Association for Financial Markets in Europe

Briefing Note

IFRS in the European Union

July 2018

Executive Summary

Regulation (EC) No 1606/2002 ('the IAS Regulation') requires all listed companies (those whose securities are traded on a regulated EU market) to prepare their consolidated financial statements in accordance with international accounting standards[1] as adopted by the EU.

The IAS Regulation allows Member States to permit or require the following to also be prepared in accordance with those standards:

- The annual accounts of those listed companies referred to above.
- The consolidated accounts and/or the annual accounts of companies other than those referred to above.

This briefing note outlines:

1. The process for endorsement of international accounting standards for use in the EU
2. AFME's views on the existing process

1. Overview of the endorsement process

The IAS Regulation created a process for endorsing international accounting standards for use in the EU. The endorsement process involves the following steps:

i. Following the publication of a standard by the International Accounting Standards Board ('IASB'), an amendment to an IFRS Standard, or the publication of an interpretation by the IFRS Interpretations Committee, the European Commission ('EC', 'the Commission') requests endorsement advice from the European Financial Reporting Advisory Group ('EFRAG').

ii. After a period of consultation, EFRAG issues advice to the Commission on whether the criteria for endorsement for use within the EU have been met. Those criteria are that the standards:

   - are not contrary to the principle of the true and fair view set out in the Accounting Directives of the European Union;
   - are conducive to the European public good;
   - 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.

iii. If the Commission decides to endorse the new standard, interpretation or amendment, it prepares a draft endorsement Regulation and submits it to the Accounting Regulatory Committee of representatives of EU Member States ('ARC').

[1] Under Article 2 of Regulation (EC) No 1606/2002 'international accounting standards' means International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and related Interpretations (Standard Interpretations Committee / IFRS Interpretations Committee interpretations), subsequent amendments to those standards and related interpretations, future standards and related interpretations issued or adopted by the International Accounting Standards Board.

iv. If the ARC's opinion is positive, the Commission submits the draft regulation to the European Parliament and the Council of the European Union for a 3-month scrutiny period.

v. If there are no objections from the European Parliament or the Council, the Commission adopts the endorsing regulation. Following adoption, the Regulation is published in the *Official Journal of the European Union* and is applicable in all EU countries. The effective date of application in the EU will be laid down in the Regulation and may be later than that established by the IASB.

The IAS regulation allows the EU the option to either not adopt certain provisions of a standard or not adopt the Standard as a whole (both of which result in a 'carve-out'), but it does not authorise the EU to change the text published by the IASB ('carve-in') or to draft an alternative standard.

2. AFME's views on the existing process

AFME's position is summarised below and remains consistent with views previously expressed in responses to the 2013 Philippe Maystadt paper *Should IFRS Standards be More "European"?* and the European Commission 2014 public consultation to assess the impact of IFRS in the EU.

AFME members have continued to strongly support the development of a single set of high quality accounting standards providing global consistency and comparability.

Whilst our members are in favour of maintaining a standard-by-standard adoption procedure for adoption of IFRS in the EU, AFME strongly disagrees with amending the existing endorsement process to allow for either changes to be made to a standard as issued by the IASB (i.e. a 'carve-in') or the development of alternative standards for use by EU companies[2]. We believe that this would be a first step in the fragmentation of accounting standards, ultimately reverting to a system of national standards.

The implementation of IFRS in the EU in 2005 has brought many advantages. Not only are consolidated accounts prepared on a consistent basis across Member States, but the widespread adoption of IFRS means that the advantages of comparability of financial reporting are far reaching. Users of financial statements benefit from the increased transparency resulting from IFRS and preparers benefit operationally from applying the same reporting framework across a number of legal entities.

Furthermore, the Securities and Exchange Commission (SEC) has allowed EU companies with US listings to include in their filings with the SEC, financial statements prepared in accordance with IFRS[3], without reconciliation to US GAAP. Maintaining this equivalence is important to members as it generates significant cost savings therefore allowing more cost-effective access to funding in US markets.

IFRS Standards are developed by the IASB via a thorough, transparent and participatory due process that ensures a wide consultation with interested and affected parties through a variety of means including, but not limited to, invitations to comment, individual meetings and fieldwork. Members believe that this process ensures that EU stakeholders have an opportunity to provide input into the standard setting process which should facilitate the process of endorsing those standards for use in the EU.

The current EU endorsement process ensures that not only do IFRSs meet certain technical criteria, but that they are also not contrary to the true and fair view principle and are conducive to the European public good. It is within the assessment of European public good that members feel that any consideration of sustainability and long-term investment should be considered, with the caveat that such broader objectives should not be the driver of accounting standards.

The IASB's Conceptual Framework for Financial Reporting assists the IASB in developing IFRSs that are based on consistent concepts and provides additional guidance to firms when setting their accounting policies in

[2] Please note, one of our members would support the EU retaining the option to make specific amendments to IFRS in very rare, narrow and specific circumstances

[3] As issued by the IASB

those situations not covered by an appropriate standard, or when a standard allows a choice[4]. A revised Conceptual Framework for Financial Reporting was issued in March 2018 following substantial due process including input from EU constituents (including EFRAG).

Members are supportive of the endorsement of the Conceptual Framework for Financial reporting due to the additional guidance it would provide to EU firms as noted above. Consistent with the approach to endorsing IFRS Standards, members would support the endorsement of the Conceptual Framework in its entirety.

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[4] The Conceptual Framework for Financial reporting (March 2018) Paragraph SP1.1