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from: Secretary-General of the European Commission,  
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 27 September 2010

to: Mr Pierre de BOISSIEU, Secretary-General of the Council of the European  
Union

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Subject: REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT  
AND THE COUNCIL  
Report on the funding of the International Financial Reporting Standards  
Foundation

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Delegations will find attached Commission document COM(2010) 504 final.

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EUROPEAN COMMISSION

Brussels, 27.9.2010  
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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND  
THE COUNCIL**

**Report on the funding of the International Financial Reporting Standards Foundation<sup>1</sup>**

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<sup>1</sup> Following revision of its constitution, on 1 March 2010 the International Accounting Standards Committee (IASC) Foundation name was changed to the International Financial Reporting Standards (IFRS) Foundation (the change will be effective in July 2010). This report uses the new name (IFRS Foundation) although Decision No 716/2009/EC refers to the old name (IASCF). The IFRS Foundation is the parent body of the International Accounting Standards Board (IASB), whose standards are incorporated into EU law pursuant to Regulation No. (EC) 1606/2002 of 19 July 2002 on the application of international accounting standards, OJ L 243, p. 1 of 11.09.2002.

# REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

## Report on the funding of the International Financial Reporting Standards (IFRS) Foundation

### 1. INTRODUCTION

In 2009, the European Union reviewed the **IFRS Foundation funding arrangements** and decided to encourage the move towards non-voluntary, stable and transparent funding arrangements with a broad geographic basis. In light of this objective, it agreed a legal basis (the Decision<sup>2</sup>) that would allow the European Commission to provide a financial contribution towards the IFRS Foundation budget<sup>3</sup>, subject to satisfactory progress being made to enhance the IFRS Foundation governance.

The present report on the governance reforms of the IFRS Foundation provides the Commission's submission to the European Parliament and to the Council pursuant to Article 9, paragraph 3, of this Decision.

The Commission examines in this report the latest developments concerning governance, without prejudging the debate about the need for further, more comprehensive reforms of the IFRS Foundation's governance, which are currently being reviewed through the IFRS Foundation's Monitoring Board (see point 4 below).<sup>4</sup> Until the latter formulates its recommendations and until they are implemented, it is essential that the International Accounting Standards Board (IASB) continues to have sufficient resources to deliver a number of urgent projects, notably those related to the financial crisis as well as key priorities for the EU, such as insurance accounting.

### 2. BENCHMARKS SET-OUT IN DECISION NO. 716/2009/EC

Article 9, paragraph 3 of Decision 716/2009/EC states that "the report [about the IFRS Foundation] shall focus on the governance structure and processes, including the composition and powers of the Monitoring Board, in particular on the ability of that body to accomplish its public interest mission in a transparent and efficient manner. The report shall also set out progress as regards the roadmaps for third countries to apply IFRS to their domestic issuers." The last aspect is covered in section 5 of this report.

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<sup>2</sup> Decision No 716/2009/EC of the European Parliament and of the Council of 16 September 2009 establishing a Community programme to support specific activities in the field of financial services, financial reporting and auditing, OJ L 253, p. 8-16 of 25.09.2009.

<sup>3</sup> The financial contribution in the Decision is based on figures available at the time that the Commission proposal was prepared and does not anticipate future budgetary developments.

<sup>4</sup> See announcement about the creation of a working group by the Monitoring Board on [http://www.iosco.org/monitoring\\_board/](http://www.iosco.org/monitoring_board/)

Recital 19 of the Decision refers to the expectations set out in the European Parliament Resolution of 24 April 2008 on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) and in the Council Conclusions of 8 July 2008, in particular the creation of the Monitoring Board with relevant powers and appropriate composition, greater transparency and legitimacy in regard to the IASCF's standard-setting and agenda-setting processes, the enhancement of the effectiveness of the Standards Advisory Council and the formalisation of the role of impact assessments as part of the due process of the IASB.

### **3. PROGRESS MADE BY THE IFRS FOUNDATION TO MEET THE BENCHMARKS**

#### **3.1. Recent changes to the IFRS Foundation's constitution**

On 15 January 2009, the Trustees completed the first part of their five-yearly review of the IFRS Foundation's Constitution. This part of the review addressed public accountability by creating a link to a Monitoring Board of public authorities (see point 3.2 below). It also expanded the membership of the IASB from 14 to 16 members (to be implemented no later than July 2012) in order to ensure a broad geographic distribution within the Board.

In January 2010, the Trustees completed the second part of their five-yearly review of the IFRS Foundation's Constitution. The focus was on enhancing the transparency and accountability of the IFRS Foundation and the IASB and expanding stakeholder engagement and outreach, whilst enhancing governance. The key changes were the following:

- the IASB will in future be required to carry out a public consultation (every 3 years) about its work programme, with the first consultation starting no later than mid-2011. This is intended to bring greater transparency to the IASB's agenda-setting process, which is one of the most important elements to ensure the accountability of the Board and, more generally, of the IFRS Foundation;
- the term of office of IASB members will become shorter (5 years, extendable by 3 years maximum), except for the Chair who will remain eligible for a full 5 years second term. This is intended to promote greater turnover of IASB members, thereby ensuring the regular infusion of "new thinking" into the standards-setting process;
- there will be a possibility to shorten the due process below the minimum 30-day duration foreseen in the IASB's Handbook. This brings greater flexibility in cases of urgency, such as that which arose in October 2008, at the height of the financial crisis, and which made it necessary to introduce new reclassification rules for financial instruments;
- the objectives of the IFRS Foundation are amended to emphasise that the overall objective is the global adoption of IFRS, whereas convergence is only a means to facilitate this objective. This change is already being reflected in the preliminary discussions about the IASB's future (post-2011) work programme – for example in the IFRS Advisory Council (formerly the Standards Advisory Council or SAC).

### **3.2. Composition and powers of the Monitoring Board**

The Monitoring Board comprises one representative of the International Organization of Securities Commissions (IOSCO) Emerging Markets Committee, one representative of the IOSCO Technical Committee, the Commissioner of the Financial Services Agency of Japan (JFSA), the European Commissioner for the Internal Market and Services and the Chairman of the US Securities and Exchange Commission (SEC). The Basel Committee on Banking Supervision participates in the Monitoring Board as an observer.

The relationship and responsibilities of the participating organisations are described in the Memorandum of Understanding (MoU) developed by the members of the Monitoring Board and the Trustees. The principal responsibilities of the Monitoring Board are to:

Participate in the Trustee nominations process and approve Trustee nominees;

Review the adequacy and appropriateness of Trustee arrangements for financing the IASB;

Review the Trustees' oversight of the IASB's standard setting process, in particular with respect to its due process arrangements;

Liaise with the Trustees regarding the regulatory, legal and policy developments that are pertinent to the IFRS Foundation's oversight of the IASB; and

Refer matters of broad public interest related to financial reporting for consideration by the IASB.

The Monitoring Board is still developing its procedures and working arrangements to accomplish in practice its public interest mission. The Commission considers that the Monitoring Board is a useful step towards greater accountability and transparency of the IFRS Foundation's work. Nevertheless, the Commission considers that a comprehensive review of the IFRS Foundation's governance framework - including the role of the Monitoring Board - is appropriate, in particular to assess the need to strengthen its accountability towards public authorities (see point 4).

### **3.3. Other commitments made by the Board of Trustees**

At the same time that the Trustees of the IFRS Foundation agreed the latest constitutional changes in January 2010, they also agreed to further review three important aspects of the Foundation's governance. In particular, Trustees agreed:

- to undertake immediately a full strategic review of the Foundation beyond June 2011, i.e. beyond the completion of the convergence agenda of the IASB and the US Financial Accounting Standards Board (FASB), including the financing of the organisation. The review will include public consultation with stakeholders and the Monitoring Board;
- to undertake, and complete by the end of 2010, a full review of the effectiveness of the IFRS Advisory Council, in order to assess the recent reforms introduced and to determine whether further reforms are necessary. The review will also consider the size, structure and operation of the IFRS Advisory Council;

- to review the Trustees' oversight framework of the IASB and their fulfilment of their oversight functions over the Board.

The European Commission welcomes the launch of these reviews. Consultations have already started in a number of fora. The Trustees held a first discussion about the strategic review with the Monitoring Board during the latter's meeting in April 2010. The IFRS Advisory Council has also held a first discussion with the Trustees about the review of its effectiveness. The European Commission will closely monitor progress of these reviews through its participation in the relevant fora.

#### **4. FUTURE GOVERNANCE REFORMS**

Notwithstanding the abovementioned positive steps towards enhancing the transparency and accountability of the IASB, the European Commission considers that a comprehensive review of the IFRS Foundation's governance framework is necessary. For example, recent events surrounding the reprioritisation of the IASB-FASB convergence agenda and high-level appointments within the IFRS Foundation, illustrate the importance of further enhancing the transparency and accountability of its decision-making process.

These concerns are shared by other members of the Monitoring Board, which has therefore established a Governance Working Group (WG) to carry out such a comprehensive review. The Governance WG has been given broad mandate to cover all relevant aspects of the IFRS Foundation's governance, including its institutional structure as well as the link between accounting standards and various public policy objectives, including market transparency and financial stability. The European Commission considers that the Governance WG should aim to report its conclusions and recommendations by the end of 2010 and that the latter should be implemented as soon as possible thereafter.

#### **5. ROADMAPS FOR THIRD COUNTRIES TO APPLY IFRS TO THEIR DOMESTIC ISSUERS**

The Commission adopted a report to the European Parliament on convergence between IFRS and third country national Generally Accepted Accounting Principles (GAAPs) on 4 June 2010. As stated in that report, many countries have continued to make progress towards the full convergence of their standards with IFRS and towards the eventual adoption of IFRS for their domestic issuers.

The Committee of European Securities Regulators (CESR) has provided advice to the Commission and has indicated that China, Canada, India, and South Korea continue to make progress in pursuing their convergence or adoption programmes. The United States has conducted a public consultation on the adoption of IFRS and on 24 February 2010 the US SEC issued a policy statement confirming that it intends to take a decision about IFRS during 2011. In addition, the US Securities and Exchange Commission (SEC) has acknowledged the need to ensure adequate funding of the IFRS Foundation from the US during recent meetings of the Monitoring Board.

Japan has also continued the work on convergence between GAAP and IFRS, and has recently announced its intention to take a decision around 2012 on whether to

adopt IFRS by 2015 or 2016. In the meantime, some Japanese companies can already apply IFRS on a voluntary basis. Other major economies have also recently announced their intention to adopt IFRS, such as Argentina, Brazil, Mexico and Taiwan. In Russia however, there are no indications of substantial development as far as mandatory use of IFRS is concerned.

In the coming years the Commission will continue to monitor the situation and assess the ongoing efforts by third countries converging to IFRS or intending to adopt IFRS, with the technical assistance of CESR. The Commission will continue to support the efforts of those countries which have undertaken to converge their accounting standards to IFRS and also of those countries which have undertaken to adopt IFRS.

## 6. CONCLUSIONS

The Commission concludes that the IFRS Foundation has made progress on several key benchmarks referred to in Decision 716/2009/EC. In addition, the Monitoring Board has launched a comprehensive review of the IFRS Foundation's governance.

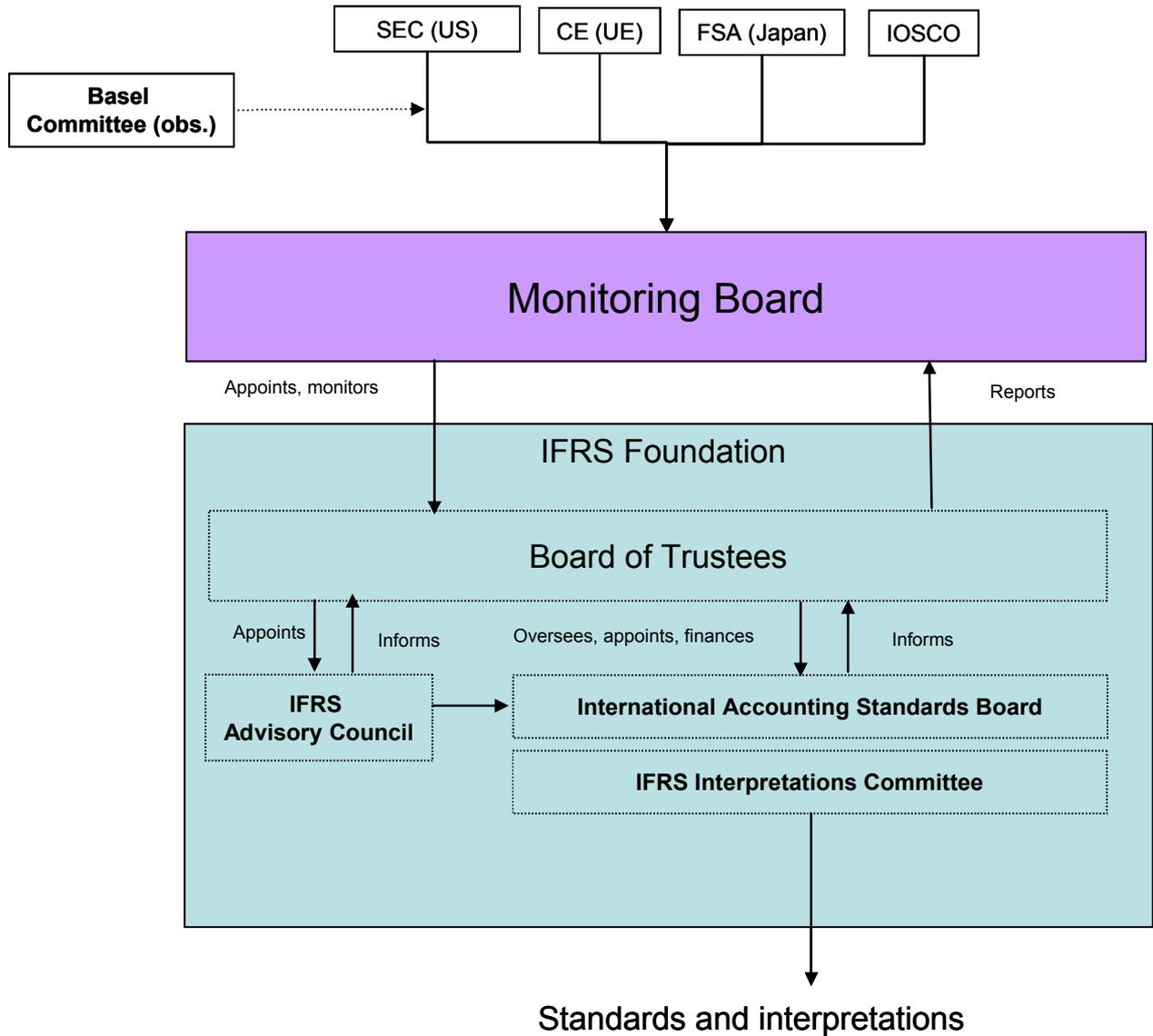
As part of any future comprehensive reform of the IFRS Foundation, the latter's funding arrangements would need to ensure a non-voluntary, transparent and stable funding platform with a broad geographical basis (see Article 9.4 of the Decision). In this respect, it is particularly important that all major jurisdictions contribute towards the budget of the IFRS Foundation in proportion to their weight in global capital markets.

While discussions continue concerning a more comprehensive reform of the IFRS Foundation's governance model, the IASB should be appropriately funded to ensure that it can deliver urgently required standards, including those related to the financial crisis such as the reform of the accounting requirements concerning financial instruments. The Commission therefore considers that the short-term funding needs of the IASB should be supported, in accordance with the Decision 716/2009/EC, while a comprehensive review of its governance model is carried out by the Monitoring Board.

On the basis of the preceding analysis, the Commission recommends that the EU should provide the IFRS Foundation with the funding foreseen in Decision 716/2009/EC from 2011. The Commission nevertheless emphasises that a comprehensive review of the IASB's governance model should be carried out as a matter of urgency. The recommendations arising from this assessment will need to be available by 2011 and implemented as soon as possible thereafter.

**ANNEX**

**1. Description of the internal governance structure of the IFRS Foundation**



## 2. Glossary of the key acronyms referred to in the report

### **Financial Accounting Standards Board (FASB)**

The FASB is a private sector organisation in the United States that establishes financial accounting and reporting standards for business enterprises reporting under US Generally Accepted Accounting Principles (US GAAP).

### **US Generally Accepted Accounting Principles (US GAAP)**

Accounting requirements for business enterprises in the United States, established by the Financial Accounting Standards Board (FASB), predecessor organisations and others.

### **International Accounting Standard (IAS)**

A standard adopted by the International Accounting Standards Board's (IASB) predecessor, the International Accounting Standards Committee (IASC). When the IASB replaced the IASC in 2001, it adopted all IASs then in force.

### **International Accounting Standards Board (IASB)**

The IASB is an independent, privately-funded accounting standard-setter.

### **International Accounting Standards Committee Foundation (IASCF)**

The former name of the parent entity of the International Accounting Standards Board (IASB), now known as the IFRS Foundation

### **International Financial Reporting Standard (IFRS)**

A standard and interpretation adopted by the International Accounting Standards Board (IASB).

### **IFRS Foundation**

The name of the parent entity of the International Accounting Standards Board (IASB)

### **Standards Advisory Council**

A forum for the International Accounting Standards Board (IASB) to consult interested organisations, now called the IFRS Advisory Council. The Advisory Council meets three times a year, and Advisory Council members provide the IASB with input on its agenda, its work programme and particular projects.