmonisation are very real ones. They cannot be readily set aside. They certainly cannot be ignored. Rather they suggest that progress must be dependent on a considered and conscious approach to change, carefully based on analysis, dialogue and a recognition of the roles that can be played by both national and Community authorities.

The analysis in this report suggests that a modification of existing Community structures can adequately serve this role, providing a means for facilitating dialogue, drawing together the appropriate analyses and endowing any resultant recommendations with the necessary aura of authority and legitimacy. Having both a broadly based process of decision making and a clear mandate for authoritative action, such an institutional solution to the problem is much less likely to result in either regulatory excess or a well intentioned inactivity.

European accounting developments increasingly attract the attention of a wide range of interested parties, as has been made quite clear in the above discussion. Inevitably they therefore tend to be considered in a not dispassionate manner. Whilst recognising both the inevitability and legitimacy of this, it nevertheless is to be hoped that whatever solutions finally emerge are ones that reflect the very real potential which accounting can play in furthering the development of the Community rather than more narrowly conceived professional, national or commercial interests.

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VII. AMENDMENTS TO THE FOURTH DIRECTIVE
Reduction of the options available in drawing up annual accounts

I. The options contained in the Fourth Directive of 25 July 1978 on annual accounts are listed in the Annex.

II. The list of options does not include:

1. the exceptions made for credit institutions and insurance companies (Article 1(2);

2. the special provisions applicable to investment and financial holding companies (Articles 5, 36, 43(2) and 60);

3. the possibility open to member States of requiring the disclosure of information other than that required by the Fourth Directive (Article 2(6));

4. the possibility open to Member States of requiring adaptations of the layout, nomenclature and terminology of items in the balance-sheets and profit and loss accounts of undertakings forming part of particular economic sectors (Article 4(2));

5. departures from certain general principles of the Directive in exceptional cases, which are to be disclosed in the notes on the accounts together with an explanation for them (Articles 3 and 31(2));

6. departures from the principle of "materiality" (Article 4(3)(a), third sentence of Article 18, third sentence of Article 21, Article 29, Article 43(1)(2) and (10));

7. exceptions for small and medium-sized companies (Articles 11, 12, 27, 44, 47(2) and (3) and 51(2));

8. different disclosure arrangements (Articles 45(1) and 47(1));

9. special provisions applicable to companies which are to be included in consolidated accounts (Articles 57, 58 and 61);

10. transitional provisions (Articles 15(3)(b) and 55(2)).

III. The options are listed by subject. An indication is given in each case of whether the exercise of the option:

1. is to be recorded in the annual accounts;

2. is dependent on certain conditions or subject to certain restrictions;

3. entails the application of other provisions, e.g. regarding depreciation, profit distribution, reserves, etc.

IV. The options can be broken down into:

1. those open to Member States, which may in turn make them available to companies. This group covers all options except those referred to below;

2. options open to companies, which must be made available to companies by all member States. This group includes the options listed at 17, 23, 25, 26 and 30.

V. The options can be further broken down according to whether their exercise:

1. affects the profit or loss for the financial year;

2. affects the content or extent of the information contained in the annual accounts; or

3. changes only the place at which certain information has to be provided in the annual accounts.

Ad 1
The options affecting profit or loss involve:
(a) the entry under "Assets" of:
- formation expenses (No 6)
- self-created rights (No 7)
- research and development costs (No 8)
- own shares (No 10)
(b) the entry under "Liabilities" of:
- provisions for pensions and similar obligations (No 15)
- provisions to cover charges (No 19)
(c) a different valuation through:
- application of methods other than those based on purchase price or production cost (No 22)
- additional value adjustments (Nos 23, 24 and 28)
- inclusion of certain interest charges or costs in the production costs (Nos 25, 26 and 27)
- calculation of the purchase price or production costs of the same category of goods according to different methods (No 29).

Ad 2
The options which are neutral in their effect on profit or loss and which affect the content of the information contained in the

annual accounts include, as far as the profit and loss account is concerned, the choice between the total costs procedure and the turnover costs procedure (No 20). Otherwise, they consist solely of options which affect the extent of the information:

- showing of certain accounting-apportionment items under "Debtors" or "Creditors" (Nos 11 and 12);
- the fixing of the proportion of capital assumed to represent a participating interest at different levels alters the number of undertakings on which information is to be provided in the notes on the accounts (No 18);
- taxes on the profit or loss on ordinary activities and taxes on the extraordinary profit or loss (No 21).

Ad 3

The options which are neutral in their effect on profit or loss and which simply lead to items being shown differently are as follows:

- combination of items (No 1);
- adjustment of figures for the preceding financial year (No 2);
- adaptation of the layout of the profit and loss account (No 3);
- account form or vertical form for the balance sheet (No 4);
- capital (No 5);
- accounting-apportionment items (Nos 11 and 12);
- profit or loss (Nos 13 and 14);
- commitments by way of guarantee (No 16);
- movements in fixed asset items (No 17).

ANNEX

1. The balance-sheet and profit and loss account items that are preceded by Arabic numerals may be combined in the interests of clarity. However, items so combined must be dealt with separately in the notes on the accounts (Article 4(3)(b)).

2. Where the figures and items in the balance sheet and in the profit and loss account are not comparable with the corresponding figures for the preceding financial year, the latter figures may be adjusted. Any adjustment of the figures must be disclosed in the noted on the accounts, with relevant comments (Article 4(4)).

3. Member States may authorize or require the layout of the balance sheet and the profit and loss account to be adapted to include the appropriation of profit or the treatment of loss (Article 6). Where the appropriation of profit or the treatment of loss appears in the annual accounts, it need not be disclosed separately (Article 50).

4. For the presentation of the balance sheet, Member States may prescribe a layout in account form (Article 9) or in vertical form (Article 10) or they may allow companies to choose between the two forms (Article 8).

5. The following options are available for showing capital (Article 9, Assets A and D II 5, Liabilities A I; Article 10 A, D II 5 and L I):
   (a) subscribed capital to be shown on the liabilities side under A I or L I. The subscribed capital unpaid must then be shown under A on the assets side. The portion of subscribed capital called must be disclosed.
   (b) The part of the capital called is to be shown on the liabilities side under A I or L I, with the amounts of subscribed and paid-up capital being shown separately. Under those circumstances, the part of the capital called but not yet paid is to be shown on the assets side, either under A or under D II ("Debtors") 5.

6. <u>Formation expenses (Article 9, Assets B, Article 10 B)</u>
   (a) These expenses may be shown as an asset. They must be written off within a maximum period of five years. If such expenses have not been completely written off, there are restrictions on the distribution of profits. The amounts entered under "formation expenses" must be explained in the notes on the accounts (Article 34).
   (b) In the event of such expenses appearing as an asset, they may be shown either under B or as the first item under "Intangible assets" (CI).

7. Concessions, patents, licences, trademarks and similar rights and assets may be shown as assets even if they were created by the undertaking itself (Article 9 assets C I 2 (b), Article 10 C I 2 (b)).

8. Research and developments costs
   (a) These costs may be shown as assets (Article 9 Assets C I 1, Article 10 C I 1). The amounts entered must be explained in the notes on the accounts (Article 37(1) and Article 34).
   b) Where they are shown as an asset, they may either be written off within a maximum period of five years or in exceptional cases (the reasons for which must be disclosed in the notes on the accounts) within a longer period (Article 37(1)).
   (c) In exceptional cases (the reasons for which must be disclosed in the notes on the accounts), derogations from the restrictions on the distribution of profits during the depreciation period may be allowed (Article 37(1)).

9. Goodwill may be systematically written off over a limited period exceeding five years provided that this period does not exceed the useful economic life of the asset and is disclosed in the notes on the accounts together with the reasons therefore (Article 37(2)).

10. Own shares may be shown as an asset. If they represent fixed assets, they are to be shown on the assets side under C III 7 or, if they represent current assets, under D III 2. It is specifically prohibited for them to be shown in items other than those prescribed (Article 13(2). Furthermore, in the case of public limited companies a transfer to reserve must be made on the liabilities side (Article 9 Liabilities A IV 2 or Article 10 L IV 2).

11. Prepayments and accrued income
   (a) These are to be shown either under E or under "Debtors" in D II 6.
   (b) Income which is not due until after the expiry of the financial year in question may be included in "Debtors" (Article 18).

12. Accruals and deferred income
   (a) These are to be shown either under D or K or are to be included in "Debtors" under C9 or I 9.
   (b) Where they represent charges which will be paid only in the course of a subsequent financial year, they may be included in "Creditors" (Article 21).

13. A loss for the financial year may be shown either on the assets side under F or on the liabilities side in "Capital and reserves" under A VI or L VI (profit or loss for the financial year).

14. A profit for the financial year may be shown on the liabilities side either under E or in "Capital and reserves" under A VI or L VI (profit or loss for the financial year).

15. Provisions for pensions and similar obligations are to be shown either on the liabilities side in the balance sheet under B 1 or J 1 or are to be disclosed in the notes on the accounts (Article 43(1)(7)).

16 Commitments by way of guarantee which are not to be shown as liabilities must be shown either at the foot of the balance sheet or in the notes on the accounts (Article 14).

17. Movements in the various fixed asset items and, if necessary, formation expenses (see option No 6) are to be shown in the balance sheet or in the notes on the accounts (Article 15(3)(a)).

18. The percentage required for the presumption of a participating interest may be set lower than a share of 20 % of the capital of another undertaking (Article 17). Such an option also exists for the obligation to disclose details of such undertakings in the notes on the accounts (Article 43(1)(2)).

19. Provisions may be created to cover certain charges (Article 20(2)).

20. For the presentation of the profit and loss account, Member States may prescribe the total costs procedure or the turnover costs procedure (both in account or vertical form) or may permit companies to choose between all or part of the layouts in question (Articles 22 to 26).

21. For the disclosure of taxes on the profit or loss, the following option is available regarding the prescription of separate items (Article 30):

<u>1st solution</u>:
- taxes on the profit or loss on ordinary activities
- profit or loss on ordinary activities after taxation
- extraordinary profit or loss
- taxes on the extraordinary profit or loss
- other taxes not shown under the above items
- profit or loss for the financial year

<u>2nd solution</u>:
- profit or loss on ordinary activities
- extraordinary profit or loss
- taxes on the profit or loss
- taxes not included under the above items
- profit or loss for the financial year.

In the event of the second solution being adopted, the notes on the accounts must disclose the extent to which the taxes on the profit or loss affect the profit or loss on ordinary activities and the extraordinary profit or loss.

22. Valuation other than on the basis of purchase price or production cost (Article 33):
    (a) valuation by the replacement value method for tangible fixed assets with limited useful economic lives and for stocks, or
    (b) valuation by methods designed to take account of inflation, or
    (c) revaluation of tangible fixed assets and financial fixed assets.

    In these cases, the method employed must be disclosed in the notes on the accounts, a revaluation reserve must be created and a comparison must be provided with valuations based on the purchase price and production cost methods.

    (d) valuation by the equity method for holdings on the basis of which a dominant influence is exercised (Article 59).

23. Value adjustments may be made to financial fixed assets so that they are valued at a lower figure on the balance sheet date (Article 35(1)(c)(aa)). These value adjustments must be charged to the profit and loss account or disclosed in the notes on the accounts.

24. Exceptional value adjustments may be made in respect of fixed and current assets for taxation purposes. The amounts of such adjustments and the reasons for making them must be indicated in the notes on the accounts (Article 35(1)(d), Article 39(1)(e)).

25. A reasonable proportion of the costs which are only indirectly attributable to the product in question may be added into the production costs to the extent that they relate to the period of production (Article 35(3)(b) and Article 39(2)).

26. Interest on capital borrowed to finance the production of fixed assets may be included in the production costs. The inclusion of such interest under "Assets" must be disclosed in the notes on the accounts (Article 35(4)).

27. Interest on capital borrowed to finance the production of current assets may be included in the production costs. The inclusion of such interest under "Assets" must be disclosed in the notes on the accounts (Article 39(2)).

28. Exceptional value adjustments may be made in respect of current assets to take account of future fluctuations invalue. The amount of such adjustments must be disclosed separately in the profit and loss account or in the notes on the account (Article 39(1)(c)).

29. The purchase price or production cost of goods of the same category may be calculated on the basis of weighted average prices according to various methods (Article 40(1)). The method employed must be disclosed in the notes on the accounts (Article 43(1)(1)). Where such a valuation differs materially from that based on the market value, the amount of that difference must likewise be disclosed in the notes on the accounts (Article 40(2)).

30. Where the amount repayable on account of any debt is greater than the amount received, the difference may be shown as an asset. It must be shown separately in the balance sheet or in the notes on the accounts and must be written off no later than the time of repayment of the debt (Article 41).

VII. AMENDMENTS TO THE 4TH DIRECTIVE

Summary of the answers by delegations to the questions concerning point VII

FIRST QUESTION

What subjects (if possible in order of priority) which have not yet been dealt with in the 4th Directive ought to be made subject to harmonisation at Community level?

Several delegations have expressed the view that it is too early to define new needs for harmonisation in the accounting area and that more experience with the recently adopted measures is required before new initiatives are envisaged on subjects which have not been dealt with in the 4th Directive. It has also been stressed that the Commission should ensure that companies in all Member States comply with the filing requirements.

The following subjects have been suggested for action at Community level, without stating any order of priority at this stage. In order to facilitate the discussion a reference has been added to the relevant provisions in the 4th Directive:

- leasing
- foreign currency translation
- valuation of pension commitments
- deferred taxation (Article 43 paragraph 1 point 11)
- new financial instruments
- inflation accounting (Article 33)
- mergers and acquisitions
- goodwill (Articles 9, 10 and 37)
- statement of sources and uses of funds
- segmentation of certain information
- off-balance sheet rights and commitments (Article 14 and 43 paragraph 1 point 7)
- information concerning related party transactions
- work in progress
- accounting for intangible fixed assets (Articles 9, 10 and 37)
- government grants
- distinction between capital and reserves and liabilities
- valuation of certain assets at market price
- auditing standards.

In addition, it has been suggested to clarify certain basic accounting principles stated in the 4th Directive such as the true and fair view principle (Article 2), the realization principle (Article 31), the prohibition to set off (Article 7).

Finally, it was felt that harmonisation is also needed in respect of the sanctions which are applicable in the case of non-compliance with the obligations concerning the preparation and disclosure of accounts.

SECOND QUESTION

Are you in favour of a reduction of the options provided for in the 4th Directive (if so, which ones?)(1)

Most delegations feel that it is premature to reduce the options at this stage. Several options reflect the differing underlying legal and fiscal differences which are at the basis of these options.

It has been suggested to delete the following options:

- the possibility to prescribe special layouts for the annual accounts of investment companies and of financial holding companies (Article 5 paragraph 1);

- the possibility to include the information concerning undertakings in which a participating interest is held in a statement to be filed with the register (Article 45 paragraph 1 a);

- the possibility to make the annual report available to the public at the company's registered office (Article 47 paragraph 1);

- the possibility to adapt the layouts for undertakings forming part of a particular economic sector (Article 4 paragraph 2);

- the possibility to authorize or to require an adaptation of the layouts in order to include the appropriation of profit or the treatment of loss (Article 6);

- possibility to create provisions to cover charges (Article 20 paragraph 2);

- possibility to amortize goodwill over a limited period exceeding five years (Article 37 paragraph 2);

- possibility to show certain assets in the balance sheet at a fixed quantity and value (Article 38);

- possibility to choose between more than one layout for the balance sheet (Articles 9 and 10) and for the profit and loss account (Articles 23 - 26);

- possibility to apply the equity method in the annual accounts (Article 59);

- possibility to choose between three alternative valuation methods instead of a valuation based on the principle of purchase price or production cost (Article 33)

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(1) See also conference paper XV/213/89 concerning the options in the 4th Directive

VII. AMENDMENTS TO THE 4TH DIRECTIVE

Contribution by Mr. G. TIMMER
Raad voor de Jaarverslaggeving
Netherlands

Mr. Chairman,

"All roads lead to Rome" according to a well-known saying in the Netherlands, where it is also said that Cologne and Aachen were not built in a day. Further harmonization of accounting standards within the European Community can be achieved in a wide variety of ways. It will certainly be a long-term process. One possible way, perhaps not the easiest, would be to reduce the number of options provided for in the 4th Directive.

The 4th Directive appears to have been a major success. Indeed, at first sight, annual accounts in Germany and the Netherlands seem very similar. The layout of the balance sheet and of the profit and loss account, together with the descriptions of the individual items, are practically the same. But don't be misled: a closer examination will show that the corresponding figures may not be at all comparable. Does this mean that we have not been so successful after all ? I would not go so far as to say that. We have all set out together on the road towards establishing accounting standards, and that is quite an achievement. There is no denying that the quality of financial reports in Europe has been substantially improved by the 4th (and the 7th) Directive.

But what tends to happen once a few rules are introduced? Those who issue the rules and some of those who are bound by them push for greater certainty in the shape of more and stricter rules.

An exceptional situation exists where accounting standards are concerned in that thorough international self-regulation is carried out by accountants. In addition, consultations are held with the users and providers of accounts. It is a situation which does not exist or hardly exists elsewhere and which has so far yielded favourable results worldwide. You will have realized that I am referring to the IASC. The rules are, as it were, becoming more specific in content, and national and international legislators look on from the sidelines. There is no reason for them to step in unless there is a serious decline in the quality of the rules.

Where annual accounts are concerned, this happens when the insight which they must provide - the true and fair view - is no longer properly ensured by the rules, in other words, when, for example, a number of choices or options seriously detract from the overall cohesion of the operation.

However, this is not the only aspect to be wary of. A reduction in the number of existing options might have unacceptable results as regards the insight into the accounts. In other words, the aim of presenting a true and fair view might be jeopardized. In addition, a reduction in the number of options could result in a kind of rigidity which will make it more difficult to introduce new ideas that might bear fruit in the future.

Clearly, the international accounting standards to which I have just referred are not mandatory. There is, however, still the question of whether it is possible to diverge from them at will. Indeed, since the rules were drawn up in consultation with users and providers of accounts, it is extremely difficult to disregard them. There is also a greater chance that the person responsible for inspecting the accounts will be held liable if he departs from generally accepted principles without warning.

Mr. Chairman, further harmonization through a reduction in the number of options must be seen in the light of an improvement in the comparability of accounts. The globalization of capital movements is creating international interest in accounts and is promoting a call for enhanced comparability. However, enhanced comparability of accounts must never become an end in itself. The aim is to give a true and fair view. A situation in which accounts are fully comparable but do not always provide the insight needed is unacceptable to the Netherlands.

To conclude, further harmonization through a reduction in the number of options should never be at the expense of the necessary insight into the accounts. As long as there is incomplete agreement on the insight which should be provided in respect of valuation, exchange rates, leasing and such like (the main problem areas referred to by Mr. Regoort yesterday), we should not set about reducing the number of options. Lastly, international and national legislators must promote the phenomenon - which accounting law permits - of self-regulation by those concerned by annual accounts. A practical comment by way of conclusion: it would be a waste of time and energy to carry out once again the good work which has already been done.

Mr. Chairman, this brings me to the end of my prepared speech. After listening to the various speakers yesterday and today, I would like to sum up my views on the matter under discussion in four short statements.
Firstly: A reduction in the number of options contained in the 4th Directive would not appear to be the top priority.
Secondly: The top priority would appear to be the study of a number of problem areas which were so clearly set out by Mr. Regoort yesterday.
Thirdly: Those problem areas should be studies in close collaboration with the IASC and the national standard-setting bodies within the European Community, in order to avoid any inconsistency with worldwide harmonization.
Fourthly: The European Community should not endeavour to set its own standards. The method applied by the OECD Working Group might, to some extent, serve as a model for the future work of the European Community.

VII. AMENDMENTS TO THE 4TH DIRECTIVE

Contribution from Mr. Alain Le Fèvre
Ministry of Justice
France

If you will permit me, I will leave it to my colleague, Mr. Milot, to talk to you in detail about the amendments which could profitably be made to the Fourth Directive.

For my part, I would like to outline briefly to you the spirit in which, in my opinion, we should work in carrying out any future reform of accounting law and the principles which we should always abide by if we wish to lay down new rules or amend existing ones.

Firstly, we should remember that Europe has the economic, ethical and cultural potential necessary to play a leading role.

That is not to say, of course, that we should not acknowledge the importance of international trade or refuse to conclude from that there is a need for the greatest possible comparability of accounts between the largest possible number of countries.

But it does not follow, just because a few countries from the American area of influence (e.g. the United States, Canada and Australia) have adopted a practice or agreed on something, that Europe should necessarily fall in line for fear of being marginalized. Many countries in the world are not in that sphere influence. They include - to quote a topical example - the Eastern European countries which will perhaps be inclined, in opening themselves up to the market economy, to adopt European customs.

It is therefore a little artificial, and not always accurate, to contrast, as is often done, what is "international" (meaning principally American and Japanese) with what would be simply European.

Europe must therefore be prepared to adopt the models of other countries if they prove to be better but also, conversely, to retain its own and permit them to influence other countries outside the Community.

Europe cannot adopt a subservient attitude towards countries in which it was the original civilizing influence. It should be an entirely separate partner and even, in some cases, play the leading role.

The second point I wish to make is that the field of accounting law and financial information is not concerned only with financial markets and competition between large multinational enterprises. Furthermore, we frequently hear talk of the "market" as though it were a living being endowed with reason which alone regulated the economy and to which people were subject; the fact is that there are people behind this leviathan, and I would simply point out that nothing can be done without their involvement.

At all events, financial information concerns the whole economic structure, which, in most of our countries, is largely made up of small and medium-sized firms. In France, for example, firms with a turnover not exceeding FF 500 million and with not more than 500 employees account for half of the total turnover and approximately a third of employees in the industrial sector alone; these proportions are higher if agriculture is included.

Furthermore, I would point out that this conference is concerned with the Fourth directive on annual accounts and not with the seventh directive on consolidated accounts and that it is this latter Directive which relates more specifically to international groups.

Steps should therefore be taken to ensure the comparability and accessibility of accounts and equality of competition for the whole economic structure of the Member States; within the framework of a single market, this is particularly important, for example, for small and medium-sized firms established in frontier areas.

My third point is that, in view of these economic and social and therefore political factors, control over standardization should remain in the hands of states, and more generally the public authorities. The task is not simply one involving technical problems to be solved among professional people.

A distinction must be made in this regard between consultation and standardization.

It is essential that the public authorities (whether national or Community) should, before taking decisions or making official proposals, consult all the organizations concerned to the fullest extent with a view to exploiting their valuable experience and technical expertise.

But it is absolutely impossible to delegate in any manner whatsoever to private organizations, however prestigious they may be, the power of establishing binding standards.

Such power presupposes political legitimacy stemming from democratic control, which only states and public authorities established by treaty between states possess.

In the case of the European Communities, the standardization of accounting practice can proceed only through the channels established by the Treaty of Rome, i.e. principally Council directives adopted by at least a qualified majority of Member States following negotiations between those Member States alone.

These three point seem to me to be fundamental to the issue in question, and I was anxious to make them to you before we tackled the more technical questions involved in the content of the Fourth Directive.

VII. AMENDMENTS TO THE 4TH DIRECTIVE

Contribution by Mr. J.P. MILOT
Conseil national de la comptabilité
France

As a follow-up to Mr. Lefèvre's remarks, I would add that the harmonization of Community accounting standards should be viewed as a key element in the construction of the large internal market. It is part of a wider process involving the approximation of business and tax legislation and is therefore not limited to any attempt to make accounts comparable by seeking to achieve equivalence of information. The aim is rather to create a common language to facilitate the development of trade and businesses within a large internal market.

Moves towards Community harmonization cannot therefore be reduced simply to the concern to ensure the ex post comparability of results but should also include the other objectives which are generally involved in accounting.

This approach makes it all the more necessary to adapt the content of the Directive to changes in economic life. Without entering into a discussion of the procedure that should be adopted to carry out that adaptation, I would like to mention briefly the two subjects which seem to me to be the most important and to require urgent attention at Community level, since, even if there is no immediate change in the legislation, the preparations for that must be made now.

The first point concerns the current consequences of the events which have been disrupting the international financial system for some 20 years now. The abandonment of a system of fixed exchange rates has exposed any company involved in international trade to an exchange-rate risk. The techniques developed by those in the profession to manage that risk have automatically entailed the need to take account of an interest-rate risk at company level. The very rapid development of means of processing and transmitting information and the globalization of financial markets have now made those techniques highly sophisticated and have created specific operations and activities.

The execution of those operations, whether of the market or hedging variety, is not reserved for banks or even for very large companies. It is therefore necessary for accounting procedures to be able to show such operations and activities, which are not simply a vogue but a consequence of the way in which the international financial system works. The valuation principles laid down in the Fourth Directive should therefore enable companies seeking to manage such risks to take account of the workings of the system. Although it cannot be claimed to provide the final answer, the Directive on the annual accounts of banks already offers certain solutions which could be extended to companies generally subject to the adaptations made necessary by the specific features of banking activities.

Similarly, company acquisitions or mergers involving considerable volumes of assets are increasingly showing the importance of intangible items. While the Fourth Directive already permits account to be taken of such assets in many cases, there would seem to be an urgent need for discussion of the possible or desirable limits on the extent to which such assets are included in balance sheets. If no action is taken, there is a danger that the growing divergence between the reality of transactions and how they are reflected in accounts will either rob those accounts of any meaning or provoke attacks against accounting principles.

With regard, finally, to the reduction in the options provided for in the Directive, we take the view that most of them were included only to take account of legal differences (in the business or tax fields) between Member States.

As long as such differences persist, therefore, it will be premature to abolish those options. It would be desirable for the Commission's departments to take regular stock of this situation.

SUMMARY:

The harmonization of Community accounting standards is not limited to measures aimed at ensuring comparability of results. It is part of the process of building the large internal market, being based on an approximation of legislation, and it may thus become the source of a common accounting language.

The upheavals in economic life, particularly those caused by the transformation of the international financial system, have led to the emergence of new operations and activities. It should be possible for these to be described in accounts, and there is therefore an urgent need to consider possible changes to the valuation principles laid down by the Directive. Similarly, the development of intangible assets should raise the question of the capacity of current legislation to describe them adequately.

Any reduction in the options provided for in the Directive can be considered only as part of the progressive elimination of the legal differences which are responsible for them.

VIII. PROCEDURAL REFORMS

Summary of the answers by delegations to the question concerning point VIII

How could one improve at Community level the procedure for the adoption and modification of accounting standards?

Some delegations believe that the directive should continue to be used in the future as the instrument for further harmonisation. Other delegations are of the opinion that there is a need for a more flexible instrument than the directive. They would prefer a distinction to be made between the basic rules which should be included in a directive and the more technical details for which a more simplified procedure should be used.

The organisations which represent the users and preparers of accounts have expressed the wish to be more closely associated with the discussions about accounting standard setting.

The idea has been advanced of the creation of a forum where national standard-setting bodies and representatives of interested parties could regularly meet in order to exchange views and experiences, to coordinate their work and to prepare a common position which could be defended internationally. The proceedings of such a forum should be published. Any action by the Community should be placed in the context of a worldwide harmonisation. However, before international standards could become compulsory within the Community they would have to be submitted to a prior approval procedure. Some delegations have referred in this context to the procedure for the harmonisation of technical standards within the framework of CEN and CENELEC.

As for the Contact Committee, several delegations have suggested to reinforce its action by changing its composition, its organisation and its competence. The Contact Committee should dispose of enough resources to undertake technical studies. Its proceedings should be published under its own responsibility.

The stock exchanges have suggested to concentrate further work on listed or large companies. Conflicts between Community measures and the international accounting standards should be avoided.

VIII. PROCEDURAL REFORMS

Contribution by Mr. H. BIENER
Federal Ministry of Justice
Germany

1. The obligation under Article 54(3)(g) of the EEC Treaty to coordinate safeguards has been met to a large extent in the field of accounting. Leaving aside the insurance industry, it is not necessary, in order to achieve freedom of establishment, to undertake any further coordination of the safeguards which are required by Member States for the protection of the interests of members and others, since the task is to ensure equivalence, not to create uniform law. If it can be shown that accounting rules have a direct effect on the establishment or functioning of the common market, they could be included in the approximation of laws under Article 100 of the EEC Treaty. Article 100a is not applicable, since uniform accounting rules are not necessary for the completion of the internal market by 1992.

2. It is not possible under the EEC Treaty to transfer law-making powers to other organizations or agencies. Neither the Council nor the Commission, therefore, can leave the coordination or approximation of legal provisions to other organizations or agencies, or submit to their recommendations. The powers of the national legislatures are restricted only by Community law that has been created in accordance with the Treaty. Only an amendment to the EEC Treaty could change this, but such an amendment appears to be inconceivable for this purpose.

3. In contrast to the procedure for technical standards, the Community's accounting directives (the Seventh and Eighth Directives) do not refer to general principles of accounting to ensure uniform interpretation or to close loopholes. That technique is sometimes employed in national law: in Germany, for instance, reference is made to generally accepted principles of orderly accounting or to pronouncements by specialist committees. Under current Community law, it is not possible for Council or Commission statements (including opinions of the Contact Committee set up under the auspices of the Commission by the Fourth Directive) or pronouncements of an international organization or a specialist body to be given the force of binding Community law. Uniform interpretation of rules in the accounting directives can be achieved only through the Court of Justice. But the closing of loopholes through development of the law by the Court is probably ruled out.

4. For the reasons set out in point 3, it would be possible to modify accounting standards along technical standardization lines only under the following conditions:

(a) On a proposal from the Commission, the Council decides to include accounting in the approximation of laws under Article 100 of the EEC Treaty. At the same time it decides that, for this purpose, reference will be made in the accounting directives to the principles of orderly accounting or the recommendations of certain bodies (as explained in point 3);

(b) As regards practical implementation, the Council opts for one of the procedures in the Council Decision of 13 July 1987 laying down the procedures for the exercise of implementing powers conferred on the Commission (87/373/EEC, OJ No L 197/33), e.g. Procedure III (in Article 2);

(c) If Procedure III is the one selected, the Commission would be supported by the existing Contact Committee. In this case, the Commission could propose that recommendations by international organizations or specialist bodies on accounting questions could be considered as principles within the meaning of the accounting directives, so that where such principles were used there would be a presumption that the directives were being correctly applied. The Commission could issue its recommendations after endorsement by the Contact Committee or following a decision by the Council. Variants of this procedure are conceivable. But it would still not be possible generally to refer to recommendations of the IASC or other bodies.

5. Quite apart from creation of the procedural conditions set out at point 4, an effort should very soon be made to cooperate with the IASC. There is no internationally active body better suited to promoting harmonization worldwide. This is the only way of avoiding duplication of effort.

Cooperation could take the following form: existing recommendations would be examined for compatibility with Community law, and the Community would work with the IASC on the preparation of new recommendations in suitable form.

6. Since the approach described cannot be applied immediately, the Contact Committee's activities should be stepped up. The Committee's job is to facilitate the uniform application of the accounting directives by periodically coordinating specific aspects of their implementation. Since the coordination referred to in Article 54(3)(g) of the EEC Treaty only involves ensuring the equivalence of safeguards, this is a job which the Contact Committee could certainly handle without any fundamental modification of procedures.

IX.
SUMMING UP BY MR GEOFFREY FITCHEW, EUROPEAN COMMISSION DIRECTOR GENERAL FOR FINANCIAL INSTITUTIONS AND COMPANY LAW

Summarising the two day's discussions, Mr Fitchew said he was encouraged by the convergence of views apparent at the conference, notably concerning the implementation of the 4th Directive, further harmonisation of accounts at the EC level, procedural reforms and the international dimension.

As regards **implementation**, Mr Fitchew concluded there was warm welcome for the degree of harmonisation already achieved, but recognition that the situation was not perfect, in the sense that gaps and deficiencies exist. In particular, it was not possible to say that there is as good comparability between accounts from different Member States as would be desirable for efficient functioning of the internal market and financial markets in particular.

Turning to **further harmonisation**, Mr Fitchew said the conference recognised that it was first of all necessary for the 4th Directive to be applied effectively in all Member States. Some concern was expressed about the ready availability and accessibility of company accounts throughout the EC. The Commission recognises its responsibility to ensure that the requirements not only of the 4th Directive concerning the contents and layout of the accounts but also of the 1st Directive as regards the availability of companies' accounts are respected.

Mr Fitchew suggested that it may well be worth studying, perhaps in the framework of the 4th Directive Contact Committee what would be the most cost effective methods for ensuring **access and availability of accounts**. He recognised that there was no point in achieving harmonisation if the results were not readily accessible to those that wanted to see them.

On the subject of **small and medium sized companies**, Mr Fitchew assured those that had expressed concern that the Commission does intend to seek early agreement within the Council of Ministers on the amending Directives to grant further exemptions from the 4th Directive for SMEs and concerning limited partnerships. However, he warned that it was by no means certain that agreement would be possible.

In the meantime, Mr Fitchew insisted, until such time as the amending Directives were adopted, the obligations of the 4th Directive to SMEs are fully applicable and Member States should ensure they are applied. The motive for SMEs' exemptions is, Mr Fitchew reminded the conference, to relieve them from excessive administrative costs. The protection of SMEs from takeovers is not a valid reason for exempting them from part of the 4th Directive's obligations. On behalf of the Commission, Mr Fitchew welcomed FEE's intention to improve and continue its survey on the application of the 4th Directive and supported FEE's idea to develop a data base of European company accounts.

Concerning the possibility of removing some of the **options** currently available under the 4th Directive, Mr Fitchew noted that there was a majority view at the conference that there was no need to do so at this stage, and that any such move would be premature. However, the need to remove differences of interpretation was recognised, as was the need to study in depth the lacunae of 4th Directive. But the general consensus was that the time is not ripe for further Directves to amend the substance of the obligations laid down by the 4th and 7th Directives. The Commission accepted this.

On the question of **procedural reforms**, Mr Fitchew pointed out that the comitology procedure introduced by the July 1987 Council Decision could only be used to make binding adaptations of technical aspects of Directives. He suggested that it could well be useful at a future date if further changes in the underlying Directives were needed, but the Commission services have not yet decided whether at this stage they want to insert comitology procedures into the 4th Directive.

As for other **procedural reforms**, Mr Fitchew said that the Commission does see a need to obtain advice from not only the 4th Directive Contact Committee but also from national standards setters and preparers and users of accounts. The idea of a European accounting standards body was rejected by the Commission, as such a body could not impose binding standards, and that idea would not be pursued. A European standard-setting body might develop from a more informal consultative forum of standard setters and the accountancy profession, but was not a prospect for the immediate future.

Mr Fitchew agreed with proposals for a fuller use of the **Contact Committee**, and the publication of its conclusions, notably concerning interpretation of the 4th Directive, and indicated that the Commission will explore how to go about doing that. But in addition, there was the need to create a **consultative forum** to bring together national standards setters, the accountancy profession, some academic representatives and accounts preparers and users.

A wide degree of support existed at the conference for a consultative body of this kind, Mr Fitchew noted. Referring to a number of different suggestions that had been made concerning the body's relationship with the 4th Directive Contact Committee, he said that his own preference was that this new forum should be a separate but parallel body to the Contact Committee. The Commission would like to be able to consult the new body separately from the Contact Committee, even if its opinions were then addressed to the Contact Committee. The new body's chair and secretariat would probably be provided by the Commission, which would consult it on the interpretaton of the 4th Directive, considering lacunae and on contacts with the International Accounting Standards Committee (IASC) and other international bodies.

In general, Mr Fitchew said he shared Professor Hopwood's arguments for caution and gradual progress. Nevertheless, he noted that there were some developments on which the EC must respond quickly both internally and internationally.

Concerning the **international level**, Mr Fitchew recognised that there was agreement at the conference on the importance of work of international bodies, especially the **IASC**. Moroever, it was agreed that the EC should not just sit back and accept standards and common practices handed down by the IASC but take an active role within the IASC, which "should not be an American or Anglo-Saxon dominated body". Mr Fitchew said that the Commission therefore proposed to take up the IASC's offer to sit on the Consultative Committee, various specialised steering Committees and as an observer on the IASC Board. He stressed, however, that the Commission was not seeking to replace the role of individual Member States within the IASC, but to complement them, much as it does on the international stock exchanges organisation IOSCO.

Finally, turning to the issue of **equivalence at the international level**, Mr Fitchew noted that the agreed aim was to achieve mutual recognition internationally on the basis of minimum harmonisation and minumum dual standards. He noted that the equivalence issue will have to be tackled shortly, and that the Commission will circulate its views on the subject to the Member States in the near future.

In particular, Mr Fitchew indicated that, if it were not possible to obtain mutual recognition on the basis of EEC accounting Directives as they stand, the Commission would want to explore the possibility of bridging gaps with reference to IASC standards. However, he warned that the Commission would have to act with caution before seeking mandates to negotiate bi-lateral mutual recognition agreements with third countries. On the one hand, the Commission did not want to damage the attractiveness of the EEC's own capital markets by over-regulation, whilst on the other hand it did not want to hinder foreign companies from coming to EC markets because of the absence of mutual recognition agreements.

X. INTERNAL MARKET 1992

New challenges for financial reporting in the EC

Contribution by Mr. M. BANGEMANN
Vice-President of the Commission

Although I speak at the end of this Conference, I do not propose to draw conclusions from the discussions which have been held here during the last two days. I would rather prefer to place your work in the broader perspective of the internal market.

1992 is an important date for companies in the Community. For many companies the relevant market, i.e. the market in which they operate and compete with other companies will change with the realisation of the internal market. European undertakings will be able to benefit from a large home-market which makes it easier for them to develop new products at lower costs and sell these on the world market. Undertakings from all over the world are preparing themselves for this internal market through direct investments in the Community or through cross-border cooperation. Competition in this European market will become more intense, more international and more diverse. European undertakings must adapt their policy accordingly and start to think at least in European if not worldwide terms.
The company law harmonisation programme is particularly important in this context. It contributes to the modernisation of national company laws, furthers the freedom of establishment for companies and provides a framework for cross-border cooperation. This last point has become more important in recent years and the Commission has responded to this challenge by introducing specific proposals in this area, such as the 10th Directive on cross-border mergers, the 11th Directive on branches and the 13th Directive on takeover bids. In order to stimulate even further this cross-border cooperation, the Commission has proposed the creation of new legal forms of a European nature such as the EEIG and the S.E. While the EEIG has now become a reality (14 EEIG's have been set up so far), the S.E. is still in the stage of a proposal. Allow me to say a few words about the proposed Statute for a S.E. which is particularly dear to me.

The proposed Statute is not of a legally binding nature for all European public companies. It offers them an alternative. We do not intend to make this alternative attractive by including special tax advantages. Such a solution would unjustly distort competition between the European Statute and national structures. Nor do we want to make this Statute into a uniform European company law. Therefore, companies will be able to choose between different models of workers participation. Because Member States and to some extent also companies will be able to organize the S.E. "à la carte", different types of S.E. will coexist. This diversity has been criticized. However, other attempts in the past which aimed at more uniformity have failed. Our proposal is therefore more modest and possibly more realistic. Once the S.E. exists we can always improve it. I strongly believe in the Statute because in my opinion it could play an important role in furthering the internal market.

Turning to accountancy, there can be no doubt that the development of an internal market requires a minimum of market transparency, notably in order to avoid distortions in competition. It is therefore essential that the main actors in this market publish equivalent and comparable financial information. This is even more so within the perspective of the development of a European capital market and the growth of mergers and acquisitions in that market.

In the area of accountancy, several directives have been adopted by the Council. However, this Conference focuses on the 4th Directive which was adopted more than 10 years ago. This Directive has now been implemented in all Member States except for Italy. We regret that Italy has not been able yet to adopt the necessary legislation but are encouraged by the latest news that adoption is now expected in the next 6 months. The Commission intends to accelerate the procedure in the case of non-respect by Member States of the implementation deadlines provided for in the directives. In the same way, the Commission will see to it that the implementing legislation remains in compliance with the directives and that the legislation is effectively being applied.

The 4th Directive applies to over 3 million limited liability companies in the Community. Most of these companies are small or medium-sized. The Directive allows Member States to introduce certain derogations for these companies such as the exemption from the audit requirement or the publication of abridged accounts. Member States have used these options in a rather divergent way. In order to further harmonize these options and to alleviate the burden for small and medium-sized companies, the Commission has proposed certain amendments to the 4th Directive. These amendments will soon be discussed in the Council. At the same time the Council will discuss an earlier proposal which aims at extending the scope of application of the accounting directives to certain partnerships.

At our request the Fédération des experts comptables européens (F.E.E.) has produced a survey of accounts published by companies from 9 Member States on the basis of the 4th Directive. This survey shows that a lot of harmonisation has already been achieved in those areas which have been specifically dealt with in the 4th Directive. However, many new problems have arisen since the adoption of the Directive and the Directive also contains a large number of options for companies and for Member States. This is the reason why this Conference is organised.

At the same time we wanted to know how we can improve our procedure in the accounting area. As a matter of fact, the directives are a combination of rigidity and flexibility. They contain minimum rules and allow companies to derogate under certain circumstances from these rules, provided they justify the derogation and show in the notes to the accounts the effects of that derogation. The advantage of the directive as a legal instrument is that accounting rules become legally enforceable. This is unique in the harmonisation process of accounting standards. A disadvantage of the directive is the risk of inflexibility and obsolescence. We want the accounting standard setting process in the Community to follow the dynamics of the economic reality which it is supposed to reflect. Therefore, we should reflect on the possibility of distinguishing between the basic rules which should be contained in the directive and the technical details of those rules for which other instruments might be more appropriate. In the same way, in the area of technical standards for manufactured goods the basic principles are set at Community level, while the development of European technical standards is left to organisations such as CEN and CENELEC.

In this context, it should be stressed that all parties concerned and in particular the European Parliament have a possibility to intervene in the legislative process. For that reason it is important that the European Parliament continues to play a decisive role in the decision making process. The political decision must continue to rest with the Commission under the control of the European Parliament and the Council of Ministers.

As to the interpretations of the Directives and their application to specific problems, it might be more appropriate to set up a forum composed of representatives of national standard setting bodies and the Commission and which would also involve users and preparers. Such a forum could deal with technical issues and could also involve in one way or another the EFTA-countries. The existing Contact Committee on the accounting directives (Article 52 of the 4th Directive), which is composed of representatives of the Member States and the Commission would then remain the political forum which the Commission should consult before proposing amendments to the existing directives. Such a structure would be a compromise between the rigidity of the Community legislative framework and the economic need for flexibility. It goes without saying that the Community action should take into account international developments. At the same time we believe that initiatives at international level, notably within the International Accounting Standards Committee (IACS), should aim at avoiding conflicts with our directives. Where international accounting standards are developed in areas which are not covered by our directives we should examine whether we can adopt those standards in the Community. However, we believe that it is impossible for the Community to write a blank-cheque to organisations such as the IASC implying that we accept beforehand whatever they will do. In order to avoid conflicts the Commission intends to play an active role in institutions which aim at a harmonisation at a broader international level.

Concluding remarks

The Commission will take up its responsibility as well internally to make sure that the internal market becomes a success as externally in order to respond to the new challenges that we face as one of the most important economic spheres in the world.

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The future of harmonization of accounting standards within the European Communities

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