Is Fair Value Fair?

Financial Reporting from an International Perspective
# Contents

*About the editors*  
ix

*List of abbreviations*  
xiii

**Introduction** – Willem Verhoog  
1

1 Is fair value fair? Expert opinions on financial reporting from an international perspective: brief impressions  
Willem Verhoog  
5

## Part I The future of international accounting

2 The model of Black and Scholes is like Newtonian physics before Einstein was born  
Robert K. Elliott  
35

3 Current US accounting issues  
Norman Strauss  
49

## Part II Regulations and regulators

4 We have to produce one set of unified high-quality global standards  
Sir David Tweedie  
57
5 EFRAG: a new force to be reckoned with in the reporting field
Johan van Helleman

6 Not partial, but full application of IAS
Leo G. van der Tas

7 IAS and the European Union
Karel Van Hulle

8 IAS and legislation
Jan Klaassen

9 Shifting towards an Anglo-Saxon perspective on rules
Egbert Eeftink

10 Uniform rules are important, but they must not block the view
Jean den Hoed

Part III  Supervision and compliance

11 Towards a new supervisory landscape
Paul M. Koster

12 The Enterprise and Companies Court as supervisory body
J. (Huub) H. M. Willems

13 Globalisation is OK, as long as it takes account of Dutch culture
M. (Rien) A. van Hoepen

14 Enforcement of IAS is crucial for the realisation of a global standard for financial reporting
Ruud G. A. Vergoossen

Part IV  IAS and the users of financial statements

15 Unambiguous rules, timely reports and close supervision
Peter-Paul F. de Vries

16 The supervisory director: striking the right balance
Paul C. van den Hoek
17 Insurers are lagging behind  
*Lou Traas*  
191

18 Double Dutch in financial reporting: highly flexible = extremely judgmental?  
*Henk P. A. J. Langendijk*  
203

19 The auditor is gratefully back on his pedestal  
*Pieter T. Lakeman*  
215

**Part V Fair Value Accounting**

20 The irrepressible advance of Fair Value Accounting  
*Martin N. Hoogendoorn*  
229

21 From profit smoothing to a true and fair presentation of profits at insurance companies and pension funds  
*Alfred Oosenbrug*  
237

22 Introduction of Fair Value Accounting: little if any haste  
*Kees J. Storm*  
245

23 Fair Value Accounting will result in less transparency and more volatility in banks’ financial reporting  
*Bert Bruggink*  
255

24 Financial statements are a result of policy and not a factor informing policy  
*Joost G. Groeneveld*  
265

25 Financial reporting and the search for truth  
*Dirk M. Swagerman*  
273

26 Warning signals about the application of fair value for financial instruments  
*Tricia O’Malley* and *Petri Hofsté*  
287

**Part VI Capita selecta: external financial reporting and law**

27 IAS: right or wrong?  
*Hans Beckman*  
297
Part VII  External financial reporting and new-economy companies
28  The valuation of new-economy companies 313
   Auke de Bos

Part VIII  International financial reporting by governments
29  IPSAS and financial reporting by the Dutch government 325
   Aad D. Bac

Part IX  The relationship between management accounting and financial accounting
30  Interaction between internal and external reporting 335
   Ed G. J. Vosselman

Part X  Business combination accounting
31  A creative approach to mergers and acquisitions 345
   Jos M. J. Blommaert

Epilogue: Toward a single global reporting system

Index
About the editors

Professor Henk P. A. J. Langendijk (1952)

Professor Henk Langendijk studied Business Economics at the University of Amsterdam (1972–1976). He subsequently worked for a number of years in the accountancy field (at BDO and Arthur Andersen). From 1980 to 1988 he worked for the University of Amsterdam as a lecturer of finance and from 1988 to 2000 as a senior lecturer in the field of financial accounting. In 1997 he was appointed part-time Professor of Business Economics at the Nyenrode University. Langendijk was subsequently appointed Professor of External Financial Reporting at Nyenrode University in 1999 and Professor of External Financial Reporting at the University of Amsterdam in 2000. He gained his doctorate in 1994 on the subject ‘The market for the statutory audit in the Netherlands’ at the University of Leiden.

His recent research concentrates on the quality of external financial reporting, with a particular focus on creative accounting and fraudulent reporting. He has many articles to his name, which have appeared in international magazines such as European Accounting Review, European Journal of Finance, Accounting, Auditing and Accountability Journal and in Dutch magazines, including Maandblad voor Accountancy en Bedrijfseconomie, Accounting, Bedrijfskunde, Tijdschrift Financieel Management, De Accountant and Accountant-Adviseur. He has also written a number of books in the field of financial accounting and is a member of the Advisory Council of the Limperg Instituut. In addition, Langendijk is editor-in-chief of the magazine Accounting, editor of Accountant-Adviseur and a member of the VERA steering committee on financial reporting.
Professor Dirk M. Swagerman (1949)

Professor Dirk Swagerman attended the electrical engineering section of Patrimonium Junior Technical School in Amsterdam and was subsequently admitted to the higher general secondary education class of Ignatius College in Amsterdam.

In 1969, he enrolled at the General Political and Social Sciences subfaculty of the Municipal University in Amsterdam. He followed this with evening classes at the Contardo Ferrini High School. In 1971, he passed university entry and first-year examinations. Following Bachelor degree examinations, Swagerman chose to study Public Administration and in 1975 was awarded a Master’s degree. The most important subsidiary subjects that he studied for his Master’s degree were Research Methods and Techniques, International and European Law and, at the Faculty of Economics, Administrative Information Management, Internal Organisation and Public Finance.

He studied at the Graduate Business School of Michigan State University in 1978 and 1979 and was awarded a Master of Business Administration degree. After this, he successfully completed the SIOO postgraduate management consultancy training course, which led in 1997 to a Master in Change Management degree. At Stanford University, Swagerman followed the Senior Executive Program in 1989 and the Financial Management Program in 1999. In 1991 and 1992, he was awarded a Master of Business Telecommunications degree at the University of Delft.

Swagerman has spent a major part of his working life as a management consultant, focusing mainly on fields relating to the organisation and design of the financial function for all types of organisations in the Netherlands and abroad. As a certified management consultant, he is a member of the Netherlands Order of Management Consultants, the Royal Netherlands Institute of Engineering and the Netherlands Association of Public Administration.

Since 1994, Swagerman has been attached part-time to the University of Twente in Enschede, where he obtained his doctorate in Financial Logistics Management on 25 August 2000. He is also attached to Deloitte & Touche in Amsterdam and to the Eurac/Erasmus University Controller’s training course in Rotterdam, where he lectures on Financial Management and Treasury Management.

On 15 November 2002 he was appointed as professor at the Economic Faculty and the Faculty of Business Economics of the Rijksuniversiteit Groningen (RUG).
Willem Verhoog (1950)

Willem Verhoog has been the Secretary-general of Royal NIVRA’s Committee for the Continuing Professional Education of Registeraccountants (VERA) since 1 August 1976. Following the award of a teaching certificate at De Driestar in Gouda in 1971, he worked until 1974 as a teacher in Werkhoven and Alblasserdam/Kinderdijk. On the occasion of his 25-year NIVRA anniversary, he received a liber amicorum (with 25 contributions from professors) entitled ‘How good is a timely word’. Verhoog is responsible for the development and progress of the continuing professional education provided by VERA. In this capacity he is also involved in the organisation of pan-European congresses such as Form 20F and MD&A, Recent Trends in Valuation/Real Options and US GAAP.

Since 1990 Willem Verhoog has been the editor-in-chief of VERA-Actueel, the monthly continuing professional education magazine. He is editor-in-chief of 30 NIVRA/VERA books, of the annual VERA series Actualiteiten in Accountancy and the VERA series ‘Fifteen expert opinions on …’. In 2000, Strategic Finance in the 21st Century was published as part of this series and has now been released on the international market under the title A Vision for the Future by the British publishing house John Wiley & Sons. A Chinese version was published in 2002 and a Russian version will be published this year (2003). In January 2003 another VERA publication will be released on the international market by John Wiley & Sons under the title Recent Trends in Valuation: From Strategy to Value (edited by Willem Verhoog and Luc Keuleneer).
Abbreviations

AICPA  American Institute of Certified Public Accountants
AcSEC  Accounting Standards Executive Committee
ARC   Accounting Regulatory Committee
AA    Accountant Administratieconsulent
AEX   Amsterdam Exchange Index
AO    Administrative Organisation
ASB   Accounting Standards Board
ARC   Accounting Regulatory Commission
BV    Besloten Vennootschap
CMG   Dutch listed computer firm
CPA   Chartered Public Accountant
RA    Registeraccountant
CIMA  Chartered Institute of Management Accountants
CESR1 Committee of European Securities Regulators
CFO   Chief Financial Officer
CNOOC China National Offshore Oil Corporation
CICA  Canadian Institute of Chartered Accountants
DNB   Dutch Central Bank
DCF   Discounted Cash Flow
EU    European Union
EFRAG European Financial Reporting Advisory Group
EBITA Earnings Before Interest, Taxation and Amortisation
EBITDA Earnings Before Interest, Taxation, Depreciation and Amortisation
ERP   Enterprise Resource Planning
EITF  Emerging Issues Task Force
FASB  Financial Accounting Standards Board
FAS   Financial Accounting Standards
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAR</td>
<td>Open reserve for general bank risks</td>
</tr>
<tr>
<td>FEE</td>
<td>Fédération des Experts Compatibles Européens</td>
</tr>
<tr>
<td>IAS</td>
<td>International Accounting Standards</td>
</tr>
<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
</tr>
<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Chartered Accountants in England and Wales</td>
</tr>
<tr>
<td>IFRIC</td>
<td>International Financial Reporting Interpretations Committee</td>
</tr>
<tr>
<td>IOSCO</td>
<td>International Organisation of Securities Commissions</td>
</tr>
<tr>
<td>IPSAS</td>
<td>International Public Sector Accounting Standards</td>
</tr>
<tr>
<td>IFRIC</td>
<td>International Financial Reporting Interpretations Committee</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IFAD</td>
<td>International Forum on Accountancy Development</td>
</tr>
<tr>
<td>JWG</td>
<td>Joint Working Group</td>
</tr>
<tr>
<td>LIFO</td>
<td>Last In, First Out</td>
</tr>
<tr>
<td>MD&amp;A</td>
<td>Management Discussion &amp; Analysis</td>
</tr>
<tr>
<td>MIS</td>
<td>Management Information Systems</td>
</tr>
<tr>
<td>MAB</td>
<td>Maandblad voor Accountancy en Bedrijfseconomie</td>
</tr>
<tr>
<td>NATO</td>
<td>North Atlantic Treaty Organisation</td>
</tr>
<tr>
<td>NIVRA</td>
<td>Koninklyk Nederlands Instituut von Registeraccountants</td>
</tr>
<tr>
<td>NRC</td>
<td>Handelsblad – leading financial daily in the Netherlands</td>
</tr>
<tr>
<td>NOK</td>
<td>Norwegian ‘Kroner’</td>
</tr>
<tr>
<td>NVB</td>
<td>Nederlandse Vereniging van Banken/Dutch Bankers’ Association</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
</tr>
<tr>
<td>PCNA</td>
<td>Platform Committee of Registeraccountants and Actuaries</td>
</tr>
<tr>
<td>RJ</td>
<td>Raad voor de Jaarverslaggeving</td>
</tr>
<tr>
<td>RUG</td>
<td>Rijksuniversiteit Groningen</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td>SIC</td>
<td>Standing Interpretations Committee</td>
</tr>
<tr>
<td>SOBI</td>
<td>Stichting Onderzoek Bedrijfs Informatie</td>
</tr>
<tr>
<td>SQL</td>
<td>Structured Query Language</td>
</tr>
<tr>
<td>SEK</td>
<td>Swedish ‘Kroner’</td>
</tr>
<tr>
<td>TEG</td>
<td>Technical Expert Group</td>
</tr>
<tr>
<td>US GAAP</td>
<td>US Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>VERA</td>
<td>Voortgesette Educatie Registeraccountants</td>
</tr>
<tr>
<td>VAR</td>
<td>Secret reserve for general bank risks</td>
</tr>
<tr>
<td>VNO-NCW</td>
<td>Dutch Employers Association</td>
</tr>
<tr>
<td>VEB</td>
<td>Vereniging van Effectenbezitters (the Netherlands Association of Securities Holders)</td>
</tr>
<tr>
<td>XBRL</td>
<td>eXtensible Business Reporting Language</td>
</tr>
</tbody>
</table>
In an age that is characterised by internationalisation, the call for uniformity in rules is becoming ever louder. For the sake of comparability, intelligibility and transparency of financial information the aim is to produce universal standards. Were not the units of measurements, weights and money the most important impulses for the unification of states? The increasing demand for uniformity in rules is also observed in the practice of external financial reporting. On 7 June 2002, for example, the European Council of Ministers approved the regulation requiring that all European Union (EU) companies listed on a regulated market, from 2005 onwards, prepare and publish their consolidated financial statements in accordance with international accounting standards (IAS). In March 2002, the European Parliament endorsed the regulation, originally proposed by the European Commission in February 2001. Certain amendments were also adopted including clarification on exemptions for certain
companies until 2007. In addition to this regulation, agreements have also been made concerning the supervision of the financial reporting of listed companies and the co-ordination of this supervision. This again means a step in the direction of uniformity, harmonisation and a single, so fervently desired, capital market in the EU. Steps will also have to be taken to create a new supervisory body with special powers, which will primarily focus on the enforcement of rules concerning external financial reporting.

Clearly, the new regulations will radically change the various methods of financial reporting. Furthermore, the accountancy and controller professions will obviously be profoundly affected by the new developments. That is the reason why Wiley is publishing this book by Royal NIVRA's Committee for the Continuing Professional Education of Register-accountants (VERA) in order to cover the subject of IAS in detail. More than thirty experts present their vision of the effects that IAS will have on the practice of financial reporting. The reporting world is constantly on the move. Following a long period during which financial reporting standards changed little or not at all, we are now faced with a period of rapid change in which not only new financial reporting standards are emerging, but discussions are also taking place about the benefit and the added value of the standards. We see this discussion manifest itself in the differences in approach to reporting standards on the North American and European continents, for instance, with regard to the way in which goodwill is treated.

In any event, we are confronted with many issues in the field of standards. In this book, the term IAS will be used to denote the accounting standards of the International Accounting Standards Board (IASB). The term IFRS will – with the exception of a few contributions – not be used. The listed companies referred to will have to adapt their reporting system to the new set of rules in the very short term. Searching for a common thread in these accounting standards, it can be said that the accountants' world is evolving towards fair value and thus market value. It is expected that historical cost (also current cost) as an accounting principle will become less important in the future. The critical question to be asked is whether full compliance with accounting principles generally accepted in either the USA or in Europe automatically leads to the presentation of a ‘true and fair view’ of the company’s financial position and its results of operation. Clearly, the new accounting standards show a tendency towards ‘fair value accounting’. Whilst fair value accounting may lead to more relevant financial reporting, it may also lead to significant fluctuations in financial results over time.

The areas of attention in this book include: valuation based on fair value, the treatment of goodwill, the reporting issues of new economy companies, of insurance companies and banks, supranational and
national rules and regulations. The common ground and differences between internal and external reporting will also be covered. Furthermore, the differences between ‘accrual accounting’ and ‘cash flow accounting’ will be dealt with in various contributions. Here, cash flow accounting should be considered to include the calculation of company value as an element of fair value accounting as well as impairment calculations that are currently very relevant for the ‘capitalised goodwill’ item.


Fair value accounting, especially ‘mark-to-market accounting’ has become extremely relevant as a result of the developments at Enron and, more recently, at Worldcom. ‘Special purpose entities’, which are an important tenet of consolidation, are also very much the subject of discussion because of Enron. Generally speaking, the Enron case has accelerated developments right across the board in the accountancy profession, particularly with respect to external financial reporting and the role of accounting firms in this. The more recent Worldcom and Xerox debacles only emphasise the need for proper – that is, independent and unbiased – auditing of financial statements. The redesign of the financial reporting model is currently under discussion. It appears from the Enron case that the standard setting process is going too slow and does not always provide the best solutions for essential elements.

As a consequence, the harmonisation process between US GAAP and IAS can thus receive a new impulse, particularly because it is asserted that such problems would not have occurred quite so easily at Enron under IAS. It is important to note that ‘substance over form’ is an internationally accepted principle of accounting. This principle has always existed, both in US as well as European accounting practices. It appears that US accounting practice has developed more towards ‘checking the box’, that is, ensuring compliance with the law and regulations. In European accounting practice, the presentation of a true and fair view has always been the primary focus. In a time frame of the further globalisation of business, international convergence of accounting standards is needed. The future will show whether the Securities and Exchange Commission (SEC) and the FASB will draft more detailed rules or more substance rules and support the convergence of US GAAP towards IAS.

The book concludes with an epilogue. Although a summary of all options contained in this book does not do justice to the content and
can in no way cover all aspects and nuances, we believe that we should provide brief impressions of each contribution. The sketches in Chapter 1 indeed provide no more than an impression of what each of the experts interviewed has discussed. The fact that the abundance of ideas, opinions, critical comments, explanations and analyses cannot be covered by what is otherwise an extensive series of impressions can, on the one hand, be regarded as a shortcoming but, on the other hand, as a luxury.

Nowadays we live in a world where financial reporting – especially the so-called accounting scandals – are the talk of the town. Even hairdressers and cabdrivers have very specific opinions about financial reporting and the people who are involved in the process of preparing, auditing and analysing figures. A means of creative accounting and fraudulent reporting is ‘fair value accounting’ (e.g. Enron with their mark-to-market accounting of long-term energy contracts).

We provide many opinions by internationally recognised experts in the field of external financial reporting. In addition, participants in the social and economic process who are directly concerned with external financial reporting, give their opinion about international developments. This book is therefore vitally important for everyone who operates in the international arena where the external financial reporting of organisations plays a role. On behalf of the editors, I would like to thank everyone who has assisted in the preparation of this collection of interviews and would like to believe that after reading them you will share our opinion that external financial reporting has entered a new phase of development, which rightly deserves the attention that is devoted to it in this compilation.
Is fair value fair?

Expert opinions on financial reporting from an international perspective: brief impressions

Willem Verhoog

Willem Verhoog (1950) has been the Secretary-general of Royal NIVRA’s VERA committee since 1 August 1976. He is responsible for the development and progress of the continuing professional education of registeraccountants, provided by VERA.

In order to make it easier for the reader, this synopsis will briefly cover the main message of the persons who are interviewed. The rapid changes that are taking place in society are a recurring theme running through the interviews. One of the repercussions of these changes is the increasing importance of external reporting: the strong trend towards harmonisation in reporting rules, the role of supervisory bodies with respect to external reporting and the considerable interest shown in external reporting by the financial press.

Because of Enron, Worldcom and Xerox, the quality of external financial reporting has been thrown into the limelight. As a result, even more pressure has been put on the designers (regulators) of new rules. Fair value accounting is regarded as a solution in this respect. However, it appears from the interviews that this is not regarded by everyone as the panacea for the quality problems that have arisen.
The quintessence of the interviews is presented in this synopsis so that the reader is provided with a probing overview of the opinions of the experts who have been interviewed.

**THE FUTURE OF INTERNATIONAL ACCOUNTANCY**

**Elliott**

The opening interview with prominent accountant Robert Elliott outlines the general situation in the field of international accountancy and underpins the expectations for the short and long term. Elliott expects that the accountancy profession will not undergo any fundamental changes in the coming five years, but that IAS will subsequently exert an influence. Technological developments will also have an affect on the audit. Users will increasingly demand and receive online information in real time. Due to the asymmetry in the information available to the management of companies on the one hand and that available to stakeholders on the other, considerable demand for reliable information remains. On top of this, administrative assistance also remains important for clients. Elliott points to the problem that intangible assets are as a rule not valued on the balance sheet. This is certainly a precarious situation. The date and the number of outstanding shares are actually the only reliable information and this does not make fair value accounting a recipe for the future.

The expectation is that the IASB will develop to become the international standard-setter and thus outpace the FASB. The rules will, however, have to be designed to meet the specific demands of the users. Elliott would like to see a strict supervisory body like the American SEC, which can to a certain extent guarantee the quality and thus the reliability of external financial reporting. He wants to see companies reporting their stock options in the notes to the financial statements. All of this must, of course, be embedded in proper corporate governance, and audit committees must be appointed that have authority. For the future, Elliott sees that the accountant must continually be able to provide assurance about the reliability of information and about the systems in question. In a world of real-time information, a journal entry is the correction of an error. This seems controversial, but it isn’t.

**Strauss**

Norman Strauss points out that there are many differences in details between IAS and US GAAP, but that standard-setters are trying to reconcile financial reporting standards so that there is increasingly less and less
distinction worldwide. For Strauss, the ideal situation in the future would be a single global organisation concerned with the development of standards. He advises that those companies applying the new standards must reserve enough time for their calculations because the information required cannot be obtained from the general ledger system. Companies would do well to put together professional teams to determine the relevant values and to allocate goodwill and book values to the various business units.

Where the reporting of financial instruments is concerned, Strauss informs us that the FASB has announced that it believes that all financial instruments should eventually be valued on the basis of fair value. The IASB is also concerned with standards for financial instruments. Strauss believes that it is difficult to determine the fair value of certain financial instruments.

REGULATIONS AND REGULATORS

Tweedie

IASB chairman Sir David Tweedie foresees an important role for the Board: to develop globally applicable standards and to ensure that the various (supra)national standard-setters (particularly including the FASB) co-operate. Tweedie observes that the integration process is hampered by differences in insight, such as that concerning merger accounting, the impairment test, valuation of intangible fixed assets and the treatment of goodwill. He is sceptical about the arrival of the European Financial Reporting Advisory Group (EFRAG), which he believes has introduced a political dimension. Putting this into perspective, however, he is happy that EFRAG members are people who know what they are talking about and have an international perspective. If the IASB and the EFRAG work together intensively and continuously, it will certainly be possible to get things done.

In the short term, the IASB will mainly concern itself with the modification of existing standards, particularly those relating to financial instruments, leasing and share options. In the first instance, the standards are designed for listed companies. A simplified set of rules that are derived from these must then apply to other companies. In the new standards, the concept of ‘true and fair view’, the so-called disclosure requirement, will be retained.

According to Tweedie, a supervisory body like the SEC would be a possibility for Europe, but a Financial Reporting Review Panel would be
less expensive (fewer personnel) and could operate more effectively. Such a body examines financial statements in response to complaints.

**Van Helleman**

To advise the European Commission about the introduction of IAS and to maintain contact with the IASB, the new advisory body EFRAG has been created. This body will serve to both channel and present a European opinion about the standards. Johan van Helleman, Chairman of the EFRAG, points out that the IASB, which up until now has focused exclusively on the balance sheet, the profit and loss account, the cash flow statement and the notes, should also produce rules for the directors’ report. On this point, IAS should be able to follow the European standards that also provide rules for the formulation of the directors’ report. It is also possible that notes concerning the remuneration of directors, which according to the EU should be included in the external financial reporting, could be included in IAS.

Although Europe has opted for international standards, it also wants to have its voice heard via the EFRAG. The American influence will be considerable, however. This implies specific, detailed rules for external reporting with strict application and enforcement by accountants and an alert supervisory body with authority. In a nutshell, this means a new playing field for companies, accountants and supervisors, with new rules, ‘even though the sport will essentially remain the same’.

Responding to the new situation also involves additional training, both at universities and via VERA. Accountants who believe they are sufficiently informed will quickly discover that their knowledge is superficial and inadequate. Companies must also prepare themselves well in advance for the transition: systems and business practices must be adjusted. Various pension schemes will, for instance, have to be closely re-examined and there will be a growing appreciation of the economic consequences of external reporting.

**Van der Tas**

The Standing Interpretations Committee (SIC) answers questions about the application and interpretation of IAS. Up until now, more than 30 interpretations have been published, with SIC 12 (Consolidation of Special Purpose Entities) having the most far-reaching effect. Following a proposal by the new IASB, the SIC was replaced by the International Financial Reporting Interpretations Committee (IFRIC) at the beginning of 2002. The IFRIC consists of 12 voting members (accountants, compilers and users from various countries) and an independent chairman who has no vote but concentrates on running the meetings in a purely technical
sense. In addition, the powers of the IFRIC will be expanded. The IFRIC will also issue interpretations on subjects that have not yet been laid down in standards. The powers of this body have thus been brought more into line with its US, British and Australian counterparts. All interpretations must first be approved by the IASB.

IAS must be applied in full; IAS 1 forbids partial application. If a company wants to enjoy the best of both worlds, the accountants and supervisors will just have to make sure everyone follows the same line. If necessary, the auditor’s report must be modified, ‘because there is no point in striving for international comparability if everybody does as they like and interprets the rules according to their own insights and convenience’, according to the Netherlands’ IFRIC representative Leo van der Tas.

The IASB’s rules are stricter than the Dutch Council for Annual Reporting guidelines that still leave certain options open which the IAS no longer accept. It is, however, unwise to oblige all Dutch companies to apply IAS. If a small corner shop is a private limited company, it must prepare and file financial statements, ‘but to oblige all such companies to meet the IAS requirements simply doesn’t bear thinking about.’ A separate, simplified standard should be introduced for small companies, which are nevertheless in line with the rules for larger companies.

**Van Hulle**

In 1999, the European Commission presented a programme on financial services. The emphasis was on some 40 measures that should ultimately lead to an effective, integrated market for financial services in Europe. The programme also devotes attention to annual reporting and accounting. In an integrated and efficiently operating capital market, companies will be able to attract capital at the lowest costs. To this end, the information underlying the decision-making processes must be complete and reliable. As soon as the capital costs are no higher than strictly necessary, European companies can become more competitive, particularly in comparison with the United States.

The attainment of such an efficient capital market hinges on two crucial elements: financial reports must be comparable and standards applied by companies must be strictly enforced. For the latter element, recourse will be sought from the committee that supervises the securities markets, the SEC. The ultimate sanction – delisting – cannot be ruled out, and that can have severe consequences for investors. Publicity, too, is an important sanction, together with timely auditing of the information in the financial statements. Disciplinary sanctions can be imposed on the accountant who does not keep to the rules.
EU top civil servant Karel van Hulle reproaches Europe for having done too little to standardise annual reporting. ‘We are now paying the price for that.’ Now either US GAAP or IAS will have to be accepted. The European Commission opts for IAS. These standards can be given worldwide force provided they are meticulously worked out and every country can contribute to them. They will then gain wide support. In this respect, Van Hulle expects a lot from EFRAG: creativity, alertness and quality.

Van Hulle is critical of the specific American approach to rules and regulations as a result of their liability-driven litigation culture. ‘That’s the reason for the plethora of formalistic rules: conditions, provisos, exclusions and so on.’ A European approach must offer a counterbalance to this: lay down the principles and leave the rest to the accountant’s professional opinion. The Americans must learn to live with these cultural differences. ‘In fact, it may offer them a good opportunity to get rid of that paralysing claims culture’, according to Van Hulle.

Klaassen

Jan Klaassen is an official consultant to the Ministry of Justice on legislative issues in the field of annual reporting. A bill that attempts to impede arbitrage has recently been put before the Lower House of the Dutch Parliament. It takes the position that US or international rules must be adopted in their entirety or not at all. The latter must then be clearly motivated. Dutch legislation will continue to apply to all unlisted companies in so far as they are non-financial institutions. Where supervision is concerned, Klaassen believes that international rules require international supervision. Some subjects will continue to be organised at the national level, such as capital protection, but they can be fairly well organised ‘separately from financial reporting’. In the Netherlands, the remuneration of directors will be reported in the annual report and accounts, in the future even per person. Directors and supervisory board members must also be able to justify why a top manager ‘deserves’ a top salary, according to Klaassen. A bill is being drafted which will give shareholders a say in directors’ remuneration. ‘The nature of the problem is that remuneration is partly a question of negotiation, and you cannot negotiate with a shareholders’ meeting.’

There is a need for more supervision and perhaps the Authority for the Financial Markets can play a role in this report. Supervision via the disciplinary court is also possible, although this is not the right way of doing things. Ultimately, the company and not the auditor is responsible for financial reporting. The auditor can only be held responsible for an unqualified report issued in error. Klaassen also argues in favour of the introduction of certifying auditors.
Eeftink

Although the company remains responsible for the quality of financial reporting, the accountant can play a stimulating and supervisory role. The accountant is not the primary but rather the secondary party responsible for the quality of financial reporting and his or her opinion about financial statements must be properly substantiated. Accountants must therefore show clients how improvements can be made.

The Dutch auditor will have to insure that a company claiming to comply with IAS really has complied in full with these standards, and not only in broad outline as is sometimes the case with current Dutch reporting practice. The Dutch ‘polder model’ culture of tolerance and ‘turning a blind eye’ (the bitter fruits of which the country is now tasting in 2002) is unknown elsewhere. ‘So if we are soon to adopt international regulations, we will truly need to mend our ways as to their application before an international supervisory body gives us a good chastising. Compliance is compliance. And that means a switch from our culture and Dutch views to an Anglo-Saxon perspective on rules.’

For the auditor, there will be less room for forming an individual opinion; the job will shift more towards ‘auditing according to a checklist’ and away from interpreting general principles and standards according to the situation.

There is a strong shift towards fair value within the established financial reporting model. This particularly applies to financial instruments, but also to other assets and liabilities. The now frequently discussed impairment test is also based on fair value. Besides the often applauded advantages, fair value also has its drawbacks. For example, the fair value model still lacks conceptual underpinning. Furthermore, its reliability also leaves quite a lot to be desired. The effect of prognoses and assumptions on the determination of fair value is sometimes quite considerable, thus creating a wide margin of inaccuracy.

Under the influence of fair value, the IASB is discussing the future form and content of the profit and loss account, or ‘performance statement’. Eeftink expects a proposal for a performance statement in which all fair value changes will be included; such a proposal will not be popular with companies due to the high volatility of the bottom line. The further format of such a statement is still uncertain, but a subdivision between operating and financing activities is in any case expected. For accountants, the auditing of fair value information is sometimes difficult. Prognoses and assumptions will where necessary have to be tested against business plans and market data. More than in the past, the accountant will have to be assisted by a valuation expert.
Den Hoed

Uniform rules that are written in clear language – one which can be interpreted in one way only – are essential to international comings and goings. This therefore also applies to annual reports, according to Jean den Hoed, former financial director at Akzo-Nobel.

Introducing a rule is a doddle; enforcing it is another story. Everyone is equally convinced of the necessity of applying IAS properly in every country. As soon as deviations are detected, people – particularly in the United States – will respond sharply. The Americans will only accept IAS if the rules are applied equally all over the world. In the US, scepticism about IAS prevails, the belief is that Europe will not be able to make IAS compulsory in 2005. The Europeans will have to do everything in their power to offer a counterbalance to this belief.

It is vitally important that a single financial reporting system is introduced. Only then can one draw comparisons and take decisions on the strength of the same information. This is one of the conditions for the perfect equity market, in which everyone can access the same information at the same time. It is also important in terms of competition.

Enforcement must not become an updated audit. It would be more effective to perform a proper review of certain companies on a random basis, as the SEC does in the US. Once every five years, particular companies are thoroughly analysed. According to Den Hoed, supervision must take centre stage and be arranged at European level with the aim of preventing differences in method, approach, interpretation and the like.

Nevertheless, we must ensure that the rules do not block the view. After all, rules are a means and not an end in themselves. Ultimately, it’s all about the insight that financial reporting should provide. The purpose of the regulations is to promote transparency and not to cloud things up with all manner of complicated procedures.

SUPERVISION AND COMPLIANCE

Koster

The effects of the introduction of IAS are underestimated. Companies will have to rigorously reorganise their accounts. The Authority for the Financial Markets (previously the Securities Transactions Supervisory Board), as an independent governing body, supervises the Dutch capital market and is, if asked to do so, also prepared to enforce IAS compliance, ‘because we are closely involved with listed companies and IAS relates to them in particular,’ according to Authority for the Financial Markets board member Paul Koster.
How far the supervision of external financial reporting should go is quite a different question. This should be seen in an international perspective. Although it is not yet clear what supervision in a European context will look like, the Netherlands will follow. It is vitally important that the Netherlands continues to follow international developments because it is essential that Europe avoids creating 15 different national interpretations of IAS.

Where the supervision of financial reporting is concerned, there are many possible lines of approach: for example, the testing of annual reports on the basis of risk analysis and thematic examinations in response to national and international trends in financial reporting. The Authority for the Financial Markets wants to establish a forum with representation from the business community, the accountancy world, the university world, investment analysts and others. Together with the agenda of the IASB, this forum will provide research subjects: for example, goodwill, consolidation or stock options.

The quality of the content of annual reports has improved slightly over the past few years. Koster believes that the report of the executive board must become part of a company’s financial statement. Furthermore, he would like to see the cash flow statement be made compulsory for all companies. This statement should be given more of a prospective character, because information is far too often withheld from investors, while they are jointly responsible for financing. Koster therefore believes it would be a good thing if the accountants – and here he points to the major shortcoming of the annual report – could produce an opinion about cash flows. They will have to evaluate and elaborate upon particular scenarios so that they are not surprised by continuity problems. Accountants should have the possibility of forcing companies to make statements about realistic expectations. That is the reason why the supervision of annual reporting is so important. After all, the accountant then also receives support from the supervisory body.

Willems

The Enterprise and Companies Court judges disputes that can arise in a company: issues concerning accounting and reporting rules, employees’ participation, dismissal of supervisory directors, right of inquiry and the like.

According to Huub Willems, Chairman of the Enterprise and Companies Court, the connection between accountants and misleading financial statements cannot be directly made. He outlines the dilemma whereby the judges state an opinion about financial statements in disciplinary or civil proceedings, while if the case was dealt with in the
Enterprise and Companies Court, this court could conclude that both judges have expressed an incorrect verdict about the financial statements. The Supreme Court of the Netherlands has determined that the mere circumstance that the disciplinary tribunal has judged unfavourably about the work of an auditor does not automatically imply that the auditor is liable according to the law of tort or for breach of contract. Willems does not like the American claim culture. ‘And it certainly won’t improve matters if that is where the emphasis comes to lie.’

The question is how the standards of a body governed by private law like the IASB fit within Part 9, Book 2 of the Netherlands Civil Code. Accounting and reporting legislation in the Netherlands is still Dutch legislation and is partly dependent upon judicial interpretation. International law does of course have precedence over national law, but then only if a special treaty has been ratified. That is not yet the case.

Although a supervisory authority like the SEC or the Financial Reporting Review Panel can fulfil a useful role, the judge has the final word if a conflict occurs and the case is submitted to the magistrate.

The process of accounting for one’s decisions or plans has become increasingly important during the past few years, certainly now that shareholders are more and more often becoming involved in the discussion. The management of organisations are more and more often and increasingly emphatically being called to account for sound management. The Enterprise and Companies Court has played an important role in this respect: it has developed the principles of proper management.

**Van Hoepen**

The influence of Anglo-American culture on continental European, in general, and Dutch culture, in particular, is undeniable. That goes for external financial reporting as well. National regulations are being influenced by international (read: Anglo-American) rules. The guidelines of the Council for Annual Reporting are being ‘converted’ by stealth into IAS. The Council for Annual Reporting seeks to adapt its guidelines to IAS, given the Dutch situation. A striking example of this can be seen in the adaptation to the standard on Employee Benefits (IAS 19). In addition, further adaptation to developments, such as those in FAS 87 and IAS 19, will be necessary. Some specific Dutch circumstances, such as those created in the Pension and Savings Funds Guarantee Act, will not be so easy to incorporate into the framework of IAS 19, however. After 2005, the Council for Annual Reporting will need to guide the application of IAS in Dutch GAAP – or maybe even translate them one to one. Interpretations of certain points – given the unique Dutch situation – will always be...