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ACCOUNTING STANDARDS : A TOOL FOR THE EUROPEAN STRATEGIC AUTONOMY

By Abdeldjellil Bouzidi, Etienne Boris et Marie Delorme

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Accounting standards : a tool for the European strategic autonomy

Synthèse

Étienne Boris,
Non-Executive Director, expert in accounting standards and governance and member of the Terra Nova economic team
Djellil Bouzidi,
Coordinator of Terra Nova's economic team
Marie Delorme,
Member of Terra Nova's economic team

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The concept of "European sovereignty" is often discussed without shedding much light on its concrete meaning. Accounting standard setting is a good example of where Europe could develop a shared strategic vision. For many years, Europeans portrayed themselves as the good performers of multilateral regulation. They were proponents of international accounting standards and diligently implemented the idea of convergence in the single market. With multilateralism taking a step back in the context of increased tensions between China and the United States, Europe finds itself isolated in its way of advocating the benefits of and implementing international accounting standards. Has a Europe at the forefront of a well-regulated economy been naïve? Contrary to other world powers, Europe has chosen to largely delegate its sovereignty over accounting standards. We are advocating here for a change of strategy.

Accounting standards are at the heart of the financial system, since they shape how companies are represented, their strategies, their interactions with stakeholders and their growth trajectories. Accounting standards are not neutral. They influence the economy and weight in on how we set direction for the future, such as long-term investment or research and development spending.

For Europe to cease being naïve and to recover a sovereignty it has largely renounced to, it must adopt tools that are inexpensive, easy to implement and will

allow to defend its own interests in a world where the future is characterized by a high level of uncertainty. In order to contribute to such new strategy, we recommend three concrete measures, at the legal and institutional level; they will contribute to ensuring the right decisions are made for Europe to facilitate long term investment as well as European autonomy and resilience. First, we are proposing to provide the European Commission with the legal tools to reject or amend parts or all of an accounting standard should its fundamental interests be at stake. We are also suggesting amplifying the financial and intellectual resources of the European bodies doing the ground technical work to support the Commission, by creating a European Agency. Finally, we are recommending clarifying the European public good criteria that is used in the endorsement process. IFRS standards should be adopted only if they do not contradict the fundamental European public policy objectives, such as the ecological transition and addressing climate change.

Reappropriating sovereign powers over the governance of accounting standards setting is not simply the waking up of a continent in search of pride and sovereignty. It is essentially a pragmatic approach to respond to the major challenges and the very interests of current and future generations.

The European Commissioner for the Internal Market recently stated that "the coronavirus crisis is forcing Europe to rethink its position in the world, especially at a time when global geopolitics are changing in the face of growing tensions between the US and China[1]". Therefore, Europe wishes to strengthen its resilience and move towards greater strategic autonomy with regard to decision-making, autonomy of action. A passive Europe could become an adjustment variable and a "strategic sleepwalker[2]" in the hands of the two great powers.

Several tools can help build this European strategic autonomy: European defence fund, strategic investment fund, recovery plan, control of foreign investments, anti-dumping duties, etc. Accounting standards are also an often forgotten, but key tool. Seemingly a technical matter, they are at the heart of the financial system, since they largely determine how companies are represented, impact their interactions with stakeholders and influence how they develop.

Ultimately, they can influence on the economy and in particular, topics that are at the centre of current political thinking, such as long-term investments or research and development spending. It seems essential to us that the subject should not be solely a domain for technicians but should be placed at the centre of European thinking. Yet, Europe has largely delegated its sovereignty[3] over accounting standards, unlike other world powers.

We propose to consider accounting as a sovereign subject and as key infrastructure element of the European Union's strategic autonomy policy. On this basis, we put forward three concrete legal and institutional measures to recover European sovereignty in accounting matters and to facilitate strategic investments and ultimately European autonomy and resilience.

1. Firstly, to regain our sovereignty and autonomy in accounting standards decisions and actions, we propose to amend the European Regulation to allow Europe to reject or modify all or part of standards if it considers that fundamental European interests are at stake.

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[1] Source: https://ec.europa.eu/commission/commissioners/2019-2024/breton/announcements/repenser-notre-securite-vers-lautonomie-strategique-de-leurope-discours-au-parlement-europeen_en

[2] In the words of Pascal Boniface, *Requiem pour le Monde Occidental*, Eyrolles, 2019.

[3] This paper focuses on European groups listed on the stock exchange and therefore having to apply IFRS. Unlisted VSEs and SMEs are not required to apply these standards and are subject to the accounting standards of each country in which they are registered. However, there is an indirect link between smaller companies and IFRS. Banks and other financiers who lend them money are subject to these standards.

2. Next, we suggest the creation of a European agency by transforming EFRAG. This would strengthen Europe's own capabilities in this area.
3. Finally, we recommend clarifying the European public good criterion in the accounting standards adoption process. This approach would help ensure that the adoption of IFRS does not run counter to major European public policy objectives such as ecological and climate change transition. These objectives should, at minimum, be subject to systematic verification.

The combination of the new European legal capacity that we are advocating for, with the creation of a new European agency for accounting standards, will also enable Europe to increase its influence in debates and negotiations resulting in the development of the IFRS.

1. IN THE CONTEXT OF THE INTERNATIONALIZATION OF STANDARDS, EUROPE HAS DISPOSSESSED ITSELF OF ITS ACCOUNTING SOVEREIGNTY

1.2. ACCOUNTING STANDARDS, WHICH ARE INSEPARABLE FROM THE HISTORY OF CAPITALISM, HAVE BECOME INTERNATIONALIZED THROUGH THE IFRS

Accounting provides information to the public and investors on a company's financial situation, such as its income and expenses, the equipment at its disposal or its trade flows. As Nicolas Véron and Philippe Crouzet explain[4]: "capitalism is born of the separation of savings from the way companies are managed, the link between them being provided by the financial sphere. This separation makes it necessary to have a common language, so companies can be compared, and decisions made as to how capital is allocated. This common language is accounting".

The accounting information used for capital allocation decisions includes: the balance sheet, which provides information on the company's assets and liabilities[5], the income statement, which shows the company's economic flows and profits over a given period, a cash flow statement[6] and notes to the financial statements. They help assess the economic and financial condition of companies.

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[4] Nicolas Véron and Philippe Crouzet, *La Mondialisation en partie double*, En Temps Réel, Cahier n° 3, 2002.
[5] That is, the summary of all current assets (receivables), fixed assets (equipment) and liabilities (debt) of the company at a given date.
[6] Table summarizing income and expenditure. The balance thus displayed summarizes the total of the amounts to be paid out and received.

Accounting standards are the principles and rules underlying how financial statements are prepared. They establish a reference framework and a common language that make it possible to compare companies' financial conditions and performance, thereby facilitating sound capital allocation.

1. History of accounting standards and capitalism

Historically, the evolution of accounting standards has been a good indicator of the evolution of capitalism. Jacques Richard[7] thus identifies three phases of capitalism, from which different methods of accounting valuation have emerged.

In the first phase of capitalism, in the 19th century, entrepreneurs had unlimited liability including on their own assets in the event of bankruptcy; the "unlimited" liability regime. The valuation of companies was then based on "liquidation values", *i.e.* the amounts recoverable in the event of the company's bankruptcy.

The second phase resulted from the institutionalization of the concept of limited liability companies, marking the separation of the family assets of the entrepreneur (a natural person) from that of their company (a legal entity). The era was also characterised by the desire to attract investors to support the development of the major railway companies by allowing the distribution of dividends. We then move from liquidation accounting to accounting based on the principle of continuity, taking into account acquisition prices and wear and tear over time in order to calculate profits and the distribution of dividends. This corresponds to the transition from "liquidation value" capitalism to "realized value" capitalism.

The third phase took place in the 1970s, in the context of financial globalisation and cross-border company listings. Assets were no longer valued on the basis of their historical cost, but as a discounted sum of future cash flows. We thus moved from "realized value" capitalism to "discounted value" capitalism.

The forerunner of the IFRS Foundation[8], the IASC[9], was founded in 1973 by professional accounting organizations from nine countries[10]. It was the basis of the first set of international accounting standards and aimed in particular to facilitate cross-border company listings and to make it easier for investors to compare companies' performance in different countries and on a global scale. The IFRS Foundation was established in 2000 and the IASC was restructured to become a full-time body, the IASB[11], which is overseen by the IFRS Foundation and whose objective is to develop a single set of high-quality, understandable, enforceable and globally accepted accounting standards, known as the IFRS. They constitute

[7] Jacques Richard, "Comment la comptabilité modèle le capitalisme", *Le Débat*, n° 161 Gallimard 2010/4, p. 53-54. The text in this is box is largely inspired by this reference.

[8] International Financial Reporting Standards.

[9] International Accounting Standard Committee.

[10] Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United States and the United Kingdom/Ireland.

[11] International Accounting Standards Board.

a harmonized accounting model that has established itself as an international standard for listed companies. European support has been a fundamental element in helping the IFRS to achieve dominance: the European Union chose to require listed companies to prepare their consolidated financial statements in accordance with IFRS, from 2005 onwards[12]. Since then, more than 100 countries have required or permitted the use of IFRS in the preparation of their corporate financial statements. However, Europe is the main user of IFRS in terms of market capitalization and, less well known, is the main funder of the IFRS Foundation[13].

1.2. EUROPE HAS FULLY COMMITTED TO PROMOTING A SINGLE SET OF HIGH QUALITY ACCOUNTING STANDARDS, TO THE POINT OF GIVEN UP ITS SOVEREIGNTY IN ACCOUNTING MATTERS

The development of IFRS and their adoption in Europe has had a very positive impact that should not be called into question. IFRS have generally improved the quality of reporting standards and allow for greater transparency and comparability of financial information. They represented real progress at the European level by harmonizing and improving accounting standards. However, the purpose of this paper is to critically assess how these standards are being adopted in Europe and it's ability to influence the IASB in the development of IFRS .

As part of the construction of the European capital market in the early 2000s, the European Union had to adopt common accounting regulations. By adopting IFRS standards in 2002, it chose to abandon the idea of creating its own standards in the face of the difficulty of developing a common framework, thereby entrusting the prerogative of accounting standards-setter to the IASB, an international private-sector body. This European choice was probably motivated by the hope of seeing the emergence of global standards that would have helped Europe compete on an equal footing with the United States[14].

As the IASB is an independent body, IFRS standards must undergo a codified validation process before they can be incorporated into the European Union's legal corpus (see Box 2). The latter only allows for the full acceptance or rejection of a standard issued by the IASB

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[12] Regulation (EC) No 1606/2002.

[13] According to the Foundation's website, the 2019 budget was £31 million, with the European Commission providing £4.1 million. The big four (EY, Deloitte, KPMG and PwC) also fund the association, providing $1.1 million each (or £ 3.9 million including contributions from other smaller accounting firms). Source: https://cdn.ifrs.org/-/media/feature/about-us/funding/2019/ifrs-financial-supporters-2019.pdf?la=en

[14] As noted by Nicolas Véron and Philippe Crouzet: "At the instigation of Frits Bolkestein, Commissioner for the Internal Market, the Lisbon European Council (March 2000) therefore adopted an action plan for financial services, paving the way for the recognition of the IFRS as common accounting standards in the Union", *La Mondialisation en partie double, op. cit.*

(acceptance implies that it meets certain technical criteria, as well as the pursuit of the European public good). It also largely relies on the expertise of the EFRAG, a technical committee supporting the European Commission. This body of experts is a private not-for-profit organisation, with modest resources that do not allow it to compete with the depth of the IASB's technical expertise (EFRAG's budget is around €5 million[15] while that of the IFRS Foundation exceeds £31 million[16]). It gives almost systematic approval to the adoption of IFRS, sometimes accompanied by reservations regarding technical implementation.

In Europe, our political system has thus doubly delegated its control of financial reporting, entrusting private technical bodies[17] with both the preparation and review of accounting standards prior to their approval. This delegation, coupled with a limited legal capacity to fully adopt or reject the standards developed by the IASB, is akin to giving up sovereignty on its accounting regulation[18]. This strategy differs from that adopted by all the major powers, even though these technical standards are at the heart of how capital markets function. This "European decision is worrying in that it displays a significant increase in the use of the private sector in the creation of laws"[19].

Thus, the mechanism for the adoption of the IFRS amounts to the adoption by European public authorities of decisions taken by an international private body outside its control. There are very few other similar cases in the production and adoption of European standards.

2. IFRS endorsement process in Europe

The approval process for IFRS in Europe is based on two specific bodies: EFRAG, a European Commission technical committee made up of experts from the private sector, and ARC[20], made up of representatives of the Member States. The approval of IFRS standards includes the following steps: at the end of the IASB's standard-setting process, in which EFRAG participates by providing comments, opinions and recommendations, EFRAG expresses a positive or negative opinion on its adoption, which it then sends to the European Commission. If the latter decides to adopt the standard, it prepares a

[15] https://www.efrag.org/Assets/Download?assetUrl=/sites/webpublishing/SiteAssets/EFRAG+Annual+Review+2019.pdf&AspxAutoDetectCookieSupport=1

[16] https://cdn.ifrs.org/-/media/feature/about-us/funding/2019/ifrs-ar2019.pdf?la=en

[17] Even if the Committee of Member States ultimately validates or not the European Commission's draft.

[18] See Eve Chiapello, Karim Medjad, "Une privatisation inédite de la norme : le cas de la politique comptable européenne", *Sociologie du travail*, volume 49, Issue 1, 2007, p. 46-64. The latter point out that: "Until 2002, the European Union was based on a policy of harmonizing accounting frameworks by means of directives, which ultimately left Member States some latitude to preserve their national traditions. This slow, approximate harmonization was replaced by a 2002 Regulation that introduced rapid and binding unification for the preparation of consolidated financial statements for listed companies. Member States must now apply the standards issued by the IASB (International Accounting Standards Board), a private body over which the European Union has no institutional control."

[19] *Ibid*.

[20] Accounting Regulatory Committee.

regulation proposal adoption or rejection, which it sends to the ARC. If approved by the latter, the Commission submits the proposed standard to the Parliament and the Council for final incorporation into European accounting legislation.
IFRS are adopted by the Commission according to an endorsement process based on three principles: overall compliance with existing EU accounting directives, contribution to the "European public good", and ability to deliver high-quality financial reporting.
Thus, the Commission relies on the IASB for the preparation of standards but “theoretically” retains the power to approve IFRS on a case-by-case basis, giving them the status of a regulation applicable throughout the EU.
This organisation is therefore formally in line with the institutional traditions of most continental European countries (including Germany and France). However, it should be noted that the scope of the mechanism for adopting standards on a case-by-case basis is limited in that the Commission has no power to modify these standards or to adopt them partially, but only to accept or reject them in their entirety[21].

1.3. THIS CONFIGURATION OF THE BALANCE BETWEEN SOVEREIGNTY, INTERNATIONALIZATION AND DEMOCRACY OF NORMS IS NOT SHARED BY ALL THE WORLD POWERS

The internationalization of accounting standards can be analysed using Dani Rodrik's incompatibility trilemma[22], according to which a nation cannot simultaneously be fully integrated into globalisation, maintain a democratic system and preserve its national sovereignty. A country's position is necessarily the result of a compromise between these three options. Applied to the case of accounting standards, this means that a country cannot, in theory, simultaneously apply accounting standards set through a process that ensures the representation of public authorities (democracy), maintain its own accounting standards system or at least have some capacity for "strategic" influence (sovereignty), and be fully integrated into a global capital market with a single harmonized accounting framework to facilitate comparisons and investment (globalization).

As part of the internationalization of accounting standards, the development of standards has effectively been outsourced to a private, independent body. This implies a compromise in the democratic aspect of the development of accounting standards.

Other economic powers have opted for a compromise that gives greater weight to their accounting sovereignty. Japan and China, while committing to cooperation and accounting convergence with IFRS, reserve the right to deviate from them if necessary. China presents

[21] See Eve Chiapello and Karim Medjad, "Une privatisation inédite de la norme", 2007 and Nicolas Veron and Philippe Crouzet, *La Mondialisation en partie double*, *op. cit*, 2002.
[22] Dani Rodrik, *Nations et mondialisations, les stratégies nationales de développement dans un monde globalisé*, Paris, Editions de la Découverte, 2008.

a convergence of Chinese standards and IFRS estimated at around 90% to 95%, having removed some parts *(carve-outs*) and modified others *(carve-ins)* where they conflicted with its fundamental interests.

The United States plays a special role in this accounting landscape because, while retaining its sovereignty, it is one of the main forces influencing the content of the accounting standards issued by the IASB, enabling it to achieve a better reconciliation between democracy and internationalisation. First, the United States have retained full accounting sovereignty: the FASB, the US equivalent of the IASB, is accountable to the *Securities and Exchange Commission* (SEC) and Congress. The latter may go so far as to withdraw the delegation of accounting authority. The financial crisis of 2008 once again illustrated that Congress is indeed the ultimate decision-maker in the United States in accounting matters by imposing to relax fair value accounting rules within a few days (from *mark-to-market* to *mark-to-model*[23]). A member of congress told the FASB Chairman in rather direct, undiplomatic language: "If the accounting authorities do not act now to improve standards, then Congress will have no option but to do so itself". While the United States considered adopting the IFRS, it has now given up on doing so.

Conversely, the FASB aims to influence the development of IFRS standards at an early stage. It is interesting to note that the IFRS Foundation and the IASB were inspired by the US institutional system. However, unlike the United States, the IASB is not accountable to any public authority or representative institution. The IFRS Foundation and the IASB are outside the European system of governance and powers. Furthermore, the FASB openly states its desire to influence the IASB, indicating that it "actively participates in the development of IFRS"[24]. This does not prevent it from systematically assessing whether its own standards would be improved by the implementation of IFRS. IFRS are evaluated on a case-by-case basis, without any obligation on the part of the FASB.

What conclusions can be drawn for Europe? It could draw inspiration from strategies adopted by other countries around the world with regard to adopting IFRS and influencing their development in order to opt for a balance that gives greater weight to European sovereignty and democracy within Rodrik's trilemma. This approach follows on from the recent special EU Summit in October 2020, which focused on the notion of strategic autonomy and restoring

[23] Bischof-et-al (2016); "Press Release: SEC Office of the Chief Accountant and FASB Staff Clarifications on Fair Value Accounting"; 2008-234; Sept. 30, 2008.
[24] https://www.fasb.org/international#section_2

the shared vision of a more sovereign European Union in economic and industrial matters. The European Union, leaders declared, “must strengthen its capacity to define its own rules and make autonomous strategic choices".

2. ACCOUNTING REGULATIONS INFLUENCE THE BEHAVIOUR OF ECONOMIC AGENTS AND ARE A KEY STAKE FOR PUBLIC AUTHORITIES

2.1. ACCOUNTING STANDARDS, BY INFLUENCING COMPANIES’ AND INVESTORS’ DECISIONS, HAVE MULTIPLE ECONOMIC CONSEQUENCES

One of the assumptions of standard setters, including the IASB, underlying the development of accounting standards is neutrality in accounting. In this approach, the global harmonization of accounting standards, by reducing differences in national regulations, would reduce the cost of capital, thereby promoting growth and development.

Conversely, the view we present here is that financial reporting is a language that influences economic agents’ perception, and therefore their behaviour and decisions. Technical standards thus have an impact on the functioning of capital markets and, more generally, on economies as a whole. Accounting is not an exact science; it requires choices and trade-offs that are inspired by a particular conception of the economy[25]. The current accounting construction presupposes the acceptance of a central mission by the IFRS Foundation: the construction of standards essentially to meet the needs of investors (who do not always have a long-term view).

Firstly, accounting standards can have an impact on the way companies finance themselves (in particular by defining the criteria for distinguishing between companies’ debt and equity).

[25] As the purpose of this report is not to discuss in detail the conception and choice of this economic model, please refert for more details to Institut Montaigne report, "Le capitalisme responsable : une chance pour l'Europe", 2020 or Terra Nova, "Le capital patient - un horizon pour la France et l'Europe", 2016. The central idea being the observation of a form of exhaustion of the growth model that has prevailed in recent decades and which was largely based on a financialized, short-term capitalism with little responsibility regarding future generations. In order to break this deadlock, we must find ways to promote another model: patient capital. This model considers that capitalism only makes sense and has a future in a long-term perspective, in which its role is to finance essential requirements (infrastructure, innovation, access to rare resources), for the benefit of all, without sacrificing future generations. Among the key reforms enabling progress towards a patient capital model, accounting standards have an important place. Institut Montaigne suggests that, "...regaining control over accounting, financial and non-financial information, bringing such information into line with European values... means regaining control over accounting standardisation, currently delegated to an independent body (IASB), which has endorsed a short-term view of the financial representation of companies". The recommendations in this report are in line with this approach and go further by proposing a legal reform that would enable the regaining of control over accounting matters.

The IASB standard is criticised in this respect: it does not allow certain instruments that are settled by the delivery of shares to be classified as equity, whereas it does allow instruments that behave economically like debt - perpetual hybrid debt in particular - to be classified as such[26].

Secondly, standards relating to the valuation of financial instruments held by a company have been criticized as a source of volatility and pro-cyclicality in financial markets. IFRS regulations encourage the valuation of shares held at market price *(mark to market*). This principle has been the subject of debate since the early 2000s, as it can be a source of high volatility of a company's equity. These debates resurfaced during the 2008 financial crisis, with the mark-to-market principle being identified as a source of pro-cyclicality[27]. In the United States, Congress required the FASB to amend the relevant standards (see above), while Europe reacted along the same lines but only later, asking for the removal of differences in rules with those resulting from the joint SEC and FASB press release of 30 September 2008. On 13 October 2008, the IASB published amendments to its standards allowing the suspension of the application of mark-to-market in certain cases.

Accounting standards also guide the nature and duration of business investment, which may have implications for industrial policy, among other things.

Accounting standards can have an influence on research and development (R&D) expenditure. A recent study[28] showed that the accounting method partly determines the amount invested in R&D by a firm. These expenses may be amortized (this option is required under IFRS) or expensed (this option is allowed under UK GAAP). The study reveals that English companies, during the transition from UK GAAP to IFRS, having changed their accounting method for their R&D investments have indeed increased the amount invested in connection with this change. This study, even if its scope remains limited and focused on the United Kingdom and the transition from UK GAAP to IFRS, also demonstrates that the application of IFRS standards can have positive impacts on a subject as strategic as R&D investment.

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[26] This has the effect of reducing equity capital and therefore weakens companies concerned by this downturn.

[27] Since markets became illiquid, prices reflected a credit risk premium unrelated to the underlying risk, creating a mismatch between intrinsic value and market value (mark-to-market).

[28] Denis Oswald, Ana Simpson, Paul Zarowin (2016), "Capitalization vs Expensing and the Behavior of R&D Expenditures", London School of Economics ; https://www.lse.ac.uk/accounting/assets/Documents/LSELUMSMBS-Conference/2-OSWALD-Capitalization-vs-Expensing-and-the-Behavior-of-RD-Expenditures-PP.pdf

The way financial instruments are valued also affects the investment horizon. In this case, since their application in Europe, the IFRS standards have been accused of leading to "an increased financialization of our economy and to management methods in companies that favour short term results"[29]. The debate on the short-term orientation of this standard remains topical today: IFRS 9 (see Box 3 below) does not take into account the holding period of shares held and may therefore discourage long-term investment.

Another concrete example of an accounting standards issue can be identified in the impact of IFRS 16. These standards change the way in which leases are accounted for in financial statements and have a significant impact on companies' balance sheets and the structure of their income statements. As an illustration, the Renault group's first-half 2019 activity report states that the application of IFRS 16 had a negative impact of €633 million on its net liquidity position[30], even though the effect on net financial income was not significant. The LVMH Group[31] saw its debt increase by 12 billion euros as of 31 December 2019 following the first application of the standard. The application of this standard in the automotive industry has influenced a revision of the business model for the marketing of electric vehicles and batteries.

3. Impact of IFRS 9 on long-term investments

IFRS 9: the standard on the classification and measurement of financial assets (applicable from 2018) could hinder long-term investments, which are essential for growth[32].
IFRS 9 requires shares held to be valued at market value, even if they are not listed on an active market, without differentiating their investment horizon, which creates volatility in financial statements. Interestingly, the IASB's chair acknowledged in a recent speech that IFRS 9 may indeed generate greater volatility in the short term, but that an investor who holds shares must be prepared to accept this and to manage it[33]. By introducing instantaneous market value into financial statements, this standard induces short-termism because players tend to react in a pro-cyclical manner. Also, IFRS 9 does not allow to recognise in the income statement capital gains/losses on medium-term investments in shares (but only dividends), which does not allow the performance of the investments, i.e. the change in their value over time, to be taken into account. This aspect may therefore also contribute to discouraging long-term strategic investments.

[29] Letter from Jacques Chirac to Romano Prodi, President of the European Commission in 2003.
[30] Renault, Activity report for the first half of 2019, p.12 and 28.
[31] https://www.lvmh.com/news-documents/press-releases/record-results-for-lvmh-in-2019/
[32] Prudential standards in the banking and insurance sectors also have a very significant impact on long-term investment, notably the ability of the financial sector to invest in businesses. Accounting standards are an essential element in the application of prudential rules.
[33] https://www.ifrs.org/news-and-events/2019/12/accounting-standards-and-the-long-term/

2.1. ACCOUNTING STANDARDS CAN BE SEEN AS AN ECONOMIC POLICY INSTRUMENT IN THEIR OWN RIGHT

The strategic use of accounting standards can be illustrated by the case of the the United States. In the 1980s, the "Pooling of Interest" method favoured the emergence of global American players during the wave of mergers and acquisitions; it made it possible to minimize the accounting impact of such transactions on the consolidated net results of the new entity, thereby promoting better returns on capital invested. This method was only authorised in France in 1999 following BNP's takeover bid for Paribas. In addition, during the massive development of technology *start-ups*, the United States for a long time blocked the FASB's proposals on stock options accounting[34], because of the importance of this tool for attracting talent to Silicon Valley[35].

Since accounting standards have economic repercussions, it is essential that they do not hinder the pursuit of important European policy objectives (financial stability, financing of the economy, etc.), especially in a context of economic, social and climate urgency. The European agenda shows Europe's willingness to strengthen its sovereignty in order to rethink its growth strategy for a greener, sustainable, more inclusive economy, which can be illustrated in particular through the implementation of the Green Deal. These policy goals should be reflected accounting terms, so as to measure the environmental or social impacts of investments that will increase human or natural capital.

Moreover, aspects such as the financing of the economy or financial stability are not part of the IASB's mandate. It is therefore natural that this body should not take into account the impact of its proposals in this area, and even less so on broader issues such as long-term investment or sustainable development. Europe must therefore strengthen its control over accounting matters in order to influence the IASB on these issues.

On the subject of climate change in particular, Europe must occupy the intellectual space in order to influence and not just be subjected to the definition of a global standard, by extending the reflection already carried out, notably through the European Commission's report proposing a green taxonomy (standardized classification of an asset's sustainability). Nevertheless, we believe that climate risks, rather than being considered a non-financial reporting matter, should be measured and integrated into corporate accounting. It would be

[34] A form of variable compensation for employees in the form of stock options in the employer's company.
[35] "Stock Options Debate Comes to Silicon Valley", *New York Times*, 25 June 2004.

worthwhile to reflect on this subject in order to move towards a more patient, greener capital through accounting that integrates climate costs and benefits.

3. STRENGTHENING THE INSTITUTIONS AND THE PROCESS OF ADOPTION OF ACCOUNTING STANDARDS WOULD CONSOLIDATE THE EFFORTS ALREADY MADE TO REGAIN EUROPEAN ACCOUNTING SOVEREIGNTY

3.1. THE EUROPEAN UNION HAS BEGUN INITIAL EFFORTS TO STRENGTHEN ITS ACCOUNTING POSITION

Europe has not remained entirely passive in the face of these challenges. Reflection has been initiated on the subject, in particular through the Maystadt report (2013) "*Should IFRS be more European?"* commissioned by Mr Barnier, then Commissioner for the Internal Market and Services. The report stressed the need for better consideration of European interests at an earlier stage of standards development, without calling into question the process itself. The publication of this report led to a governance reform of EFRAG to ensure that all European accounting interests were represented in EFRAG, thereby unifying Europe's voice for greater international influence. However, the fundamental aspects of the institutional accounting system remain unchanged.

EFRAG remains a private body, a characteristic often criticised in the European ecosystem: at the time of its reform in 2014, the European Supervisory Authorities[36] refused to become full members of the EFRAG board because they considered that EFRAG's private status did not require it to serve the general interest. In the summer of 2017, EFRAG almost had its mission transferred to ESMA[37], an option that was identified in the Maystadt report. Similarly, the European Parliament has on occasions expressed mistrust of EFRAG, which it has recommended be transformed into a public body[38].

Moreover, EFRAG's financial and technical resources may be considered insufficient in view of the accounting issues involved in European economic policy and sovereignty. EFRAG's funding, which takes the form of contributions from the founding professional organisations, the Commission and voluntary Member States, has remained broadly stable since the early

[36] The European Securities and Markets Authority, European Banking Authority, and European Insurance and Occupational Pensions Authority.
[37] European Securities and Markets Authority.
[38] https://www.europarl.europa.eu/doceo/document/A-8-2016-0172_EN.pdf?redirect

2010s. Since its inception, EFRAG has certainly, on a technical level, considerably expanded its approval opinions, and has developed analyses of the impact of the application of IFRS standards. However, these analyses are not systematic (a shortcoming highlighted in particular by the European Parliament[39] in the context of the validation of IFRS 9) and are poorly developed in relation to studies conducted by the European supervisory authorities, for example in the context of the implementation of prudential standards. These elements give rise to concerns that current efforts will not make it possible to effectively regain control of European accounting sovereignty.

This does not mean that IFRS should be rejected, or that an autonomous European standardisation process should be created. It means that Europe should give itself the means to amend the standards proposed by the IASB when its fundamental interests are at stake. This view is often contrasted with the desirability of a single set of accounting standards around the world, the risk of increased cost of capital, or the increased cost and complexity for companies listed on different markets[40]. The proposed mechanism for Europe to regain its sovereignty continues to be based on IFRS, thus ensuring strong continuity, except when Europe's voice, motivated by its fundamental interests, is not taken into account by the IASB. Where appropriate, a reconciliation will enable an understanding of the differences, if any, between EU IFRS and IFRS. Europe's regained sovereignty would increase its influence on the IASB's standard-setting process because of its weight in the use of these standards. This increased influence will help the reduce possible differences arising. Europe's regained sovereignty would also put it on an equal footing with the United States and China. On these terms, and given the methods used by analysts and investors to analyse company performance, an increase in the cost of capital as a negative consequence of this recovered sovereignty seems unlikely[41].

3.2. WHAT PROPOSALS TO IMPROVE THE EUROPEAN GOVERNANCE OF ACCOUNTING STANDARD-SETTING?

Without calling into question the clear positive contribution made by IFRS standards, our proposals are intended to initiate reflection on the reconfiguration of a new balance between internationalisation, sovereignty and democracy of standard-setting process. This approach

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[39] *Idem.*
[40] EU Commission public consultation on the Fitness check on the EU framework for public reporting by companies. 21 March 2018 - 31 July 2018.
[41] See PwC's qualitative study, "What investment professionals say about financial instrument reporting", July 2010.

is in line with a movement already undertaken by the European Union both in terms of its sovereignty and the modalities of its growth strategy.

1. Amend the European regulation to adapt the endorsement process for IFRS standards in Europe to allow, where appropriate, the rejection or amendment of parts or all of a standards adopted by the IASB[42]. If we stop considering (i) that accounting as a purely technical matter, (ii) that accounting standards would be neutral, and (iii) acknowledge that fundamental options and choices underlying accounting standards can affect the economy, the standard adoption and endorsement mechanisms should have appropriate democratic legitimacy[43]. Our proposal to amend the European regulation for the incorporation of IFRS is therefore also justified from a democratic point of view. The European Parliament would make the technical options subject to an assessment from a policy standpoint; instead of regulatory acts under the sole control of the Member States, it could move to "delegated acts", another formula that provides for equal supervision of the European Parliament and the Member States of European Commission draft decisions. European sovereignty, restored through full legal capacity and complemented by our other proposals, would enable Europe to increase its influence in the international IFRS standard-setting process[44]. We are not proposing to change the European representation within the IFRS Foundation or the IASB, considering that it is first necessary to re-establish European order; moreover, any change in the governance of the IASB, if it were useful, would be subject to a multilateral process that is beyond the sole European control.

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[42] The question of considering a different structuring, or even a reform of the governance of the IFRS foundation and the IASB, in order to strengthen the influence of Europeans arises. We shall not deal directly with this issue in this report. However, the legal proposal to amend the European regulation would indirectly significantly increase Europe's capacity for influence within these two bodies.

[43] Étienne Boris, “Normes comptables : la mondialisation en panne”, En Temps Réel, cahier n° 50, 2012.

[44] This strengthening of Europe's influence is all the more important because, as Eve Chiapello and Karim Medjad point out: "...the Commission is sometimes influenced by private actors who propose draft standards. However, these cases are one-offs and are the result of lobbying regarded as an ongoing process by private actors. Here, the roles are reversed: it is the European Union which finds itself, as a result of its own actions, obliged to lobby the IASB... The accounting field is thus the only one in which the private sector has a monopoly on writing standards with a hard-law destiny on a given subject. This additional degree of loss of public power is in fact twofold, as it also manifests itself in standards white papers, with IASB being solely responsible for establishing its work programme. Beyond the question of how, the European Union also cannot decide if and when a particular accounting issue should be dealt with", "An unprecedented privatisation of standards", *op. cit.*

2. Transform EFRAG into a European agency would (i) enable political authorities to make their decisions in a more informed manner (ii) strengthen its financial, intellectual resources hence its ability to influence (financial and intellectual resources should be commensurate to those of the IASB or the FASB). Like the European Medicines Agency, whose role and capacities are being strengthened in the context of the health crisis, such a European agency would have the necessary legitimacy and credibility to weight in on the international scene.
3. Clarify the criterion of European public good in the adoption process for accounting standards in order to take into account major European public policy objectives, in particular issues relating to the climate, long-term investment and health. The European Parliament has already requested clarification on the European public good criterion applied in the endorsement process[45], with a view to including financial stability and economic development objectives. We therefore propose to take up this same approach, adding a substantive debate on the proposed objectives. At the very least, rearming existing bodies would allow EFRAG to go into details on the extent to which each new standard meets or does not meet these objectives.

The implementation of these proposals will pave the way for an indispensable in-depth reflection on the integration of climate risks and other environmental aspects not as extra-financial subjects but rather as an integral part of financial statements.

One proposed way forward would be to introduce, at the level of accounting standards, a climate premium for the discounting of any investment or financing project. This premium would increase with the project's carbon footprint, thereby penalizing the value of future flows as calculated today[46]. This approach and other possibilities deserve to be investigated and taken further, like the G30 proposal, which concerns long-term investments, to review fair market value accounting methodology, with a time-weighted average of amortized cost and market value[47]. Taking account of climate risk, and "human capital", which are at the heart of the European social market economy, are priorities, which need answers in Europe, without

[45] https://www.europarl.europa.eu/doceo/document/A-8-2016-0172_EN.pdf?redirect
[46] See Abdeldjellil Bouzidi, "How 'discounting' can be used in investment decisions for the benefit of future generations", Environmental Finance, 2016.
[47] Group of Thirty, "Long-term finance and economic growth", Working group on long-term finance, 2013.

penalising European companies in the global competition. Recovering European sovereignty is a necessary condition for such progress.

CONCLUSION

The European Commission's agenda is very ambitious, embracing European strategic autonomy, resilience and the Green Deal. The latter, especially with its energy transition financing aspect, seems to break several taboos. Europe therefore has an historic opportunity to differentiate itself if it wishes to promote a new "Green Deal" model of prosperity.

As the subjects of "sovereignty" and "social and environmental resilience" are closely linked, the Green Deal and post-Covid reconstruction should enable us to reexamine IFRS in a positive way, as they are not designed to meet the challenges of reconstruction and energy transition.

The reappropriation of accounting standards as a sovereign matter is not simply the pride of a continent wishing to assert its independence. It is also and above all a pragmatic approach to meet the major challenges and interests of current and future generations.

These issues are too important to be treated exclusively by chartered accountants, especially as they have no political legitimacy. It is only on this basis that we will be able to regain a sense of the long term, to finance and execute the Green Deal, and to regain our strategic autonomy, which is so important in the current context, characterized by the health crisis and the weight of major powers such as the United States and China.

Europe can no longer be naïve and must recover a sovereignty that it has largely abandoned in this area, one that China and the United States have preserved. To do so, it must equip itself with inexpensive, easily implementable tools that will enable it to defend its own interests in a world in which uncertainty is becoming the norm.

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