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PREPARE FOR THE FUTURE: CHANGES BROUGHT BY IFRS ARE STILL TO COME
BY FRANÇOISE FLORES

Introduction

The survey is carried out by MEDEF and speakers in this morning's round table have highlighted the request made by the entire financial community for a pause in changes in accounting standards. None of the changes that I am about to present is expected to be mandatory before 2009, at the earliest. We will see if this pause is sufficient to match your expectations.

I intend to describe the in-depth reforms that the IASB is undertaking and which, in my view, should be at the heart of our debates, even if the standards under development are not due to be applied in the short term, i.e. before 2009. It is probably on these reforms that we must focus our attention, because they can either solve the issues that have been highlighted earlier this morning, or on the contrary, increase the concerns which the IFRS have created and which have been pointed out.

The IASB's work programme as a whole can be examined as follows: firstly, a series of "adjustments" to be made to the current standards, all resulting from the short-term convergence programme agreed upon jointly by the IASB and the FASB; then the "new solutions" currently being developed, in areas where no standard exists today, or else in view of modernising existing standards marginally, without any change of principle; finally, many "in-depth reforms", mostly carried out jointly with the FASB, and likely to "deeply" transform our current accounting model.

Adjustments resulting from the IASB/FASB short term convergence plan

First of all, let us start with subjects on which the IASB is working as part of its short-term convergence programme. Several options are to be eliminated: hence, capitalisation of borrowing costs is expected to become compulsory (elimination of the expensing option), equity accounting should be applied to all JV (elimination of proportionate consolidation). Virtually all exceptions to differed tax accounting are to be eliminated, as a result of harmonising IAS 12 and FAS 109. The short term convergence programme also includes changes in the accounting for government grants: grants ought to be recorded in income as soon as there is no remaining contractual obligation to meet, even if the purpose for which it is obtained is not yet achieved. Finally, segment reporting requirements are being aligned with the American standard. This enables internal reporting to be directly imported into the entity's external communication.

While these different reforms may be considered minor from an accounting perspective, they can however have significant consequences for companies who have to implement them. Capitalising borrowing costs obviously implies changes in IT systems and consolidation procedures. The elimination of proportionate consolidation is likely to have significant impacts on financial reporting. This change, which is understandable from an accounting perspective, is a significant cause of concern for issuers. In the future, on what basis will they be able to communicate on external growth achieved through the setting up of JVs or on major commercial agreements which also call for such structures? Finally, changes in segment reporting are most welcome by issuers since they allow for full consistency between internal and external reporting.

New solutions

“New solutions” are two-fold: first, they are meant to provide accounting requirements in areas where they are at present missing. I mention the interpretation on “Service concession arrangements” although it is about to be finalised. This is not a standard, however much more than an interpretation. It reflects the way in which the IASB would wish to see IFRS widely applied: the application, to a particular industry, of principles common to all sectors, without the need to specify separate principles in an industry-specific standard.

I have also included in this category the fair value measurement project, which also forms part of the convergence work programme. The objective of the project is to incorporate into IFRS a new standard identical to the recently issued FAS 157. This standard defines fair value. Defining fair value precisely is necessary, since there is no widely shared understanding and agreement of what fair value ought to represent. The standard also defines how fair value should be determined. And this is necessary as well, as, in the absence of clearly defined valuation methods, determining an asset or a liability at fair value is today far from ensuring comparability of financial statements.

I also need to mention the “Insurance” standard, which is due to meet the need of an entire industry. In fact, this standard would deserve to be classified under “in-depth reforms”, since I believe that it also, and in advance of all others, adequately illustrates the new principles that the IASB plans to introduce.

These “new solutions” are also efforts at modernising some existing standards. The IASB is starting off a first phase of reform of the standard on employee benefits, including most notably the possible elimination of the corridor.

The Board has also started a major work on consolidation, which I have not classified under in-depth reforms, since the Board is expected to confirm the existing consolidation principle based on exclusive control. The intent is to make the consolidation standard both more robust and easier to apply and also enable the same basic principles to govern consolidation of special purpose entities; I believe that this is indeed the objective which the IASB is trying to achieve.

In depth reforms: some guiding principles

Finally, the famous “in-depth reforms” - which can either fulfil all promises expected from the adoption of IFRS, or on the contrary increase the level of concern. Our attitude in this debate is likely to have influence, or so we may hope, on the final outcome of these in-depth reforms.

What I am about to mention is far from exhaustive and includes only some guiding principles which seem to drive these in-depth reforms. I need to make clear that I am in no way citing an extract from some kind of IASB authorised source. What follows arises from close observation of the IASB debates and thorough analysis of the tentative decisions they make in the development of their projects. Such observation and analysis enable us to foresee or to distinguish some of these guiding principles. It is therefore my own analysis and I do not pretend it has more value; Gilbert, indeed and also Philippe, are invited to oppose my comments if they consider that I am mistaken.

First of all, and I believe this matches one of the expectations of analysts as expressed to us earlier, the development of new standards should attempt to account for all assets and liabilities, all those which exist and can be identified. For example, as regards lease agreements, a project to be started by the Board is to ensure that all financial commitments that companies make under these agreements are in the Balance Sheet, and clearly appear as liabilities. Assets and liabilities should also be accounted for, irrespective of their probability level; that is indeed the major change which is proposed in the revised IAS 37, ie the standard on non financial liabilities which is in the course of redeliberations. Obviously, we cannot fail to mention the valuation of assets and liabilities at fair value. IASB members do not miss any opportunity to remind us that full fair value accounting is none of their objectives. There might indeed in the future remain some exceptions to full fair value accounting. Nevertheless, it appears that according to the IASB and the FASB, the most relevant valuation attribute for investors is fair value, as long as it can be valued reliably. The conceptual framework debate should be the opportunity to debate this issue in-depth, when the IASB and the FASB address measurement, and we hope that it will be the case.

I cannot fail to draw attention to the substance over form principle which seems to be somewhat different from what we have been taught in the past, although the IASB still refers to “economic substance”. We however rather tend to see emerge a new concept of “legal substance”. In other words, a tendency to record as assets and liabilities, purely and simply, rights and obligations as they arise from contractual agreements or from the legal environment. This new concept completely disregards what we could call “economic compulsion”, in other words disregards the constraints of rational behaviour by the issuer. This move is perfectly illustrated at present in the debate over debt/ equity classification. It is also present in the development of the joint conceptual framework.

Finally, the IASB and FASB together tend to confirm a move already present in the improvement project, ie to leave aside the traditional proprietary perspective and to adopt the entity’s perspective instead. A further and more significant move has been made into that direction in the second phase of the business combination project. Progress in the conceptual framework project also confirms the change, justifying it as the only way to adequately respond to a wide range of users’ needs.

Scope of in depth reforms

These principles will be expressed or are expressed already in a number of projects that the IASB and the FASB are carrying out jointly. Convergence efforts are, according to the two Boards, most effective when starting new projects from a blank sheet of paper, the only efforts that truly deserve allocation of their resources. Indeed, rather than patching up their existing standards by selecting one or the other of the existing methods, they are likely to make more valuable progress in defining new accounting solutions. Such an effort is likely to bring to IFRS the desirable level of internal consistency, the lack of which being one of the reasons why IFRS fail to be applied in a principle based approach as has been highlighted earlier at the round table. One optimistic view of what lies ahead of us.

What projects are IASB and FASB developing jointly? Firstly, they are developing a common conceptual framework and have issued earlier this year a discussion paper presenting the objectives and the qualitative characteristics of financial reporting. They have also developed in common their future standard on Business Combinations. In parallel, the IASB has been revising its standard on non-financial liabilities, which deserves to be mentioned as part of the in-depth reforms since it features the possible future elimination of the probability recognition criterion. Revenue recognition and presentation of financial statements are high on the list, as related requirements are likely to have the most critical impacts on financial reporting. I have already mentioned the project dealing with leases and will close the list with the Debt/Equity project which could radically transform our existing accounting model.

I am mentioning only projects which have already been subject of agenda decisions. Consequently, this list of future developments lying ahead is not exhaustive; other projects are already shaping up on intangible assets or phase 2 of Employee Benefits, for example, which would be carried out together with the FASB. A very heavy programme indeed.

Which horizon for all these changes?

We cannot end this presentation without talking about timing. I have already indicated in my introduction – in order not to raise any alarm - that none of these significant changes would require to be implemented before 2009. Indeed, the IASB has wisely decided to allow to all jurisdictions having adopted its standards a period of one year from the date of publication for translation and endorsement purposes. We therefore seem to benefit by a quiet period.

The new due process that requires that consultation on all these in-depth reform projects be initiated on the basis of a discussion paper also seems to grant supplementary time. The horizon could thus appear far off since the first reforms are expected to be applied in 2009, then 2010, then 2011, then 2012, etc. Actually, there is a very very busy period ahead of us from now on, as the main debates are taking place in the discussion paper phase. It is therefore NOW that we need to seriously consider future developments. The debate has already started, it will go on, and it is therefore in the very next coming years, 2007-2008-2009, that the discussion papers will need to be studied and discussed. It is critical to be fully involved at the earliest stage possible to ensure that changes to come have the expected positive effect and do not move financial reporting further away from economic reality.

