INT/101
International accounting standards

Brussels, 11 July 2001

OPINION

of the

Economic and Social Committee

on the

Proposal for a Regulation of the European Parliament and of the Council on the application of international accounting standards

(COM(2001) 80 final - 2001/0044 (COD))

On 16 March 2001, the Council decided to consult the Economic and Social Committee, under Article 95 of the Treaty establishing the European Community, on the

Proposal for a Regulation of the European Parliament and of the Council on the application of international accounting standards
(COM(2001) 80 final - 2001/0044 (COD)).

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 27 June 2001. The rapporteur was **Mr Byrne**.

At its 383rd plenary session (meeting of 11 July 2001), the Economic and Social Committee adopted the following opinion by 97 votes to one.

1. Summary of the Commission's document

1.1 The Lisbon European Council of 23/24 March 2000 set a deadline of 2005 for the implementation of the Commission's Financial Services Action Plan[1]. This proposed Regulation is an important element of the Plan.

1.2 The purpose of the Regulation is to ensure that by 2005 all listed EU companies will apply *adopted* International Accounting Standards (IAS). This will affect the 7000 listed companies in the EU.

1.3 The arrangements being made will also ensure that the EU will participate in future in shaping the development of International Accounting Standards.

1.4 Strategic business and financial considerations rather than technical accounting issues are the most compelling reasons driving this change. These include marketability, cross-border mergers and acquisitions, shareholder dialogue and finance raising.

1.5 The Commission points out that seven Member States (Austria, Belgium, Germany, France, Finland, Italy and Luxembourg) already specifically allow listed companies to prepare their consolidated financial statements in accordance with IAS.

1 COM(1999) 232 final of 11.05.1999.

2. Details of the proposals

2.1 Basic requirement

At the latest from 2005 onwards, all EU *listed* companies as well as companies preparing for admission to trading on a regulated market must prepare their **consolidated** financial statements/accounts in accordance with adopted International Accounting Standards (IAS) (*Article 4*). Adopted International Accounting Standards are those which have been adopted for application within the EU in accordance with the proposed Endorsement procedure (*Article 6*).

2.2 Member States' Discretions (Article 5)

Member States may:

- require or permit the application of adopted IAS in the preparation of **annual** accounts for those companies referred to in Article 4[2];
- require or permit the application of adopted IAS to unlisted companies;

or

- require uniform application of adopted IAS by important sectors such as banking or insurance, regardless of whether companies are listed or not.

2.3 Endorsement Mechanism

2.3.1 The Endorsement Mechanism is a critical element in the proposed regulation. To ensure that no IAS contain deficiencies which would render them inappropriate for application in the EU, all IAS will be subject to an Endorsement Mechanism which will have a regulatory and an expert level.

2.3.2 The regulatory level - the Accounting Regulatory Committee - will include representatives of all Member States and will give its opinion as to whether or not an IAS standard should be adopted by the EU and the date of application.

2.3.3 The Commission will be supported by an expert level which will be provided by an accounting technical committee. The Accounting Technical Committee will be advisory in nature and will have the expertise needed to assess the standards but furthermore, by staying continuously in touch with the IAS standard setting process, it will be in a position to influence these developments and ensure timely decision-making on new standards.

2.3.4 The Commission intends that all existing IAS and related interpretations listed in the annex to the Regulation will be subject to this adoption procedure by 31 December 2002 at the latest.

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2 i.e. the accounts of the Holding Company itself as opposed to the consolidated accounts for the Group.

2.4 Role of Accounting Directives

2.4.1 The Existing EU Accounting Directives will remain in force and conformity with them will be a requirement for all companies. The application of IAS will be a supplementary requirement for all listed companies.

2.4.2 The Commission has already initiated the process to amend the Fourth[3] and Seventh[4] Accounting Directives to deal with a small number of instances where they are incompatible with IAS.

3. General Comments

3.1 The ESC strongly supports the objective of the proposed Regulation i.e. to establish a common basis of accounting across the EU for all listed companies. This is an important element in the programme to complete the Single Market in financial services.

3.2 The Committee recognises that the choice made now is very important in that it is likely to shape the direction of all EU financial reporting in the longer term. The Committee believes therefore that the interests of all stakeholders from investors to workers must be considered.

3.3 The Committee accepts there are only very limited options available by which to achieve the agreed objective. In fact the only practical alternative is US GAAP[5]. The Committee believes that it would be totally inappropriate for the EU to adopt the US financial reporting requirements as a world standard because, for example, EU interests would not be reflected at all in the development of these standards.

3.4 The Committee believes therefore that IAS are the only accounting standards having wide international recognition by which the objective of developing standards via global participation could be achieved.

3.5 Given the size and importance of the EU economy the proposal will establish the EU as a corner-stone of international support for the IASB[6] (which has recently been reviewed and strengthened). Although the EU will not be a direct participant, this will ensure that EU interests will be very much to the fore within the IAS development processes, in addition to the five European based members of the IAS Board.

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3 78/660/EEC, O.J. L 222 of 14.08.1978, p.11.

4 83/349/EEC, O.J. L 193 of 18.07.1983, p.1.

5 Generally Accepted Accounting Principles.

6 International Accounting Standards Board, previously International Accounting Standards Committee.

3.6 The Committee recognises that there are approximately 300 EU companies which use US GAAP. This is primarily because it is currently a requirement in order to obtain a SEC (US Securities and Exchange Commission) market listing, rather than because of any inherent value in the US GAAP *per se*.

3.6.1 The Committee believes that the chosen route provides strong support to the IASB in their efforts to get SEC agreement to accept IAS based accounts without a reconciliation to US GAAP, although it accepts that this is unlikely to be achieved by 2005. This would parallel the situation where US companies can obtain an EU listing on the basis of their US GAAP based accounts.

3.7 The Committee suggests that the long term interests of all parties would be best served by an eventual convergence of both IAS and US GAAP and it should be noted that, despite the US attachment to US GAAP, the US is fully represented on the IASB Board.

3.8 The Committee agrees with the Commission that the proposed Regulation will not only advance the integration of European capital and financial services markets but will encourage inward investment into EU listed companies.

3.9 While expressing its support for the use of IAS, the Committee also welcomes the Endorsement Mechanism which is being established. This will ensure that should an IAS inappropriate for use in the EU be published it will not be implemented in the EU.

3.9.1 Thus IAS will not automatically apply within the EU but will only do so when they have been *adopted* under the Endorsement Mechanism in which the Accounting Regulatory Committee, chaired by the Commission and with representatives of all Member States, will play a critical role.

3.9.2 However to provide a detailed technical evaluation, an Accounting Technical Committee is being established as described in paragraph 8 of the recital in the draft Regulation.

3.9.3 At the invitation of the Commission, this function will be provided and financed by a private sector body named EFRAG – European Financial Reporting Advisory Group[7]. As a private sector body its recommendations will not be binding on the Commission which will provide a full report detailing the EFRAG recommendation and its own evaluation to the Accounting Regulatory Committee for decision.

3.9.4 This body will not only support the Endorsement Mechanism but will enable the EU to monitor and contribute to the development of future standards.

3.9.5 The Committee strongly supports the Commission's intention that each IAS will either be adopted or rejected in total. To introduce partial approval or modified versions of IAS would be extremely confusing and would undermine the fundamental decision to use IAS.

3.10 The Committee recommends that in considering the use of the discretion available under Article 5, Member States should have regard to the potential impact on (a) the taxation of the companies concerned, and (b) the level of information available to workers about the enterprise in which they work.

3.11 The Committee is particularly concerned that the needs of SMEs be addressed. It is pleased to note, therefore, that SMEs will be represented in EFRAG.

3.12 The Committee also suggests that since the likely long term evolution of all financial reporting in the EU will be based on IAS, the IASB should now be urged to begin the process of developing a standard or set of standards more appropriate for SMEs; the enhanced reporting requirements for listed companies would be additional. Since some SMEs will become the listed companies of the future, this would enable a relatively easy transition for the SME when required.

3.13 The purpose of adopting the IAS will be undermined if non-adoption is other than a most exceptional event. The Committee hopes that the EU expert involvement in the standard setting

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7 The bodies that make up EFRAG are as follows:

CEA - European Insurance Committee

EFAA - European Federation of Accountants and Auditors for SMEs

EFB - European Banking Federation

EFFAS - European Federation of Financial Analysts Societies

ESBG - European Savings Banks Group

FEE - Federation of European Accountants

FESE - Federation of European Stock Exchanges

GEBC - European Group of Co-operative Banks

UNICE - Union of Industrial and Employers' Confederations of Europe

UPEAME - European Association of Craft and Small and Medium-sized Enterprises.

process and the recognition by the IASB of the value of maintaining EU support will ensure that non-adoption will rarely, if ever, happen.

3.14 The Committee stresses to the Commission that it must ensure that *all* IAS and related interpretations are available in *all* Community languages.

3.15 The Committee is aware that the Banking and Insurance industry is concerned at certain aspects of the possible introduction of full fair value accounting for financial instruments in a future IAS and that this matter is under review by the Commission. It will also be subject to the normal consultation procedures used in developing new accounting standards. The Committee trusts that a satisfactory solution will be found.

3.16 The Committee notes in Article 2 that it is possible to use “equivalent accounting standards”. The Committee understands that the Commission intends that this provision would only be used on a temporary basis until an appropriate IAS becomes available. The Committee believes that Article 2 should be redrafted to make this clear.

3.17 The introduction of these proposed financial reporting requirements for listed companies must, if they are to achieve their objective, be supported by measures to ensure compliance. The Committee suggests that the company’s auditors should state in their report if the accounts comply with IAS. If they do not, the national authorities in the Member State should have the power to require the company to republish its accounts in the correct format.

3.18 The Committee notes that the operation of the Regulation will be reviewed by 1 July 2007 at the latest and would be happy to comment on this review in due course. The Committee believes it will be particularly important to review the operation of the Endorsement Mechanism to ensure that the aim of using IAS in the EU is working effectively.

4. **Conclusion**

4.1 The Committee strongly supports the objectives of the proposed Regulation and believes the adoption of IAS is the only practical option for achieving it.

4.2 The Committee also strongly supports the Endorsement Mechanism, which provides a legal basis for the use of IAS and a procedure for validating their appropriateness. It believes that early EU involvement in all new IAS developments is the best way of protecting European interests.

4.3 The Committee stresses the need to plan ahead for the needs of SMEs and other entities not immediately affected by the proposed Regulation, so that a truly common basis for accounting may emerge in the EU as a necessary component of the Single Market.

4.4 The Committee believes that other important requirements such as taxation and worker information should not be adversely impacted by the new proposals.

4.5 The Committee stresses again that full availability of IAS and related interpretations in all Community languages is a *sine qua non*.

4.6 The Committee draws attention to the need for measures to ensure full compliance with the new reporting requirements.

4.7 Finally the Committee suggests that the EU should use its influence to encourage the IASB to enter into a dialogue with their US counterparts to pave the way for an eventual common international framework for financial reporting.

Brussels, 11 July 2001.

The President of the Economic and Social Committee	The Secretary-General of the Economic and Social Committee
Göke Frerichs	**Patrick Venturini**