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European norms ?***

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Série des Working Papers du
Centre Perelman de philosophie du droit
n° 2009/4

Comment citer cette étude ?

A. Van Waeyenberge, *International Financial Reporting Standards (IFRS) : a new way to build European norms ?*, Working Papers du Centre Perelman de philosophie du droit, n° 2009/4, <http://www.philodroit.be>

International Financial Reporting Standards (IFRS): a new way to build European norms?

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Paper prepared for Advanced Colloquium on Regulatory Reform, Organised by the
Centre for European Governance, University of Exeter 6-7 July, 2009

Introduction

By way of introduction to this reflection on the European accounting system, it is obligatory to explain briefly, characteristics particular to accounting in general, as well as the conceptual break existent between the Anglo-Saxon and the European continental worlds.

The accounting system is often perceived as a neutral technique – often esoteric to non-experts – not immune to critique and academic discussion.¹ Yet this perception seems reductive insofar as it is not a neutral instrument, but rather a vector and a reflection of society when perceived through its principles and conventions. Indeed, a minimum knowledge of practical accounting rapidly indicates that an income statement is not solely an exercise in arithmetical balance. To more precise, it is the result of an anthology of choices of assessment that could lead to extremely different results.²

It is therefore not surprising to conclude, beyond a certain accounting normalization, that many systems with various sensibilities exist. Nevertheless, two families can be easily distinguished.

On one hand, the Anglo-Saxon system, which favours the economic substance to the legal form, is more inclined to side with investors/shareholders, and its producers of standards are mainly accounting professionals. On the other hand, the Continental

¹CAPRON M., « Les enjeux de la mondialisation des normes comptables », *L'économie politique*, 2007/4, n°36, pp. 81 à 91.

²CAPRON M., « Les normes comptables internationales, instruments du capitalisme financier », *Management et Sciences Sociales*, Ed. L'Harmattan, n° 2, 2006, p. 115.

accounting system is more related to a national heritage endowed with strong legal print. It is also more sensitive to the protection of creditors and granting priority to the principle of prudence.³ The Continental system seeks the consensus of different social-economic actors and, moreover, leaves the legislator the power of the last word on the adoption of standards.⁴

The image of the “company” also varies. Anglo-Saxons consider “the company” to be a commodity whose assets can easily be sold on the different markets. The company’s destiny lay solely in the hands of shareholders whose aim is to maximize its value. As for Continentals, “the company” is a sort of “institution” of an economic nature defined by its “social interest.” This conceptual institution holds multiple objectives (economic, social, and environmental) even if profit remains at the centre of preoccupations.⁵

After these preliminary remarks of a general nature, the next few lines desire to analyse the accounting system for listed companies recently implemented by the European Union through Regulation 1606/2002⁶ (hereinafter “Regulation”). This Regulation sets up an accounting system for listed companies and provides that, henceforth, the “standards of application” for all listed companies will be those issued by the IASB (“*International Accounting Standards Board*”), a private body on which the European Union has no means of institutional control.

This recourse to the private field in lawmaking is relatively common in Community law and reveals the new governance modes that currently go through Community action. Nevertheless, and this will be our thesis, the system set up by the European Union reaches a particular advanced degree of privatisation that consequently shows the limits of this type of mode of governance.

The outline of this article consists of three parts. The first part describes in detail the scheme of the Regulation. The second part briefly retraces the reasons and the context in which the European Union has set up this accounting system, and the manner in which it reacted to the financial crisis that we are currently going through. Finally, the last part punctuates this article in more critical terms regarding the system adopted by the Union.

³ *Ibidem*, p. 117.

⁴ CAPRON M., « Les enjeux de la mondialisation des normes comptables », *Op. Cit.*, p. 83.

⁵ PLIHON D., « Les nouvelles normes comptables internationales : une réforme aux implications considérables », *L'économie politique*, 2007/4, n°36, pp. 76 et 77.

⁶ Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

I. The European scheme on accounting standards production⁷

The IASB, since the adoption of the Regulation, has become the “official” producer of the European Union’s standards in the area of accounting for companies listed on the stock market. So as to be able to oppose a critical view, it is essential to have a better knowledge of its origin; (A) its structure and its functioning mode, (B) the mechanisms enabling the incorporation of these standards in European law through an atypical approval procedure, and (C) the material principles on which this accounting system rests.

A. The IASB’s origins, structure and functioning mode⁸

In 1973, an international body named IASC (*International Accounting Standard Committee*) that reassembled about ten professional accounting associations of national scale, was created in London by Henri Benson. This association had as a purpose, the production of an international reference standard so as to facilitate the convergence of national accounting standards. In the years following its establishment, the IASC made and published an increasing number of standards that progressively became a complete set of rules which was finalized in 1998 as a game of standards (IAS, “*International Accounting Standard*”) numbered from 1 to 39. In parallel, the organisation decided in the late 1990s to reform, in-depth, its structure insofar as the 1970s inherited structure – built in an empiric manner – was dominated by professional-accountants and functioned with little transparency. The organisation is thus substantially modified in 2000-2001 so as to make it more efficient and increase its independence.⁹

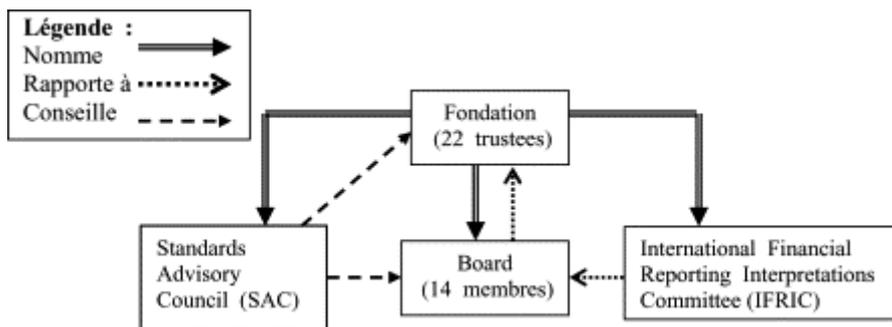
Schema¹⁰

⁷ CHIAPPELLO E. et MEDJAD K., « Une privatisation inédite de la norme : le cas de la politique comptable européenne », *Sociologie du travail*, 2007, pp. 48 à 51.

⁸ VERON N., *The Global Accounting Experiment*, Bruxelles, Breugel Blueprint, 2007, p. 9 et s.; CAPRON M. et CHIAPPELLO E., « Les transformations institutionnelles : l’Europe recule, l’IASB s’impose », CAPRON M. (dir.), *Les normes comptables internationales, instruments du capitalisme financier*, Paris, La Découverte, 2005, p. 59 et s. ; CAPRON M., « Les enjeux de la mondialisation des normes comptables », *Op. Cit.*, p. 84 et s. ; VERON N., « Histoires et déboires possibles des normes comptables internationales », *L’économie politique*, 2007/4, n°36, pp. 93 et s. ; CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, pp. 48 à 51.

⁹ VERON N., « Histoires et déboires possibles des normes comptables internationales », *Op. Cit.*, p. 94.

¹⁰ www.iasb.org



The structure is multiple:

The IASC (*'trustees'*) is an American foundation (Delaware) that is in charge of finding funding¹¹, appointing the IASB's members, and governing general policy.¹² The members are chosen according to a principle of geographic representation of capital markets, and at least two members must belong to big audit cabinets ("the Big Four").¹³ The nomination of members is done by cooptation and members are only accountable to themselves. About 80% the funding comes from voluntary contributions of which those of the "Big Four" hold the highest ranking.¹⁴

The IASB (*'Board'*) is the driving force of the IASC. Based in London, the Board elaborates international accounting standards (IAS, today known as IFRS) with the obligation to consult the public by means of a "*due process*" procedure. *In fine*, the Board makes its decisions autonomously insofar as the Trustees cannot attend meetings or vote. This system has been set up so as to guarantee the Board's independence *vis-à-vis* the Trustees. The fourteen members are chosen according to their technical competence. The rule of geographic representation does not exist at this level.¹⁵ Nevertheless, it is evident that the Anglo-Saxon world is over represented. As often in Anglo-Saxon models, their legitimacy relies on technical expertise.¹⁶

The system of remuneration and payment has been set up for the members of these two instances in order to guarantee a certain independence and thus promote general

¹¹ That mainly comes from the private sector.

¹² CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 49.

¹³ This second condition is due to the fact that each big audit cabinets bring a lot of money to the IASC.

¹⁴ A. FLECKNER, « FASB and IASB : Dependence despite Independence », *Virginia Law and Business Review*, 2008, p. 295.

¹⁵ A reform which consist on a geographical representation and an enlargement to 16 members has been decided and will be applied from 2012.

¹⁶ R. CHANTIRI-CHAUDEMANCE, « La normalisation comptable et ses acteurs », *Revue des sciences de gestion*, 2004, 43, cité par CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 63

interest. However, these human and material means (17 million pounds in 2007) come exclusively from private companies.¹⁷

The diagram also shows two committees whose members are appointed by the trustees. The first, the IFRIC (*International Financial Reporting Interpretations Committee*), consists of 12 volunteers and has as an aim, the interpretation of accounting standards established by the Board. These interpretations are in fact proposals that must afterwards be ratified as such by the Board. These interpretations are particularly important inasmuch as the standards created by the Board only enunciate principles. The second, the SAC (*Standard Advisory Council*), is an advisory committee that takes the form of a forum open to every person and any of the organisation's representatives who wish to take part (members include, among others, the European Commission and the IMF). This group communicates its "advices" to a Board that is free to implement them or not.¹⁸

Finally, it is necessary to note that the IASB's structure and governance, as well as its satellites, have numerous similarities with the *Financial Accounting Standards Board* (FASB), which is the most powerful accounting standardisation body in the United States.¹⁹

B) The incorporation of the IASB's standards in Community law

After having tried – and failed – to harmonize the accounting standards via directives (cf. *Infra*), the European Union thus decided to collaborate with the IASB. This collaboration took the form of a Regulation that therefore introduced an accounting system for European listed companies and held that the standards adopted by the IASB, i.e. the IFRSs, were applicable according to Article 3 of the Regulation on the triple condition that proposed standards not be contrary to the true and fair principle; not fall short of European public interest and meet the criteria of understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management.

The IAS/IFRS's holdings therefore do not directly apply to the European Union. In a way, they must be "approved" by a regulation from the Commission following an endorsement process that, as writes the European Commission, "ensures technical

¹⁷ BAERT D et YANNO G., *Rapport d'information relatif aux enjeux des nouvelles normes comptables*, Assemblée nationale de la République Française, 10 mars 2009, disponible via le lien http://www.focusifrs.com/menu_gauche/documentation/ouvrages_et_articles_de_fond/rapport_d_information_baert_yanno_relatif_aux_enjeux_des_nouvelles_normes_comptables, p. 13.

¹⁸ CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 50

¹⁹ A. FLECKNER, *Op. Cit.*, p. 275 – 309.

quality and political legitimacy”²⁰. On the contrary, the Regulation does not grant any particular power to the Commission to create accounting standards by its own means or to modify the content of those suggested by the IASB.²¹

The approval procedure within the Community legal order is particularly complex.

The first step is the submission of a technical opinion by the *European Financial Reporting Advisory Group* (EFRAG). This group, created in 2001 following the private sector’s initiative, has as a task the verification of new accounting standards which should be in compliance with the European framework directives by means of opinion. Once this opinion is rendered, the *Accounting Regulation Committee* (ARC), a committee (comitology) provided by the Regulation (that is, more political where each Member State sits and is presided by a representative from the Commission), gives its opinion on the Commission’s proposal to adopt one or several IFRS’s proposals by a qualified majority vote.²² If the vote is in favour of accepting the proposal, the Commission, in the final step, takes on the regulation so as to adopt the new standard only after having followed the “*regulatory procedure with scrutiny*”²³ which refers to the process by which the European Parliament and the Council are provided the opportunity to oppose or uphold the endorsement of IFRS by the European Commission.

The EFRAG is an atypical group on the European institutional landscape created in 2001 by preparers, users, and members of accountancy professions, with the support of national standardisation body. The agreement of March 23rd 2006 with the Commission recognizes EFRAG’s competence to express technical opinions as they relate to standards and interpretations of proposals before their final review and approval by the Commission. For the purposes of the quality, transparency and credibility of the endorsement process, it was important to establish an ‘independent’ body that would guarantee the objectivity of EFRAG’s opinions. The Commission therefore instituted – within its structure – the *Technical Expert Group* (TEG), a standards advisory review committee composed of independent members whose competences and experiences in the area of accounting are widely recognised at the EU level. The TEG, as a body, is composed of members that respects and represents a geographic balance within the European Union, so as to examine the accounting standards issued by the EFRAG

²⁰ *Rapport de la Commission au Conseil et au Parlement européen concernant l’application du règlement n° 1606/2002 du 19 juillet 2002 sur l’application des normes comptables internationales.*

²¹ A. FLECKNER, *Op. Cit.*, p.291.

²² COLASSE, « La régulation comptable entre public et privé », M. CAPRON (dir.), *Les normes comptables internationales, instruments du capitalisme financier*, Paris, La Découverte, 2005, p. 42-43.

²³ Décision of the Council 2006/512/EC of 17 July 2006

impartially.²⁴ The task of this committee is to advise “*the Commission, prior to decision-making on endorsement matters, on the well-balanced and objective character of opinions given by the EFRAG*”.

In addition to its competence in the capacity of providing technical advice on standards and interpretations, and prior to their approval as mentioned hereinabove, the Union has also given EFRAG the task of making its voice heard during a consultation process that the IASB launched on the occasion of standard projects (“*due process*”).²⁵

C) The guiding principles of the IFRS accounting system²⁶

Although it is not possible, considering the restricted frame of this working paper, nor relevant, considering the ambition of this article, to identify and explain the set of guiding principles of the IFRS accounting system, we cannot do without certain clarifications.

The IASB unquestionably relates to the Anglo-Saxon accounting standardisation tradition, while refusing the rules-based approach which is the United States’, it favours the principles-based approach used in the United-Kingdom, thus leaving the user an assessment margin for their application.

- *The pre-eminence of the financial reality over the legal form: the “substance over form” principle²⁷*

Unlike the Continental conception of accounting that is based on the legal fiction according to which an asset represents one unit of goods, the IFRS strives to reveal the underlying economic substance, i.e. accounting must reflect economic rights, duties and advantages that are at the disposal of an entity. This is how certain assets, securitised or lodged in vehicles legally separated from the company, can be reintegrated in the balance sheet, or how assets covered by a leasing agreement (and thus do not legally belong to the company) must be integrated in the asset.

- *The “fair value” principle²⁸*

From a conceptual standpoint, the “*fair value*” is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's

²⁴ BAERT D et YANNO G., *Op. Cit.*, p. 18.

²⁵ CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 51.

²⁶ BAERT D et YANNO G., *Op. Cit.*, p. 28 et s.

²⁷ BAERT D et YANNO G., *Op. Cit.*, p. 28 et s.

²⁸ BAERT D et YANNO G., *Op. Cit.*, p. 28 et s.

length transaction” (IAS 16 §6). In other words, the application of “fair value” presupposes a market functioning in normal conditions, i.e. sufficiently liquid to set a price to the concerned asset or liabilities. In fact, “fair value” rests on, in particular for financial assets, the markets’ self-referential assessment so as to know the company’s instant value and not its operational performances. This leads to a system where standards are mainly oriented towards the financial information of investors/shareholders and where the balance sheet prevails over the profit and loss statement.

In addition, from a conceptual standpoint, recourse to “fair value” undoubtedly makes the company appear under its Anglo-American acceptance, that is, not as an institution but as a sum of detachable and marketable elements where human resources are not considered as such, but as a source of value in itself.

II. A doubly difficult context: the origins and the financial crisis.

In order to correctly appreciate this new corpus of rules, a double detour by, (A) the explanation of the context in which these IFRSs have been adopted by the European Union, and (B) its role in the current crisis context, seems appropriate.

A) Origin

From the 70’s to the early 80’s, the European Union had adopted with success, a certain number of directives on, among others, annual accounts²⁹ and consolidated accounts³⁰ on or relating to the the statutory audits of accounting documents³¹. Presently, no directive has yet been adopted by a market waiting for a harmonization process to be implemented that improves current practices of the EU institutions.³² This position was all the more disorganized since the directives left many gaps in legislation and offered many options to Member States during the transposition to implement adhoc remedies. Despite the will of the Commission to advance on this topic in a much more

²⁹ Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies.

³⁰ Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts.

³¹ Eighth Council Directive 84/253/EEC of 10 April 1984 on the approval of persons responsible for carrying out the statutory audits of accounting documents.

³² CAPRON M. et CHIAPPELLO E., « Les transformations institutionnelles : l’Europe recule, l’IASB s’impose », CAPRON M. (dir.), *Les normes comptables internationales, instruments du capitalisme financier*, Paris, La Découverte, 2005, pp. 50 and s.

accomplished internal market framework, the Guardian of the Treaties was confronted by a series of political blockades mainly coming from the defence, by a series of Member States, of their own systems and the refusal to see them substantially over modified.

Powerless, considering the unanimity required in the Council for any amendment, the Commission nevertheless accepted, in 1990, the invitation of the International Accounting Standard Committee (IASC) to become an observer so as to be kept informed of developments at the international level.³³

Two years later, the Commission re-approached the Member States and tried to introduce “comitology” procedures in the area of accounting in order to review the directives by means of lightened procedures. For the reason that a certain number of Member States, including Germany, were not in favour, the European accounting system remained once more at a standstill allowing each Member State to progressively take back control over the subject matter. In the face of such rigorous uncertainties, the big European companies often decided to adopt the American standards (FASB), or the standards suggested by the IASC. As a consequence of European impotence, the FASB guidelines became the European standards of reference.

At the end of 1994, the political position of a certain number of Member States evolved and allowed the Commission to publish the communication “*Accounting harmonisation: a new strategy vis-à-vis international harmonisation*”.³⁴ This document gives the reasons that officially encouraged the Commission to turn away from the harmonization strategy that had been followed until then, and underlines the necessity of a solid and reassuring accounting framework for European companies while, at the same time, remaining compatible with American standards.³⁵ The Union therefore decided to contact the American authorities so as to try to establish a principle of “mutual recognition” between the two economic giants. The United States, however, did not demonstrate much interest insofar as their accounting system was already recognized in every Member State. The project was therefore abandoned.

The situation was henceforth the following: (i) the Union desired to keep the *acquis* of its previous directives, (ii) the harmonisation via directives did not seem any longer desirable, (iii) the American standards were more and more imperative, and (iv) the Commission disposed of the Member States’ political will to forge ahead.

³³ *Ibidem*

³⁴ COM 95 (508)

³⁵ CAPRON M. et CHIAPPELLO E., « Les transformations institutionnelles : l’Europe recule, l’IASB s’impose », *Op. Cit.*, p. 54.

The solution that was thus chosen and that led to, in 2000, the following communication, “*EU Financial Reporting Strategy: the way forward*”³⁶, which suggested that all listed companies elaborate their consolidated accounts according to international accounting standards (IAS, now known as IFRS). The 2002 European regulation legally consecrated this solution that was guided by considerations of practical order since the IAS/IFRSs had a very complete normative corpus already. These considerations were also of a political order because they did not favour the system of any particular Member State and allowed, by the same occasion, direct competition with the American market.

B) The IFRSs and the financial crisis³⁷

Without providing a complete historic and economic analysis of the financial crisis within which we are currently embroiled, the intention of this sub-chapter seeks only to illustrate the role accounting standards played in its development.

Seeing that the principles upon which the international accounting standards (IFRS) are based and, whose ambition, for reminder, is rather to enlighten shareholders and financial investors than to reflect an image of the company’s economic value, it was logical to conclude that the stock markets’ failure would result in a series of problems. More particularly, the application of “fair value” presupposes, as explained above, a market that operates properly in normal conditions, i.e. sufficiently liquid to set a price on the asset. *“Yet, one of the current crisis’ characteristics is the contraction of the loan structured products’ market and the securitisation in general. Listening back to reason and conscience of the collapse the underlying of these derived products (the American real estate), the investors henceforth refuse to buy these products. Their market value is therefore theoretically (quasi-) equal to zero, thus obliging their holders, in application of accounting standards, to massively depreciate them in their balance sheet.”*³⁸

However, real estate, while strongly impaired on the stock market, will never have an economic value equal to zero. In such a scenario, the IFRS has planned to determine its “fair value” by means of mathematic models of valorisation that are supposed to re-set the price to which would have led a balanced operation on a liquid market. This solution shifts the problem insofar as no one knows, besides the financial head offices of the concerned organisations, which hypotheses have been used to create these models. This

³⁶ COM (2000) 359 final

³⁷ BAERT D et YANNO G., *Op. Cit.*, p. 70-76.

³⁸ Personale Translation from BAERT D et YANNO G., *Op. Cit.*, p.71.

reinforces the mistrust of investors in banks and even between banks. The paralysis of the interbank market that we are currently going through undoubtedly stems from this phenomenon which rests partly on accounting standards.³⁹

The consequences of these “write-downs” have been strengthened by the intervention of prudential standards.⁴⁰ Indeed, when the accounting rule obliges an evaluation of the assets in “fair value” and that the latter collapse, the write-downs that banks are obliged to inscribe in their accounts diminishes their own funds. In parallel, since the rating agencies have, considering the numerous critiques that have been expressed towards them with regards to the thoughtless manner in which they have attributed triple AAA, considerably reduced the mark of structured products that banks hold on their balance sheet, their need of proper funds increases even more in order to simply respect prudential standards.⁴¹ In addition, and as we already explained, seeing that the interbank loans are deficient and that shareholders are out of breath, banks are henceforth obliged to sell – or rather to sell cut-price – their assets (even non toxic) on a moribund and extremely falling market so as to regain sufficient liquidity. The write-downs cycle thus maintains itself. Finally, considering the lack of proper funds of banks, the latter are almost unable to lend money and the crisis is passed on to the real economy (*credit crunch*).⁴²

We can conclude that even if accounting standards alone were not at the origin of the financial crisis, they unquestionably had, combined with prudential standards, a pro-cyclic effect that aggravated the crisis by inciting financial institutions to get rid, “at any price,” of their assets, even the healthiest, even though financial markets were weakened.

III. Observations and consequences

The described scheme brings to the fore a new degree of privatisation and delegation in the production of European norms. (A) This observation clearly shows at least three limits of this system: the relative independence of standard producers, the loss of the Union’s influence on these standards and the disenchantment of the co-regulation model (B).

³⁹ BAERT D et YANNO G., *Op. Cit.*, p. 71.

⁴⁰ Prudential standards, said “Basel II” define the proper funds/risk activities ratio: the more a bank has risk activities or holds titles qualified as “risk” by notation agencies, the more the bank has to maintain a high ratio of proper funds.

⁴¹ BAERT D et YANNO G., *Op. Cit.*, p. 72.

⁴² BAERT D et YANNO G., *Op. Cit.*, p. 74.

A) A new degree of privatisation and delegation in the production of the Community standard

It is surprising to notice that the implemented Regulation deprives the European Union of the perfect command of the content of accounting standards⁴³. Indeed, by setting up an *ex post* approval, the Union can decide to entirely, or partly, refuse a standard, but cannot modify its content nor create a new standard. The Union therefore deprives itself of the possibility to Europeanize a primary basis of accounting that has, as yet, a worldwide vocation⁴⁴ and to react quickly vis-à-vis the financial crisis.

The comitology structure set up (for reminder ARC/ERFAG) for approval is also more impregnated with private actors than usual comitologic procedures.

This rendering of delegation to the private sector, and the lack of influence on these accounting standards, is amplified by the fact that the Union does not have any power over the appointment of the IASB's members and further, that the IASB's agenda is beyond the Union's control.

Of course, the European Union always has the official possibility to refuse to approve an IFRS proposal that will consequently not be included in the European *corpus iuris*. However, in this scenario, the Commission suggests that companies still use this standard but on a voluntary basis.⁴⁵ This advice from the Commission to companies reveals the formal and hypothetical character of this refusal of approval.

The indications of this particularly large and complete delegation to the IASB's experts are therefore numerous and in agreement; compatibility therefore seems to be the only area in European law where “*the entire compulsory normative production has been delegated to a private body.*”⁴⁶

Faced with this observation, the defenders of the IASB assert that a procedure of *due process* exists and corresponds to a particularly important step in the elaboration of accounting standards. This process, which is advisory, consists in the possibility for

⁴³ Of course, beyond the content in the accounting directives of 1978 and 1983.

⁴⁴ Besides, the Commission prevents Member States from completing, limiting and interpreting the soft law elaborated by the IASB which is a private body.

⁴⁵ “*insofar as the standard is not incompatible with the adopted standards, [...] a standard that has been rejected by the European Union can also be used for orientation*” European Commission, Observations concerning certain articles of the CE 1606/2002 regulation, July 19th 2002, and of the 4th and 7th directives.

⁴⁶ Personal translation - BAERT D et YANNO G., *Op. Cit.*, p. 19.

civil society, companies, European institutions, etc... to put forward their comments/recommendations, via internet, at the attention of the IASB's members. This procedure clearly advances and enables, undoubtedly, enlightenment of decision-makers; nevertheless, this procedure does not in any way constitute a sufficient guarantee for the defence of general interest by the IASB.

B) Limits: independence – loss of influence – co-regulation

This observation on the set up of the European system being clear enough, we attempt now to pinpoint more particular problems that imply and consequently demonstrate the limits of this generous delegation to the private sector.

- *The IASB's relative independence*

The IASB's independence raises the possibility of an excess of independence. This fear is based on rules which solely provide a certain geographic representativeness and do not confer a guaranteed space for public institutions (such as the European Commission). The risk is that this system falls into a cyclic cooptation system between experts of the same network. This risk is far from being theoretical considering the sociology of the appointed members that nearly exclusively corresponds with the employees/executives of donor enterprises of the association.⁴⁷

The answer given by the IASB as a reaction to this critique always focuses on the competence of its members as a guarantee for the respect of independence. And yet, as Eve Chiappello and Karim Medjad correctly point out “... *everything is presented as if the fact of choosing experts mainly on the criteria of competence, paying them a full-time salary, and enjoining them to work for the general interest was enough to erase their experiences, their way of thinking and their relationship networks.*”⁴⁸

Moreover, independence and competence are essential to found a technical and rational legitimacy but are insufficient to legitimate standards in an area such as accounting. Indeed, accounting is not a science but is at the junction of financial, social, and economic interests and henceforth requires enhanced guarantees in terms of taking into account general interest. This is all the more true when we realise that *in casu*, the big multinational audit companies are both the IASB's main donors and main “staff” suppliers. In addition, they also “audit” the companies that have to apply the IASB's standards.⁴⁹

⁴⁷ CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 57.

⁴⁸ Personal translation - CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 57.

⁴⁹ CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 58.

- *The European Union loss of influence reduced to the role of lobbyist group*

The current situation is paradoxical. On one hand, the European Union consciously sets up a system in which the production of accounting standards is beyond its control and, on the other, the Union regrets its lack of influence and tries by means of lobbying to get back a power that it delegated. In this respect, let us recall the arm-wrestling between the European Union⁵⁰ and the IASB in 2003-2004 concerning the IAS/IFRS 39 relative to the enlargement of the scope of financial instruments requiring “fair value” accounting (i.e. the amount for which it could be exchanged, between knowledgeable, willing parties in an arm's length transaction) whereas European continental countries traditionally authorise retaining “historical cost” (i.e. the purchase price, even if the instrument has been acquired long before). The discussion rapidly took a political turn seeing that the European Union did not desire to adopt the fair value accounting method for certain financial instruments. The Union thus decided to bring its desire to the knowledge of the IASB so that the latter modifies IAS/IFRS 39 along the lines of the Commission. The IASB, on the grounds of its independence, empathically refused to yield forcing the EU had to submit to the essential. The IASB has not modified its standards, and the compromise that enabled them to save face was the censoring of some paragraphs, at the last minute, in November 2004.⁵¹ This episode shows how the Union is henceforth incapable of making its viewpoint prevail⁵² and restricts the Union to the role of classic lobby by trying to use at its best the *due process* procedures - via the EFRAG – to make its opinion heard.⁵³

- *A co-regulation not very cooperative*

This shift in standards production from the public sector to the private sector is particularly manifest in the European accounting political framework and clearly falls within the co-regulation logic that, for reminder, is a technique through which private actors act with public bodies in the drafting of a standard that will be *in fine* approved in positive law. This technique was initiated in the white paper on governance in 2001⁵⁴,

⁵⁰ VERON N., *The Global Accounting Experiment*, Bruxelles, Breugel Blueprint, 2007, p. 36 et s.

⁵¹ VERON N., « Histoires et déboires possibles des normes comptables internationales », *Op. Cit.*, p. 106.

⁵² It is surprising to read, in the American doctrine that the European Union has a considerable influence on the IASB considering the importance of its economy and the positive effect on third countries – cf. A. FLECKNER, « FASB and IASB : Dependence despite Independence », *Virginia Law and Business Review*, 2008, p. 287.

⁵³ CHIAPPELLO E. et MEDJAD K., *Op. Cit.*, p. 62.

⁵⁴ White paper on the European governance - COM/2001/0428 final; in this document the Commission considers that the legislative channel is often only a part of a larger solution and, consequently, the

confirmed in a communication from the Commission in 2002⁵⁵, reaffirmed in 2006 through the Commission's communication on the implementation of the Community Lisbon programme,⁵⁶ and joined to the "better regulation"⁵⁷ program knows currently a certain success in Community law and reveals the European Union's search for legal instruments so as to fulfil its missions that have been devolved by the Treaty.

The regulation framework of the European policy on accounting standardisation chronologically and ideologically corresponds to this policy. However, the European policy presents a particular pronounced character in favour of the private sector which gives rise to traditional questions linked to a delegation of power to this type of actor, such as questions of independence, legitimacy, research of general interest.

Yet this co-regulation supposes a co-operation between public actors and private actors. In the policy framework that we are here analysing, this collaboration is far from being harmonious insofar as the current situation is unbalanced. The European partner can only approve or refuse; there is not really any constructive dialogue and the relations of powers are not horizontal, but rather vertical. It therefore seems that this co-regulatory experience does not bear its fruits and that this way of producing law requires a certain balance between involved partners.

Conclusion

Generally speaking, it is striking to notice that the Classic Community Method (as described in the Nice Treaty) does not enable one to understand the manner in which accounting law is currently produced in the Union. On the contrary, the Union appears as a complex network of powers whose overall logic is more material than formal, more functional than organic. Europe seems more attracted by the objectives to attain, the policies to carry out, the common actions to develop (the common market, the economic and social development, owning an European accounting system...) than by the setting-

Commission encourages the use of different instruments of public policy such as framework directives and co-regulation mechanisms.

⁵⁵Communication from the Commission – Action plan "Simplifying and improving the regulatory environment" COM (2002) 278 - More particularly, it describes in details how it intends to implement the use of co-regulation.

⁵⁶ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the regions – "Implementing the Community Lisbon programme: a strategy for the simplification of the regulatory environment" (COM/2005/0535) – in which the Commission specifies in some cases, co-regulation can turn out to be more efficient and practical than the classic legislative tools to reach certain objectives. The Commission establishes moreover that its reinforcement could lead to its extension to a maximum of sectors.

⁵⁷End 2003, an inter-institutional agreement "Better regulation" came into being. It recognizes the utility to have recourse to alternative regulation mechanisms and develops in particular two mechanisms: co-regulation and self-regulation. COM (2006) 690 final and COM (2006) 691 final.

up of rules and the institutional scheme likely to bring them to completion. It is as if the political end (the substantial objectives to reach) justified the legal means (the procedures and bodies imagined for this purpose).⁵⁸ Yet the legal means imagined in the accounting framework analyzed in these few lines put forward a certain number of shortcomings that cannot be ignored.

Recourse to the private sector, delegation of certain powers and co-regulation are not *per se* reprehensible. However, their substantial combination accompanied with an absence of European consensus regarding the appropriate policy to carry out give rise to an atypical and complicated situation that shows the limits inherent to a governance mode where private actors hold an excessively important place.

Moreover, the current situation presents a paradoxical character insofar as the structure and the competences devolved to the European Union (in particular the realization of an internal market) should have logically led to find a European solution for the referential accounting; yet the Member States' sovereignty (and the unanimity required at the Council), has finally established an European accounting system elaborated by a private body on which political control cannot be exerted. The difficulty to see a European accounting system emerge from national or international authorities legitimates, from a democratic viewpoint, such as in other areas, "*the opening of a space for private standardisators and self-regulator approaches that appear more efficient and, paradoxically, less prejudicial to national sovereignty.*"⁵⁹

The aim of this article was not to enter into a politological analysis of the IASB with regards to the Community system nor formulate proposals for the IASB's reform – even if we consider such proposals desirable, even essential. At the very most, we venture to consider that the IASB has an effective power and yet its structure of responsibility, its funding mode and its numerous conflicts of interest seem worrying.⁶⁰ It is thus paradoxical that an organisation that elaborates accounting standards is accountable to no one.⁶¹

⁵⁸ MAGNETTE P. et REMACLE E., « La grande transformation de l'Europe », *Le nouveau modèle européen*, Bruxelles, Editions de L'Université de Bruxelles, Vol. I. Institutions et gouvernance, 2000, p. 7 à 23 et OST F. et van de KERCHOVE M., *De la pyramide au réseau ? Pour une théorie dialectique du droit*, Bruxelles, Éditions des FUSL, 2002, p. 71 et 72.

⁵⁹ Personal translation - BAERT D et YANNO G., *Op. Cit.*, p. 17.

⁶⁰ VERON N. « Les IFRS en pratique », *Option Finance*, cahier hors série n°C7, 18 juin 2007.

⁶¹ BAERT D et YANNO G., *Op. Cit.*, p. 15.