



**DRAFT**

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**NOTE  
On  
The impact of IFRS implementation on banking regulations  
European Experience with IAS/IFRS implementation**

**Introduction**

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**Introduction: European experience with IFRS**

The Lisbon Summit of the European Council in 2000 established the necessity of a unique set of accounting standards in the EU, for those consolidated groups listed in a stock market from year 2005 onwards, with the goal of promoting the creation of a European integrated capital market. The standards chosen were those issued by the IASB (International Accounting Standard Board): the International Financial Reporting Standards (IFRS, known until 2002 as International Accounting Standards – IAS) and some interpretations related with them (IFRI – International Financial Reporting Interpretation - or SIC in their former acronym).

The adoption of IFRS means a breaking point with the accounting rules and principles of each Member State, as well as a first step into an effective harmonization throughout the EU.

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## II. Implementation of IFRS in Europe: Record of Legislation Process

1. In **1995**, the Communication "Accounting Harmonisation: a new strategy vis-à-vis international harmonisation" **proposed that the member states allow the Global Players to use IFRS**, as long as these standards were in conformity with the Accounting Directives and their implementation in the European countries. As shown in the summary table, some European countries adopted this proposal (namely, Austria, Belgium and Germany). It was accepted that Accounting Directives would be amended to eliminate conflicts -if any- with IFRS.

2. **From 1996**, a Task Force and the Contact Committee first, and EFRAG2 since 2001, studied the conformity between European Directives and IFRS, as published. In 1996 it was concluded that no major conflicts between both regulations existed. Afterwards, with the approval of new IFRS, some conflicts were identified (fair value, investment properties, biological assets, et cetera) that have been solved, with the approval of new regulations in Europe (see following paragraphs).

3. In **June 2000**, and as a result of the Lisbon European summit and the Communication on the "**EU Financial Reporting Strategy: the way forward**"<sup>3</sup>, the Commission proposed that **all listed EU Companies should prepare their consolidated accounts in accordance with IFRS, at the latest in 2005**. This strategy was established in European Law, through a **system of recognition of the IFRS (endorsement mechanism)**. It is important to highlight that whereas the target of the 1995 Communication was to provide an answer to a specific problem of several listed groups in non-European countries, the new strategy had a more ambitious objective: to implement the requirements **to build a European capital market**. To this end it was necessary to make financial reporting and disclosure in Europe more comparable.

4. In **February 2001**, the proposal for a **Regulation of the European Parliament and of the Council on the application of International Financial Reporting Standards**<sup>4</sup>, introduced the requirement for all EU listed corporations to produce their consolidated accounts in conformity with the IFRS, at the latest in 2005, and proposed the **setting up** of an **Accounting Regulatory Committee (ARC)** mandated by the Commission, at the political level, and the **European Financial Reporting Advisory Group (EFRAG)**, a private group of European experts in accountancy to act as a liaison between the EU and IASB5. It was decided to **introduce this by means of a Regulation, rather than a Directive**, because a Regulation does not need specific implementation by EU countries, thus avoiding delays and national variations.

5. In **September 2001**, a Directive of the European Parliament and the Council was passed to amend Directives 78/660/CEE, 83/349/CEE and 86/635/CEE, relating to valuation rules applicable to individual and consolidated accounts of limited liability companies, banks and other financial institutions, in order to introduce fair value in the valuation of certain financial instruments.

6. In **June 2002**, the EFRAG issued an opinion recommending endorsement of IAS (1 to 41) and SIC (1 to 33) extant at 1 March 2002 "en bloc", once the above-mentioned Directive eliminates all remaining conflicts. However, the decision of the European Commission excluded IAS 32 and 39 (and their related interpretations) from the initial endorsement of IFRS/IAS.

7. In **July 2002**, the European Council approved the EU regulation. Companies listed in Europe have to establish their consolidated accounts in accordance with IFRS by 2005. Postponement until 2007 was granted to companies that use another reporting system, due to quotation on a non-European stock market, and to companies that only quote fixed-interest rate securities. The Regulation set a deadline to decide on the applicability of the IFRS: 31 December 2002.

8. In **July 2002**, the IAS Directive<sup>6</sup> was approved, defining the legal framework of the implementation of IFRS, determining the scope of companies which have to adopt IFRS compulsorily and the possibility given to member states of going further in the application of IFRS.

9. With respect to Council Directive 78/660/EEC on annual accounts of certain types of companies as regards amounts expressed in euro, there is a project to change the current requirements to present annual accounts using the abbreviated format. It is foreseen the amendments to be in force by 2009.

10. In **June 2003: adoption of Directive 2003/51/EC to modernise and update accounting rules**. A new Directive was issued, amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings. The directive allows Member States to be able to modify the presentation of the profit and loss account and balance sheet in accordance with international developments, as expressed through standards issued by the International Accounting Standards Board (IASB) as well as to permit or require the application of revaluations and of fair value in accordance with issued by the IASB. The information should not be restricted to the financial aspects of the company's business. It was expected that, where appropriate, this should lead to an analysis of environmental and social aspects necessary for an understanding of the company's development, performance or position. The Directive also points out the necessity of consistency with the audit reports in Europe.

11. In **July 2003**, the ARC voted unanimously in favour of the draft Commission Regulation proposing the endorsement of all existing IFRS and related interpretations, with the exception, at this stage, of IAS 32 and 39.

12. In **September 2003**, the European Commission adopted the regulation endorsing IFRS. As agreed by the ARC in July, IAS 32 and 39 as well as their related interpretations (SIC 5, 16 and 17) were not included in the scope of the endorsement. The endorsement referred also to banks and insurance companies, as stated by the IAS Regulation adopted in 2002 by the Council and the European Parliament. In October

2003, the endorsed IFRS were published in the official languages of the EU and in the Official Journal of the EU.

13. At the end of **March 2004**, the Council of Ministers gave the final approval to a new Transparency Directive, which will improve the information investors receive. Amongst the provisions, it is stated that half-yearly reports will be based on IAS 34, that quarterly financial reports are not compulsory, although an interim management statement is, and that more information about related parties will be required.

14. In **April 2004**, the Commission amended the regulation adopting IFRS, in order to include IFRS 1 among the adopted standards. Consequently, IFRS 1 was published in the Official Bulletin of the EU7.

15. On **1st October 2004**, ARC endorsed IAS 39, with two parts of it optional (restriction on the use of fair value to liabilities, and permission of use of fair value hedge accounting for interest rate hedges of core deposits on a portfolio basis) under a national decision.

16. On **1st January 2005**, the IFRS regulation came into force, moving over 8.000 listed European companies to IFRS. First financial statements presented according to IFRS were those for the first quarter of year 2005. 17. IFRS 2 was endorsed by the European Commission in **February 2005**. This standard is included in the stable platform, that is to say, standards to be applied by European listed groups when presenting their financial statements.

18. Although in **October 2002**, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) jointly announced their commitment to achieving real convergence between their respective accounting standards by 2005, the agreement was not accomplished finally. The European Commission held a meeting with SEC (Stock Exchange Commission) in **April 2005**, in the search of an agreement between IFRS and US GAAP. Their common plans take into consideration that by no later than 2009; listed companies in USA using IFRS will not have to present a reconciliation statement to US GAAP.

19. In **May 2005**, ARC recommended the endorsement of IFRIC 2 (Members' shares in co-operative entities and similar instruments)8; whereas EFRAG did not supported the endorsement of IFRIC 3 (Emission rights). Furthermore, in July, IASB withdrew IFRIC 3 Emission Rights with immediate effect. 20. In **November 2005**, the European Commission adopted a regulation endorsing the fair value option in IAS 39, implying the elimination of one of the two carve-outs to IAS 39. The regulation's adoption is retroactive and companies were allowed to apply the amended IAS 39 for their 2005 financial statements. An amendment on hedging is awaited in order to remove the remaining carve-out of IAS 39 and therefore fully endorse IAS 32 and IAS 39.

21. In the **last quarter of 2005**, the European Commission endorsed the following IFRS, interpretations and amendments: amendments to IAS 39 Transition and initial recognition of financial assets and financial liabilities; amendments to IAS 19 Employee benefits;

IFRS 6; IFRIC 4; IFRIC 5; amendments to IAS 39 Cash-flow hedge accounting of forecast intragroup transactions; amendments to IAS 39, amendments to IAS 1 Capital disclosures; IFRS 7; IFRIC 6; amendments to IAS 21; and IFRIC 7.

22. In **April 2006**, the European Union adopted a new auditing directive, which broadened the scope of the existing 84/253/EEC Directive. It specifies the duties of the statutory auditors, their independence and their ethics, apart from introducing new requirements for external quality assurance and public oversight of the auditing profession.

23. In **June 2006**, a Directive<sup>9</sup> modified the 4th and 7th company law directives (78/660/EEC and 83/349/EEC) as well as the accounting directive for banks (86/635/EEC) and for insurance undertakings (91/674/EEC). Main amendments introduced are the following:

- collective responsibility of board members for the financial statements and annual reports is established.
- transparency in related parties' transactions and off-balance arrangements is enhanced.
- a corporate governance statement is required for publicly traded companies.
- size thresholds for small and medium-sized entities are raised (balance sheet total and net turnover thresholds are increased by 20%, to 17.500.000 € and 35.000.000 € respectively).

24. In **July 2006**, the IASB announced that application of new IFRS or major amendments will not be established before 2009, providing four years of stability in the accounting framework to those institutions which applied IFRS for the first time in 2005.

25. In **September 2006**, the European Commission published Regulation 1329/2006, adopting IFRIC 8 (Scope of IFRS 2) and IFRIC 9 (Reassessment of embedded derivatives).

26. In **November 2006**, a new procedure for endorsement of IFRS was set up. According to it, the European Council will decide on those issues where the European Commission and the European Parliament can not reach an agreement.

27. In **December 2006**, the European Commission extended two more years the exemption granted to foreign companies presenting financial statements under national GAAP and issuing securities in EU stock markets (see paragraph 7). These non-EU companies are not subject to present a restatement to IFRS until December 2008 if they prepare their financial statements according to Canadian-GAAP, Japanese-GAAP, US-GAAP or an IFRS equivalent national-GAAP

28. In **March 2007** the European Commission adopted transparency regulations concerning issuers' disclosures of half-yearly financial information, investors' disclosures of major holdings, minimum pan-European information disseminated to the public, and minimum requirements for acceptance of third-country regulations.

29. In **April 2007**, the European Parliament opposed to implementation of IFRS 8 (Operating segments) in European Union, mainly because segments are not univocally and objectively defined in the new standards and its adoption would mean the acceptance of an “alien” standard (from USA) into European legislation.

30. In **April 2007**, the European Commission reported on IASB/IASCF governance areas which shall be improved:

- accountability of the Board and the Trustees to their constituents
- role of the IFRIC should be strengthened by means of explaining relationships with shareholders, reporting in writing reasons why topics are not addressed and establishing liaisons with national standards setters
- more representation should be given to those countries already using IFRS

31. In **June 2007**, the European Union published two Commission Regulations adopting IFRIC 10 (Interim financial reporting and impairment), and IFRIC 11 (IFRS 2 – Group and treasury share transactions).

32. In **June 2007**, the European Commission published a public consultation regarding the endorsement of IFRS 8 (Operating segments), for its consideration by European Parliament when it decides about the matter in September 2007. The consultation is addressed to a wide range of constituents: users, preparers, auditors, academics and standard setters.

### **III. IFRS Application Some Countries**

As mentioned above, the fact that there are no conflicts between European Directives and IFRS does not necessarily mean that there are no conflicts with the national laws of the European countries. For the consolidated accounts of listed groups the situation is clear because conflicting situations have been removed from the national legislation: in such a case, the Regulation approving the IFRS is the one applicable. The options remain open for unlisted consolidated groups and for individual accounts of, both, listed and unlisted companies. Some European countries have decided to introduce in their national legislation the accounting options accepted by IFRS, which are available in the Accounting Directives, but which have not yet been implemented in the country (for instance, Spain is rewriting its national accountancy laws and, in addition, individual and consolidated accounts of financial institutions and also individual accounts of listed corporations must include from 2005 an IFRS reconciliation statement). Adopting this solution is very difficult in those countries with a close link between accounting and taxation (Germany and France, for example), and, consequently, it is rather difficult to adopt IFRS as the basis for the individual accounts. To sum up, for the individual accounts of all countries studied, except the Italian exemption mentioned below, there is no obligation to use IFRS directly.

#### **a. Austria**

The Austrian Commercial Code was amended in 1999 and allows all Austrian groups, whether listed or not, to use international standards instead of Austrian financial standards, if they comply with the EU Directives.

According to the regulations of the European parliament capital-market oriented companies are compelled to establish their consolidated accounts under IFRS with the beginning of the financial year 2005 as far as they are listed at a stock exchange within the European Union. Non capitalmarket oriented enterprises will still have a choice to establish their consolidated accounts under IFRS. The individual accounts of not capital-market oriented and capital-market oriented enterprises have to be established only under the Austrian commercial code.

As it stands only for information it will be allowed to establish the individual accounts under IFRS. This IFRS accounting will have no discharging effect because of the dependence between the Austrian commercial code and the Austrian tax law.

Similar to the situation in Germany those enterprises that are capital-market oriented will have to create three different sets of annual accounts:

- tax accounts (tax law),
- individual accounts (Austrian commercial code),
- consolidated accounts (IFRS).

#### **b. Belgium**

Belgium's accounting framework is based on the Commercial Code of May 1999 and it's implementing royal decree of 30 January 2001, while consolidated accounts are based on a particular royal decree of March 1990. The authorities set up the accounting regulation after taking into consideration the opinion of the ASC (Accounting Standard Commission). The main differences between Belgian legislation and IFRS are chiefly based on the prudence principle and on the existence of a tax burden that heavily influences Belgian rules, since Belgian financial statements are the main basis for corporate tax returns. **Global players are allowed to use IFRS (not subject to authorisation) or US GAAP (only until 2007 and subject to authorisation from the Ministry of Economy) to prepare consolidated accounts** (also including medium-sized companies to be listed on the EASDAQ). This is called the "Global Player Policy". 282 out of 886 companies used non- Belgian standards when preparing consolidated accounts (database on consolidated accounts filed with the NBB for the year 2005). Of these 282 companies, 166 used IFRS.

On the 9th of February 2005, a Royal Decree was published to regulate the use of IFRS in **consolidated** accounts:

Quoted companies:

- compulsory application of IFRS as from the 1st of January 2005, by virtue of the direct effect of the European IFRS Regulation
- postpone the application of IFRS until 2007 for companies that use another reporting system, due to quotation on a non-European stock market, and for companies that only quote fixed-interest rate securities

Unquoted companies:

- possibility to apply IFRS on a voluntary basis for accounting periods starting on or after 31st of December 2003

Regarding the **statutory** financial statements, the Belgian Accounting Standards Committee proposed four years ago to proceed to a practical adjustment of the current Belgian accounting law to the IFRS standards. To study this issue, three working groups have been established that concentrate on the following topics: tax law, company law and SMEs.

By means of the Royal Decree of the 8th of March 2005, Belgium decided not to introduce into Belgian accounting law, for the time being, the framework created by the European Directive relating to the valuation at **fair value** of financial instruments. The Royal Decree only requires information on the fair value in the notes to the financial statements.

Taking into account the non-existence of a tax burden in the case of **real estate investment funds**, and taking into account the limited number of such funds, a Royal Decree has been published on the 29th of June 2006, in order to oblige real estate investment funds to establish their statutory financial statements in accordance with IFRS as from 2007. Real estate investment funds are allowed to draw up IFRS-compliant statutory accounts as from 2005, on a voluntary basis. The Royal Decree also defines the format that should be used for these IFRS-compliant accounts. As a result of the discussion paper written by the European Commission<sup>11</sup> regarding the simplification of accounting rules for small and medium-sized companies, it is unlikely that any other convergence towards IFRS will come into force in the near future.

### c. France

In April 1998, the CRC (Accounting Regulation Committee) was created with legal authority to approve new accounting standards. In practice, **only French standards are allowed**<sup>12</sup>. In 1999 a new methodology on consolidation was passed by the CRC in order to reconcile, to a certain extent, French GAAP with IFRS. Significant differences still remain (intangible assets, goodwill, business combinations, fair value and optional adjustments). In June 2003, the National Accounting Body (CNC) has restated its preference as regards the faculty given to each member states to adopt IFRS for individual accounts. At the latest in 2004, the French Parliament has followed CNC's preferences.

CNC's preferences:

<b>Consolidated accounts</b>	Listed groups	IFRS compulsory from 01.01.2005 onwards with postponement until 2007 for companies that only quote fixed-interest rate securities (approximately
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		970 groups concerned)
	Unlisted groups	Option given to the groups to adopt IFRS in 2005. Progressive convergence of national GAAP towards IFRS (approximately 8,000 groups concerned)
<b>Individual accounts</b>		<b>Option not allowed.</b> <b>Progressive convergence of national GAAP towards IFRS</b> with simplifications for SME

From 2005 listed companies must apply IFRS for their consolidated accounts (postponement until 2007 for companies that only quote fixed-interest rate securities), while unlisted groups have the option to adopt IFRS or national GAAP. Adaptation of regulation CRC 99-02 relating to consolidated accounts was completed in November 2005: new rules came into effect from 1st January 2006.

As regard individual accounts, the wish of the National Accounting Body (CNC) is a progressive endorsement of IFRS through a selective approach. **National rules have already evolved with the partial adoption of four IFRS, namely IAS 16, 36, 37 and 38.** Besides, **changes in tax regulation** seem to have preserved so far the link between accounting and tax.

The CNC worked on the impact of IFRS related to taxation, SMEs, and law issues. Reports were published in 2005 and 2006. About the SMEs project of the IASB, the CNC has analyzed the discussion paper, during regular meetings, focussing on four topics:

- consolidation
- financial instruments
- recognition of assets and liabilities
- presentation of financial statements

At least a new organization of the National Accounting Body (CNC) has been studied to increase its resources so as to improve its functioning and its influence in the decisions process.

#### **d. Germany**

In 1993 Daimler-Benz AG decided to expand its activities. To raise additional capital the company applied to the US SEC for permission to be listed on the New York Stock Exchange. To this end, the company had to comply with the US accounting standards (US GAAP). At the same time, it was still obliged to publish its financial statements in Germany in accordance with the German Commercial Code. Therefore, two kinds of financial statements had to be prepared. Under German Commercial Code, the company reported a profit of DEM 615m, and in accordance with US GAAP, a loss of DEM 1.839m. Thus, German accounting rules obtained a bad reputation, even within Germany the rules for consolidated accounts were the target of extensive criticism.

In the same year, Puma AG was the first German company publishing consolidated financial statements according to IFRS. After 1993 more and more German enterprises decided to publish their financial statements voluntarily in accordance with IFRS or US GAAP. Some of them hid the accounts based on the German Commercial Code at the same time, others even stated that they fulfil IFRS and the German rules in one set of statements, so called dual financial statements. However, this was only possible because of the missing enforcement of accounting standards in Germany.

In 1998 the law has been changed and from this year on it has been possible to draw up consolidated accounts under IFRS or US GAAP only, provided that the German company is listed on the German Stock Exchange. This regulation was valid until 2004. At the same time, the German Federal Ministry of Justice founded a Committee to represent Germany in international standard setting committees and to develop new standards for consolidated accounts based on the German Commercial Code.

Currently, a discussion takes place in Germany on the future of individual accounts, especially for these enterprises which are capital-market oriented and have to prepare the consolidated accounts according to IFRS from 2005 on. They prefer the idea of moving towards one commercial code for individual as well as for consolidated accounts.

On the other side, there are a lot of German enterprises which are not capital-market oriented and hence they are not very interested in changing their accounts towards IFRS or even adapting the German Commercial Code in small steps with IFRS-rules.

Another problem is the close relationship of German tax laws and the Commercial Code. There is a lot of conformity between them which enables German enterprises to create only one unified annual accounts. As IFRS can not be used as the basis for German taxes, a liberalization of the individual accounts towards IFRS would make it necessary that the German government establishes independent tax rules.

With the fiscal year 2005 the consolidated accounts of capital-market oriented German enterprises must be established under IFRS rules. Non capital-market oriented enterprises have a choice to establish their consolidated accounts under IFRS or German Commercial Code. Individual accounts of not capital-market oriented and capital-market oriented enterprises have to be established under the German commercial code. Only for information it is allowed to establish additional individual accounts under IFRS, which can be published in the federal gazette instead of the one based on the Commercial Code. This IFRS accounting will have no discharging effect because of the dependence between the German commercial code and the German tax law as well as capital maintenance rules. So far, no individual accounts under IFRS were published in the federal gazette.

A debate about the need to internationalize financial statements for small and medium-sized enterprises is currently taking place in Germany. The positions of the opponents are:

- it is very expensive to switch from German GAAP to IFRS rules with high employee training expenses and large investments in data processing systems,
- IFRS rules are frequently amended,
- many of the IFRS rules are very complex, some even being too complex for big corporations,
- IFRS rules are more comprehensive than the rules of the German commercial code.

The standpoint of the supporters is:

- it is not good to have two accounting classifications,
- banks and rating agencies want to have one system of accounts for their financial statements analyses, and that will probably be IFRS,
- many German small and medium-sized enterprises have a lot of international customers, IFRS financial statements fit their needs,
- some small and medium-sized enterprises look for investors or new owners, therefore it is better to have international accounts,
- some small and medium-sized enterprises are subsidiaries and they need to draw up financial statements based on IFRS in order to be consolidated. Therefore, costs should be reduced for these enterprises.

The publication of the Exposure Draft “IFRS for SMEs” gave this discussion a new direction. More or less all interested parties in accounting do not see this draft standard as appropriate for SMEs in Germany.