

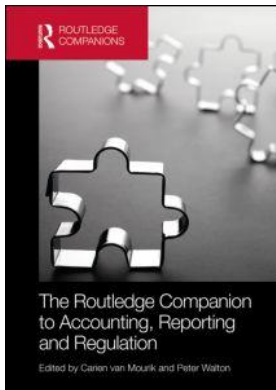
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### **Stock Exchanges and International Financial Reporting**

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# Stock Exchanges and International Financial Reporting

*Philippe Danjou*

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## **1. Introduction: globalization of trade and financial markets led to the internationalization of accounting standards**

Accounting practices and standards play an increasingly central role in intermediating information in capital markets and shaping business behaviour. Thus, the decision made by the European Union in the early 2000s to abandon national accounting standards for its listed companies and adopt instead the International Financial Reporting Standards (IFRS) can be considered among the most momentous of financial market policy initiatives of the past few decades. The EU decision also had a key influence in triggering similar moves to adopt IFRS in a number of jurisdictions, including China, Australia, Canada, South Korea, and possibly Japan and India as well in the near future. Even the United States, which in the past half-century had led many developments in accounting, is now considering recognition of IFRS as an acceptable set of standards for at least some of the companies listed on its markets (Véron, 2007: vi).

Globalization of financial markets is part of a wider phenomenon of globalization of national economies. The rapid growth of the international trade in goods and services which really took off around the middle of the twentieth century was accompanied by substantial increases in international capital flows. Between 1970 and 2000 the value of world exports of goods and services increased twenty-fold and was supported by a fifty-fold increase in foreign direct investment (source UNCTAD). Realizing that there were opportunities to accelerate their own growth, many countries, among which the developing economies, have modified their legislation with a view to reducing legal barriers and making it easier to attract foreign capital. At the same time, the leading corporations in Europe and the USA which were faced with limited opportunities for growth on their domestic markets decided to develop internationally through direct investments or mergers and acquisitions. As a cash settlement of the acquisitions was often too onerous, many transactions were effected through exchanges of shares which frequently entailed the admission of the newly issued shares to trading on a foreign market. The differences in the accounting regimes applicable to the parties to such transactions became more visible and

Table 18.1 Global market capitalization 2010 (in trillion of US\$)

<i>Geographical area</i>	<i>2001 (rounded amount)</i>	<i>2001 (percentage)</i>	<i>2010 (rounded amount)</i>	<i>2010 (percentage)</i>
USA	14	52	17	30
Americas excl. USA	1	3.7	5	9
Europe, Africa & Middle East	8	30	15	27
Asia excl. China	3	11	10	18
China	1	3.7	8	15

Source: World Federation of Exchanges, market capitalization by region  
[www.world-exchanges.org/files/statistics/excel/Ts2%20Market%20cap.XLS](http://www.world-exchanges.org/files/statistics/excel/Ts2%20Market%20cap.XLS) (accessed on 30 September, 2012)

created unnecessary costs and efforts to explain differences to investors and sometimes reconcile between the different sets of standards.

Table 18.1 summarizes the globalization of the financial markets and the development of significant financial markets in the developing economies as follows:

- In 2001, the USA accounted for 52 per cent of the global market capitalization (totalling approximately 28 trillion US \$), followed by Europe at 30 per cent and Asia (excluding China) at 11 per cent. With a market capitalization of some one trillion US\$, China accounted for only 3.7 per cent of the total.
- In 2010, the total market capitalization reached some 55 trillion US\$, but the US market share had fallen to 30 per cent, Europe's share to 27 per cent. The share of Asia excluding China has increased to 18 per cent and the share of China to 15 per cent of the total. The remaining share (9 per cent) relates to the Americas excluding USA, which did not figure in the league ten years earlier.

More and more, the development of businesses and the financing of projects draw their funding from the capital markets. Capital markets offer unique investment opportunities for the private and institutional investors. The development of international trade and the globalization of cultures make cross border investments a natural behaviour.

In the process of the developing globalization of financial markets seen over recent decades, both technological advances and financial innovation played a key role. In the past few decades, information systems have become able to compute and store more data more rapidly. Telecommunications networks have extended their ramifications and augmented their capacity while more reliable data exchange protocols have made it possible to connect computing machines in more efficient ways. As a result, cross-border financial deals have become both easier and more secure, effectively lowering the barrier constituted by distance, be it determined by geography or other factors.<sup>1</sup>

However, whereas the growing use of English as the language of business made it easier to invest internationally, a significant impediment to this evolution was the heterogeneity of the financial communication languages used on the different financial markets. The demand for a single, internationally accepted financial reporting language became more and more pressing. International Accounting Standards (IAS) which had been developed steadily since 1973 by the IASC represented a real opportunity. In this chapter, we will explain the key roles played by the European Union and by the International Organization of Securities Commissions towards

the adoption of a high quality, single set of accounting standards to be used globally in reporting financial information to providers of capital. Over the past decade, significant progress has been made: as of this year (2012), two-thirds of G20 members require the use of IFRSs, and decisions are expected from the USA and Japan regarding the accounting standards to be followed by their domestic issuers. [Table 18.2](#) provides information about the use of IFRS in the world as of March 2012.

*Table 18.2* The use of IFRS in the world as of March 2012 for the countries belonging to the G20

<i>Country</i>	<i>Status for listed companies as of December 2011</i>
Argentina	Required for fiscal years beginning on or after 1 January 2012
Australia	Required for all private sector reporting entities and as the basis for public sector reporting since 2005
Brazil	Required for consolidated financial statements of banks and listed companies from 31 December 2010 and for individual company accounts progressively since January 2008
Canada	Required from 1 January 2011 for all listed entities and permitted for private sector entities including not-for-profit organisations
China	Substantially converged national standards
European Union	All member states of the EU are required to use IFRSs as adopted by the EU for listed companies since 2005
France	Required via EU adoption and implementation process since 2005
Germany	Required via EU adoption and implementation process since 2005
India	India is converging with IFRSs at a date to be confirmed
Indonesia	Convergence process ongoing; a decision about a target date for full compliance with IFRSs is expected to be made in 2012
Italy	Required via EU adoption and implementation process since 2005
Japan	Permitted from 2010 for a number of international companies; decision about mandatory adoption by 2016 expected around 2012
Mexico	Required from 2012
Republic of Korea	Required from 2011
Russia	Required from 2012
Saudi Arabia	Required for banking and insurance companies. Full convergence with IFRSs currently under consideration
South Africa	Required for listed entities since 2005
Turkey	Required for listed entities since 2005
United Kingdom	Required via EU adoption and implementation process since 2005
United States	Allowed for foreign issuers in the US since 2007; target date for substantial convergence with IFRSs is 2011 and decision about possible adoption for US companies expected in 2011

*Source:* IFRS Foundation website [www.ifrs.org/Use+around+the+world/Use+around+the+world.htm](http://www.ifrs.org/Use+around+the+world/Use+around+the+world.htm) (accessed 30 September 2012)

*Note:* More than 100 jurisdictions in the world require or permit the use of IFRS for the preparation of financial statements of listed companies and certain public interest entities (financial institutions and insurance companies). A detailed analysis by jurisdiction is available on the web site [iasplus.com](http://iasplus.com) maintained by Deloitte: [www.iasplus.com/Plone/en/resources/use-of-ifrs](http://www.iasplus.com/Plone/en/resources/use-of-ifrs)

The current global framework of financial reporting under IFRS is relatively complex and requires an understanding of the roles played by a number of actors and numerous types of legislation. At the risk of oversimplifying the picture, I would describe it as follows:

- Within the EU, the basic elements of legislation concerning listed entities can be found in documents covering various aspects of the information provided by them to the investors:
  - regulations concerning the information to be provided when securities are offered to the public (e.g. in the EU, the Prospectus Directive 2010/73/EU<sup>2</sup>);
  - regulations concerning the periodic and punctual information to be published by issuers (in the EU, it is to be found in the Transparency Directive 2004/109/EC<sup>3</sup>)
  - regulations concerning the manner in which periodic financial statements are to be prepared (in the EU, the 4th and 7th Accounting directives<sup>4</sup> and the IAS Regulation);
  - regulations concerning the auditing of the financial statements (in the EU, the 4th and 7th Directives as amended by Directive 2006/46/EC<sup>5</sup> on statutory audits of annual and consolidated accounts);
  - other regulations or codes of conduct relating to internal controls and aspects of corporate governance;
  - regulations concerning accepted market practices, the definition of inside information, market integrity and market manipulation (Commission Directive 2003/124/EC and Directive 2003/6/EC of the European Parliament and the Council<sup>6</sup>); and
  - in addition, a very important legislative text was published by the European Union in 2004: the Markets in Financial Instruments Directive 2004/39/EC<sup>7</sup> (known as ‘MiFID’) as subsequently amended, is a European Union law that provides harmonized regulation for investment services across the 30 member states of the European Economic Area (the 27 member states of the European Union plus Iceland, Norway and Liechtenstein). The main objectives of the Directive are to increase competition and consumer protection in investment services. As of the effective date, 1 November 2007, it replaced the Investment Services Directive.
- ‘Preparers’ of financial statements are the entities (‘Issuers’) who issue financial instruments (equity or debt instruments) listed on financial markets and present their financial statements under the applicable accounting standards. More and more often, they report under IFRS either because they are required to do so by their national accounting requirements, or on a voluntary basis. In addition to listed issuers, certain public interest entities or regulated entities such as financial institutions or insurance companies are often required to use IFRS. The application of IFRS is either general, i.e. for all financial statements published (parent-only company accounts and consolidated financial statements) or, more often, partial, which means that only the consolidated financial statements are presented in accordance with IFRS. When issuers do not report under IFRS, they either follow national GAAP (e.g. US GAAP or Japanese GAAP) or, when permitted, they use the other accounting framework which has de facto been recognized as internationally acceptable, the US GAAP. When the ‘parent only’ financial statements are not prepared according to IFRS, they follow the applicable national standards, which in the EU are somewhat harmonized (at least in terms of formats of presentation) on the basis of the 4th Directive.
- The standard setters who publish the accounting standards applicable are the national standard setters (e.g. the French ANC, the UK Accounting Standards Board, the US Financial Accounting Standards Board) and the international standard setter IASB together with its interpretation Committee IFRIC. The structures of the IASB and its parent organization

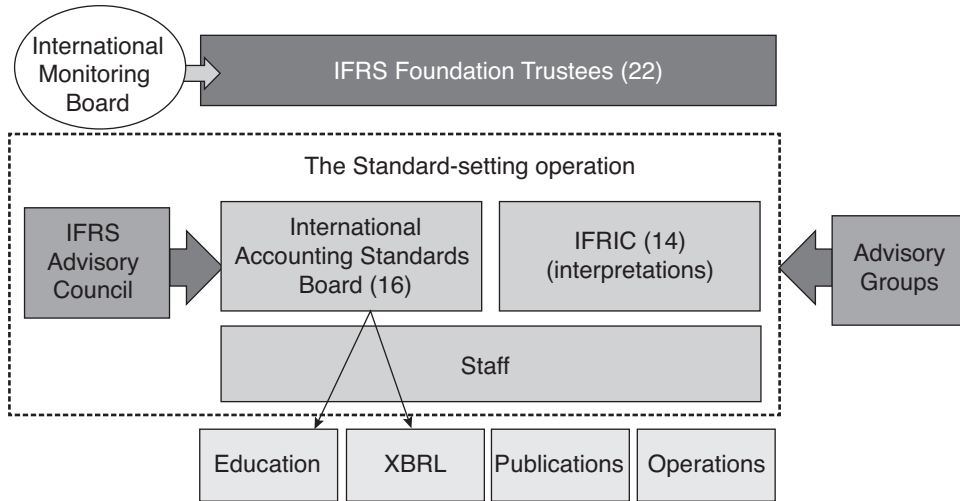


Figure 18.1 The structure of the IFRS Foundation

the IFRS Foundation are illustrated in [Figure 18.1](#). Since 2002, IASB and FASB have been working together with a view to converge their two sets of standards but there are still a number of significant differences between the two.

- In many jurisdictions, there is an endorsement mechanism (see [Figure 18.2](#)) which involves public authorities and gives to the accounting standards the force of law. This is the case for instance in the USA, where the US SEC recognizes the FASB and its pronouncements as the mandatory regime applicable to the US issuers. It is also the case in the European Union where the IASB is recognized as the international standard setter and the organization responsible for developing the standards, but where its output is incorporated into the EU legislation through endorsement decisions which become the applicable law when they are published in the Official Journal of the EU.
- The endorsement mechanism sometimes involves official expert committees to advise the responsible public authority about the acceptability of the standards issued by the accounting standard setter. In Europe, those committees are the Accounting Regulatory Committee (ARC) and the European Financial Reporting Advisory Group (EFRAG).
- The authorities in charge of the surveillance of financial markets and investors' protection are as of today the national securities commissions (e.g. the US SEC, the German BAFIN, the French AMF). Their roles usually consist of approving the listing of securities and admission documents (prospectuses) which contain financial information as prescribed by the applicable legislation. Quite often, they are also tasked with the enforcement of the proper application by issuers of the accounting requirements applicable in their respective jurisdiction. The enforcement mechanisms usually involve a domestic issuer following domestic GAAP and a domestic enforcement agency. But more and more there are situations where an issuer is listed on several national markets, with the result that the enforcement may involve several national agencies. Furthermore, with the growing use of IFRS as accounting standards applied internationally, domestic agencies have to enforce international standards in addition to their domestically applicable standards. International cooperation in the area of enforcement has become a necessity so as to avoid divergent

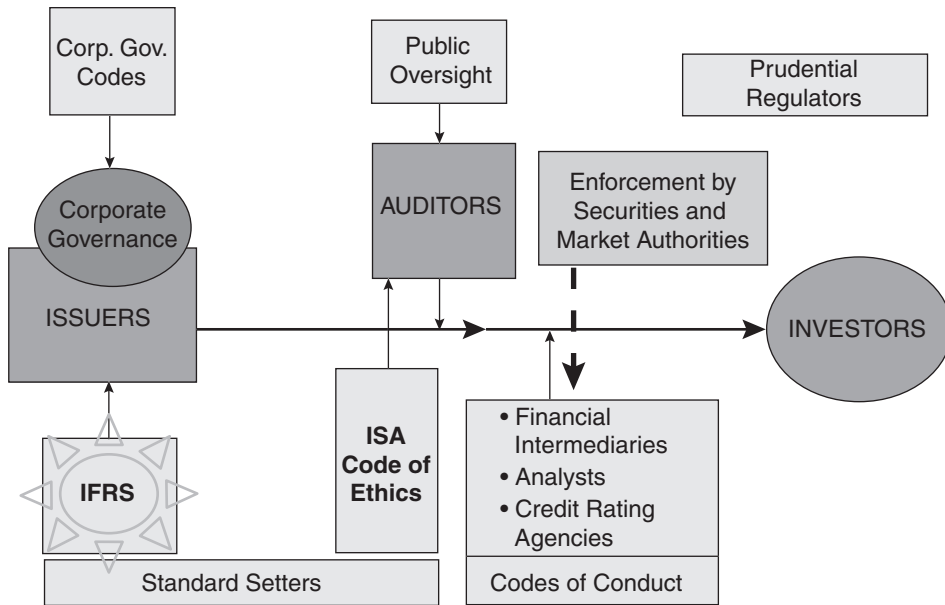


Figure 18.2 The financial information chain and the related actors and frameworks of reference

application of IFRS. As a consequence of this international cooperation on enforcement (which is conducted mainly within the European Union, and, albeit to a lesser degree, on a worldwide basis under the IOSCO) the interaction between enforcement agencies and the international standard setter has developed steadily.

The quality of the financial information provided by issuers to investors depends on many factors and the interaction of several classes of actors: management and directors of the issuers, auditors, enforcement authorities, financial intermediaries, as illustrated in Figure 18.3. Each class of actor follows its applicable regulations and standards of reference, or codes of conduct.

In this chapter, we will describe the roles of each key regulatory authority and the policies they have been following over the past decade in relation to promoting international accounting harmonization, and how they have organized the support system after the adoption of IFRS. We will also explain the roles of the committees who intervene in the adoption of IFRS promulgated by the International Accounting Standards Board and how they interact with the standard setter and with the other regulatory authorities. Most of the contents will be factual and based on publicly available data.

## 2. The situation of financial reporting that prevailed on regulated capital markets before the adoption of IFRS: the Tower of Babel and resulting investors' confusion

Prior to 2005, there was a large variety of accounting standards used by listed companies. In Europe, they most often used the national GAAP which were only partly harmonized on the basis of the 4th and 7th EU Accounting directives. Many large German companies, which were listed in the USA in addition to German markets, reported under US GAAP, as did a few French companies. Swiss companies reported either under International Accounting Standards (IAS) or

US GAAP as well as under Swiss GAAP. Often, such companies presented two sets of financial statements prepared under the different GAAP. However, in total only a handful of companies reported on the basis of IAS.

Outside the EU, US companies reported under US GAAP, while their Canadian neighbours reported either under US or Canadian GAAP. Japanese companies reported under Japan GAAP, while some of the more international ones used US GAAP:

- *US SEC required US GAAP or a reconciliation of financial information to US GAAP until 2007:* As many companies sought a listing on US markets to tap capital from US investors, at a time when the US markets were the deepest and most liquid ones, the SEC only accepted registration statements prepared under US GAAP, or required a full reconciliation from the financial statements prepared under the domestic GAAP to US GAAP. This was a costly and complex exercise and created a certain amount of confusion as the investors were presented with two sets of financial data, often giving quite different pictures of the financial situation and performance of the entity. Further, many of them asserted that such additional information was of little use to investors, as very few of them asked questions about the reconciling items during investors meetings. Was this reconciliation from national GAAP to US GAAP really useful? It seems that to a large extent it was required because the SEC did not trust the quality of the GAAP used by foreign registrants and wanted the reconciliation to provide a ‘fair presentation’ as required under US standards and by this means be able to verify the quality of the underlying financial data.

For example in 1998, Daimler Benz AG took over the Chrysler Corp. through a public offering of shares exchange. Daimler Benz AG had to prepare a reconciliation from its financial statements prepared under German GAAP to US GAAP, and the huge amounts that showed up in the reconciliation table were widely commented at the time in the financial press. Many investors were shocked to discover the extent to which different accounting standards could give a contrasted picture of the financial situation.

- *The relative lack of regulatory action by stock market enterprises:* It is rather surprising to note that in this context, the stock market enterprises (the ‘bourses’) were relatively inactive and let the supervisory authorities initiate the reforms of accounting standards. A search on the web site of the World Federation of Exchanges did not return any results about accounting standards prior to 2007, in which year its annual meeting<sup>8</sup> included a round table discussion about accounting standards convergence (WFE, 2007).

### 3. IOSCO’s policies on financial reporting and their outcomes 1995–2000

#### 3.1 Background information about the International Organization of Securities Commissions

The International Organization of Securities Commissions (IOSCO) was created in 1983 with the decision to change from an inter-American regional association (created in 1974) into a global cooperative body. Eleven securities regulatory agencies from North and South America took this decision in April 1983 at a meeting in Quito, Ecuador. In 1984, securities regulators from France, Indonesia, Korea and the United Kingdom were the first agencies to join the organization from outside the Americas.



Today IOSCO is recognized as the international standard setter for securities markets. Its membership regulates more than 95 per cent of the world's securities markets and it is the primary international cooperative forum for securities market regulatory agencies. IOSCO members are drawn from, and regulate, over 100 jurisdictions and its membership continues to grow.

IOSCO provides comprehensive technical assistance to its members, in particular those which regulate emerging securities markets.

In 1998 IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles), which is recognized as the international regulatory benchmark for all securities markets. In 2003 the organization endorsed a comprehensive methodology (IOSCO Principles Assessment Methodology) that enables an objective assessment of the level of implementation of the IOSCO Principles in the jurisdictions of its members and the development of practical action plans to correct identified deficiencies.

In 2002 IOSCO adopted a multilateral memorandum of understanding (IOSCO MMoU) designed to facilitate cross-border enforcement and exchange of information among international securities regulators. Then in 2005 IOSCO endorsed the IOSCO MMoU as the benchmark for international cooperation among securities regulators and set out clear strategic objectives to expand the network of IOSCO MMoU signatories by 2010. It approved as an operational priority the effective implementation – in particular within its membership – of the IOSCO Principles and of the IOSCO MMoU, which are considered primary instruments in facilitating cross-border cooperation, reducing global systemic risk, protecting investors and ensuring fair and efficient securities markets.

The member agencies currently assembled together in the International Organization of Securities Commissions have resolved, through its permanent structures, which include a General Secretariat:

- to cooperate in developing, implementing and promoting adherence to internationally recognized and consistent standards of regulation, oversight and enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
- to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
- to exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.

The IOSCO's Executive Committee has established two specialized working committees. The first one, the Technical Committee, is made up of eighteen agencies that regulate some of the world's larger, more developed and internationalized markets. Its objective is to review major regulatory issues related to international securities and futures transactions and to coordinate practical responses to these concerns. The work of the committee is divided into the following six major functional subject areas:

- multinational disclosure and accounting;
- regulation of secondary markets;
- regulation of market intermediaries;

- enforcement and the exchange of information;
- investment management; and
- credit rating agencies.

The Technical Committee is responsible for the co-ordination of international cooperation on the regulation of securities transactions. It was intended that the Committee would gather experts from member countries to review regulatory problems related to the issue and trading of international securities and propose practical solutions to these problems. The Technical Committee consists of senior representatives from securities commissions or stock exchanges with an active interest in international securities trading. The member regulatory bodies are from the following countries: Australia, Canada, (Ontario and Quebec), France, Germany, Hong Kong, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.

The second specialized committee, the Emerging Markets Committee, endeavours to promote the development and improvement of efficiency of emerging securities and futures markets by establishing principles and minimum standards; preparing training programmes for members' staff; and facilitating the exchange of information and transfer of technology and expertise

At the occasion of the next annual conference held in May 2012, a new organizational structure, the principles of which were approved by the President's Committee,<sup>9</sup> was implemented. A Transitional Board is to be set up for two years, tasked with preparing a new organization chart with a single committee regrouping the Executive, Technical and Emerging Markets committees.

### *3.2 Monitoring of IAS and encouraging further progress to reduce options and improve transparency*

The first indication about IOSCO's policies in the field of accounting standards harmonization can be found in a September 1989 report<sup>10</sup> on International Equity Offers which noted that:

Globalisation of the financial markets has facilitated distribution of capital market products in multiple jurisdictions both by public offers and private placements. This benefits issuers, by increasing competition and reducing costs of capital. Investors also benefit from greatly enhanced investment opportunities, as does the world economy, by promoting efficiency of capital allocation.

Internationalised financial markets present substantial challenges to the financial and securities regulators in each market. To maximise the benefits of internationalisation, regulators must co-operate to protect the soundness and integrity of the world's capital markets and to reduce unnecessary costs involved in compliance with redundant, conflicting or inconsistent regulation (IOSCO, 1989: 3).

The differences in disclosure requirements, particularly with respect to financial statements, and audit practice present major obstacles to international equity offers. While there is some evolution of disclosure practice towards using a single, common prospectus in international equity offers involving offers to the public, differing requirements for financial statements (particularly with respect to accounting and auditing standards) in various jurisdictions may persuade issuers to make the offer on a private basis to avoid the problem of co-ordination of disclosure requirements (IOSCO, 1989: 7).

In response to the problems identified, the Working Party reached six basic conclusions and recommendations one of which deals directly with the harmonization of standards so as to allow issuers to prepare a single set of disclosures:

**Disclosure/harmonization**

- a) Efficiency of the capital raising process would be greatly enhanced by permitting issuers to prepare one disclosure document for use in each jurisdiction in which it chooses to sell securities. There appear to be several ways of reaching that goal:
  - Standards could be harmonized among jurisdictions; jurisdictions could accept the disclosure document prepared in accordance with the home country (predominant market) requirements, which, while not the same, are sufficiently based on the same model with the same regulatory purposes to be deemed to provide investors with adequate disclosure.
  - It is recommended that regulators be encouraged, where consistent with their legal mandate and the goal of investor protection, to facilitate the use of single disclosure documents, whether by harmonization of standards, reciprocity or otherwise.
- b) A critical factor in the evolution of reliance on a single disclosure document is acceptance of financial statements in multiple jurisdictions. Development or recognition of adequate internationally acceptable accounting, auditing and independence standards would greatly facilitate the development of the use of a single disclosure document. The recommendations of the IOSCO Working Party No. 2 on Accounting and Auditing Standards will be an important contribution to the development of these standards (IOSCO, 1989: 8).

Five years later, the recommendation had seen some implementation as indicated by the following abstract from the Report of the Chairman of the Working Party presented in October 1994 at the IOSCO Annual Meeting in Tokyo:

Working Party No. 1 and its Subcommittee on Accounting and Auditing have focused their efforts for the last year on international accounting standards and international auditing standards. Significant progress has been made in the area of international accounting standards. In the area of international audit standards, on the other hand, developments have been disappointing.

The goal of the Working Party's efforts in the International Accounting Standards area is the implementation of the second recommendation included in the Working Party's 1989 Report on Cross Border Equity Offerings. That recommendation, which was endorsed by IOSCO at its Annual Meeting in Santiago, Chile November 1990 stated:

A critical factor in the evolution of reliance on a single disclosure document is the acceptability of financial statements in multiple jurisdictions. Developments, or recognition, of adequate internationally acceptable accounting, auditing and independence standards would greatly facilitate the development of the use of a single disclosure document.

The Working Party's plan of work, ratified by the Technical Committee in June 1993, provides for the Working Party to:

- 1. Continue to review and comment on each international standard during each phase of its development by the IASC.

2. Identify for the IASC those standards that will be reviewed by the Working Group in determining whether it can recommend to the Technical Committee that there is an acceptable comprehensive body of International Accounting Principles that could be used in cross-border offerings. The goal would be to enumerate those standards for the IASC no later than the end of 1993.
3. Advise the IASC of the Working Party's views with respect to each standard as finalized. The view will be determined by consensus. If there is not a consensus on a final standard, the Working Group would not express a view on the final standard, but would transmit to the IASC opinions expressed in the meeting, which will be considered in finalizing standards by the IASC. The timing will be dictated by the IASC.
4. Upon the IASC's completion of the comprehensive body of standards identified as indicated in paragraph (2), to advise the Technical Committee as to the Working Party's recommendation with respect to the use of such standards in cross-border offerings.

Thus, a recommendation by the Working Party to endorse IASC standards will be based on a consideration of a comprehensive body of core accounting standards (IOSCO, 1994: 1–2).

By letter dated 16 August 1993 to the IASC, the IOSCO Working Party identified those core standards it found to be necessary components of a comprehensive set of international accounting standards. From 1996 onwards, IOSCO had sent observers to the IASC Board meetings and a working relationship established, with a view to accelerate the improvements to IASs that IOSCO had identified. A complete analysis of the relationship between IOSCO and IASC is developed by Kirsch (2006).

### The May 2000 Sydney resolution on the use of IAS's core standards<sup>11</sup>

This important resolution, which really created a worldwide impetus for the adoption of IASs, is to be found in the Report of the Technical Committee of IOSCO:

The Technical Committee has received and approved for publication the following report. This report summarizes the work of its Working Group on Multinational Accounting and Disclosure (the Working Party) assessing the accounting standards published by the International Accounting Standards Committee (IASC).

After considering this report, the Technical Committee recommends to IOSCO members the use of 30 selected IASC standards for cross-border listings and offerings by multinational enterprises, as supplemented in the manner described in this report (i.e., reconciliation, supplemental disclosure and interpretation), where necessary to address outstanding substantive issues at a national or regional level. These 30 standards and their related interpretations are referred to in this report as the 'IASC 2000 standards' [and are listed in Appendix A].

[...]

Those supplemental treatments are:

- reconciliation: requiring reconciliation of certain items to show the effect of applying a different accounting method, in contrast with the method applied under IASC standards;

- disclosure: requiring additional disclosures, either in the presentation of the financial statements or in the footnotes; and
- interpretation: specifying use of a particular alternative provided in an IASC standard, or a particular interpretation in cases where the IASC standard is unclear or silent.

In addition, as part of national or regional specific requirements, waivers may be envisaged of particular aspects of an IASC standard, without requiring that the effect of the accounting method used be reconciled to the effect of applying the IASC method. The use of waivers should be restricted to exceptional circumstances such as issues identified by a domestic regulator when a specific IASC standard is contrary to domestic or regional regulation. The concerns identified and the expected supplemental treatments are described in the report entitled *IASC Standards – Assessment Report 4* (Assessment Report).

IOSCO notes that a body of accounting standards like the IASC standards must continue to evolve in order to address existing and emerging issues. IOSCO's recommendation assumes that IOSCO will continue to be involved in the IASC work and structure and that the IASC will continue to develop its body of standards. IOSCO strongly urges the IASC in its future work programme to address the concerns identified in the Assessment Report, in particular, future projects (IOSCO, 2000).

### IOSCO supports the setting up of IASB and encourages further convergence of accounting standards

IOSCO had been a member of the Strategy Working Party (SWP) formed in 1996 to review the future strategy of IASC. Mr Ed Waitzer, a former chair of IOSCO's Technical Committee, was appointed chairman of the SWP (Kirsch, 2006: 340–41). After lengthy discussions, which culminated with the approval of the new structures for the forthcoming IASB and the Foundation, at a meeting in December 1999 the Board of IASC appointed a Nominating Committee (NC) to select the first Trustees of the Foundation. Members of the NC included Mr Michel Prada,<sup>12</sup> the then Chair of IOSCO's Technical Committee and three other senior representatives of markets authorities (US SEC, represented by its chairman Arthur Levitt, who was appointed chair of the NC, the chair of the UK FSA and the chair of the Hong Kong SFC). The 'old' IASC held its last meeting in December 2000 and was 'decommissioned' in March 2001, at which time the new Constitution of the IFRS Foundation came into operation.

The Final Communiqué<sup>13</sup> of the 27th Annual Conference of IOSCO held in May 2002 included the following comments:

Following up on its *Resolution Concerning the Use of IASC Standards for the Purpose of Facilitating Multinational Securities Offerings and Cross Border Listings* adopted by the Presidents' Committee in May 2000, IOSCO conducted a survey of the acceptance of International Accounting Standards by IOSCO members. The results indicate that many jurisdictions permit incoming issuers to use IAS, and others are actively working towards this end.

Moreover, since May 2000, there have been a number of developments promoting the use of IAS. These include: (i) the decision of the EU Council of Ministers (ECOFIN Council) requiring the use of IAS by 2005; (ii) the completion of the reconstitution of the IASB into a full-time independent standard setter; and (iii) the formation of the Committee of European Securities Regulators with a special sub-group devoted to these issues. Looking ahead, to further these efforts, IOSCO encourages the IASB and national standard setters to work cooperatively and expeditiously to achieve convergence in order to facilitate

cross-border offerings and listings and encourages regulators to address the broader issues of consistent interpretation, application and enforcement.

### 3.3 IOSCO's other activities aimed at improving financial reporting

IOSCO has also been active, through its Standing Committee (ex Working Party) on Multinational Disclosure and Accounting, on strengthening the quality of audits performed on the issuers' financial statements and the independence of auditors. For instance, in 2002 IOSCO issued two policy documents:

- Principles of Auditor Independence and the role of Corporate Governance in Monitoring an Auditor's Independence;<sup>14</sup> and
- Principles for Auditor Oversight.<sup>15</sup>

It is noteworthy that those policy statements influenced the creation of auditors' oversight agencies in different jurisdictions, for instance the Public Company Accounting Oversight Board<sup>16</sup> in the USA, or the Haut Conseil du Commissariat aux Comptes<sup>17</sup> in France.

In June 2009, IOSCO issued a Statement endorsing the International Auditing Standards revised as a result of the IAASB's 'clarity project':<sup>18</sup>

IOSCO has long encouraged efforts around a set of internationally developed auditing standards through the work of the International Auditing and Assurance Standards Board (IAASB), the private-sector standard setting body that develops International Standards on Auditing (ISAs). For the last several years the IAASB has carried out a project to restructure and improve the body of ISAs (known as the 'Clarity Project'). IOSCO has encouraged these efforts, as noted in its 9 November 2007 Statement on International Auditing Standards. The IAASB has now announced the completion of this work and the release of the clarified ISAs. IOSCO welcomes achievement of this milestone.

IOSCO endorses the replacement of the previous ISAs with the new standards, noting the improvements that have resulted from clarifying the ISA requirements. IOSCO looks forward to continued progress in terms of the translation, education and other efforts by many to facilitate global audit practices as well as the continuous improvement of ISAs over time.

### 3.4 IOSCO's participation in the IFRS Foundation's Monitoring Board

In April 2009, acknowledging the need to improve the public accountability of the IFRS Foundation (which at the time was named the IASC Foundation – IASCF), the Trustees of the Foundation and the authorities responsible internationally for the oversight of the major financial markets decided to establish a Monitoring Board to establish a formal relationship between capital markets authorities and the IASCF in order to facilitate the ability of capital markets authorities that allow or require the use of IFRS in their jurisdictions to effectively discharge their mandates relating to investor protection, market integrity and capital formation.

The Charter of the IASCF Monitoring Board is available on the website of IOSCO<sup>19</sup> which hosts all documents regarding the activities of this Board. IOSCO's representatives<sup>20</sup> currently have two seats on the Monitoring Board (MB). The structure of the IFRS Foundation is illustrated in [Figure 18.1](#) (above). A key responsibility of the Monitoring Board is to ratify the

appointment of the Foundation's trustees, who report to it on the activities of the Foundation. A Memorandum of Understanding has been signed between the Foundation and the members of the MB to further describe the purpose and duties of the MB and the oversight of the IASB's due process.

#### **4. The EU regulation 1606/2002 on IFRS, a final outcome of the 1999 Financial Services Action Plan**

The roots of the European Commission's Internal Market Directorate's policy are to be found in a 1995 Communication<sup>21</sup> titled 'Accounting Harmonization: a new strategy vis-à-vis international harmonization' which includes the following important statement:

The approach proposed in the present communication consists of putting the Union's weight behind the international harmonisation process which is already well under way in the International Accounting Standards Committee (IASC). The objective of this process is to establish a set of standards which will be accepted in capital markets world-wide.

The Union must at the same time preserve its own achievements in the direction of harmonisation, which are a fundamental part of internal market law. It therefore needs to take steps to ensure that existing international standards (IAS) are consistent with the Community's Directives and that IAS which remain to be formulated remain compatible with Community law.

The ideas contained in this document gained support, probably as a result of the concurrence of the views with those professed by IOSCO, and were politically endorsed in 1999.

##### **4.1 The FSAP**

Originally adopted in May 1999, the Commission's *Implementing the Framework for Financial Services Action Plan (FSAP)*<sup>22</sup> was designed to open up a single market for financial services in the EU. It comprized 42 measures designed to harmonize the Member States' rules on securities, banking, insurance, mortgages, pensions and other forms of financial transactions:

The wide consultations undertaken over the past 12 months, the Resolution of the European Parliament and the work of the FSPG<sup>23</sup> have confirmed that a fresh impetus is called for to harvest the undeniable opportunities offered by the single financial market and the single European currency. The present action plan consolidates the issues which have emerged from the Commission communication, as fleshed out by the FSPG discussions. In respect of most of the following actions, the Commission has already the occasion to confirm or announce its intention to proceed with initiatives as they have emerged from these discussions. Essentially action is envisaged under three headings: wholesale markets; retail markets, and sound supervisory structures. The Framework plan ... provides the detailed basis for this work, which should build on efforts undertaken in other formal or informal bodies where appropriate (COM (1999)232, 11.05.99: p. 5).

##### **Financial reporting**

Comparable, transparent and reliable financial information is fundamental for an efficient and integrated capital market. Lack of comparability will discourage cross-border investment

because of uncertainty as regards the credibility of financial statements. FSPG discussions pinpointed the urgent need for solutions which give companies the option of raising capital throughout the EU using financial statements prepared on the basis of a single set of financial reporting requirements. Capital-raising does not stop at the Union's frontiers: our companies may also need to raise finance on international capital markets. Solutions to enhance comparability within the EU market must mirror developments in internationally accepted best practice. At the present juncture, International Accounting Standards (IAS) seem the most appropriate bench-mark for a single set of financial reporting requirements which will enable companies (which wish to do so) to raise capital on international markets. In the same way, International Standards on Auditing appear to be the minimum which should be satisfied in order to give credibility to published financial statements (COM (1999)232, 11.05.99: p. 7).

More specifically, the FSAP contained the following recommendation:

Discussions in the FSPG have triggered an important debate on how the twin objectives of comparable financial reporting and alignment on international best practice can be simultaneously achieved. Consideration is currently being given to a possible solution which would provide companies with an option (as the sole alternative to preparing financial statements in accordance with national laws transposing EU accounting Directives) to publish financial statements on the basis of IAS standards. The objective of comparability in financial reporting will be secured by excluding national deviations from IAS for companies exercising this option. A screening mechanism will be required in order to ensure that IAS output conforms with EU rules and corresponds fully with EU public policy concerns. Securities markets supervisors could be associated to this task. These issues will be amplified in a Commission Communication to be published by the end of 1999, which will prefigure amendments of the 4th and 7th Company Law Directives. Auditing issues will be addressed in a separate Commission Recommendation (COM (1999)232, 11.05.99: p. 7).

This FSAP was implemented actively by the Commission, but further analysis showed that creating an 'IAS option' was not the best solution to guarantee comparability.

The Lisbon European Council of 23–24 March 2000 had emphasized the need to accelerate completion of the internal market for financial services, set the deadline of 2005 to implement the Commission's Financial Services Action Plan and urged that steps be taken to enhance the comparability of financial statements prepared by publicly traded companies. On 13 June 2000, the Commission published a Communication: 'EU Financial Reporting Strategy: the way forward' in which it was proposed that all publicly traded Community companies prepare their consolidated financial statements in accordance with one single set of accounting standards, namely International Accounting Standards (IAS), at the latest by 2005.

#### *4.2 The adoption of the IAS regulation*

On 8 June 2002, The Council of the European Union adopted an 'IAS Regulation'<sup>24</sup> requiring listed companies, including banks and insurance companies, to prepare their consolidated accounts in accordance with International Accounting Standards (IAS) from 2005 onwards. Member States could defer application until 2007 for those companies that were listed both in the EU and elsewhere and that currently used US GAAP (or other GAAP) as their primary basis of accounting, as well as for companies that had only publicly traded debt securities. The goal of



the Regulation was to eliminate barriers to cross-border trading in securities by ensuring that company accounts throughout the EU were reliable, transparent, and comparable. The Regulation had the force of law without requiring transposition into national legislation. However, 'to ensure appropriate political oversight', the Regulation established a new EU mechanism to 'assess IASs to give them legal endorsement' before they can be used in Europe. Member States had the option of extending the requirements of the Regulation to unlisted companies and to the production of individual accounts. The Recital #3 acknowledged that harmonization on the sole basis of the Accounting Directives had failed and was not a viable solution going forward:

Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions and Council Directive 91/674/EEC on the annual accounts and consolidated accounts of insurance companies are also addressed to publicly traded Community companies. The reporting requirements set out in these Directives cannot ensure the high level of transparency and comparability of financial reporting from all publicly traded Community companies which is a necessary condition for building an integrated capital market which operates effectively, smoothly and efficiently. It is therefore necessary to supplement the legal framework applicable to publicly traded companies.

The Recital #2 to the Regulation explained clearly the goal of the European Union to work towards worldwide standards, not solely to adopt common EU standards:

In order to contribute to a better functioning of the internal market, publicly traded companies must be required to apply a single set of high quality international accounting standards for the preparation of their consolidated financial statements. Furthermore, it is important that the financial reporting standards applied by Community companies participating in financial markets are accepted internationally and are truly global standards. This implies an increasing convergence of accounting standards currently used internationally with the ultimate objective of achieving a single set of global accounting standards.

Because the Regulation resulted in accounting standards being given the force of law, it was necessary to clearly identify those standards. Hence, Article 2 of the Regulation stipulates that:

For the purpose of this Regulation, 'international accounting standards' shall mean International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related interpretations (SIC-IFRIC interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board (IASB).

This article clearly established the legitimacy of the newly established IASB as the organism that would publish the standards to be followed by European listed companies. However, as the IFRS Foundation which hosts the IASB is a private entity without official legitimacy, Europe found it necessary to give a legal endorsement to the standards proposed by IASB and established the following criteria and procedure:

Article 3 – Adoption and use of international accounting standards

1. In accordance with the procedure laid down in Article 6(2), the Commission shall decide on the applicability within the Community of international accounting standards.
2. The international accounting standards can only be adopted if:
  - they are not contrary to the principle set out in Article 2(3) of Directive 78/660/EEC and in Article 16(3) of Directive 83/349/EEC and are conducive to the European public good; and,
  - they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
3. At the latest by 31 December 2002, the Commission shall, in accordance with the procedure laid down in Article 6(2), decide on the applicability within the Community of the international accounting standards in existence upon entry into force of this Regulation.
4. Adopted international accounting standards shall be published in full in each of the official languages of the Community, as a Commission regulation, in the Official Journal of the European Communities.

In a first endorsement Regulation<sup>25</sup> EC/1725/2003, the European Commission adopted ‘en bloc’ a series of IASs and SICs that were extant at 1 September 2002. IAS 32 and 39 were not part of the first set. A further Regulation 2238/2004 adopted all extant and updated standards except IAS 32 and 39. On 19 November 2004, just in time for the preparation of the first set of IFRS accounts, the Commission published a Regulation<sup>26</sup> 2086/2004 endorsing IAS 32 and 39 with an exceptional and of temporary nature exclusion (referred to in common language as ‘the carve out’) of certain paragraphs of IAS 39 relating to the Fair Value Option<sup>27</sup> and Hedge accounting. An explanatory memorandum<sup>28</sup> on ‘the carve out’ has been posted by the Commission.

### 4.3 The ARC

#### Article 6 – Committee Procedure

The Commission shall be assisted by an accounting regulatory committee hereinafter referred to as ‘the Committee’. The Accounting Regulatory Committee (ARC) is composed of representatives from Member States and is chaired by the European Commission. The Committee has been set up by the Commission in accordance with the requirements contained in Article 6 of the IAS Regulation 1606/2002. The function of the Committee is a regulatory one and consists in providing an opinion on the Commission proposals to adopt an international accounting standard as envisaged under Article 3 of the Regulation. Members of the ARC are usually the representatives of the Members states’ ministries competent for accounting matters. The decisions of the Commission and of the ARC are taken after consideration of ‘endorsement advice’ provided by the European Financial Reporting Advisory Committee (hereafter EFRAG).

### 4.4 The EFRAG

The IAS Regulation foresees an accounting technical committee which shall provide support and expertise to the Commission in the assessment of international accounting standards. The committee is called the European Financial Reporting Advisory Group (EFRAG). The function

of the Committee is a regulatory one and consists in providing an opinion on the Commission proposals to adopt an international accounting standard as envisaged under Article 3 of the Regulation:

EFRAG was set up in 2001 to assist the European Commission in the endorsement of International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) by providing advice on the technical quality of IFRS. EFRAG is a private sector body set up by the European organisations prominent in European capital markets, known collectively as the ‘Member Organisations’.

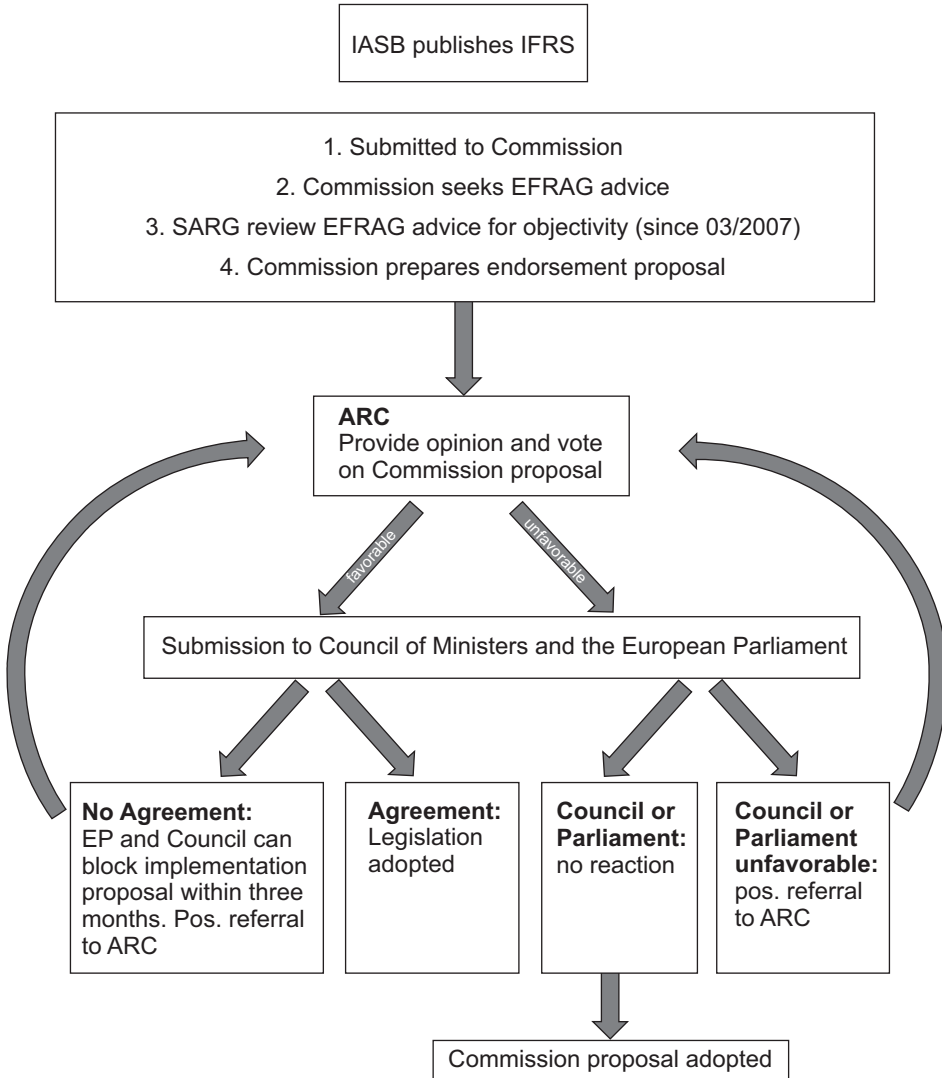
In March 2006, EFRAG’s role was formalized in a Working Arrangement with the European Commission, which states that ‘EFRAG will provide advice to the Commission on all issues relating to the application of IFRS in the EU.’ EFRAG is funded by the Member body organizations which pay subscriptions on a half-yearly basis and by voluntary contributions. In addition, EFRAG receives since 2010 financial support from the European Union - DG Internal Market and Services. EFRAG operates through a Technical Expert Group (EFRAG TEG), which makes its decisions independently of the EFRAG Supervisory Board and all other interests. The 12 voting members of EFRAG TEG were selected from throughout Europe and come from a variety of backgrounds. The chairmen of the French, German, Italian and UK Standard Setters are non-voting members of EFRAG TEG. Representatives of the European Commission and ESMA attend EFRAG TEG meetings as observers. EFRAG’s role is both proactive and reactive. In particular it:

- provides advice to the European Commission on the endorsement of new or amended IFRSs and IFRS interpretations;
- comments on proposed IFRSs and IFRS interpretations, IASB discussion papers and other consultative documents;
- attends various IASB Working Group meetings as observers;
- maintains regular contacts with the IASB through meetings with its chairman. IASB Board members and senior staff participate in each EFRAG TEG meeting;
- works closely with European National Standard Setters (NSS) on various activities designed to encourage debate in Europe on accounting matters, in order to develop European views on issues of importance and enhance the quality of Europe’s input to the IASB;
- meets quarterly with the European National Standard Setters (NSS) to exchange views;
- meets quarterly with European User representatives in the EFRAG User Panel; and
- participates in the World Standard Setters meetings (organized by the IASB).

The members of EFRAG TEG are appointed by the EFRAG Supervisory Board. The EFRAG Supervisory Board looks primarily to the qualifications of the EFRAG TEG candidates in terms of knowledge and experience and endeavours to ensure a broad geographical balance, together with experience from preparers, the accounting profession, users and academics.

#### *4.5 Endorsement status as of 31 March 2012*

EFRAG maintains on its web site an up to date report<sup>29</sup> on the endorsement status of IFRS and IFRIC’s applicable in the EU.



**ARC (Accounting Regulatory Committee):** Advisory body composed of representatives of the Member State and representatives of the Commission. It approves implementing measures by qualified majority under the so-called Comitology procedure.

**Comitology:** When implementing powers are given to the Commission, it must act in conjunction with committee(s) of national civil servants (here ARC) who has the power to block the Commission and refer the matter to the Council.

**Comitology reform:** Prior to the reform the EP had no right to block implementing measures – only the comitology committee(s) could do so, and if they did, the proposal was referred to the Council alone.

Figure 18.3 The EU endorsement mechanism

The report contains an overview per issued standard and interpretation, listing the date of the endorsement date and the date the endorsed standard/interpretation was published in the Official Journal of the European Union. The report further provides an overview of standards and interpretations pending endorsement and the dates EFRAG is expected to issue its advice, and of the corresponding ARC voting. Except for IAS 39 which was the subject of a partial 'carve out' of its provisions relating to hedge accounting and the fair value option, all IFRS and IFRIC which are currently in effect at the date of writing this Chapter have been endorsed by the Commission. The IAS 39 carve out is said to be 'temporary' and subsequently, the fair value option carve out was resolved through Commission Regulation<sup>30</sup> (EC) No 1864/2005 of 15 November 2005.

#### *4.6 Mutual recognition of GAAP: EU's decisions regarding the equivalence of accounting standards followed in certain ('third country') jurisdictions*

According to the Prospectus and Transparency Directives, financial statements presented by issuers from outside the EU should be prepared in accordance with IFRS or equivalent accounting standards. Article 23(4) of (Transparency) Directive 2004/109/EC requires the Commission to set up a mechanism for the determination of the equivalence of the information required under this Directive. The Commission is required to adopt measures to establish general equivalence criteria regarding accounting standards relevant to issuers of more than one country. Article 23(4) of Directive 2004/109/EC also requires the Commission to take decisions in relation to the equivalence of accounting standards used by third country issuers, and enables the Commission to allow the use of third country accounting standards during an appropriate transitional period. Given the close interconnection of the information required under Directive 2004/109/EC with the information required under Directive 2003/71/EC, it is appropriate that the same criteria for determination of equivalence apply in the framework of both Directives. Accordingly, Commission Regulation (EC) No 1569/2007 laid down the conditions for acceptance of third country accounting standards for a limited period expiring on 31 December 2011:

In December 2008 the Commission adopted a Decision and a Regulation,<sup>31</sup> which identified as equivalent to IFRS the US GAAP and Japanese GAAP, and accepted financial statements from companies using GAAP of China, Canada, India and South Korea within the EU on a temporary basis, until no later than 31 December 2011. Since 1 January 2009 listed companies can report using IFRS (as adopted by the EU) in the aforementioned countries, while companies from these countries listed in the EU can report using their national accounting standards.<sup>32</sup>

The Commission evaluated the usefulness and functioning of the equivalence mechanism and concluded that it should be extended for a period of 3 years until 31 December 2014. Since the period for which the Commission had put in place conditions for granting equivalence to the Generally Accepted Accounting Principles (GAAP) of third countries expired on 31 December 2011, this Regulation should apply from 1 January 2012. This is necessary in order to provide legal certainty to issuers from the relevant third countries listed in the Union and avoid the risk that they might have to reconcile their financial statements with International Financial Reporting Standards (IFRS). The provision of retroactivity thus alleviates any potential additional burden on the issuers concerned.<sup>33</sup>

## 5. The situation regarding the issuers of securities on US capital markets

### 5.1 Overall policy of the US Securities and Exchange Commission (SEC)

The SEC has taken a number of steps to explore the use of International Financial Reporting Standards (IFRS) in the United States. This includes allowing foreign private issuers in the US to use IFRS in their filings with the SEC without preparing reconciliation to US GAAP and considering the use of IFRS by US issuers. The SEC also engages in dialogue with international counterparts regarding emerging accounting issues and interpretations through its membership in IOSCO and dialogue with the Committee of European Securities Regulators (CESR), now replaced by ESMA (see below [Section 5.2](#)). The SEC has been a strong supporter as well of the International Accounting Standards Board (IASB), the standard setting body that promulgates IFRS, including through the SEC's membership in the IASCF Monitoring Board.

The SEC actively supports the efforts made by IASB and FASB to converge their accounting standards. According to a press release<sup>34</sup> issued in December 2009 in reaction to the publication by the two standard setters of an updated Memorandum of Understanding:

Today, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued a statement reaffirming the Boards' commitment to improving International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (US GAAP). In the statement the IASB and the FASB described their plans to strengthen their efforts for completing the major projects in their Memorandum of Understanding (MoU) by 2011. The publication of this statement is intended to provide an understanding of the progress that is being made by the Boards on these projects and to address public concerns regarding the potential of the two Boards to reach different conclusions in the major projects in the MoU. The respective oversight bodies of the IASB and the FASB also issued a statement fully supporting the efforts of the IASB and the FASB in reaching improved and converged global accounting standards.

### 5.2 The SEC's 2007 decision to allow foreign private issuers to report under IFRS without reconciliation to US GAAP

Noting that convergence efforts between IASB and FASB had reduced the number of differences between the two accounting frameworks, and responding to mounting pressure from Europe for a mutual recognition of applicable standards in relation to the admission of foreign issuers on their respective markets, the US Securities and Exchange Commission adopted at the end of 2007 a rule<sup>35</sup> that allows Foreign Private Issuers to present their financial statements in accordance with IFRS published by the IASB:

The Commission is adopting rules to accept from foreign private issuers in their filings with the Commission financial statements prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board ('IASB') without reconciliation to generally accepted accounting principles ('GAAP') as used in the United States. To implement this, we are adopting amendments to Form 20-F, conforming changes to Regulation S-X, and conforming amendments to other regulations, forms and rules under the Securities Act and the Securities Exchange

Act. Current requirements regarding the reconciliation to U.S. GAAP do not change for a foreign private issuer that files its financial statements with the Commission using a basis of accounting other than IFRS as issued by the IASB. The effective date is March 4, 2008.

It should be noted that in the last sentence, the SEC makes it clear that financial statements which do not fully conform to the IFRSs as issued by the IASB (for instance, where reference is made to IFRS as modified by jurisdiction X, or subject to a 'carve out' of certain IFRS provisions) will not benefit from this rule. EU issuers have therefore to assert compliance with (full) IFRS and cannot make use of the 'carve out' decided by the European Commission when it endorsed IAS 39. This also makes it very important that the EU endorsement process does not create undue delays as compared to the effective dates decided by IASB for its standards.

### *5.3 Towards allowing or requiring the use of IFRS for US domestic issuers?*

In 2008, the SEC published<sup>36</sup> a 'Roadmap for the potential use of financial statements prepared in accordance with IFRS by US issuers':

The Securities and Exchange Commission ('Commission') is proposing a Roadmap for the potential use of financial statements prepared in accordance with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board by U.S. issuers for purposes of their filings with the Commission. This Roadmap sets forth several milestones that, if achieved, could lead to the required use of IFRS by U.S. issuers in 2014 if the Commission believes it to be in the public interest and for the protection of investors. This Roadmap also includes discussion of various areas of consideration for market participants related to the eventual use of IFRS in the United States. As part of the Roadmap, the Commission is proposing amendments to various regulations, rules and forms that would permit early use of IFRS by a limited number of U.S. issuers where this would enhance the comparability of financial information to investors. Only an issuer whose industry uses IFRS as the basis of financial reporting more than any other set of standards would be eligible to elect to use IFRS, beginning with filings in 2010.

However, as of the date of writing this chapter of the book, no decision for the implementation of the Roadmap has yet been announced. The staff of the Office of the Chief Accountant has prepared several reports on the subject.

The SEC had indicated it would make a decision on incorporation of international financial reporting standards in 2011. Then, on 5 December, James Kroeker, the agency's chief accountant, said SEC staff needed 'a measure of a few additional months time' to issue a final report. At the same time, staff accountants are devising an approach for commissioners to weigh as they studied the issue of IFRS's future in the United States. At the time, Kroeker said, 'I can't give you a precise schedule, but what I can tell you is we will do so carefully and thoughtfully, being guided by an ideal that produces the maximum benefit for the investing public and the capital markets.' The issue has the potential to be politically sensitive. The US Congress may choose to hold hearings on IFRSs and time is running out for the SEC to consider the IFRS question in advance of the upcoming presidential election in November 2012. The European Commission has expressed some frustration at the lack of decision by the SEC. In a speech pronounced<sup>37</sup>

in February 2011, Mr Jonathan Faull, Director General of Internal Market Directorate, at the occasion of a conference on accounting and auditing, said:

But now, it is not only about European companies: the need for a common language is a global one. The G20 called for convergence in accounting standards. And the Commission wants to work further with the IASB to support that commitment. In particular, we look forward to the US SEC's forthcoming decision on the use of IFRS, due in 2011. From a wider perspective, this is an essential element of global reform. Why? Because if accounting standards are different, then capital requirements become different too. But in any case, whatever the US decides to do about IFRS, differences between US accounting and IFRS will narrow this year, thanks to the ongoing convergence project between the two sets of standards.

Convergence represents a massive challenge but it should not be at the expense of quality, which should remain the primary driver of the IASB's work. It is essential that the standard setter responds fully to the concerns that have been expressed by stakeholders. If a few more months are required to develop high quality solutions, then let's make use of the revised deadline set by the G-20 (December 2011)! I am of the firm opinion that this would not put the broader convergence agenda at risk.

Looking at the longer term, convergence is not an end in itself. It is only a means to facilitate the adoption of a single set of globally-accepted accounting standards, in line with G-20 recommendations. And of course, this is not just about the US. The purpose is to have as many jurisdictions as possible on board.

#### *5.4 Convergence efforts between IASB and FASB and improvements to the accounting standards are encouraged by the European Commission, the SEC and by the G20 political leaders*

A common set of high quality global standards has been a priority of both the IASB and the FASB and the objective of having IFRS accepted globally is a key element of the IFRS Foundation's mission statement: 'to develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards (IFRSs) through its standard-setting body, the IASB'. In September 2002 the IASB and the FASB agreed to work together, in consultation with other national and regional bodies, to remove the differences between international standards and US GAAP. This decision was embodied in a Memorandum of Understanding (MoU) between the boards known as the Norwalk Agreement. The boards' commitment was further strengthened in 2006 when the IASB and FASB set specific milestones to be reached by 2008 ('A roadmap for convergence 2006–2008'):

*A Roadmap for Convergence Between IFRSs and US GAAP 2006–2008: Memorandum of Understanding between the FASB and the IASB - 27 February 2006.*

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRS). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation



requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard setters and regulators.

The FASB and the IASB recognise that their contribution to achieving the objective regarding reconciliation requirements is continued and measurable progress on the FASB-IASB convergence programme. Both boards have affirmed their commitment to making such progress. Recent discussions by the FASB and the IASB regarding their approach to the convergence programme indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead, a new common standard should be developed that improves the financial information reported to investors.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards.<sup>38</sup>

In 2008 the two boards issued an update to the MoU, which identified a series of priorities and milestones, emphasising the goal of joint projects to produce common, principle-based standards. The updated plan set up the objectives for the period 2008–11. At the end of 2011, although significant progress has been achieved on several joint projects, a number of important ones are still being deliberated by the two Boards (Financial Instruments, Lease Contracts, Revenue Recognition, Insurance Contracts).

### Response to the Recommendations of the G20 leaders

As part of the action plan adopted in response to the financial crisis that erupted in 2007, the Group of 20 Leaders (G20) called for standard-setters to 're-double' their efforts to complete convergence in global accounting standards. On 2 April 2009, the G20 published a report<sup>39</sup> (G20, 2009) assessing the progress against each of the 47 actions set out in the Washington Action Plan that formed part of their commitment to reform the financial sector. The progress report included a range of reforms to be undertaken by regulators, credit rating agencies and standard-setters. The text of the recommendation in relation to accounting standard is as follows:

We have agreed that the accounting standard setters should improve standards for the valuation of financial instruments based on their liquidity and investors' holding horizons, while reaffirming the framework of fair value accounting.

We also welcome the FSF recommendations on pro-cyclicality that address accounting issues. We have agreed that accounting standard setters should take action by the end of 2009 to:

- reduce the complexity of accounting standards for financial instruments;
- strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information;

- improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty;
- achieve clarity and consistency in the application of valuation standards internationally, working with supervisors;
- make significant progress towards a single set of high quality global accounting standards; and,
- within the framework of the independent accounting standard setting process, improve involvement of stakeholders, including prudential regulators and emerging markets, through the IASB's constitutional review.

Following this request, in November 2009 the IASB and the FASB published a progress report describing an intensification of their work programme, including the hosting of monthly joint board meetings and to provide quarterly updates on their progress on convergence projects.

At subsequent summits in Pittsburgh (2009), Toronto (2010), Seoul (2010) and Cannes (2011) the G20 leaders reaffirmed their support for a single set of global accounting standards and for the completion of convergence of international and US accounting standards in pursuit of that objective. Furthermore, the G20 leaders called on the IASB to further enhance cooperation with stakeholders, with particular emphasis on support for emerging economies and within the context of their independent standard-setting framework.

The IASB publishes at regular intervals a report detailing the status of its standard-setting efforts in response to the G20 recommendation. In April 2012 the IASB and FASB published a joint progress report for the Financial Stability Board Plenary on Accounting Convergence,<sup>40</sup> in which they describe the progress made on financial instruments, including a joint expected loss impairment ('provisioning') approach and a more converged approach to classification and measurement.

## 6. Organizing consistent application and enforcement of accounting standards

### 6.1 *The European Commission's policies on consistent interpretation and enforcement*

#### The short lived EU roundtable on consistent implementation of IFRS

From the very early days of the transition to IFRS, the European Commission and CESR (the forerunner of ESMA) were concerned that the full benefits of adopting IFRS would be reaped only if there was a consistent application and enforcement of the standards, and that a system where the standards are principles-based and include only a limited amount of detailed guidance was not yet successfully tested. The Commission relied on CESR regarding the enforcement and encouraged the publication of the Standards on Enforcement and the establishment of a coordination mechanism (see below). However it also felt it necessary to provide a forum where certain interpretation issues could be discussed and resolved ahead of the publication of financial statements. There was also a perception that IFRIC was not sufficiently responsive to the questions put to it. The Commission organized a series of roundtable meetings which were attended by the accounting firms, representatives from CESR and from IFRIC. After a couple of years, this was discontinued as preparers and the accountants indicated there was no evidence of a real need.

### Recent evolutions of the role of IFRIC under the new IFRS Foundation strategy

In February 2012, the Trustees of the IFRS Foundation, the oversight body of the IASB, concluded their review of the strategy of the IFRS Foundation. The review was initiated at the end of 2010 as the IFRS Foundation was entering its second decade of existence and was a result of the IFRS Foundation's second Constitution Review that was completed in early 2010. The Trustees' strategy review sought to articulate a clear strategy and vision for the organization by considering the mission, governance, standard-setting process and financing of the IFRS Foundation. The report asserts that the success of IFRSs (and the objective of global standards) requires consistency and faithfulness in the application of IFRSs. The Trustees reached the following conclusions:

In pursuing its mission, the IFRS Foundation has a vested interest in helping to ensure the consistent application of IFRSs internationally. The Foundation should pursue that objective in the following ways:

- The IASB, as the standard-setter, should issue standards that are clear, understandable and enforceable. The IASB will provide guidance on its standards that is consistent with a principle-based approach to standard-setting.
- Application guidance and examples should be provided when it is necessary to understand and implement the principles in a consistent manner.
- The IASB will work with a network of securities regulators, audit regulators, standard-setters, regional bodies involved with accounting standard-setting, accounting bodies and other stakeholders to identify where divergence in practice occurs across borders.
- Where divergence in practice could be resolved through an improvement in the standard or an Interpretation, the IASB or the IFRS Interpretations Committee will act accordingly.
- The IFRS Foundation, through its education and content services, should undertake activities aimed at promoting consistent application.
- The IASB, in partnership with relevant authorities, will identify jurisdictions where IFRSs are being modified and, in these circumstances, encourage transparent reporting of such divergences at the jurisdictional level.
- The IFRS Foundation will seek the assistance of the relevant public authorities to achieve this objective.

Among the tools available to the IFRS Foundation in its efforts to ensure consistent application are: the IFRS Interpretations Committee, to identify emerging areas of divergence across borders before they become entrenched practice, to refer issues to the IASB when standards require improvement, and to issue Interpretations within a principle-based environment. In the second decade, the Interpretations Committee will probably play a more active role, in close co-ordination with the IASB (IFRS Foundation, 2012a: A5).

Both the IASB and IFRIC are currently implementing the organizational changes necessary to give effect to those recommendations. On 2 May 2012, the Trustees of the IFRS Foundation published<sup>41</sup> recommendations on efficiency and effectiveness of the IFRS Interpretation Committee, with the key objective of the Committee being equipped with 'a broader range of tools', 'enabled to be more responsive to requests for assistance' and having 'to deal with a wider range of requests'.

## 6.2 The EU authorities responsible for enforcement: from FESCO to ESMA

### 6.2.1 FESCO

Cooperation between authorities responsible for financial markets in the EU began rather informally in the late 1990s through a discussion forum: the FESCO (Forum of European Securities Commissions). The press release issued by the French COB<sup>42</sup> on 9 December 1997 reads:

The implementation of the European Directives in the financial field, and the forthcoming introduction of the Euro, imply an increasing integration of financial activities in Europe.

Considering that investor protection, that efficiency, integrity and transparency of markets and that the overall safety of the financial system are fundamental to achieving sound and stable financial markets, 17 of the statutory Securities Commissions of the Member States of the European Economic Area (EEA), during their meeting in Paris on December 8, 1997, have adopted a Charter creating the Forum of European Securities Commissions (FESCO).

By doing so, the members of FESCO have expressed their resolution to adhere, both in principle and in practice, to the commitments stated in the Charter, and in particular:

- to share their experience and work together to facilitate the fair and efficient realisation of the European Single Market in financial services;
- to unite their efforts in order to develop common regulatory standards in respect of the supervision of financial activities or markets concerning aspects that are not harmonized by the existing European Directives and where a common approach is appropriate; and
- to provide, to the extent permitted by law, the broadest possible mutual assistance and to strengthen cross-border cooperation so as to enhance market surveillance and effective enforcement against abuse.

In 2000, FESCO decided to focus on the harmonization of financial reporting in the context of the European plans to create a single financial market:

FESCO has decided to create an expert group on Accounting, chaired by Henrik Bjerre Nielsen, Director General of the Finanstilsynet of Denmark. This group will explore institutional and substantial issues in relation to accounting standards, and in particular to the implementation and enforcement of IAS in the EEA. FESCO is taking up the challenge posed by the communication of the European Commission 'EU Financial Reporting Strategy: the way forward', which makes clear securities regulators must play an important role in the implementation and the consistent enforcement of IAS throughout the EEA (FESCO, 2000).<sup>43</sup>

### 6.2.2 CESR

A few years later, in response to the rapid developments of the European Commission's plans to implement its single financial market strategy, and following the recommendations of the Baron Lamfalussy Report,<sup>44</sup> the authorities decided to strengthen and make their cooperation

arrangements more institutional. They established a Committee of European Securities Regulators to replace the Forum:

CESR was established as an independent committee of European securities regulators. All undertakings, standards, commitments and work agreed within the Forum of the European Securities Commissions (FESCO) will be taken over by CESR. The role of this Committee is to:

- Improve co-ordination among securities regulators;
- Act as an advisory group to assist the EU Commission, in particular in its preparation of draft implementing measures in the field of securities;
- Work to ensure more consistent and timely day to day implementation of community legislation in the member states.

The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the committees envisaged in the 'final report of the group of Wisemen on the regulation of European securities markets'. The report itself was endorsed by the Stockholm European Council Resolution. Each Member State of the European Union has one member on the Committee. The members are nominated by the Member States and are the Heads of the national public authorities competent in the field of securities. The Committee of European Securities Regulators met the first time, in Paris, on Tuesday 11 September 2001.

At about the same time, two other 'Level-3 committees' of the European Union foreseen in the 'Lamfalussy process' were created: the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

### 6.2.3 A brief overview of the Lamfalussy process

The 'Lamfalussy process', named after Baron Alexandre Lamfalussy, is a four-level process that has been adopted in the EU for the development, implementation and enforcement of EU legislation regarding financial markets. It was first established in relation to the securities markets and later extended to cover banking, insurance and occupational pensions, and UCITS:

- At Level 1, the European Parliament and the Council adopt, following proposals from the Commission, legislative acts (Directives and Regulations) establishing core or essential principles. For instance, the EU Transparency Directive, the EU Regulations on Prospectus and on the use of IAS are Level 1 documents.
- At Level 2, the Commission, assisted by Committees in accordance with comitology procedures (for instance, the European Securities Committee or the Accounting Regulatory Committee) and advised at Level 3 by networks of national regulatory agencies, adopts technical measures to implement the Level 1 essential principles.
- Level 3 involves work on implementation by the networks (e.g. CESR, CEBS and CEIOPS), including the development of common approaches and dissemination of best practices through the issuance of standards, recommendations and other forms of guidance.
- Level 4 deals with compliance and enforcement of Level 1 and 2 principles and implementation texts.

The Lamfalussy Report had identified the following key priorities to be adopted and brought into effect at the latest by the end of 2003:

- a single prospectus for issuers, with a mandatory shelf registration system;

- modernization of admission to listing requirements and introduction of a clear distinction between admission to listing and trading;
- generalization of the home country principle (mutual recognition) for wholesale markets, including a clear definition of the professional investor;
- modernization and expansion of investment rules for investment funds and pension funds;
- adoption of International Accounting Standards; and
- a single passport for recognized stock markets (on the basis of the home country control principle).

#### 6.2.4 CESRFin and EECS

As the adoption of the IFRS was decided by the European Union in 2002, CESR immediately identified the need to monitor the change over from the national GAAP being used so far to the new accounting framework. There were concerns that, absent a coordinated and orderly transition, the change in accounting standards could generate reporting errors, disrupt investors' analyses of financial data, and create severe market confusion. Also, the Regulation 1606/2002 called in particular for CESR to have a role in developing standards for enforcement. Recital n. 16 of the regulation says:

A proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets. Member States, by virtue of Article 10 of the Treaty, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach to enforcement.

On this basis, CESR established a permanent working committee CESRFin tasked with the monitoring of the transition to IFRS and developing a harmonized enforcement regime. CESRFin's Work Plan, which was approved by CESR in January 2002, includes the development of principles, guidelines and standards in the areas of:

- definition of enforcement;
- selection techniques;
- powers to be attributed to the enforcers; and
- cross-border listings and offerings.

#### The standards on enforcement

In March 2003, CESR published<sup>45</sup> the first Standard on Financial Information, which defines the purpose of enforcement, the instruments and documents to which it applies, the required characteristics of enforcement authorities, and the methods of enforcement. The 21 principles contained in this Standard #1 are still in force today, insofar as they have been adopted without change by ESMA, the successor to CESR.

In April 2004, CESR released its Standard #2 on the coordination of enforcement of financial information.<sup>46</sup> According to the press release:

The standards adopted will contribute to the creation within Europe of robust and consistent enforcement of the internationally recognised set of accounting standards (as published

by the International Accounting Standards Board and endorsed by the European Commission) to be implemented by 2005. This will therefore deliver greater consistency of accounting treatment across Europe and will ensure a level playing field.

The key principles introduced by Standard # 2 include:

- discussion of enforcement decisions and experiences within a formalized structure which will involve CESR Members and delegated authorities that are non-securities regulators, for example, stock exchanges, or national review panels ('European Enforcers Co-ordination Sessions' – EECS).
- the principle that all supervisors should take into account existing decisions taken by EU National Enforcers.
- additionally, CESR proposes that where practicable within constraints of time and confidentiality, discussions with other EU National Enforcers should take place before significant decisions are taken.
- the development of a database as a practical reference tool which sets out decisions taken by EU National Enforcers, to provide a record of previous decisions reached in particular cases. The database of enforcement decisions will set out the principles upon which decisions have been taken by EU National Enforcers.

The mechanism of the enforcement data base and the criteria for the publication of enforcement decisions will be described further down.

### 6.2.5 Organizing an orderly transition from national GAAP to reporting under IFRS, so as to limit disruptions to investors

Regarding the transition from national accounting standards to IFRS, CESR issued in December 2003 a 'Recommendation'<sup>47</sup> for additional guidance regarding the transition to IFRS'. This Recommendation contained several proposals whereby European listed Companies can be encouraged to provide markets with appropriate and useful information during the transition phase from local accounting standards to International Financial Reporting Standards (IFRS). Those recommendations relate primarily to:

- what type of information could usefully be published before the year of transition in relation with the changeover to the IFRS framework;
- the accounting framework to be used by issuers when interim financial information is published during the financial year beginning on or after 1 January 2005; and
- how to achieve comparability of information published for the year 2005 with preceding periods.

The context of this Recommendation was explained by CESR as follows:

In view of the unusual importance of this complete change in accounting principles and its potential impacts on financial markets, CESR believes that useful guidance should be provided by its Members regarding the financial information that has to be published by European listed companies during the transition phase (starting at the date of adoption of the IAS Regulation) in order to:

- contribute to the successful implementation of this process;

- foster the presentation of comparable information among companies during the transition phase; and
- promote a framework such that the information published is relevant and as understandable as possible by investors.

Indeed, it is probable that, anticipating the importance of the event represented by the mandatory application of IAS/IFRS as from 1 January 2005, many investors and financial analysts will be impatient to assess the real impact of the transition for listed companies. Around the turning point, accounting information will often be analysed in terms of its forthcoming significance under IAS/IFRS (CESR, 2003b: §3).

The Recommendation addressed the annual and interim financial statements that would be published during period from 2003 to the end of 2005, during which national accounting standards would remain applicable.

The change towards IAS/IFRS implies a complex process that could usefully be accompanied by a particular effort of financial communication in order to prepare gradually the market to assess its impact on the consolidated financial statements. CESR has identified four different milestones in the transition process that coincide with the publication of the 2003 annual financial statements, 2004 annual financial statements, 2005 interim financial statements and 2005 annual financial statements (CESR, 2003b: §11).

It should be noted that, as CESR had no direct regulatory power regarding the application of European legislation, it could only encourage its member organizations to act in a coordinated way. This is acknowledged in the text of the Recommendation:

The present document is clearly a recommendation from CESR Members to themselves to encourage listed companies to adopt the proposed disclosure guidelines.

Although each national regulator could decide to go beyond and require full or partial compliance with this guidance, CESR believes that a recommendation is sufficient at this stage in order to meet two objectives. The first objective is to keep the distinction between standards provided by EU regulations and directives in the area of financial reporting (notably through endorsement of IASB's standards) and additional guidance provided by CESR Members. The second objective is that the recommendation remains at the level of principles whose primary aim is to foster listed companies to adopt proper communication policies during the transition process with sufficient flexibility and not to create detailed reporting rules, in terms of timing and content of such reporting (CESR, 2003b: §6 and §7).

There is sufficient evidence that this approach was efficient as practically all CESR members issued their own guidance or regulations applicable to the issuers under their authority, based on the Recommendation.

## 6.2.6 ESMA

The European Securities and Markets Authority was established on 1 January 2011 to succeed CESR by the EU Regulation 1095/2010.<sup>48</sup> The decision gave full effect to the conclusions of the Lamfalussy report mentioned above and to the further conclusions of a High-Level Group



chaired by Mr Jacques de Larosière. The High-Level Group recommended that the supervisory framework be strengthened to reduce the risk and severity of future financial crises. It recommended reforms to the structure of supervision of the financial sector in the Union. The group also concluded that a European System of Financial Supervisors should be created, comprising three European Supervisory Authorities, one for the banking sector, one for the securities sector and one for the insurance and occupational pensions sector and recommended the creation of a European Systemic Risk Council.

As a matter of fact, a European Banking Authority (EBA) and a European Insurance and Occupational Pensions Authority (EIOPA) were established at the same time as ESMA to replace respectively CEBS and CEIOPS. The first Recital to the 1095/2010 Regulation states that:

The financial crisis in 2007 and 2008 exposed important shortcomings in financial supervision, both in particular cases and in relation to the financial system as a whole. Nationally based supervisory models have lagged behind financial globalisation and the integrated and interconnected reality of European financial markets, in which many financial institutions operate across borders. The crisis exposed shortcomings in the areas of cooperation, coordination, consistent application of Union law and trust between national supervisors.

ESMA has been given a greater role in Level 2 in drafting what can be considered as subordinate acts (known as delegated acts and implementing acts). Delegated acts are concerned more with the substantive content of the legislative requirement, for example setting out what authorization information firms must provide to competent authorities, whilst implementing acts are similar to executive measures giving effect to the substantive requirements, this might include for example, standard forms, templates and procedures for communicating information or processes between competent authorities.

At Level 3, ESMA will develop guidelines and recommendations with a view to establishing consistent, efficient and effective supervisory practices within the European System of Financial Supervision, and to ensure the common, uniform and consistent application of Union Law. The guidelines and recommendations are addressed to competent authorities or financial market participants. Whilst not legally binding, these have been strengthened under ESMA and competent authorities must now make every effort to comply and must explain if they do not intend to comply. Financial market participants can also be required to report publicly whether they comply. ESMA will also take other steps under Level 3 to ensure supervisory convergence.

At Level 4, a fast track procedure has been introduced by the Regulation establishing ESMA. On this basis, ESMA now has a new role. At the request of a national competent authority, the European Parliament, Council, Commission or the Stakeholder Group, ESMA can be requested to launch an enquiry and can issue a recommendation addressed to the national authority, within two months of launching its investigation. ESMA will also be able to launch investigations on its own initiative. The Commission will also be able to follow its usual procedures for referring a case against the Member State to the Court of Justice.

ESMA has organized itself around a number of working committees. One of them is of particular relevance to the area of financial reporting. The Corporate Reporting Standing Committee conducts all ESMA's work on issues related to accounting, audit, periodic reporting and storage of regulated information. In particular, it:

- pro-actively monitors and influences regulatory developments in the area of accounting and auditing, including an active monitoring of the EU endorsement process of international standards and the work of relevant EU accounting and/or auditing Committees;

- coordinates the activities of National Enforcers from the European Economic Area relating to the enforcement of compliance with IFRS. Notably this includes:
  - Analysis and discussion of individual enforcement decisions this under IFRS and emerging financial reporting issues under IFRS.
  - Identifying issues which are not covered by financial reporting standards or which may be affected by conflicting interpretations for referral to standard-setting or interpretative bodies such as the IASB and IFRIC.
  - Facilitating the exchange of views and sharing of experiences on methods for supervising the financial information of companies offering publicly securities and/or having these securities listed on an EU regulated market.
- pro-actively monitors and influences developments relating to periodic financial reporting under the Transparency Directive; and
- establishes and maintains appropriate relationships with securities regulators from major capital markets outside Europe, to foster operational cooperation between EU and non-EU regulators on the competences in the remit of the Standing Committee.

An example of ESMA's activities regarding the consistent application of IFRS, and of its interaction with IASB, can be found in the Public Statement<sup>49</sup> on Sovereign Debt in IFRS financial statements, issued on 25 November 2011 following letters exchanged between the Chairmen of IASB and ESMA. It should also be noted here that ESMA has been given a role that CESR did not have: ESMA is exclusively responsible for the registration and supervision of Credit Rating Agencies in the European Union. In addition, ESMA also carries out policy work to prepare future legislation, such as regulatory technical standards, and guidelines. This work is undertaken through the CRA technical committee, which has representatives from all the national competent authorities.

### 6.2.7 Publication by the European Enforcers Coordination Sessions (EECS) of selected enforcement decisions

EECS is a forum which has been working under the oversight of CESR (now ESMA) and brings together all EU National Enforcers of financial information. The enforcers meet to exchange views and discuss experiences of enforcement of IFRS. A key function of EECS is the analysis and discussion of decisions taken by independent EU National Enforcers in respect of financial statements published by issuers with securities traded on a regulated market and who prepare their financial statements in accordance with IFRS. The purpose of this is to increase convergence amongst enforcers' activities across Europe. ESMA regularly publishes extracts from the EECS database of enforcement decisions contributing to provide greater transparency for market participants on application of standards that they consider useful. A selection of enforcement decisions published by ESMA, as well as periodic reports on the enforcement activities at the level of the European Economic Area, can be found on its web site.<sup>50</sup> The report on enforcement activities for 2010 says:

As a result of IFRS enforcement activities in 2010, around 20 per cent of the approximately 700 actions taken in Europe have been subject to coordination at EECS level. The accounting issues giving rise to actions arose in all areas covered under IFRS, and most frequently related to: recognition, measurement and disclosures of financial instruments, application of new requirements for operating segments, disclosure on impairment of non-financial

assets, measurement and presentation of non-current assets held for sale and discontinued operations or aspects related to share-based payments. A range of topics has also been discussed with representatives of the IFRS Interpretations Committee (IFRS IC), as part of the regular feedback EECs is providing to the IFRS IC (ESMA, 2011a).

### 6.3 Was the transition from national GAAP to IFRS successful?

A report<sup>51</sup> for the European Commission was published in October 2007 by the ICAEW: 'EU Implementation of IFRS and the Fair Value Directive', whose objectives were defined as follows:

The objectives of the study of EU implementation of IFRS and the Fair Value Directive are to provide the European Commission with:

- a general analysis of the first year of application of IFRS in the EU so that DG Internal Market has the necessary information to carry out an evaluation of the functioning of the IAS Regulation and to feed into discussions in the Accounting Regulatory Committee on how the IAS Regulation has worked in practice; and
- information on the application of the modernised Accounting Directives, especially provisions related to fair value accounting in the Fourth Company Law Directive 78/660/EEC as amended by the Fair Value Directive so that DG Internal Market has the necessary information to carry out a review of these provisions (ICAEW, 2007: 5).

The key findings regarding the transition to IFRS were the following:

The IAS Regulation has been effective in achieving the core objective of all publicly traded entities preparing consolidated financial statements in accordance with IFRS-EU, subject to the deferral of implementation in some countries to 2007 for entities with only debt securities admitted to trading or those entities listed on a non-EU market and using internationally accepted standards.

The roundtable discussions and interviews highlighted the fact that the journey from national GAAP to IFRS had varied enormously in different jurisdictions. At one extreme, in some countries IFRS had been used widely by large companies for many years, and for those companies at least, the transition was a fairly low key affair. In other countries, there was no experience of IFRS application and national GAAP bore no resemblance to international standards, resulting in tremendous challenges for all parties involved in the financial reporting process. The quality of financial reporting under national GAAP was acknowledged to have varied, and it was mentioned that SEC registrants were better equipped than others to make the transition. It was also apparent that the level of economic development and governance environments found in each jurisdiction had a major bearing on the process. In short the concept of a single transition to IFRS in the EU 2005 was shown to be of limited usefulness, even in the narrow context of publicly traded companies.

Against this background, the message from the roundtables was broadly consistent, and substantially confirmed the findings of the on-line survey. In particular, IFRS implementation had been challenging, but successful, as evidenced by a lack of material problems uncovered with the 2005 numbers during the process of preparing financial information for 2006 and the absence

of any general loss of confidence in financial reporting. It was reported that larger companies especially had prepared early, and had devoted considerable resources to educating and training their boards, staff and investors. The contribution of the IASB to this process, in making necessary improvements to IFRS in time for 2005 application, was referred to.

It was also emphasised by several participants that the experience of smaller quoted companies was often very different from larger companies. Resources available to manage the transition and to deal with ongoing changes were far more limited, preparation tended to be undertaken at a later stage, and it was much less likely that the company or their auditors had prior experience of IFRS. Nonetheless, it was pointed out that there was little evidence of problems being identified with initial IFRS numbers in the second year of reporting under the IAS Regulation (ICAEW, 2007).

With regards to the role of regulators in the process of transition to IFRS, the ICAEW noted that:

European regulators, along with other stakeholder groups, play a key role in ensuring that IFRS are applied with a degree of consistency appropriate in the context of principles based accounting standards. Our discussions with some securities regulators and our reviews of reports and correspondence confirm our view that the consolidated financial statements of Sample 1 companies generally comply with IFRS-EU, IFRS or both. They also confirm that there are issues which require further attention by companies, including disclosures regarding accounting policies and key judgements made by management, but that none of these issues are sufficiently major to undermine the level of compliance with IFRS-EU or IFRS (ICAEW, 2007).

Another report was commissioned from Ineum Consulting and published<sup>52</sup> in December 2008. It concluded that the overall quality of IFRS financial statements had improved in 2006 in comparison with 2005. However, the application of IFRS by small and medium-sized listed companies posed specific problems and the choice of presentation options for the format of the financial statements remained influenced by national accounting cultures. Overall, disclosures had improved but there remained room for improvement of disclosures on judgments and estimates. The communication of additional non-GAAP performance measures was not prevalent and 84 per cent of companies commented their net IFRS results in their management report, thus contradicting a view expressed by some that IFRS measures are not widely used by management.

## **7. Financial reporting standards in the EU for entities traded on non-regulated securities markets and for non-listed entities**

It is important to note that the IAS Regulation applies in a mandatory way only to issuers whose financial instruments are listed on a regulated market, a notion which differs from that of an organized trading facility. The scope of the Regulation is as follows:

- mandatory for preparation of the consolidated financial statements as determined under the 7th Directive;
- if, at the balance sheet date, the securities of the entity are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

The Directive on Investment Services (ISD), which was later on replaced by the MIFID Directive (see above), provides criteria for a regulated market:

it shall function regularly, be characterized by the fact that regulations issued by the competent authority define the conditions for the operations of and access to that market, and it requires compliance with all the reporting and transparency requirements laid down pursuant to articles 20 and 21 of the ISD.

The ISD requires each Member State to draw a list of those markets that fulfil the above conditions. As a result, each competent authority in cooperation with the stock market enterprises decides the regulations which apply to each domestic market and classifies the markets as either regulated or unregulated vis-à-vis the ISD. In the case of NYSE-Euronext, it operates Euronext Securities Markets in Amsterdam, Brussels, Lisbon, London and Paris via its five Euronext Market Undertakings (market operators). These Euronext Securities Markets are Regulated Markets within the meaning of the MIFID. NYSE-Euronext also operates Alternext markets in Paris, Amsterdam and Brussels, which under the scope of article 4(1)(15) of the MIFID are ‘organized multilateral trading facilities’. The harmonized ‘Alternext Markets Rule Book’<sup>53</sup> prescribes that the financial statements of the issuer admitted on one of the markets shall be prepared, consolidated where applicable, in accordance with IFRS (if allowed by its National Regulations) or with the accounting standards applicable in the country of its registered office. So, there is an IFRS option but no requirement to follow IFRS.

In addition, Paris and Brussels operate ‘free markets’ (marche libre and delisted securities market) which are also non-regulated multilateral trading facilities. Their functioning is governed by ‘organization memoranda’<sup>54</sup> which indicate that the accounting requirements of the entities admitted to trading are ‘those determined by their legal form’, i.e. by the national accounting requirements applicable to any legal entity.

The IAS Regulation also contains a series of Member States options to extend the use of IFRS beyond the mandatory application to the consolidated financial statements of entities listed on a regulated market. Those options<sup>55</sup> are:

- to require or permit the application of IFRS in preparing individual (parent company) accounts of those entities required to follow IFRS for the preparation of the consolidated accounts;
- to require or permit the application of IFRS in the preparation of consolidated accounts by entities not listed on a regulated market; and
- to require or permit the application of IFRS in preparing individual (parent company) accounts of the entities not listed on a regulated market.

A study on the application of Member States options regarding the use of IFRS is available on the European Commission’s website.<sup>56</sup> A broad conclusion to be drawn from the survey could be that the application of IFRS beyond the mandatory requirement is usually permitted for consolidated accounts but still limited for non listed companies, with a majority (18 out of 27) of Member States allowing an alignment of the accounting standards for annual and consolidated accounts of the entities listed on a regulated market, and a vast majority (25 out of 27) permitting IFRS to be used in lieu of the national GAAP for the preparation of consolidated accounts of non listed companies. For those Member States (11 out of 27) who are reluctant to extend the use of IFRS to annual accounts of non listed companies, an explanation often given

is the strong linkage between the profit basis for income tax calculations and the profit or loss determined according to national GAAP.

## 8. Conclusion

On the basis of this factual review of the evolution of policies and regulatory authorities since 1995, it is in my opinion clear that the successful globalization of IFRS was the result of the combined actions of IOSCO and the European Commission. In the key year of 2000, both the EU and IOSCO took the decisions that put international accounting standards on the launching ramp. The 2002–5 transition period coincided with the introduction of a coherent framework of legislation for the admission to trading of securities and the organization of the supporting enforcement mechanisms. The new IFRS Foundation was created to replace the IASCF following a model borrowed from the one that existed in the USA (the technical Board FASB being overseen by the Financial Accounting Foundation) and this structure, which was improved continuously and endorsed by the public authorities, gave the IASB the credibility necessary to be recognized as a worldwide standard-setter.

The use of IFRS has now reached the critical mass. Nearly a half of the companies in the Global 500 league published by *Fortune* magazine now report under IFRS. The large investors get used to utilize IFRS financial data and there is no evidence that their needs are not served adequately. The continued support of the G20 leaders to the convergence of financial regulations make it likely that at some point in the future, the jurisdictions who are still hesitant will take a positive decision to move beyond the mutual recognition of standards and fully adopt IFRS. It may well take a number of years, but as we say in my home country '*Paris ne s'est pas fait en un jour*'.

Please note that this chapter was written in April 2012 and that further developments have not been taken into account.

## Notes

- 1 Speech by Professor Otmar Issing, 12 September 2000, Ottobereun. [www.ecb.int/press/key/date/2000/html/sp000912\\_2.en.html](http://www.ecb.int/press/key/date/2000/html/sp000912_2.en.html) (accessed 30 September 2012)
- 2 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:327:0001:0012:EN:PDF>
- 3 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0057:EN:PDF>
- 4 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:01983L0349-20090716:EN:NOT>
- 5 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1983L0349:20090716:EN:PDF>
- 6 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0124:EN:NOT>
- 7 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:145:0001:0044:EN:PDF>
- 8 [www.world-exchanges.org/files/statistics/excel/Notes per cent20on per cent20the per cent20Proceedings per cent20- per cent202007 per cent20Annual per cent20Meeting.pdf](http://www.world-exchanges.org/files/statistics/excel/Notes%20on%20the%20proceedings%20-%20per%202007%20Annual%20Meeting.pdf)
- 9 [www.iosco.org/library/statements/pdf/statements-19.pdf](http://www.iosco.org/library/statements/pdf/statements-19.pdf)
- 10 [www.iosco.org/library/pubdocs/pdf/IOSCOPD2.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD2.pdf)
- 11 [www.iosco.org/library/pubdocs/pdf/IOSCOPD109.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD109.pdf)
- 12 Effective 1 January 2012, Mr Prada was appointed Chairman of the Trustees of the IFRS Foundation.
- 13 [www.iosco.org/news/pdf/IOSCONEWS5-English.pdf](http://www.iosco.org/news/pdf/IOSCONEWS5-English.pdf)
- 14 [www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD133.pdf)
- 15 [www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD134.pdf)
- 16 <http://pcaobus.org/Pages/default.aspx>
- 17 [www.h3c.org/](http://www.h3c.org/)
- 18 [www.iosco.org/library/statements/pdf/statements-7.pdf](http://www.iosco.org/library/statements/pdf/statements-7.pdf)
- 19 [www.iosco.org/monitoring\\_board/pdf/Monitoring\\_Board\\_Charter.pdf](http://www.iosco.org/monitoring_board/pdf/Monitoring_Board_Charter.pdf)
- 20 The chair of the Technical Committee and the chair of the Emerging Markets Committee.

- 21 COM 95 (508) EN.
- 22 [http://ec.europa.eu/internal\\_market/finances/docs/actionplan/index/action\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf)
- 23 The Financial Services Policy Group (FSPG) was established in 1998 by the Commission to update rules governing financial trade among Member States; it consisted of representatives of the EU finance ministers.
- 24 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:243:0001:0004:EN:PDF>
- 25 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003R1725:EN:HTML>
- 26 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:363:0001:0065:EN:PDF>
- 27 The exclusion of the parts of IAS 39 dealing with the Fair Value Option (FVO) was rescinded on 15 November 2005 by Regulation 1864/2005 following IASB's 2004 decision to propose restrictions to, and additional related disclosures, on the use of the FVO and subsequent discussions with the European central bank and the Basel Committee of banking supervisors.
- 28 [http://ec.europa.eu/internal\\_market/accounting/docs/ias/explanatory-memo-2004-09-ias39-proposal\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/ias/explanatory-memo-2004-09-ias39-proposal_en.pdf)
- 29 [www.efrag.org/Front/c1-306/Endorsement-Status-Report\\_EN.aspx](http://www.efrag.org/Front/c1-306/Endorsement-Status-Report_EN.aspx)
- 30 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32005R1864:EN:NOT>
- 31 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:103:0011:0012:EN:PDF>
- 32 [http://ec.europa.eu/internal\\_market/accounting/third\\_countries/index\\_en.htm](http://ec.europa.eu/internal_market/accounting/third_countries/index_en.htm)
- 33 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:103:0011:0012:EN:PDF>
- 34 [www.sec.gov/news/press/2009/2009-237.htm](http://www.sec.gov/news/press/2009/2009-237.htm)
- 35 [www.sec.gov/rules/final/2007/33-8879.pdf](http://www.sec.gov/rules/final/2007/33-8879.pdf)
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- 45 [www.esma.europa.eu/system/files/03\\_073.pdf](http://www.esma.europa.eu/system/files/03_073.pdf)
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- 51 [http://ec.europa.eu/internal\\_market/accounting/docs/studies/2007-eu\\_implementation\\_of\\_ifrs.pdf](http://ec.europa.eu/internal_market/accounting/docs/studies/2007-eu_implementation_of_ifrs.pdf)
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- 53 [https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/nyse\\_alternext\\_rules\\_en\\_1501210.pdf](https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/nyse_alternext_rules_en_1501210.pdf)
- 54 [https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/Organisation\\_memorandum\\_-\\_consolidated\\_version\\_effective\\_on\\_March\\_29\\_2010.pdf](https://europeanequities.nyx.com/sites/europeanequities.nyx.com/files/Organisation_memorandum_-_consolidated_version_effective_on_March_29_2010.pdf)
- 55 Additionally, Member States were permitted to defer to 2007 the mandatory application of IFRS by entities whose debt securities only were admitted on a regulated market.
- 56 [http://ec.europa.eu/internal\\_market/accounting/docs/ias/ias-use-of-options\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/ias/ias-use-of-options_en.pdf)

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