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COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

on the operation of Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting standards

(Text with EEA relevance)

1. LEGAL BASIS

Article 10 of Regulation (EC) No 1606/2002 of 19 July 2002 (the "IAS Regulation")[1] requires the Commission to review the operation of the Regulation and report thereon to the European Parliament and to the Council by 1 July 2007.

2. OPERATION OF THE IAS REGULATION

2.1. Main provisions of the IAS Regulation

The IAS Regulation places an obligation on European companies whose securities are admitted to trading on a regulated market in the EU to prepare their consolidated accounts, as of 1 January 2005, in conformity with IAS/IFRS[2] and SIC/IFRIC[3] issued by the International Accounting Standards Board (IASB) and endorsed by the EU.

Member States may permit or require this accounting framework to be applied to the consolidated accounts of companies whose securities are not admitted to trading on a regulated market in the EU and/or to annual (individual) accounts regardless of whether the company is admitted to trading on a regulated market in the EU. The use of the options in the Article 5 of the IAS Regulation by Member States is described in the table below[4]:

[1] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11.9.2002, p. 1

[2] International Accounting Standards (IAS) were first issued by the International Accounting Standards Committee (IASC), the predecessor of the International Accounting Standards Board (IASB). The IASB issues International Financial Reporting Standards (IFRS).

[3] The Standing Interpretations Committee (SIC) was the predecessor to the International Financial Reporting Interpretations Committee (IFRIC).

[4] Information taken from a Commission requested study made by the Institute of Chartered Accountants in England and Wales "EU Implementation of IFRS and the Fair Value Directive", 2007, page 24.

Use of options in the IAS Regulation by Member States

	Companies	Publicly traded companies		Non-publicly traded companies	
		Consolidated	Legal entity	Consolidated	Legal entity
Austria	All	Required	Not permitted	Permitted	Not permitted
Belgium	Credit institutions	Required	Not permitted	Required	Not permitted
	Other	Required	Not permitted	Permitted	Not permitted
Cyprus	All	Required	Required	Required	Required
Czech Republic	All	Required	Required	Permitted	Not permitted
Denmark	All	Required	Permitted	Permitted	Permitted
Estonia	Credit institutions, insurance companies, financial and mixed financial holding companies and investment companies	Required	Required	Required	Required
	Other	Required	Required	Permitted	Permitted
Finland	Insurance	Required	Not permitted	Required	Not permitted
	Other	Required	Permitted	Permitted	Permitted
France	All	Required	Not permitted	Permitted	Not permitted
Germany	All	Required	Not permitted	Permitted	Not permitted
Greece	All	Required	Required	Permitted	Permitted
Hungary	All	Required	Not permitted	Permitted	Not permitted
Ireland	All	Required	Permitted	Permitted	Permitted
Italy	Supervised financial companies, companies with financial instruments widely distributed among the public	Required	Required	Required	Required
	Insurance companies	Required	Not permitted	Required	Not permitted
	Other	Required	Required	Permitted	Permitted
Latvia	Banks, insurance companies and other financial institutions	Required	Required	Required	Required
	Other	Required	Permitted*	Permitted	Not permitted
Lithuania	Banks and controlled financial institutions	Required	Required	Required	Required
	Other	Required	Required	Not permitted	Not permitted
Luxembourg	All	Required	Permitted	Permitted	Permitted
Malta	All	Required	Required	Required	Required
Netherlands	All	Required	Permitted	Permitted	Permitted
Poland	Banks	Required	Not permitted	Required	Not permitted
	Pending admission to regulated market	N/A	N/A	Permitted	Permitted
	Subsidiary in IFRS group	N/A	N/A	Permitted	Permitted
	Other	Required	Permitted	Not permitted	Not permitted
Portugal	Banks and financial institutions	Required	Not permitted	Permitted	Not permitted
	Subsidiary in IFRS group	N/A	N/A	Permitted	Permitted
	Other	Required	Permitted	Permitted	Not permitted
Slovakia	All	Required	Not permitted	Required	Not permitted
Slovenia	Banks and insurance companies	Required	Required	Required	Required
	Other	Required	Permitted	Permitted	Permitted
Spain	All	Required	Not permitted	Permitted	Not permitted
Sweden	All	Required	Not permitted	Permitted	Not permitted
United Kingdom	All	Required	Permitted	Permitted	Permitted

* Latvia: companies listed on the official list of the Riga Stock Exchange are required to prepare IFRS-EU legal entity accounts for listing purposes only.

Member States were also allowed to postpone application of this framework to 1 January 2007 for companies which have issued only debt securities admitted to trading on a regulated market in the EU and for companies whose securities are admitted to trading outside the EU and which, for that purpose, had been using internationally accepted standards before the IAS Regulation was published.

Only international accounting standards and interpretations adopted and issued by the IASB and its predecessor the International Accounting Standards Committee (IASC) are endorsed for the purposes of the IAS Regulation. They are endorsed by the Commission following a committee procedure. First the Commission should receive technical endorsement advice from the European Financial Reporting Advisory Group (EFRAG)[5], then an opinion from the Standards Advisory Review Group (SARG)[6] assessing whether EFRAG's technical advice is objective and well-balanced. Following this, the Commission decides whether to propose the standard/interpretation for endorsement. The endorsement vote in the Accounting Regulatory Committee (ARC)[7] is followed by confirmation by the European Parliament. If all these steps go well, the Commission decides whether to endorse the standard/interpretation and publish it in the Official Journal.

2.2. Main sources of input for the report

The Commission has drawn on input from various sources for this report. Member States have been consulted – within the Accounting Regulatory Committee – on the main points covered. The Roundtable[8] for the consistent application of IFRS in the EU was another valuable source of input. The Commission Services concerned have also kept regular contact with stakeholders during the introduction of IFRS in the EU.

In order to have a full technical analysis of implementation of IFRS, the Commission Services have also considered a number of reports on the 2005 IFRS implementation prepared by different organisations and companies[9].

This Commission report also takes into account a report by the Committee of European Securities Regulators (CESR) entitled "CESR's review of the implementation and enforcement of IFRS in the EU"[10] and results from other studies and literature available on initial application of IFRS in the EU.

2.3. Effective use of IFRS in the EU

In 2005 the number of IFRS adopters whose securities were admitted to trading on a regulated market in the EU stood at 7 365, of which 5 534 were equity issuers.

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5 For further information see: efrag.org

6 For further information see: http://ec.europa.eu/internal_market/accounting/ias_en.htm#standards

7 For further information see: http://ec.europa.eu/internal_market/accounting/committees_en.htm#arc

8 For further information see: http://ec.europa.eu/internal_market/accounting/ias_en.htm#060609

9 In particular the report mentioned in footnote 4. This report contains an exhaustive listing of other studies made.

10 This review was published as document CESR/07-352 on 7 November 2007 and is available on the CESR website: http://www.cesr-eu.org/index.php?page=contenu_search_res&doconly=all&searchdatefromday=1&searchdatefrommonth=1&searchdatefromyear=1970&searchdatetoday=29&searchdatetomonth=2&searchdatetoyear=2008&searchkeyword=07-352

Extract from the CESR report, Appendix 1: Number of IFRS adopters listed on a regulated market in the EU by country (equity issuers and bond issuers)

CESR Members	Equity issuers	Bond issuers[11]	Total
Austria	72	11	83
Belgium	144	2	146
Bulgaria	369	60	429
Cyprus	141	0	141
Czech Rep	66	24	90
Denmark	140	8	148
Estonia	16	6	22
Finland	135	15	150
France	680	200	880
Germany	768	172	940
Greece	356	0	356
Hungary	34	1	35
Iceland	23	8	31
Ireland	43	40	83
Italy	288	65	353
Latvia	13	4	17
Lithuania	43	4	47
Luxembourg	35	200	235
Malta	15	19	34
Norway	188	0	188
Poland	197	0	197
Portugal	50	28	78
Romania	N/C	N/C	N/C
Slovakia	N/C	N/C	N/C
Slovenia	60	6	66
Spain	190	120	310
Sweden	350	35	385
NL	165	25	190
UK	953	778	1 731
TOTAL	5 534	1 831	7 365
NC: answer not provided			

By 31 December 2005 the following standards and interpretations had been endorsed: IAS 1 to 41, IFRS 1 to 6, SIC 7 to 32 and IFRIC 1 to 5, excluding those superseded or abolished before or after that date[12]. Additional standards and interpretations were endorsed in 2006 (IFRS 7 and IFRIC 6 to 9) and 2007 (IFRS 8 and IFRIC 10 and 11), along with amendments to previously endorsed standards. Some standards (IFRS 6), amendments to standards (on IAS 39) and interpretations (IFRIC 4 and 5) endorsed in 2005 could be applied as from

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11 Some bond issuers may have decided to postpone application of IFRS until 2007 in accordance with Article 9 of Regulation (EC) No 1606/2002 of the European Parliament and of the Council.

12 IAS 3 to 6, IAS 9, IAS 13 to 15, IAS 22, IAS 25, IAS 30, IAS 35, IFRIC 3, SIC 1 to 6, SIC 8 and 9, SIC 11, SIC 14, SIC 16 to 20, SIC 22 to 24, SIC 26, SIC 28, SIC 30 and SIC 33.

1 January 2006. It was also possible to apply IFRS 7, IFRIC 6 and amendments to some standards endorsed on 11 January 2006 to 2005 financial statements.

CESR's members have undertaken a full review of 1 410 companies' 2005 IFRS financial statements and a thematic review of an additional 920 companies' 2005 IFRS financial statements. They have set up a database in which 85 enforcement decisions had been entered by the end of August 2007.

2.4. Consistent application of IFRS in the EU

Based on the information gathered from the sources mentioned in Section 2.2, the Commission has analysed the consistency of application of the endorsed standards/interpretations in the EU for the financial year 2005. The Commission reached the following conclusions:

- Overall, application of IFRS has been a challenge for all stakeholders, but it has been achieved without disrupting markets or reporting cycles. This is a major achievement, bearing in mind that implementation of IFRS has meant a general overhaul of the accounting framework in the EU for companies falling under the scope of the IAS Regulation. The switch to IFRS has required hard work and significant resources from the companies concerned, in particular from smaller listed companies[13].

- There is a general perception among preparers, auditors, investors and enforcers that application of IFRS has improved the comparability and quality of financial reporting and has led to greater transparency.

- The options to extend the scope of the IAS Regulation have been implemented in different ways in different Member States (see above 2.1), depending on their individual economic and legal environments. This flexible approach has allowed implementation tailored to the characteristics and peculiarities of the accounting environment in each Member State, in particular the links to fiscal rules and company law. Compulsory use of IFRS does not appear to have been widely extended to non-listed companies and/or to individual accounts.

- Most stakeholders believe that the understandability of financial statements has generally improved, except for certain areas, where there seems to be room for improvement, notably on financial instruments, business combinations and share-based payments.

- IFRS accounts are still influenced by national accounting traditions. One reason for this is the lack of experience and accounting doctrine. In practice, introduction of this principles-based accounting approach, requiring considerable professional judgment, has been a challenge in some Member States. However, as preparers

[13] Analysis of implementation costs and subsequent recurrent application costs in the ICAEW study (see footnote 4) has shown that they appear higher for smaller companies (turnover below €500m) amounting respectively to 0,31% and 0,06% of their turnover, which remains an acceptable level. Smaller quoted companies have also faced more difficulties in applying IFRS because of limited resources and a lack of prior experience of IFRS.

and auditors become more familiar with IFRS, initial application problems should be resolved.

- The IFRS recognition and measurement provisions appear to have been applied more consistently and clearly than certain disclosure requirements. In particular, there is room for further improvements in disclosure of general accounting policies. Security regulators have taken note of these issues, but have concluded that they have not undermined the general level of compliance with IFRS.

- Options allowed by IFRS, including those related to employee benefits, borrowing costs and joint ventures, have been used in diverse ways by companies. Options in IFRS for early application have also been widely used. However, options to widen application of fair value measurement have not been extensively used and use of the carve-out in IAS 39 is limited to very few banks. Enforcers have expressed concern and wish the number of options available in IFRS to be reduced in the future.

- Specific concerns have been identified by the CESR in certain areas, such as business combinations (goodwill, as well as *de facto* and common control), financial instruments (impairment), non-current assets, disclosure on accounting policies, estimates and assumptions. Enforcers also recommend improving disclosure relating to pension schemes and share-based payments plus further streamlining of the balance sheet and income statement formats.

- Few technical accounting issues have been referred to the Roundtable for the consistent application of IFRS in the EU. The number of issues sent to IFRIC for interpretation has also decreased. This seems to indicate that the principles-based approach has generally been working well.

- Academics have started to analyse the impact of introduction of IFRS on securities markets, but it is still too early to give conclusive results. However, preliminary studies indicate that there is an overall reduction in the cost of capital for companies supplying IFRS accounts.

2.5. Functioning of the endorsement process and related administrative requirements

This part of the report looks at how the endorsement process has been working, including technical analysis, preparation of political decisions and flanking administrative and practical activities. The report covers mainly the period up to 1 July 2007, but also other subsequent elements have been added for completeness.

The Commission has the following comments to make on different aspects of the endorsement process:

- ***Technical analysis and endorsement advice:*** The European Financial Reporting Advisory Group (EFRAG) has supplied timely, high-quality analyses and endorsement advice to the Commission. The endorsement advice has provided the Accounting Regulatory Committee and the European Parliament with the technical input needed for their decisions. All endorsement advice, except in the case of IAS 39, has expressed a clear view on whether the standard concerned should be endorsed. Over time EFRAG has improved the structure of its advice, which now regularly provides a basis for conclusions. EFRAG's Technical Expert Group (TEG) holds a three-day meeting every month.

- ***Review by the Standards Advisory Review Group (SARG):*** SARG was set up to ensure that the endorsement advice received from EFRAG was well-balanced and neutral. SARG has put in place efficient working procedures and delivered timely assessments. The group held three meetings during 2007.

- ***The endorsement and committee procedures:*** The endorsement procedure has been working well, and most standards and interpretations have been endorsed in good time. Endorsement of standards/interpretations in accordance with the IAS Regulation has followed the current committee procedures[14]. These procedures will be changed[15], and more emphasis will be put on scrutiny by Parliament and the Council. Parliament closely follows developments in the field of accounting and participates actively in the endorsement process. Parliament has also requested that analysis of the effects should be introduced in the endorsement process.

- ***Need to analyse the effects of introducing new standards and interpretations:*** Impact assessments have been an integral part of the general legislative process at EU level and in Member States for many years. The Commission attaches such assessments to all new legislative proposals. The need to analyse the effects of accounting standards is becoming apparent. Impact assessments or effect analyses should be carried out at an early stage in the standard-setting process, and the Commission has therefore asked the IASB to perform such analyses as part of the process of preparing new standards. The International Accounting Standards Committee Foundation (IASCF)[16] has committed itself to doing this for future standards. Until then, the Commission – after discussion with the European Parliament – has agreed that such analyses of effects for upcoming major standards and interpretations should be performed at EU level. The Commission Services have finalised an effects study for IFRS 8 ("Operating Segments") and will prepare similar analyses for IFRIC 12 ("Service Concession Arrangements") and IAS 23 ("Borrowing Costs"). For subsequent upcoming standards, EFRAG – in close cooperation with the Commission Services – will contribute to such analyses as part of preparing its endorsement advice.

- ***Endorsements and "carve-outs":*** The basic idea behind the IAS Regulation is that IFRS and IFRIC should be of high quality and obtain such general support that they can be endorsed in the EU. All standards and interpretations, except limited parts of IAS 39, have been endorsed. At the time of endorsement of IAS

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[14] Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ L 184 of 17 July 1999, page 23.

[15] Council Decision 2006/512/EC of 17 July 2006 amending Decision 1999/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ L 200 of 22 July 2006, page 11.
The latest stage: Regulation of the European Parliament and of the Council amending Regulation (EC) No. 1606/2002 on the application of international accounting standards, as regards the implementing powers conferred on the Commission has been adopted and published in the OJ on 9 April 2008

[16] The IASCF is the foundation behind the IASB.

39, it was expressly stated that the IAS 39 carve-out should be limited in time and in scope. Concerning a first carve-out relating to the fair value option, after contacts with banking supervisors and central banks the IASB quickly presented a new solution which was subsequently endorsed in the EU. The second carve-out concerning certain hedging rules has been more difficult to resolve. Despite hard work in the IASB and in the banking industry, no solution has been found yet. The Commission has urged both sides to present new solutions to this issue.

- ***Consolidation and translation of IFRS:*** Each individual IFRS is endorsed in the EU by a regulation. This means that no full consolidated version of the endorsed IFRS is available. Furthermore, the quality of some of the language versions of endorsed IFRS has been questioned by Member States and stakeholders. To address these concerns, the Commission Services responsible have started a major consolidation project coupled with a detailed language review of all endorsed standards and interpretations.

- ***The overall length of the endorsement procedure:*** The average time between publication by the IASB and adoption of an endorsed standard by the EU has been about eight to ten months. The decision to perform effect analyses at EU level is likely to add about six more months to this process. However, in the future such analyses will become part of the IASB standard-setting process, in which case endorsement by the EU should remain to eight to ten months. In urgent cases, Member States and Parliament have shown flexibility in order to allow quick endorsement decisions (this was the case, for instance, for IFRS 7 – "Financial Instruments: Disclosure"). There is a common interest in making the endorsement process as expedient as possible. Concerning IFRS 7 as well as IFRS 8, a number of listed companies approached the Commission to request swift endorsement which would allow early application of these standards.

3. CONCLUSIONS

The first year of mandatory application of IFRS in the EU has been generally positive, even if the regulatory changes and lack of experience have posed a challenge for first-time appliers. The value of the accounting information supplied has increased and IFRS have generally been applied consistently in the EU. The level of consistency between IFRS accounts is likely to increase over time as preparers and auditors gain experience with applying the new accounting framework.

The EU endorsement process per se ensures technical quality, political legitimacy and relevance to business. The system has been working well and standards have been endorsed in good time. The endorsement system is flexible and has already been amended – inclusion of SARG, new working methods in EFRAG, new rules on committee procedures, effect studies, etc. The net result has produced an efficient and legitimate structure.

In order to maintain the current high acceptance of IFRS in the EU, it is important that stakeholders feel that the work programme of the IASB is addressing the right issues and that future standards/interpretations will provide suitable accounting solutions. Some stakeholders have expressed doubts about some of the accounting projects currently being prepared by the IASB. It is therefore crucial that EU institutions, Member States and stakeholders become involved in the standard-setting process as early as possible, as this enhances the quality of the work and increases the legitimacy and acceptance of future standards/interpretations. The way the IASB undertakes impact assessment in future will also be monitored carefully.

In order to ensure the overall quality of future IFRS and IFRIC it is also important that the IASB/IASCF has suitable governance structure and secure funding. The Commission Services regularly assess the governance and funding of the IASB/IASCF and publish reports that can be downloaded from the Commission website[17].

[17] For further information see: http://ec.europa.eu/internal_market/accounting/ias_en.htm#070112