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Ex-ante evaluation for establishing a Union Programme to support specific activities in the field of financial reporting and auditing

Accompanying the document

Proposal for a Regulation of the European Parliament and of the Council

on establishing a Union programme to support specific activities in the field of financial reporting and auditing for the period of 2014-2020

{COM(2012) 782 final}

1. EXECUTIVE SUMMARY

1.1. Background

The single market, where goods, services, people and capital circulate freely, is among the European Union's greatest achievements. One of the biggest challenges of the coming years for Europe is to step on a sustainable growth path in order to overcome the financial and sovereign debt crisis that unfolded since 2008. Integration and a perfectly functioning internal market are indispensable in achieving that objective.

In particular, the freedom to establish a business entity is crucial to a well-functioning single market and the economic prosperity of Europe. Transparency and a level playing field for entities doing business within Europe and globally are key factors to allow that freedom unfold in practice. In order to establish a favourable business environment, the harmonisation of accounting and audit rules are crucial.

As capital markets are global, harmonisation of financial reporting and audit rules at global level is essential for the sake of transparency, comparability, the smooth functioning of the capital markets and also the realization of an integrated market for financial services in the EU. It is generally recognised that the EU Accounting Directives did not bring about a sufficiently high level of harmonisation in the financial reporting of listed companies in the EU. Therefore, instead of introducing its own set of regional financial reporting standards, and thereby harmonising the EU-level legislation but adding to regional fractions at the global level, the EU has decided to adopt international accounting standards.

The European Union has long been an advocate of one single set of global accounting standards. The G20 has also called for global accounting standards and convergence at several instances.[1] The Union showed leadership in the process in 2002 when it adopted international accounting standards (IFRS)[2] issued by the International Accounting Standards Board to be used by companies listed in the EU when drawing up their consolidated financial reports.[3] In addition, several Member States allow or require the use of those standards by non-listed companies and/or for annual reports.

Progress towards a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards has been steady. All major economies have established time lines to converge with or adopt IFRS in the near future.

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1 Repeated calls since the 2009 London declaration; last time in Los Cabos, 2012

2 For the purposes of this paper, the term 'international accounting standards' refers to IAS, IFRS and IFRIC as well

3 Regulation 1606/2002 of the European Parliament and the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11.09.2002, p.1.; Directive 2004/109 of the European Parliament and of the Council of 15 December 2004 on the harmonisation requirements in relation to information about issuers whose securities are admitted to trading on q regulated market and amending Directive 2001/34 OJ L 390, 31.12.2004 p. 38.; and Directive 2003/71 of the European Parliament and of the Council of 4 November 2003 on, the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34 OJ L 345 31.12.2003 p.64.

With more and more countries moving towards and adopting IFRS, Europe's weight in the international standard setting process is decreasing. In order to be heard and listened to, the Union has to speak with one voice. EFRAG[4], the European Commission's technical adviser in accounting matters has gradually taken up the role of providing upstream, technical and credible input to the IASB's standard setting process.

Both the international standard setter and the organisation representing Europe's interests need to be independent, possess the sufficient capacity and expertise to produce quality standards and input to those standards, and have sound financial basis in order to be able to carry out their public interest mission on a long-term basis.

To these ends, in 2009 the European Parliament and the Council established a Community Programme to support specific activities in the field of financial services, financial reporting and auditing[5]. The purpose of the current ex ante evaluation is to examine closely whether the EU co-financing should be continued.

1.2. Beneficiaries of the 2010-2013 financing

The beneficiaries of the current Programme were originally the Committees of Supervisors (CESR[6], CEBS[7] and CEIOPS[8]), the IFRS Foundation (legal successor of the IASCF[9]), EFRAG[10] and the PIOB[11]. In 2011, the newly established European Supervisory Authorities took over the responsibilities of the Committees of Supervisors and the Committees ceased to exist. Thus, the Programme can be prolonged with respect to the current beneficiaries: the IFRS Foundation, EFRAG and the PIOB.

The **IFRS Foundation** is a not-for-profit corporation incorporated in the State of Delaware, USA. Its operating office is based in London, United Kingdom. The Foundation provides the overall governance and funding framework for two entities, the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (formerly: IFRIC), which respectively issue International Financial Reporting Standards (IFRS) and interpretations of such standards. The International Accounting Standards Board (IASB) involves a broad range of stakeholders in its work through an open consultation process, including preparers of financial statements, investors, auditors and national accounting standards setters.

Regulation (EC) No 1606/2002 on international accounting standards (the 'IAS Regulation') foresees that the European Commission may, subject to certain conditions, decide on the applicability of IFRS and related interpretations to the consolidated accounts of companies with securities listed on a regulated market within the Community. Pursuant to the IAS Regulation, IFRS have been in force in the EU since 2005. New standards are periodically adopted by the Commission, subject to a regulatory comitology procedure with scrutiny.

4 European Financial Reporting and Advisory Group

5 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 of 25.9.2009 p.8.

6 Committee of European Securities Regulators

7 Committee of European Banking Supervisors

8 Committee of European Insurance and Occupational Pensions Supervisors

9 International Accounting Standards Committee Foundation

10 European Financial Reporting Advisory Group

11 Public Interest Oversight Board

European Financial Reporting Advisory Group (EFRAG) is a Belgian law non-profit international association ("IVZW/AISBL") set up in Brussels by the main European professional associations interested in financial reporting. Its current members are BUSINESSEUROPE (European Business Federations), FEE (European Federation of Accountants), Insurance Europe (European Insurance Organisation), EBF (European Banking Federation), ESBG (European Savings Banks Group), EACB (European Association of Co-operative Banks) and EFAA (European Federation of Accountants and Auditors). It also co-operates with national accounting standards-setters from EU Member States. The European Commission is an observer in several EFRAG internal committees and working groups. EFRAG was set up in 2001 to assist the European Commission in the endorsement of international accounting standards by providing advice on the technical quality of such standards. EFRAG is also gradually taking up the role of pro-actively influencing the development of international accounting standards. This role is seen as crucial by all European stakeholders as it is important to ensure that the standards developed at the international level reflect the business reality and concerns of European companies.

Public Interest Oversight Board (PIOB) is a non-for-profit Spanish Foundation set up in Madrid. The key partners of the PIOB are the Monitoring Group (MG), which is the body representing international regulators and institutions[8], and the International Federation of Accountants (IFAC), which is the private body representing accountants and auditors worldwide[9]. The PIOB consists of ten members including its Chairman. The PIOB members are persons nominated by the Monitoring Group for a three-year period according to a Memorandum of Understanding. The PIOB constituency comprises a variety of stakeholders: legislators (e.g. the European Parliament, national legislators), regulators and supervisors of financial markets including auditor's oversight bodies, national standard setters for accounting and auditing, auditors and audit profession in general, preparers of financial statements (companies), users of financial statements (e.g. investors, analysts, researchers, suppliers), academics.

PIOB's role is to guarantee that due process, oversight and transparency are respected in the proposal, development and adoption of international standard for auditors in the framework of the International Federation of Accountants (IFAC). The Foundation is governed by a Board of Trustees in which each member of the PIOB is a trustee.

A detailed analysis of the current situation for each of these bodies is set out in the Annexes, establishing any shortcomings that need to be addressed with a view to ensuring the efficient functioning of the European single market.

1.3. Experiences of the grants 2010-2013

The current financing Programme was aligned to the financial framework 2006-2013: in the case of EFRAG and the PIOB it has covered the period 2010-2013, whereas in the case of the IFRS Foundation, the financing started only in 2011. Thus, we have some, although limited experience (1-2 years) with the co-financing.

It may be premature to draw scientifically sound conclusions from the experiences of only a few years. Nevertheless, some trends can be identified.

1.3.1. The experiences of the IFRS Foundation's financing in 2011

One of the aims of the Community co-financing has been to allow for a decrease in voluntary and/or private funding of the IFRS Foundation thereby raising its (perceived) independence. During 2011, the only year of financing so far, the IFRS Foundation saw increases in funding from various sources. The receipt of the EC grant provided the bulk of the increase compared to 2010. The voluntary contributions for 2011 were about the same level as 2010. The Foundation was able to achieve increases with the big accounting firms and saw a decrease in voluntary contributions, primarily those from US companies. It is the Foundation’s long term goal to reduce reliance on voluntary contributions. The receipt of the EC grant is a significant step forward to achieving that goal. The EU contribution to the IFRS Foundation's budget in the 2011 fiscal year was €4.229.165,14 (17% of the Foundation's eligible expenses for that year).

The EC grant is the IFRS Foundation’s largest institutional funding. In one respect it is the Foundation’s “lead funding” that encourages other countries to create funding mechanisms. This is important not only for the independence of the organisation, but is key to the completion of the Foundation’s mission, meeting the demands of the work plan and building adequate reserves. The EC grant has enhanced the Foundation’s reputation to attract funding, staffing and volunteers.

As a result, in 2011 the Foundation has made substantial progress with its work plan and further worked on other important standards such as those for Leases, Revenue Recognition and Insurance Contracts. Substantial progress has been made in completing the work plan but some complex issues remain and the convergence project of IFRS with other accounting standards (mainly with US GAAP) will continue.

Nearly all IFRS Foundation staff is employed under permanent contracts and is recruited from a range of sources. There is approximately 50 technical staff (not including the 15 IASB members) of which there are 6 secondee positions occupied by practise fellows recruited from a range of accounting firms who serve up to 2 years. Since the IFRS Foundation is competing for the best professionals on the labour market, its funding arrangements should allow being able to attract and retain its staff on its own payroll.

1.3.2. The experiences of EFRAG’s financing 2010-2011

EFRAG’s dependence on precarious/voluntary funding from interested parties has been reduced, thus the credibility and independence of its work has been considerably enhanced. Among others, now the Technical Expert Group (TEG) chairman (the leader of EFRAG’s technical work and operations) is on EFRAG’s payroll instead of being paid by a big accounting firm.

In parallel to the establishment of the grant programme, EFRAG’s governance reforms were completed in 2009. They enhanced its independence, accountability, transparency and the public policy aspects in its operations. The EU grant ensured that those reforms did not lose ground. The funders of EFRAG accepted that their influence in the organisation considerably diminished, whereas their level of contributions had to be maintained.[12] Without the additional staff that the EU grant allowed to employ, EFRAG clearly would not have been able to cope with the IASB's level of activities. Moreover, the additional funding allowed EFRAG to be more pro-active in on-going projects.

The EU co-financing, and the expansion of its budget also allowed EFRAG to take up new activities. Most importantly, the pro-active European input to the IASB's standard setting process is now institutionalised: EFRAG's Planning and Resource Committee has been set up. This committee provides a stable platform for views from all over Europe (not only the big Member States) and continuity in the actions (as opposed to ad-hoc projects previously). An indicator for the success of this type of activities is that the vast majority of the pro-active projects selected by EFRAG became high also on the IASB's agenda. EFRAG is now regularly asked to present its pro-active projects at the World Standard Setters' Meeting.

Representatives of smaller Member States with fewer resources often remark that their only chance to influence the IASB is to do it through EFRAG. They would not have the capacity to do themselves the work that EFRAG does for them. Based on the feedback received from those standard setters, they feel sufficiently associated to EFRAG's work. It is therefore important that EFRAG received sufficient financing for representing the views of those smaller Member States. Indeed, the EU grant serves the purposes to allow for forming a truly pan-European accounting view, where all Member States' interests are taken into account irrespective of their financial or other resources.

In sum, the Union's grant contributed to make EFRAG better equipped to fulfil its public interest mission. EFRAG managed to employ more staff and take over its chairman on EFRAG payroll. Nevertheless, EFRAG is still somewhat understaffed: some activities are not undertaken and the current staff is under workload pressure. On the basis of EU financing Decision of 16 September 2009, the EU contribution to EFRAG in the 2011 fiscal year was €2.288.160 (43% of EFRAG's total budget for that year).

1.3.3. The experiences of PIOB's financing 2010-2011

Funding contributions to the PIOB were expected to come from a variety of stakeholders from all over the world but primarily from the other members of the Monitoring Group. However, the usual difficulties associated to international co-funding arrangements have been exacerbated in recent times by the financial restrictions facing all international bodies and institutions due to the negative prevailing financial and economic climate. As a result, at present, only IFAC and the EU co-finance the PIOB.

On the basis of EU financing Decision of 16 September 2009, the EU contribution to the PIOB in 2010 fiscal year was €286.231. Such an amount represented 22% of the PIOB's total eligible expenses (€1.301.050). On the other hand, the EU contribution to the PIOB in 2011 fiscal year was €288.991,78, which also represents 22% of the PIOB eligible expenses for that year (€1.313.599)

The PIOB co-funding experience has been up to now positive. The European Commission has had the opportunity to visit the PIOB premises twice (March 2010 and April 2011) and to

[12] The EU co-financing did not have a squeeze-out effect; EFRAG needed additional funding.

verify their financial controls. The European Commission also trained its staff on EU budgetary procedures. From a practical point of view the activities involved in the management of the operating grant for the 2010 and 2011 fiscal years have been a very useful learning experience for both sides. This has paved the way for a straight and more efficient management of future funding contributions.

The EU co-financing of the PIOB has become an example for other potential contributors. Several international institutions are expected to provide funds to the POIB already for the 2013 fiscal year. Moreover, the Monitoring Group, the PIOB and IFAC have created a Task Force to select and convince a group of donors from all over the world to provide funding to the PIOB on a stable and long-term basis.

1.4. Problem definition and objectives

Without the Union co-financing, the problem in the financing of the three proposed beneficiaries is two-fold:

- The financing structure is not stable enough (is based on voluntary contributions) and comes from stakeholders that have a direct interest in the work of the beneficiary (this is the case of the IFRS Foundation and the PIOB and it partly applies to EFRAG);

- The financing received from the other sources would not sufficient to cover its public interest mission (this is typically the case of EFRAG).

In addition, in the case of the IFRS Foundation, Europe can maintain its seat in the Monitoring Board (the body overseeing the IFRS Foundation) if it contributes to the funding of the Foundation.

The overall objective of co-financing the accounting bodies proposed is to support the adoption of IFRS and its acceptance as a global single accounting language and to preserve the EU’s weight and voice in influencing the setting of IFRS at the same time. Therefore it is rational to co-finance the international body (the IFRS Foundation) and the European technical body (EFRAG) at the same time in a coordinated manner.

The EU co-financing is also expected to contribute to enhancing the independence of the beneficiaries in the field of accounting by allowing them to move from voluntary and/or private funding sources to stable, predictable, public financing. The EU grant also contributes to boosting the beneficiaries’ reputation and thus helping them in attracting financing from other sources and in the recruitment of highly qualified experts.

In the case of EFRAG, it is also expected that fair burden sharing among Member States is enhanced. Also, the EU co-financing should equip EFRAG with sufficient financial resources to carry out its European public interest mission.

In the case of the PIOB, the aim is strengthen the independence of the organisation: an oversight body must not be financially dependent on the stakeholders it oversees. Public oversight may be inefficient or at least not credible otherwise.

1.5. Available policy options

In our analysis, we compared the identified policy options to the baseline scenario: ‘no action’, meaning stopping the EU co-financing of the proposed beneficiaries. The policy options examined were:

- setting up only National Funding Mechanisms (ensuring the EU’s contribution from only other sources than the EU budget);
- “internalising” the beneficiaries’ functions (setting up a European standard setter, or a dedicated EU agency to pro-actively influence the IASB’s standard setting and provide technical advice to the Commission); and
- keeping the status quo, i.e. continuing the EU co-financing of the proposed beneficiaries.

When comparing the above options, the following factors were taken into account:

- whether the given option contributes to achieve the objectives envisaged;
- the political consequences of the given option;
- feasibility; and
- implications for the EU budget.

It has been established, that the most cost-efficient option that achieves the objectives and is feasible is to continue the EU co-financing of the proposed beneficiaries.

1.6. Volume of appropriations, human resources and other administrative expenditure

Our estimations for the proposed financing are based in the figures of the current Programme, the beneficiaries' budget projections, the expected inflation rate and took into account the current context of budget austerity and sovereign debt crisis. From a policy and political point of view, we think that the current level of funding should be maintained. Therefore our proposal accounts for an increase commensurate with the expected inflation rate (2%). The beneficiaries' activities are expanding; therefore their total budgets are also projected to increase. This means that the level of EU co-financing will gradually decrease in terms of percentage of the beneficiaries' budget. Accordingly, the EU intervention should amount to the following sums:

	Yearly average contribution (in EUR)	**Total contribution over the 2014-2020 period (in EUR)**

IFRS Foundation	4.6 million	32.2 million
EFRAG	3.36 million	23.5 million
PIOB	0.33 million	2.3 million
Total amount	8.3million	58.0 million

Note: Deviations may be caused because of the rounding up; for exact amounts please refer to the Legislative Financial Statement of the draft Regulation

In the case of the IFRS Foundation, we took into account only the expected inflation rate (2%)[13]. Ideally, the EU share of financing should be commensurate with its weight in the global economy. In the current Programme, the co-financing stemming from the EU aims at covering 20-25% of the IFRS Foundation's budget (together with the voluntary contribution of Member States) in line with the EU's weight in the global economy (based mainly on the GDP figures). Since the increased use of IFRS globally and the associated necessary expansion of the organisation results in a significant increase in the Foundation's costs and total budget, this rate is unlikely to be maintained by the current proposition. Should the budget projections of the IFRS Foundation prove correct, the EU co-financing ratio may even drop to 10%. This would mean that either the Foundation will not have sufficient resources to carry out its public interest mission in a satisfactory manner, or new founding sources will have to be found.

In the case of EFRAG, the expected inflation rate (2%) and the current austerity context were taken into account. The proposed co-financing level does not allow for the additional tasks to be taken up and increased activities performed by EFRAG; such activities will have to be financed by EFRAG's own resources.

In the case of the PIOB it is proposed to keep the same level of co-financing as in the previous programme (300.000 euro per year) adjusted by a reasonable expected annual rate of inflation (2%) from 2014 onwards. We also took into account the EU weight in the international financial and economic systems which imply a level of co-financing around 22% of total eligible expenses, what is similar to the previous programme. This represents a base funding of 306.000 euro in 2014 and a total for the seven year programme of 2.274.891 euro.

For more details please refer to the respective chapters on the beneficiaries.

Finally, management of the Community programme would entail related **administrative work by the services of the European Commission**. It is estimated that no additional posts for officials in the financial field would need to be created as the new Programme will not create significant additional workload compared to the current Programme.

1.7. Performance indicators

The ultimate aim of the Commission in the area of financial reporting is to ensure comparability and transparency of company accounts throughout the EU and to ensure a level playing field for European companies at the world market. Thus, the current programme (i)

13 The ECB aims at inflation rates of below, but close to, 2% over the medium term.

aims at supporting the smooth functioning of the EU's internal market of financial services and (ii) is part of the external dimension of the Europe 2020 strategy.

The performance indicators for the assessment of the proposed co-financing programme are aligned to the above objectives:

- The acceptability of IFRS for the EU's purposes can be measured by the number of standards issued by the IASB compared to the number of standards endorsed. The aim is to arrive at 100% by 2020.

- The success of the external dimension is measured by the global acceptance of IFRS; i.e. the number of countries using IFRS around the world. The target is a significant increase in the number of countries using IFRS.

In the field of auditing, the Commission aims to introduce International Auditing Standards (ISAs) in the EU and to promote convergence and high quality international standards for auditing all over the world. The commensurate indicator, once the EU has adopted ISAs, should therefore be the number of countries with advance economies applying the International Auditing Standards (ISAs). The objective is to arrive at 100% by 2020.

2. PROPOSED UNION FUNDING OF THE INTERNATIONAL FINANCIAL REPORTING STANDARDS FOUNDATION (IFRS FOUNDATION)

2.1. Background

Accounting standards play a critical role to ensure the effective operation of capital markets and of the broader economy. By ensuring that investors, creditors and other stakeholders have access to reliable and relevant information about the financial condition of companies, accounting standards *inter alia* allow companies to raise funds and facilitate contractual relations with their suppliers and customers. Accounting standards can also have important tax implications and regulatory impacts, notably for regulated financial institutions.

The Community first adopted harmonised accounting requirements for limited liability companies in 1978 in the form of the 4th company law directive on annual accounts[14]. This was followed in 1984 by the 7th company law directive on consolidated accounts[15]. After almost 20 years which saw no major changes to the Community's accounting legislation, a major breakthrough was made in 2002 with the adoption of Regulation (EC) No 1606/2002 on international accounting standards (the IAS Regulation)[16].

The adoption of the IAS Regulation took place in the context of a broader Financial Services Action Plan (FSAP) whose objective was to promote the integration of European capital markets. The use of IFRS is also required pursuant to the Transparency Directive[17] and to the Prospectus Directive[18], two major elements of the EU's securities markets legislation that were also adopted in the context of the FSAP.

The IAS Regulation foresees that the European Commission may, subject to certain conditions, decide on the applicability of International Financial Reporting Standards (IFRS) and related interpretations to the consolidated accounts of companies with securities listed on a regulated market within the Community. Pursuant to this Regulation, IFRS have been in force in the EU since 2005. New standards are periodically adopted by the Commission, subject to a regulatory comitology procedure. So far the Commission has adopted all IFRS in full, with one partial exception related to the accounting standard on financial instruments.

The IAS Regulation includes an option allowing Member States to extend the scope of application of IFRS to the annual accounts of listed companies or to the accounts of non-listed companies. Several Member States have taken advantage of this option, especially in relation

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14 Directive 78/660/EC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, OJ L 222, 14.8.1978, p. 11.

15 Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts, OJ L 193, 18.7.1983, p. 1.

16 Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, OJ L 243, 11.09.2002, p. 1.

17 Directive 2004/109/EC of the Council and o the European Parliament of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390, 31.12.2004, p. 39.

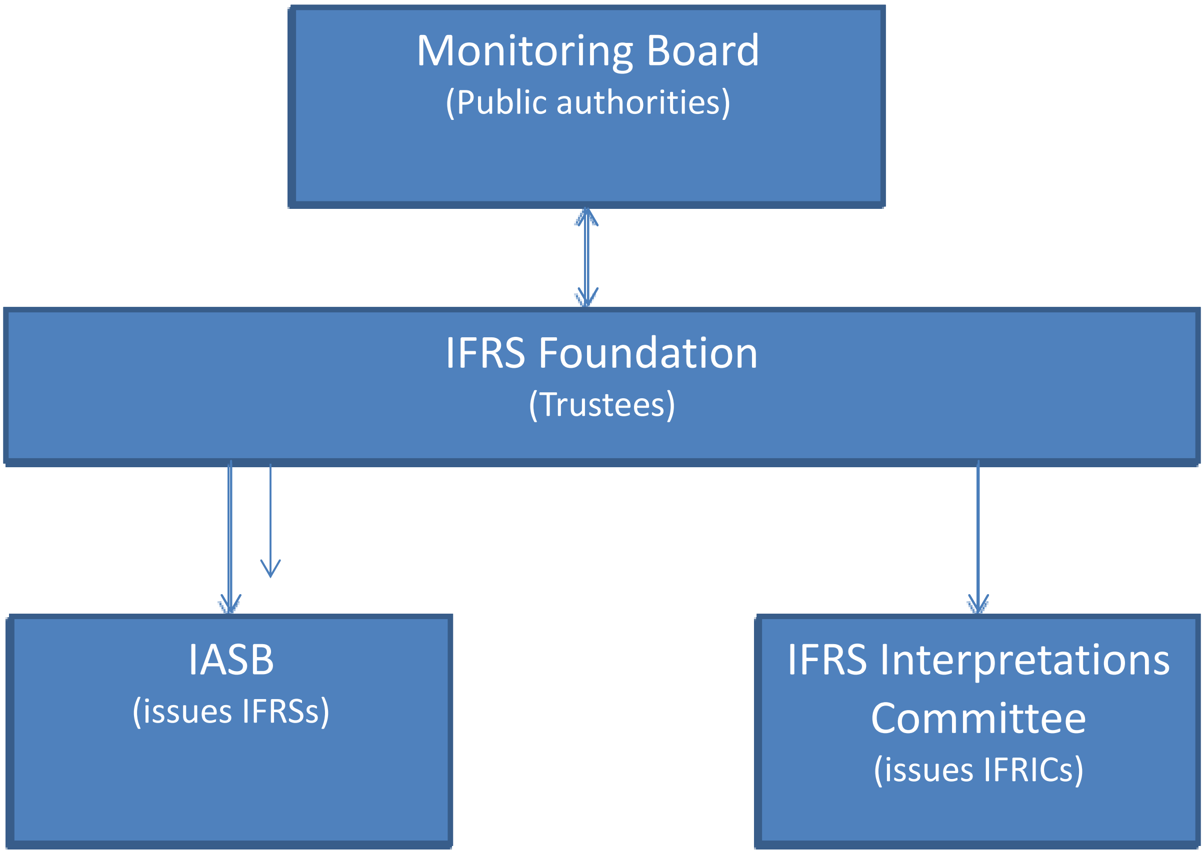
18 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, OJ L 345, 31.12.2003, p. 64.

to regulated financial institutions, including two Member States that require the use of IFRS for all limited liability companies.

The incorporation of IFRS into Community law and into the national law of Member States means that these standards play a major role to ensure the effective operation of the Single Market and of the EU's economy. Although the Commission can in principle refuse to adopt standards that do not meet the relevant criteria – and has made use of this option in one occasion – this option has serious disadvantages and is only to be used as a last resort. The Community therefore has a direct interest to ensure that the process through which these standards are developed delivers accounting standards that are consistent with the public interest (e.g. financial stability) and with the Community's legal framework. One aspect that must be considered in this context is the funding of the standard-setting process.

IFRS and related interpretations are issued by the International Accounting Standards Board (IASB) and by the IFRS Interpretations Committee, two bodies of the International Financial Reporting Standards Foundation (IFRS Foundation). The Foundation is a not-for-profit corporation incorporated in the State of Delaware, USA. Its operating office is based in London, United Kingdom. It provides the overall governance and funding framework for the IASB and the IFRS Interpretations Committee. Figure 1 shows a simplified diagram of the current structure of the IFRS Foundation and of its standard-setting bodies. The IFRS Foundation is a legal successor of the IASCF.

Figure 1: IFRS Foundation's current structure (simplified)



2.2. Governance of the IFRS Foundation

The cornerstones of the Foundation's public accountability are:

- The Monitoring Board: The Trustees have established a formal public accountability link to a Monitoring Board of public capital market authorities.

- The Constitution Review: The Constitution of the IFRS Foundation requires the Trustees to undertake a formal, public, five-yearly review of the Constitution.

- Due process: A formal due process for the IASB, the IFRS Interpretations Committee and XBRL ensures extensive outreach, which includes mandatory public consultation. Comment letters received in response to formal proposals are made public on the website.

- Public meetings: All meetings (other than meetings on administrative matters) of the bodies of the IFRS Foundation, including the IASB, the Interpretations Committee and its formal advisory bodies, are held in public and are webcast. Meeting notes are available to the public as observer notes.

The Trustees' effectiveness in exercising their functions is assessed annually by the Trustees' Due Process Oversight Committee. The Trustees' Due Process Oversight Committee (DPOC) is responsible for approving due process and overseeing the IASB's compliance with due process, and reviewing the Trustees' fulfillment of their oversight function in accordance with the Constitution of the IFRS Foundation.

The European Commission has sought fundamental reforms of the IFRS Foundation's governance arrangements, including of its funding regime, in order to address the concerns expressed by the Community legislators.[19]

The most important issues related to the governance reforms of the IFRS Foundation are described in more detail below.

2.2.1. Accountability and oversight role of the IFRS Foundation Trustees

In accordance with the requirements of its Constitution, the IFRS Foundation (IASCF) launched a five-yearly constitutional review in March 2008.[20] A discussion document proposing changes to the public accountability of the IFRS Foundation (IASCF) and to the composition of the IASB was published in July 2008.[21] Following a public consultation and several roundtables, the Trustees concluded part one of the Constitution Review at their meeting in New Delhi on 15 and 16 January 2009[22] and issued a report setting out the conclusions of phase one in April 2009.[23]

The first phase of the IFRS Foundation's (IASCF's) Constitutional Review has led to two changes:

– the establishment of a Monitoring Board;

– changes to the composition of the IASB.

The composition of the IASB is discussed under point 2.2.2 below.

The Monitoring Board is an independent body, without legal personality, separate from the IFRS Foundation and governed by its own Charter. Its relationship with the IFRS Foundation is set out in a bilateral Memorandum of Understanding. The Monitoring Board's aim is to ensure the accountability of the IFRS Foundation to public authorities responsible for setting statutory accounting standards. Its principal powers and responsibilities are:

- to participate in the nomination of Trustees and to approve the latter's appointment;
- to review the Trustees' oversight of the IASB's work; and
- to assess the adequacy of the IFRS Foundation's funding arrangements with a view towards promoting a non-voluntary, transparent and stable funding platform.
- The Monitoring Board also has the possibility to refer matters of broad public interest for consideration by the IASB on a "comply or explain" basis.[24]

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19 See the Commission staff reports on governance developments in the IASB and IASCF available at http://ec.europa.eu/internal_market/accounting/iascf_iasb_governance_en.htm

20 http://tinyurl.com/mrj3dz.

21 http://tinyurl.com/marhsu.

22 http://tinyurl.com/blqaze.

23 http://tinyurl.com/nx77hg.

24 The Monitoring Board's Charter and its Memorandum of Understanding with the IFRS Foundation are available at http://www.iasb.org/Monitoring+Board/Monitoring+Board.htm.

The Monitoring Board meets two to three times a year.

The G20 has welcomed the establishment of the Monitoring Board, pointing out that this "will enhance the IASB's accountability, governance and legitimacy"[25].

The second phase of the IFRS Foundation's Constitutional Review started with the publication of a discussion document in December 2008. The review was completed in early 2010.

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[26]. 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. To obtain input from its stakeholders, the Trustees published two consecutive consultation documents. Both sets of reviews were subjected to extensive global public consultation with interested parties, and included public round tables in Hong Kong, London, New York and Tokyo. For more information, see the timetable of the strategy review.

The Trustees agreed to co-ordinate their activities with those of the Monitoring Board of the IFRS Foundation, which was conducting its own independent wide-ranging review at the same time. As a result, the Trustees of the IFRS Foundation and the Monitoring Board published their respective reports jointly on 9 February 2012.[27]

The Monitoring Board primarily reviewed institutional aspects of governance, focussing on the composition and the respective roles and responsibilities of the Monitoring Board, Trustees and the IASB. Its main recommendations are the following:

- Expand the Monitoring Board membership[28] to include major emerging markets, based on use of IFRSs domestically (Basel Committee to continue as observer)
- Improved procedure for IASB agenda referrals
- Improved procedure for IASB Chair selection
- Increased transparency of MB functions and activities
- Clarification of criteria and process for Trustee nominations

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25 Report of G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets http://www.astrid-online.it/Dossier--d1/Documenti/The-London/G20_wg2_27_03_09.pdf , p. 24.

26 http://www.ifrs.org/Alerts/PressRelease/Strategy+review+Feb+2012.htm

27 http://www.ifrs.org/News/Press+Releases/trustee+monitoring+board+joint+statement+2011.htm

28 The MB is currently composed of 5 members: the EC, the US SEC, the Japanese FSA, IOSCO technical committee and IOSCO emerging markets committee.

- Improve IASB management structure and segregation of staff functions.

Thus, the Monitoring Board review introduces a dynamic framework for the membership selection, based on the principle that "domestic use of IFRS" is a condition to become a member of the Monitoring Board, comprising a transitional period for new members before acquiring permanent membership and regular reviews for existing members. Another important criterion of Membership is the contribution towards the IFRS Foundation's budget.

At the same time, funding should not be directly linked with influence on the content of IFRS. The Foundation’s fund raising activities are separate from the accounting standard-setting activities of the IASB, the independent standard-setting body of the Foundation. This separation was recently enhanced following the review above. The Trustees changed the Foundation’s Constitution to remove the title of Foundation Chief Executive Officer (CEO) from the IASB Chair and reassigned functions “to ensure segregation of responsibilities for IASB operations from any oversight or funding matters which may create an actual or perceived conflict of interest in standard-setting”.

The IASB actively seeks the input and views of a wide range of stakeholders but ultimately it is the 15 independent members of the IASB that debate and decide the content of accounting standards. These principles for the IASB are outlined in the Foundation’s constitution.

The Trustees in their strategy review recommended four areas that the IFRS Foundation should focus on:

- mission (in particular improved definition of the public interest served by the Foundation's work);
- governance (improved accountability and independence);
- standard setting process (ensure that standards are of high quality and are implemented consistently); and
- stable financing.

2.2.2. Adequate representation of stakeholders

The changes adopted in the first phase of the IFRS Foundation's current Constitutional review include a requirement to ensure a balanced geographical membership of the IASB. The revised Constitution introduces a geographical basis for appointing IASB members and increases the Board's maximum size. Six members (out of a maximum of 22 members) will be from Europe. The Constitution was also amended to explicitly require that members of the IASB formally commit to act in the public interest in all matters.

The current composition of the IASB broadly ensures a balanced sectoral membership drawn from investors, preparers, auditors, regulators and standards-setters.

2.2.3. Role of the Advisory Council (former Standards Advisory Committee (SAC))

In February 2009, the IFRS Foundation's Trustees announced changes to the membership of the SAC. An important departure from previous practice, members are no longer appointed in a purely personal capacity but as representatives of relevant organisations with an interest in accounting standards-setting. The Trustees also announced two vice-chairmen to serve alongside Paul Cherry, including Mr. Patrice Marteau, Chairman of ACTEO[29] and of the Accounting Committee of Business Europe.[30]

The changes to the membership of the SAC enhanced its representativity. The active role of the new SAC Chairman has also enhanced the SAC's effectiveness.

2.2.4. Due process with stakeholders

The interaction between accounting standards, prudential regulations and financial stability has been brought to the fore by the current financial crisis. While the primary purpose of accounting standards is to provide investors with access to timely and relevant information about a company's financial position, the IFRS Foundation's Constitution recognises a broader objective "to help participants in the world's capital markets and other users make economic decisions." Moreover, the IASB's Due Process Handbook recognises that the regulatory environment and regulatory requirements should be considered as part of the Board's agenda- and standard-setting process.

Several organisations in the field of prudential regulation and/or financial stability are represented in the reconstituted Advisory Council, including the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the International Organization of Securities Commissions. Both the European Securities Market Authority (ESMA) and the European Central Bank are also represented in the Advisory Council.

In addition, the IFRS Foundation started its first formal public agenda consultation in June 2011.

2.3. Funding arrangements of the IFRS Foundation

According to Article 9.4 of Decision 716/2009 of the European Parliament and the Council (the legal base of the current EU grant programme), the Commission will report on whether the IFRS Foundation has made significant progress towards ensuring that neutral funding arrangements form a majority of its total funding, including from third-country participants. The present chapter thus analyses the funding arrangements of the IFRS Foundation.

2.3.1. On the way towards independent, non-voluntary funding

In order to ensure the independence of the IASB, the IFRS Foundation is expected to move towards non-voluntary, stable and transparent funding arrangements with a broad geographic basis. In line with this objective, the European Parliament and the EU's Member States have established a legal basis (the current co-financing Programme) allowing the Commission to provide co-funding to the IFRS Foundation up to a maximum of €12.75 million from 2011 to 2013, i.e. €4.25 million per annum.

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29 Association pour la participation des entreprises françaises à l'harmonisation comptable internationale.

30 http://www.ifrs.org/News/Press+Releases/Trustees+announce+membership+of+reconstituted+Standards+Advisory+Council.htm

The IFRS Foundation itself is aware of the need for a reform in its funding structure. The "Trustees' Strategy Review 2011" and Monitoring Board's "Final Report on the Review of the IFRS Foundation's Governance" (see above footnote 27) issued in February 2012 prominently included discussions on the importance of independence and financing. These are matters considered at the highest levels in the organisation.

Regarding voluntary funding, the US is the only country where the Foundation seeks voluntary contributions in addition to the global voluntary funding provided by the major accounting firms. Non-voluntary contributions from the US were anticipated to significantly replace accounting firm contributions. In 2011, voluntary funding from US corporations and the major accounting firms amounted to about 35% of total contributions compared to 42% in 2007. Due to the recent SEC document concerning the US adoption of IFRS[31], voluntary funding is expected to continue until the SEC decides on a central funding mechanism. The Foundation's staff continues to work with the US SEC on possible public funding alternatives.

Funding is requested from new countries in the course of their adoption of IFRS. Several countries are in this category including: Russia, Turkey, Mexico, Indonesia, Argentina, Chile, Israel and Saudi Arabia.

The Foundation computes the amount of country funding requested to meet the financing needs of their working programme both with and without the support of the major accounting firms. In this way they are working with the contributing countries to increase the Foundation's funding in an effort to phase out contributions from the major accounting firms. This is a long term project that could take several years to achieve.

The above developments and efforts are expected to lead to the establishment of a non-voluntary, transparent and stable funding platform for the IFRS Foundation and the IASB towards which the EU would need to contribute.

2.3.2. Financial highlights

The two main sources of the Foundation's income are the revenues from publications and other copyrighted activities and the income from contributions as shown in table 1.

Table 1: IFRS Foundation's sources of operating income for 2009 and 2010

INCOME	**2009**		**2010**	
Contributions	16.584	(73%)	16.640	(73%)
Interest income	377	(2%)	271	(1%)
Other income	34		58	
Revenue of publications and related activities	5.654	(25%)	5.804	(25%)
TOTAL INCOME	**22,649**		**22,773**	

31 "Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers Final Staff Report July 13, 2012 http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-final-report.pdf

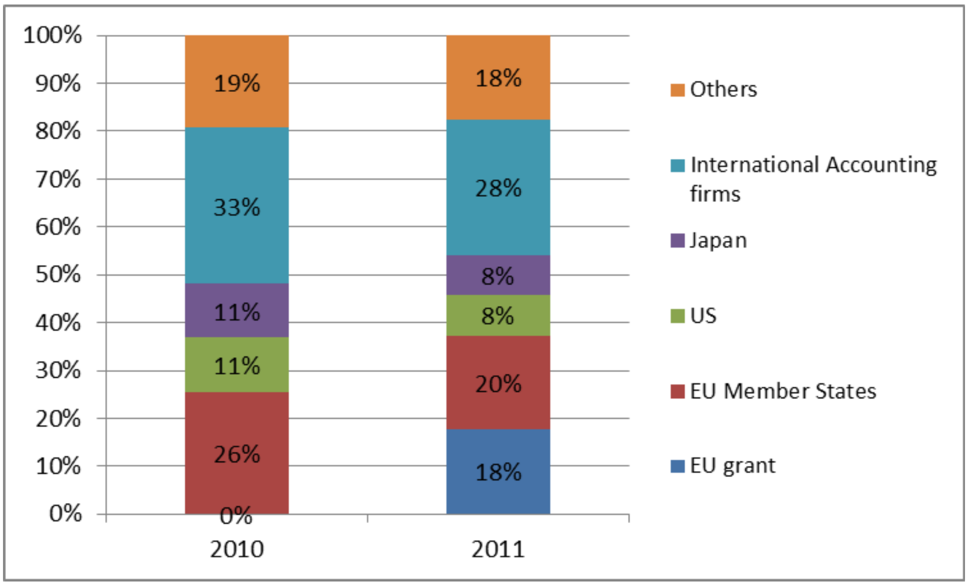
Source:http://www.ifrs.org/NR/rdonlyres/EB99AF27-22F7-45AF-A033-75A36CDC3549/0/IFRSANNUALREPORT_ALL_12July.pdf

Contributions form the main part of the budget's revenue side (73%). Contributors come both from the private and the public sector. Public sector contribution can be based either on a voluntary system (as it was the case in Germany in 2010) or by a levy-like system, where contributions are collected by a public body (e.g. in Japan). Private sector contributors are: (i) contributions of the 'big4' accounting firms (their financing covering 24% of the IFRS Foundation's budget) and (ii) the majority of the contributions coming from the US are private as well. Altogether the share of private funding in all contributions was approximately 45%, whereas it amounted to ca. 33% of the total budget.

In 2011, the EU co-financing started. Thus, the funding situation changed significantly: only 35% of contributions are clearly coming from the private sector. In that year the US was the only remaining place where the IFRS Foundation still sought direct contributions from companies.[32] The breakdown is illustrated by Figure 2 below.

[32] http://www.ifrs.org/news/features/ifrs+foundation+financing.htm

Figure 2: The IFRS Foundation's contributors in 2010 and 2011[33]



Source: Draft annual report of the IFRS Foundation 2011, final report on the 2011 Grant Agreement with the European Commission

As the figure clearly shows, the European Union (the EU grant and certain individual Member States together) were among the main contributors to the IFRS Foundation's budget in 2011. This is in line with the EU's role as the biggest region applying IFRS and supports the Commission in international negotiations.

In the coming year further changes can be expected in the breakdown of funding: the IFRS Foundation's 2012 funding goal[34] for the US is to increase their contributions from £1.7 million to £3.2 million primarily with government funding. At the same time, the change is dependent on adoption of IFRS by the US.

It should be noted that individual EU Member States may consider lower or abandon their contributions to the IFRS Foundation's budget given the current context of sovereign debt crisis and austerity measures. The table below shows their contributions so far.

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[33] Private funding: financing coming from the international accounting firms and mainly that coming from the US; public funding is all the rest.

[34] A target level of funding received from the given jurisdiction based on its respective weight in the global economy.

Table 2: Contributions to the IFRS Foundation's budget by Member States 2010 and in 2011(in thousand GBP)

Country	**Funding in 2010**		**Funding in 2011**	
	(in £)	(in % of total contributions)	(in £)	(in % of total contributions)
Germany	1,048,546	6%	952.120	4%
France	860,733	5%	853.679	4%
United Kingdom	855,000	5%	860,730	4%
Italy	628,246	4%	661.117	3%
Spain	430,585	3%	348.281	2%
Netherlands	339,126	2%	333.978	2%
Bulgaria	5,240	0%	0	0%
Cyprus	4,441	0%	0	0%
Greece	17,239	0%	0	0%
Ireland	6,205	0%	0	0%
Portugal	16,504	0%	0	0%
MS Total	**4,256,865**	26%	**3.653.314**	18%
EU grant	**0**	0%	**7,663,218**	37%

Source: Data received from the IFRS Foundation; exchange rate: 1.1462 EUR/GBP

2.4. Problem Definition

2.4.1. Reliance on non-diversified, voluntary and precarious funding from interested parties and its negative consequences

There have been long-standing concerns about the IFRS Foundation's funding arrangements, a subject that has been repeatedly highlighted by the ECOFIN Council in its conclusions adopted in July 2006[35] and July 2007[36]. In its conclusions of 8 July 2008, the ECOFIN Council also referred to the urgent need to secure appropriate funding for the IASCF (IFRS Foundation).[37] The European Parliament (EP) has also criticised the IASCF's funding arrangement and called on "the Community to examine under what conditions and in what form it might consider contributing to that funding."[38] The pace of progress achieved in reforming the IFRS Foundation's funding arrangements, is one of the elements that will

35 http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/90465.pdf

36 http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/95233.pdf

37 http://www.iasplus.com/europe/0807ecofingovernance.pdf

38 See paragraph 16 of the EP's Resolution on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) adopted on 24 April 2008, http://tinyurl.com/http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0032+0+DOC+PDF+V0//EN

influence the EP's willingness to accept future IFRS. In its opinion dated 10 September 2008, the Committee on Economic and Monetary Affairs of the EP reiterated that "*sufficient funding must be set aside for […]* international accounting standard setting, in particular to the International Accounting Standards Committee Foundation, including the International Accounting Standards Board."[39] The IFRS Foundation has responded to the concerns expressed by the EU institutions by attempting to secure and diversify its funding base. "The expanding funding regime now includes the participation of thousands of market participants."[40]

Since 2006 the Trustees have sought to establish national financing regimes[41], proportionate to a country's relative GDP, that establish a levy on companies or provide an element of publicly supported financing. Now the great majority of the Foundation's finances are based on such regimes, and this approach has been particularly successful in Asia-Oceania and Europe. In 2010, the IFRS Foundation saw the continued advancement to those types of regimes.

The IFRS Foundation's financial dependence on the voluntary contributions of key stakeholder groups gives rise to continued concerns about the latter's potential influence over the IASB's standard-setting process. This situation undermines the IASB's operational independence, an indispensable requirement in the case of the EU as the standards issued by the IASB are bound to become EU law. Similar concerns about the funding arrangements of the US Financial Accounting Standards Board (FASB) led to the enactment of a non-voluntary funding regime pursuant to the Sarbanes-Oxley Act of 2002[42].

In addition, there is no guarantee that these voluntary funding contributions will continue to be available in the future: companies could withdraw funding in protest against the adoption of accounting standards they do not favour or due to financial difficulties.

Funding of the IFRS Foundation raised within the EU comes currently from two main sources: the operational grants from the EU budget and contribution of certain individual Member States. To date, national funding schemes have been established in only seven Member States[43] either through privately-arranged voluntary funding schemes or, in a minority of cases, via statutory levies on companies with listed securities.[44] This situation raises concerns of equity (stakeholders in some Member States bear the cost of the IFRS Foundation's funding, while those in other Member States do not) which may lead some existing national funding schemes to withdraw funding, thus threatening the continuity of the IASB's operations. There is clear and present risk that such a withdrawal could occur in the

39 http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-407.786+02+DOC+PDF+V0//EN&language=EN

40 http://www.ifrs.org/News/Press+Releases/Update+on+Funding+for+2008.htm and http://www.ifrs.org/Archive/INSIGHT+journal/Q1+and+Q2+2008/Four+principles+ensuring+sustainable+funding.htm

41 Non-voluntary system of contributions to be collected by a Member State

42 The Sarbanes–Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745, enacted July 29, 2002), also known as the 'Public Company Accounting Reform and Investor Protection Act' (in the Senate) and 'Corporate and Auditing Accountability and Responsibility Act' (in the House) and more commonly called Sarbanes–Oxley, Sarbox or SOX, is a United States federal law that set new or enhanced standards for all U.S. public company boards, management and public accounting firms. http://en.wikipedia.org/wiki/Sarbanes%E2%80%93Oxley_Act

43 France, Germany, Italy, Spain, Sweden, Denmark and the United Kingdom

44 Mandatory levies on listed companies exist in Italy, Spain and the United Kingdom.

near future. In addition, considering the current context of budget austerities, several Member States may consider decreasing their contributions.

Failure to reform the IFRS Foundation's funding arrangements risks undermining the acceptability and legitimacy of IFRS in the EU. That could in turn lead to the non-endorsement of IFRS for use in the EU. A refusal by the European Parliament and Council to endorse one or more IFRS would undermine the implementation of the IAS Regulation, of the Transparency Directive and of the Prospectus Directive, possibly triggering a damaging political debate about the continued appropriateness of IFRS as a whole for the EU. Such an outcome would undermine the functioning of the Single Market and, in particular, of the EU's capital market.

2.5. Objectives

2.5.1. Strategic objective

The strategic objective to be achieved by the proposed funding arrangement is to ensure stable, diversified, sound and adequate funding to enable the IFRS Foundation to carry out its public interest mission in a way that ensures its independent and efficiency, as well as the high quality of the accounting standards produced by the IASB.

Another strategic objective is to preserve the EU's weight in the international financial reporting arena: only jurisdictions contributing the IFRS Foundation's budget can be members of the Monitoring Board overseeing the organisation.

2.5.2. Operational objectives

2.5.2.1. Avoid reliance on precarious, voluntary funding from interested parties thus ensuring stability and independence of the IFRS Foundation's work

The first operational objective is to guarantee the IFRS Foundation's financial independence from voluntary contributions from parties with a direct interest in accounting standards, while at the same time ensuring sound, stable and sustainable funding arrangements. For the reasons explained in section 3.2., this in practice implies that the IFRS Foundation's funding should rely mainly on non-voluntary contributions. In particular, the IFRS Foundation should in future no longer rely on voluntary contributions from the four major international accounting networks which currently contribute US$8 million per annum. This funding needs to be replaced from new sources.

2.5.2.2. Ensure a level playing field for all stakeholders within the Internal Market

The second operational objective is to reform the IFRS Foundation's funding regime to allow the Community to contribute in a manner that ensures a fair burden sharing for stakeholders throughout the EU. This could in principle be achieved by establishing non-voluntary funding schemes in all Member States (involving a statutory levy on all listed companies in each Member State or a direct contribution from the Member States' national budgets) or by a direct contribution from the Community budget.

2.5.2.3. Promote the international acceptance of IFRS in the world's major capital markets

A third operational objective is to support the Community's financial reporting strategy, which seeks to promote the international use and acceptance of IFRS, in particular in the world's major capital markets.

This is particularly relevant in relation to the US. The EU has implemented a multi-annual joint work programme with the US, in particular with the Securities and Exchange Commission (SEC) and accounting standard-setter (FASB) to facilitate the convergence of US accounting requirements with IFRS, with a view to the latter's eventual implementation in the US. Consequently, the US SEC has adopted a roadmap towards the full implementation of IFRS by US listed companies by 2015.[45] Based on this roadmap and the US announcements, a decision of the implementation/adoption of IFRS in the US can be expected by mid-2012.

Should the US decide to fully implement IFRS in the US, it would require the SEC to recognise the IASB as a standard-setting body pursuant to the Sarbanes-Oxley Act, which *inter alia* mandates that recognised standard-setting bodies must be funded in a manner that ensures their independence from those parties directly affected by accounting standards.[46] In practice, recognition of the IASB by the SEC would require all or a majority of the IFRS Foundation's funding to be raised through non-voluntary sources. A contribution from the Community budget to the IFRS Foundation's budget (our preferred policy option as described below) would align the latter with the requirements set out in the Sarbanes-Oxley Act, thus facilitating the IASB's recognition as a standard-setting body by the SEC and supporting the Community's objective of achieving global acceptance of IFRS.

2.5.2.4. Achieve the above objectives within a reasonable period of time considering their urgency in the current EU and international context

A final operational objective is to achieve the abovementioned objectives within a reasonable period of time considering their urgency in the context of the current financial crisis. In particular, given the anticipated timetable of the reform of the IFRS Foundation's funding arrangements (2010-11), it is important to complete preparations within the EU – including, if necessary to create a legal basis – for this commitment as soon as possible. If an EU legal basis needs to be created, it needs to be adopted before the end of the current parliamentary term, failing which the EU risks being unable to participate in the reform of the IFRS Foundation's funding regime, thus putting at risk the achievement of the objectives set out in section 3.3.2.1. to 3.3.2.3.

45 http://www.sec.gov/news/press/2008/2008-184.htm

46 This issue was for example raised on 14 November 2007 by US Senator Christopher Dodd, Chairman of the US Senate Committee on Banking, Housing and Urban Affairs, and Senator Jack Reed, Chairman of the Subcommittee on Securities, Insurance and Investment, in a letter to the Chairman of the SEC, in which they stated that "The IASB's lack of independent funding sources is troubling and inconsistent with the framework set by Congress for the SEC's recognition of any accounting principles established by a standards-setter other than the SEC itself."

2.6. Available Policy Options

It is therefore necessary to reform the IFRS Foundation's funding arrangements in a manner that achieves the objectives set out in section 3.3. The remainder of this section describes the available policy options.

2.6.1. Baseline scenario: Discontinuing the EU co-financing (no action)

In the absence of a policy intervention by the Union, we judge that Member States and/or the private sector would not be able to undertake a co-ordinated initiative to enhance the IFRS Foundation's funding. While the IFRS Founding continues its efforts to raise funding from additional Member States, little or no progress has been made in the last year towards establishing national funding schemes in all Member States. Moreover, based on informal contacts with Member States and with European stakeholders it is our assessment that no significant further progress in this direction can be expected. Thus, the current Union grant cannot be substituted from that source. In addition, it is unrealistic to expect current contributors to the IFRS Foundation's budget to increase, since – as shown in Figure 2 above – contributors are already struggling to meet their current funding target.

The no policy intervention therefore implies that the objectives identified in section 2.5. are unlikely to be achieved. This risks undermining the acceptability and legitimacy of IFRS in the EU, which could in turn lead to the non-endorsement of IFRS for use in the EU. Such a development could undermine the implementation of the IAS Regulation, of the Transparency Directive and of the Prospectus Directive. Failure to achieve the objectives identified in section 2.5. would also risk triggering the withdrawal of funding from one or more national funding schemes in EU Member States, leaving the IASB with inadequate resources to fulfil its standard-setting role. Either outcome would undermine the goal of global financial reporting standards, thus the acceptance of standards used by European companies in the world's major capital markets – consequently the functioning of the Single Market and, in particular, of the EU's capital market.

2.6.2. Status quo: Continuing the Grant Programme

The Union currently co-finances the IFRS Foundation since 2011. Although we do not yet have a sufficiently long experience in the co-financing to draw conclusions, this policy option is likely to contribute to achieving the first objective (guarantee the IASB's financial independence) if/when all or a majority of the Foundation's funding are drawn from non-voluntary or public funds. A financial contribution from the Union alone is not sufficient to achieve this and co-ordination and co-operation among the jurisdictions with major capital markets, in particular the EU, Japan and US, is necessary to implement the necessary reforms of the IFRS Foundation's funding regime. The 2012 February report of the Monitoring Board and the report of the Trustees' Strategy Review 2011 are a step forward in this direction.

This policy option should also strongly contribute to achieving the second objective (ensure a level playing field for stakeholders throughout the EU), while it also facilitates the IASB's recognition as a standard-setting body by the US SEC. As the US moves towards implementing IFRS, it will also modify its funding arrangements towards the IFRS Foundation by implementing a non-voluntary contribution, since this is requirement for recognising the IASB as a standard-setting body pursuant to sections 108 and 109 of the

Sarbanes-Oxley Act (see section 3.3.2.3. above). We understand that the current voluntary funding of £1.8 million raised in the US is expected to be replaced by central funding. However, this change is dependent on US adoption whose date is yet uncertain. We expect other major jurisdictions to do likewise as they move towards implementing IFRS[47].

In order to maintain the status quo, a legal basis for the EU co-financing should be adopted before 2014. This would also allow the Community to fully participate in and contribute towards the reform of the IFRS Foundation's funding arrangements, thus meeting one of the Monitoring Board membership criteria.

2.6.3. Establishment of national funding schemes in all Member States (public financing or levy on industry)

If the EU is not contributing from the Union budget, another option is to see the Member States increase their contributions. Existing national funding mechanisms in EU Member States take the form either of privately-arranged voluntary funding schemes or, in a minority of cases, of statutory levies on companies with listed securities. If the IFRS Foundation's funding continues to rely on such national funding schemes, as explained in section 2.., such schemes should provide for non-voluntary contributions to the Foundation's budget. This in turn implies a non-voluntary national funding regime and the need for a statutory (legal) basis for these funding schemes.

In order to create such a legal basis, the Commission could propose a legal act requiring Member States to finance the IFRS Foundation, for example via a statutory levy on companies with listed securities. This option was assessed by the Commission services already in 2005. The conclusion is that the Treaty does not provide an explicit legal basis to require Member States to finance the IFRS Foundation nor to impose a mandatory levy on listed companies across the EU (in form of direct taxation). Even assuming such a legal basis for a statutory levy could be found, adoption of the relevant legal act would require unanimity in the Council. This is highly unlikely to be achieved for political reasons irrespective of the IFRS Foundation, as a number of Member States oppose Union intervention in fiscal matters. The adoption of a harmonised statutory levy is thus not feasible for a combination of legal and political considerations. This possibility should therefore be discarded.

Alternatively, the Commission could rely on moral persuasion to encourage stakeholders (private sector and/or public authorities) to establish national funding schemes in those Member States where none exist for the time being. This approach was already suggested in the conclusions of the ECOFIN Council of July 2006[48], but experience has shown that the Commission's moral persuasion has not yet yielded results.

2.6.4. Establishment of an EU accounting standard-setting agency

The Union could establish a European accounting standard-setting body, either in the form of a private body or by establishing a Union agency, to take over the role currently performed by the IASB. However, this approach has two major disadvantages:

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[47] Mexico and Turkey are expected to make an initial contribution for 2012 but those have not yet been confirmed. Contributions from Indonesia and Russia are under active discussion.

[48] http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/90465.pdf

1. The EU's financial reporting policy aims at achieving a single set of globally accepted accounting standards in order to facilitate cross-border investment and the integration of global capital markets (especially the trans-Atlantic capital market). It is therefore of paramount importance to avoid the emergence of regional accounting standards which would inevitably undermine this objective. Consequently, the establishment of a European standard-setter, be it private or public, is not compatible with the Union’s financial reporting policy.

2. In addition, the establishment of either a private or public European accounting standard-setter is unlikely to be possible without Union funding comparable in amount to the financial contribution to the IFRS Foundation’s funding (since an agency would ultimately be funded entirely from the Union budget). Moreover, the Commission's management of the financial contribution to and/or co-ordination with a European standard-setting body would imply administrative costs for the Commission which would also be comparable to that associated with a financial contribution to the IFRS Foundation’s budget. From the Commission's point of view, this policy option therefore does not present any significant budgetary or administrative advantages compared to the status quo.

3. Article 2 of the IAS Regulation specifically defines international accounting standards as "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)." An amendment to the IAS Regulation would therefore be required in order to allow the Commission to adopt accounting standards developed by a body other than the IASB.

2.6.5. Comparison of options

The matrix below is used to compare the relative merits of four competing options based on a qualitative assessment as reliable data are not available.

The criteria used for the comparison of options are considered equally important.

The option 'stop financing' ('no action', option 1) used as the baseline with maintained budgetary intervention from the Union is compared to the three other options based on the three following main criteria:

- the degree of effectiveness of their implementing process;
- their impact on costs for the EU; and
- the level of risk of not reaching the objectives above-mentioned in section 2.5.

Table 2: Summary of policy options

ASSESSMENT of OPTIONS	**1. Achievement of objectives** All (+++) Some (+/-)	**2. Feasibility** Straightforward (+++)	**3.Political consequences** Positive (+ to +++)	**4. Implication for EU budget** Positive	**Overall Assessment** Positive
Option 1 Discontinuin	- - -	N/A	- - -	++	- - -
Option 2 Maintaining the EU co-financing	+++	+++	+++	- -	+++
Option 3 Setting up national funding	+/-	- - -	-	++	-
Option 4 Setting up a dedicated EU	+/-	+/-	-	- -	-

Our analysis is summarised in Table 2.

Option 1 incurs no direct costs to the Union budget. However, it leaves the IFRS Foundation's funding regime unchanged, does not provide any guarantees about the stability or independence of this funding regime and would not achieve the objectives set out in section 2.5. This option thus carries unacceptable political risks. We therefore have an adverse opinion about this option, which we discard.

Option 3 likewise incurs no direct costs to the Union budget but is not feasible for a combination of legal and political considerations. This option thus also carries unacceptable political risks. We therefore also have an adverse opinion about this option, which we similarly discard.

Option 4 is inconsistent with the Union's legal framework and with the Union's policy in the field of financial reporting. Moreover, this policy option does not present any significant budgetary or administrative advantages compared to the option 1, the status quo (our preferred policy option).

Although option 2 – maintaining the Union contribution to the IFRS Foundation's budget – carries significant direct budgetary and administrative costs to the Community budget, it is the only policy option that can achieve the pursued objectives described in section 2.5. We therefore have a positive opinion about this option, which we retain for the following reasons:

- it enhances the IASB’s financial independence from stakeholders with a direct interest in accounting standards while at the same time contributes to sound, stable and sustainable funding arrangements;
- it ensures a level playing field for stakeholders throughout the EU;
- it facilitates the IASB's recognition as a standard-setting body and the acceptance of IFRS in other major capital markets, in particular the US;
- it strengthens the Union’s negotiating position in the broader discussions about the reform of the IFRS Foundation’s governance and is the only way for the Union to be represented at the Monitoring Board.

2.6.6. Method of implementation for the selected option

As the Union’s financing of the IFRS Foundation would not entail a purchase of goods and services, the most appropriate means to finance the Foundation is via a grant.

As a general rule, financial support from the Union budget could be provided either:

1. by contributing to the overall budget of the body (via operating grants); or

2. by co-financing specific targeted activities of the body (via grants for action).

Concerning publicity rules, the possibility of providing a grant following a call for proposal should be excluded from the outset since the beneficiary (the IFRS Foundation) is in a situation of legal monopoly in accordance with 190 (1)(c) RAP[49].

In view of the public policy objectives and the type of beneficiary, it is considered that a direct financial contribution from the EU budget by way of an operating grant constitutes the best solution to address the proposed funding. Indeed, the choice to provide an operating grant to the IFRS Foundation seems the most appropriate because, unlike a grant for action, which helps to co-finance a one-off action over a given period of time, an operating grant allows co-financing of the whole institution's functioning from a much broader perspective.

Regarding the IFRS Foundation as a possible eligible beneficiary of an operating grant, it complies with the requirements laid down in Article 121(1)(b) of the Financial Regulation[50] because this organisation has an objective forming part of, and supporting, the Union policy in the field of financial reporting and is a non-profit organisation (has been authorised and is regulated as a US not-for-profit foundation).

[49] Commission Delegated Regulation (EU, Euratom) No …./.. of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union

[50] Regulation (EU, Euratom) No 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union

2.6.7. Volume of appropriation, human resources and other administrative expenditure The IASB's expenses for 2009 and 20010 are shown in Table 2.

Table 3: IFRS Foundation's expenses for 2009 and 2010

EXPENSES	2009	2010
Direct cost of sales from publications & related	(3.260)	(3.246)
Salaries, wages and benefits	(14.000)	(15.089)
Trustee fees	(506)	(639)
Cost of meetings and associated travel	(2.441)	(2.629)
Accommodation	(1.285)	(1.319)
Other costs	(1.464)	(1.221)
TOTAL EXPENSES	**(22,956)**	**(24,143)**

Source:http://www.ifrs.org/NR/rdonlyres/EB99AF27-22F7-45AF-A033-75A36CDC3549/0/IFRSANNUALREPORT_ALL_12July.pdf

The IFRS Foundation's budget has been growing over the past years as a natural consequence of more and more countries using IFRS[51] and the high level of standard-setting activities, including the convergence agenda with the US standard setters (FASB). Although the convergence work should soon be completed and a 'period of calm' is expected to start soon in the IASB's activities, an ever growing number of stakeholders and jurisdictions applying IFRS (among them such big economies as China), the IFRS Foundation's expenses are expected to grow steadily. Indeed, as the head of financial reporting at accounting body ICAEW pointed out: "I can't see how the IASB alone can undertake its responsibilities without a huge increase in resources. Having the global standard setter alone would soon get out of touch with reality on the ground".[52]

In addition, the IASB has an important role to play following the crisis: the accounting standards became high on the political agenda. Among others, the organisation will need to fulfil its G20 mission of converging the IFRS with the US GAAP, and the standard about the financial instruments (IFRS 9) has to revised, too.

At the same time, some trends point in the direction that the IFRS Foundation's sources of income should be boosted irrespective of the expanding expenditure side of the budget. Some individual EU Member States that currently contribute to the IFRS Foundation's budget have informally signalled that they may be considering lowering or scrapping their contribution in the current context of austerity measures. Also, the voluntary funding received from private companies – mainly the 'big four' accounting firms – should also be replaced by 'neutral' i.e. public funding.

51 Over 100 countries have introduced IASB rules for use in listed company reporting over the past decade

52 "IASB: cutting disclosure overload a key priority" by Huw Jones http://www.reuters.com/article/2012/03/07/accounting-iasb-idUSL5E8E61JY20120307

Based on the historical figures and the trends, the budgetary and administrative impact of our preferred policy option may be estimated as summarized in table 4 below.

Table 4: IFRS Foundation's budget projections and proposed EU grant

Million EUR	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**TOTAL**
IFRS Foundation total budget	26.4	29.2	32.0	34.8	37.6	40.4	43.2	45.9	263.0
EU co-financing (based on GDP requirement)	4.3	6.1	6.7	7.3	7.9	8.5	9.1	9.7	55.3
EU co-financing (DG MARKT proposal)	4.25	4.3	4.4	4.5	4.6	4.7	4.8	4.9	32.2

Exchange rate used: 1.148 EUR/GBP

Note: Minor deviations may be caused because of the rounding up; for exact amounts please refer to the Legislative Financial Statement of the draft Regulation

The proposed amount of the EU grant is based on the 2013 grant amount (the last year of the current EU co-financing programme), takes into account the expected inflation rate (2%) but allows for no expansion of the IFRS Foundation; although some expansion is expected as more and more countries adopt IFRS. As it is demonstrated in table 4 above, the proposed EU grant is currently below the expected EU contribution based on the EU's weight in the global economy[53]. However, the individual Member States' voluntary contributions should be taken into account. Although there is a risk that the number of Member States contributing and the amount of their contribution decrease, it is our hope that after the crisis will have ended, more EU countries will contribute. So the gap could be closed and thus Europe could continue to show example.

It has to be noted that co-financing has become a criterion for membership in the Monitoring Board. Therefore, the EU co-financing needs to be continued if the Commission wishes to keep its seat at the Monitoring Board.

The envisaged funding would not entail additional administrative work by the European Commission. DG MARKT already has sufficient administrative resources to manage the grants.

2.7. Conclusion

In view of the above and in order to increase the IFRS Foundation's independence, the stability of its funding sources and the quality of international accounting standards, we consider that it is important that the Union contributes to the funding of IFRS Foundation.

53 The current EU co-financing ratio is 17%, whereas the EU's weight in the global economy (based on mainly GDP figures) is between 20-25%.

Specifically, we conclude that the best way forward is to co-finance the Foundation and accordingly reduce the contribution from the 'Big 4' accounting networks as well as the Foundation's reliance on income from the sale of publications. Specifically, it is proposed to provide the IFRS Foundation with a financial contribution in the form of an operating grant for a total sum of no more than €32.228 million for the 2014-2020 period.

The Union contribution will, among other things: (i) increase the IFRS Foundation's independence from voluntary contributions by stakeholders with a direct interest in accounting standards; (ii) simplify funding and ensure a level playing field at EU level; and (iii) promote the international adoption of IFRS in other major capital markets.

2.8. Follow-Up: Arrangements for Monitoring, Reporting and Evaluation

The Commission would closely monitor the application and evaluate the impact of the proposed funding to make sure that the money has been used in accordance with the principles of economy and cost-effectiveness. To this end, the Commission will:

- analyse the IFRS Foundation's annual reports;
- evaluate the financial statements and the auditor's report;
- discuss matters with other fund providers;
- use the Monitoring Board meetings, in which the Commission will remain a member, to discuss and clarify funding issues;
- arrange visits to the IFRS Foundation's premises when deemed necessary to verify budgetary systems and controls.

Finally, in line with current financial regulations and practices, the programme as a whole will be properly evaluated in order to determine its possible renewal in 2020.

2.9. Glossary of Acronyms

ECOFIN: Economic and Financial Affairs Council

EP: European Parliament

FASB: Financial Accounting Standards Board (the US accounting standards-setter)

FSAP: Financial Services Action Plan

IAS: International Accounting Standards (now referred to as International Financial

Reporting Standards or IFRS)

IFRS Foundation: International Financial Reporting Standards Foundation (legal successor of the International Accounting Standards Committee Foundation, the IASCF)

IASB: International Accounting Standards Board

IFRIC: Interpretations issued by the IFRS Interpretations Committee

IFRS: International Financial Reporting Standards (previously referred to as International Accounting Standards or IAS)

JFSA: Financial Services Authority of Japan

SEC: Securities and Exchange Commission (the US securities regulator)

3. PROPOSED UNION FUNDING OF THE EUROPEAN FINANCIAL REPORTING ADVISORY GROUP (EFRAG)

3.1. Background

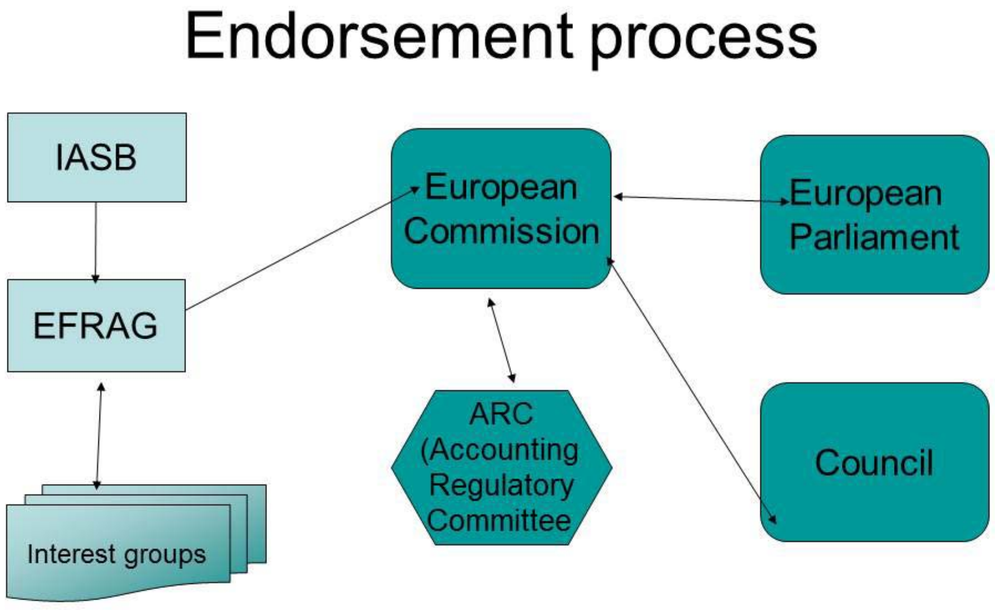
Since 2005, all companies listed in a stock-exchange of an EU Member State have to apply for their consolidated accounts the international accounting standards as they are adopted in the European Union by regulations[54]. New standards are adopted by the Commission as and when they are published by the International Accounting Standards Board (IASB) or the IFRS Interpretations Committee (two bodies of the International Financial Reporting Standards Foundation (IFRS Foundation)[55] and subject to a regulatory comitology procedure with scrutiny (thus involving the Member States, the European Parliament and stakeholders).

Based on Regulation No. 1606/2002 (the IAS Regulation), the Commission adopts international accounting standards as Community law under the comitology procedure. Before the Commission starts the comitology procedure on adopting new standards, DG Internal Market invites – in accordance with recital (10) of the IAS regulation[56] – the European Financial Reporting Advisory Group (EFRAG) to provide its (non-binding) advice on the technical soundness of new international accounting standards. The endorsement process is shown in the figure below.

54 See Regulation 1606/2002 (the ‘IAS Regulation’), Directive 2004/109 (the ‘Transparency Directive’) and Directive 2003/71 (the ‘Prospectus Directive’)

55 The IFRS Foundation is a not-for-profit corporation incorporated in the State of Delaware, USA. In a nutshell, the IASB is in charge of setting the IFRS, the IFRS Interpretations Committee is in charge of issuing consistent interpretations of such standards. They both function under the umbrella of the IFRS Foundation. For more information about the IFRS Foundation, the IASB and the IFRS Interpretations Committee, see annex of the ex ante evaluation on the proposed community funding for the IFRS Foundation.

56 "An accounting technical committee should provide support and expertise to the Commission in the assessment of international accounting standards."



(See section 4.7. for further explanation of acronyms)

EFRAG[57] was set up in 2001 to assist the European Commission by providing it with the above-mentioned endorsement advice. It is a private association representing the main European parties interested in financial reporting (EFRAG's "founding fathers"). EFRAG is located in Brussels and it was formed as a non-profit association in accordance with the Belgian law of 25 October 1919.

3.1.1. Context

EFRAG is engaged in three main activity areas:

- providing the Commission with endorsement advice – related to final standards issued by the IASB;
- issuing comment letters – related to draft standards published by the IASB; and
- early-stage pro-active work – stimulating debate in the EU and influencing the IASB's thinking before a draft standard is published.

57 http://www.efrag.org/

EFRAG's governance

EFRAG's organisation is somewhat complex, reflecting the need to balance independence and the representation of the interest of different sectors and Member States.

EFRAG's current member (founding) organisations are the following: BUSINESSEUROPE (European Business Federations), FEE (European Federation of Accountants), Insurance Europe (European Insurance Organisation), EBF (European Banking Federation), ESBG (European Savings Banks Group), EACB (European Association of Co-operative Banks) and EFAA (European Federation of Accountants and Auditors).

In order to ensure an increased public oversight and accountability, EFRAG's governance structure underwent a major enhancement in 2008. As a result of those reforms, today the representation in EFRAG's governing bodies (most importantly in the Supervisory Board) is no longer tied to the contribution to EFRAG's funding; the Member Organisations are no longer represented in the governance *ex officio.* In addition, regular liaison with the European Commission was put in place at relevant levels; the meetings of EFRAG's bodies became open to the public. Nomination processes became open and wider consultations are held than in the past. Greater transparency is ensured also through regular reports in addition to the annual reports – among others to the Accounting Regulatory Committee and the relevant European institutions.

EFRAG's General Assembly consists of the member (funding) organisations, where the votes of the members depend on their respective contribution to the financing of EFRAG. EFRAG's Supervisory Board is appointed by the General Assembly, following recommendations of the Governance and Nominating Committee.

The Supervisory Board has 17 members appointed in their personal capacity with a wide-spread nationality and background (preparers, users, SMEs, financial institutions and public policy). The roles of the General Assembly and the Supervisory Board are limited to the administrative issues and appointment of the Technical Expert Group (TEG) members.

The TEG is the core of EFRAG's professional work. Any decision and advice on the international accounting standards is taken by the TEG, which acts independently. EFRAG's chairman chairs the meetings and EFRAG has its own secretariat. Endorsement advices and comment letters form the bulk of its work but all technical papers have to be approved by the TEG.

The Planning and Resource Committee is the platform for the early stage pro-active work. In this committee, National Standard Setters and EFRAG co-operate to foster the accounting debate in Europe and influence the IASB's thinking already before issuing a draft standard.

The national standard setters of Member States continue to participate in the professional work of EFRAG as non-voting members of the TEG and the body set-up as a result of the governance reform (Planning and Resource Committee) responsible for the pro-active work. The Commission Services may attend as observers all EFRAG meetings.

EFRAG's activities

At present, the objectives of EFRAG fall in two main categories:

a) advising the European institutions in connection with the international accounting standards: providing technical opinions to the European Institutions confirming or rejecting international accounting standards and related interpretations for application in the European Union, and helping them in their assessment of possible non-conformity of the international accounting standards with the EU law (i.e. the **"original" objective**), and

b) influencing the IASB on behalf of EFRAG stakeholders before a new standard is issued, commenting draft standards via comment letters (i.e. the **pro-active work**).

There are parallels between the role of EFRAG and the national (accounting) standard setters but EFRAG is not a European standard setter.

The above-described upstream input has attracted growing political interest as a way of ensuring that the IASB's standard-setting process properly reflects the needs and interests of EU stakeholders. More and more jurisdictions (including the US and China) decide or are considering to move towards and apply international accounting standards. Applying these standards naturally awakes the desire to have an influence on their development. The increasingly wide adoption of international accounting standards at international level has given rise to concerns that Europe's influence over the IASB will diminish given the significant resources and expertise that other jurisdictions, especially the US, can mobilise. These concerns have been expressed several times by the Council of Ministers, the European Parliament[58] and by Member States in the Accounting Regulatory Committee as well. Thus, for all these reasons, it is rational to continue financing EFRAG.

[58] See in particular (i) ECOFIN Council conclusions of 8 July 2008, pp 12-13, available on http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/101742.pdf and (ii) ECOFIN Council conclusions of 15 July 2003, Item 7, available on http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/76683.pdf See in particular (i) Report of the European Parliament on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) (2006/2248(INI)) ("Radwan Report") 5 February 2008, pp 7 and 11, available on http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0032+0+DOC+PDF+V0//EN&language=EN and (ii) Written question n° E-3992/08 by Klaus Heiner Lehne (PPE-DE) to the Commission, available on http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2008-3992+0+DOC+XML+V0//EN&language=EN (with answer available on http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2008-3992&language=EN)

3.1.2. Experiences of the EU co-financing since 2010

Currently, an EU co-financing programme is in place which was established by Decision 716/2009 of the European Parliament and the Council. On that basis the Commission concluded grant agreements with EFRAG in 2010, 2011 and 2012. Therefore we have experience with the co-financing, although it may be a too short period to measure the achievements of the long-term objectives of the programme.

Based on the ex ante evaluation of the current programme, co-financing of EFRAG aimed at achieving the following objectives:

- Avoid reliance on precarious/voluntary funding from interested parties thus ensuring credibility and independence of its work
- Boost the international reputation, attractiveness and acceptance of the standards
- Ensure fair burden sharing within the EU in the financing of EFRAG
- Ensure that the relevant bodies are adequately equipped with the financial means to carry out EU or EU-related public interest mandates or activities (staffing and experts)

The experiences of the co-financing programme are analysed below on the basis of those objectives.

1. <u>Avoid reliance of on precarious/voluntary funding from interested parties thus ensuring credibility and independence of its work</u>

This objective has been partly met.

In 2008, i.e. before the EU co-funding started, EFRAG had a total budget of approximately €3.25 million, of which ca. €1.6 million was funded via voluntary cash contributions from its members and the rest via staff contributions from various resources. All TEG members, including the TEG chairman, as well as members of the specialized working groups worked without any charge for EFRAG. They were paid by the organisation employing them – national standards setters (basically the French, German, the UK, the Italian and the Swedish standard setters), organisations from the accountancy and audit profession, preparers, users and academic institutions. This contribution by delegating experts for free to take part in the work of EFRAG on an independent basis is considered as "contribution in kind" to EFRAG's budget. A declaration of the experts is however not enough for the independency credentials of EFRAG. These experts also need to be perceived as independent by the outside world. Thus an additional financing of EFRAG was partly used to put certain current experts on EFRAG's payroll, whereas the other part went to an increase in the number of its staff. The grant programme allowed EFRAG to pay also the TEG chairman, thus one of the key concerns of independence could be eliminated. However, EFRAG still needs the so called in-kind contributions, i.e. secondment of experts form its stakeholders to meet its staffing needs.

Prior to the governance reforms of EFRAG in 2008, the Standards Advisory Review Group (SARG) was set up by a Commission decision of 2006 to address the concerns regarding whether EFRAG's endorsement advice is independent. The members of that group received no remuneration for their professional services. The Commission only reimbursed their costs related to their meetings. Although SARG's additional advice about the independence of EFRAG's opinion had been seen as a solution in the case of endorsements, a similar system of additional opinions is from a practical point of view totally impossible when it comes to influencing the international standard setting process (the "pro-active" work). Thus, independence has to be an inherent feature of the body responsible for the pro-active work. In parallel to the establishment of the grant programme, EFRAG's governance reforms were completed that enhanced its independence, accountability, transparency and the public policy aspects in its operations. The EU grant ensured that those reforms did not lose ground. SARG could be dissolved. The funders of EFRAG accepted that their influence in the organisation diminished, whereas their level of contributions had to be maintained.

However, there are still concerns that EFRAG may be taken as a hostage of those four big Member States that altogether contribute 70% of EFRAG's own resources. The current EU grant Programme is designed to "double" EFRAG's own resources (the Commission may finance up to 50% of EFRAG's total budget), any loss in those Member States' contribution results in a double loss for EFRAG's budget. A solution would be to encourage more Member States to contribute to EFRAG's budget; however, in the current economic and legal context this is not a feasible option. Therefore, the current proposal for the new EU grant Programme for 2014-2020 proposes to contribute by a fix amount of grant instead of laying down the percentage. Such an arrangement is more calculable also for the Commission budget.

2. Boost the international reputation, attractiveness and acceptance of the standards

EFRAG reported that without the additional staff that the EU grant allowed to employ, EFRAG would not have been able to cope with the IASB's level of activities. Moreover, the additional funding allowed EFRAG to be more pro-active in on-going projects. At several instances, the IASB has reconsidered its position in line with EFRAG's comments, put a project on hold following EFRAG's objection, deferred a deadline to follow robust due process as also recommended by EFRAG, has started to publish Review Drafts that ERFAG called for, selected pro-active projects which have been taken up by the IASB, for instance. More details on what difference EFRAG made in the financial reporting arena you find in the Annex.

The EU co-financing, and the expansion of its budget also allowed EFRAG to take up new activities. Most importantly, the pro-active European input to the IASB's standard setting process is now institutionalised: EFRAG's Planning and Resource Committee has been set up. This committee provides a stable platform for views from all over Europe (not only the big Member States) and continuity in the actions (as opposed to ad-hoc projects previously). An indicator for the success of this type of activities is that the vast majority of the pro-active projects selected by EFRAG became high also on the IASB’s agenda. EFRAG is now regularly asked to present its pro-active projects at the World Standard-setters’ Meeting.

EFRAG started to organise so-called outreach events, where it goes out to stakeholders instead of waiting for them to take up contact. Another new type of activity is the field tests, which also allows for EFRAG to gather the widest possible input across sectors from all over Europe. Both the outreach events and the field tests are highly appreciated by the stakeholders.

Increased communication was also made possible from the additional funding EFRAG received from the EU budget. For example, EFRAG started to prepare and circulate newsletters that draw the attention of stakeholders to current issues and fosters the debate and dialogue in the field of financial reporting in the EU. A first stakeholders’ meeting with the IASB was organised. Work has started to launch the "user enhancement" communication programme to boost the representation of users in EFRAG’s work. EFRAG regularly meets with the national funding mechanisms and its member organisations, and the relationship with the academia started to be developed. It started to hold agenda-consultation on its pro-active work.

EFRAG developed its international relationships. Contacts have been established with five key international partners: the US Financial Accounting Standards Board (FASB), China, Japan, Latin-America and Asia-Oceania.

We can conclude that the EU grant has contributed to this objective, as more and more countries move to IFRS. Also, the Union is about to accept the national accounting standards (GAAPs) of three countries (South-Korea, China and Canada, in addition to the US and Japan) for an unlimited period of time. In addition, the European views remained well-represented even if the EU is gradually losing its advantage as the most important interlocutor of the IASB and user of IFRS.

3. <u>Ensure fair burden sharing within the EU in the financing of EFRAG</u>

Representatives of Member States with fewer resources (such as BE, DK, AT, PL) often remark that their only chance to influence the IASB is to do it through EFRAG. They would not have the capacity to do themselves the work that EFRAG does for them. Based on the feedback received from those standard setters, they feel sufficiently associated to EFRAG's work. It is therefore important that EFRAG received sufficient financing for representing the views of those smaller Member States. Indeed, the EU grant serves the purposes to allow for forming a truly pan-European accounting view, where all Member States' interests are taken into account irrespective of their financial or other resources.

The idea of "shared due process" also serves the aim to involve as many national standard setters as possible in EFRAG's work. The goal is to rationalize the preparatory work (e.g. field tests, outreach events) forming the ground for the European accounting opinion – sometimes work is doubled at national and at EFRAG's level. According to the shared due process, the four big national standard setters (UK, FR, DE, IT) do part of the technical work, whereas EFRAG does that on behalf of all other Member States. In this regard, again, EFRAG is the only platform through which also the smaller Member States can have a say and thus the technical documents issued by EFRAG, the input given to the IASB can truly represent a pan-European view.

In line with the current trend where national standard setters form alliances and set up their co-ordinating organisations (see in Latin-America and Asia-Oceania), EFRAG should also develop into a regional group. The IASB prefers working with regional groups instead of individual countries. Although EFRAG is not a standard setter and standard setters are not its members, it is the representative of the single European accounting voice and consequently the views of the European region. This role involves that the interests of *all* Member States are/need to be represented.

Based on the above, this objective is mostly met by the EU grant.

In fact, EFRAG encounters difficulties in ensuring that all stakeholders (users, preparers, auditors, SMEs etc.) and a wide range of Member States are represented in the TEG and the Supervisory Board. The fact that working for the TEG and the Supervisory Board requires a significant amount of time, and these positions are not remunerated (not even the costs of taking part in meetings is reimbursed) makes recruitment difficult from companies/sectors and Member States with less resources – in particular from SMEs and the Member States which joined since 2004.

4. <u>Ensure that the relevant bodies are adequately equipped with the financial means to carry out EU or EU-related public interest mandates or activities (staffing and experts)</u>

This objective has been partly met, as EFRAG managed to employ more staff and take over its chairman on EFRAG payroll. Nevertheless, EFRAG is still somewhat understaffed: some activities are not undertaken and the current staff is under workload pressure.

An important area where EFRAG should be more active is the pro-active interpretations effort to foster consistent application of the standards. The interpretation of the standards is the role of the standard setter – i.e. the IASB and the IFRS Interpretations Committee, whereas EFRAG should provide input to that. Interpretation cannot fall in the remit of enforcers (e.g. the European Securities and Markets Authority, ESMA) as the rule-setting and enforcement of the rules should always be separated. To make the EU institutional setting clear and respond to the criticisms quickly, it should be enabled (mainly financially) via EFRAG to take up a pro-active role in the interpretation of financial reporting standards.

3.2. Problem Definition

Should the current EU grant programme discontinue, we would face the following problems.

3.2.1. Reliance on non-diversified, voluntary and precarious funding from interested parties and its negative consequences

EFRAG is financed from three main sources: contributions by its founding fathers[59], the national funding mechanism of certain Member States and the EU grant. Additionally, EFRAG may receive voluntary contributions from EU professional associations.

The founding fathers usually commit to a multi-annual contribution to EFRAG's budget. However, in the current economic climate, in the recent years members have indicated their intention to reduce their contributions or left EFRAG because they could not contribute. Also, it is difficult to persuade businesses to finance activities that are a "common good" when they themselves are focussed on cost-cutting and restructuration.

Private or public national funding mechanisms, set up in certain Member States provide EFRAG with voluntary funding. EFRAG's financing needs to be reconfirmed on a yearly basis. Only a limited number of such national funding mechanisms exist and four big Member States' mechanisms (UK, FR, IT and DE) contribution amounts to almost 70% of EFRAG's own resources (if the EU grant is not taken into account). This situation implies two negative consequences: the risk of EFRAG being taken hostage by a few national interests, and the difficulty of the smaller Member States – although more numerous – to make their voice heard in EFRAG's decision-making.

Also, the annual and voluntary nature of the own resources leads to an unstable and unpredictable situation, where EFRAG cannot engage the needed experts – staff in sufficient quantity and quality. At the same time, the value added by EFRAG lies in the expertise produced by its staff and professionals.

3.2.2. Insufficient financial means to carry out EU public interest missions

EFRAG has been taking up the role of the 'single European accounting voice'. Without EFRAG being well-equipped to represent the Union, the European interests are not well taken into account at the international level. International accounting standards are developed by bodies (IASB and the IFRS Interpretations Committee) in which the European interest is not guaranteed. These standards are endorsed in the European Union after having taken into account many views and interests from stakeholders. If then the European view was not well taken into account at the level of the IASB, due to lack of resources that would allow to set up and maintain some kind of think-tank that is able to properly influence the international standard setting process, problems may arise in the course of the endorsement procedure.

Such problems were in the past temporarily solved by not endorsing the international accounting standard in question in full (referred to as "carve-outs")[60]. However, this solution can only be regarded as temporary, since the use of international accounting

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[59] EFRAG's current member (founding) organisations are the following: **BUSINESSEUROPE** (European Business Federations), **FEE** (European Federation of Accountants), **CEA** (European Insurance Organisation), **EBF** (European Banking Federation), **ESBG** (European Savings Banks Group), **EACB** (European Association of Co-operative Banks) and **EFAA** (European Federation of Accountants and Auditors).

[60] See for example the case of IAS 39 in connection with hedge accounting

standards in Europe will fulfil its function only if it corresponds entirely to the international accounting standards and interpretations issued by the IASB/IFRS Interpretations Committee as used elsewhere in the world.

The real solution is thus not to create a maze of carve-outs but to make sure that the accounting standards that we are about to endorse properly reflect the interest of the European stakeholders. Consequently, we have to influence the standard-setting process at the earliest stage possible.

In order to create a European representation at the level of the international standard setting as quickly as possible, the Proactive Accounting Activities in Europe (the PAAinE) initiative was launched in 2005. Through this initiative, EFRAG and the national standard setters[61] of the largest Member States pooled some of their resources in order to stimulate a debate in Europe on the most important international accounting standards under development. PAAinE was a coordination mechanism, which aimed at the largest extent possible to ensure that the messages Europe gives to the IASB are consistent – however, this was constrained by circumstances which are inherent features of the system.

Therefore, in 2009 EFRAG's Planning and Resource Committee took up this important proactive work to provide consistency (in PAAinE different projects are led by different groups) and accountability. Thus, a possibility of creating a truly single European voice was created, as EFRAG now offers continuity in the pro-active work. Also, the interests of the smaller Member States, that otherwise could not contribute to a pro-active project on their own, may be represented.

Even though not all Member States are always interested in contributing to a particular pro-active project, EFRAG can step in and put up the resources for some still important projects. To allow EFRAG taking up this truly pan-European role, the organisation has to be provided with sufficient funding from a pan-European source.

3.3. Objectives

Further to the above-described issues, a solution has to be found that meets the following strategic and operational objectives.

3.3.1. Strategic objective

The strategic objective to be achieved by the proposed funding arrangement is to ensure stable, diversified, sound and adequate funding to enable EFRAG to carry out its European public interest mission in an independent, efficient and satisfactory way.

3.3.2. Operational objectives

3.3.2.1. Ensure credibility and independence of EFRAG work

[61] National standard setters can be both private non-profit or public organisations depending on the actual constituency.

A first operational objective is to ensure credibility and independence of EFRAG standard-setting related activity (influencing the standard setting process and reviewing the newly issued standards) before the endorsement of these standards in the EU law.

For the credibility of a single European accounting voice it is indispensable that EFRAG is perceived as independent. Currently, the organisation relies on the voluntary contributions received from stakeholders interested in financial reporting. Their financial commitment often needs to be re-confirmed on an annual basis. These stakeholders that have a direct interest in the result of EFRAG's work have also voting and appointment rights in the governing bodies of the organisation. Making the financing of EFRAG more independent from the voluntary contributions of interested parties can guarantee the operational independence of EFRAG from inappropriate pressure coming from the business community.

3.3.2.2. Boost the international reputation, attractiveness and acceptance of the standards

A second operational objective is, in addition to the above, to boost the international reputation, attractiveness and acceptance of the standards set by the IASB/IFRS Interpretations Committee and part (or bound to become part) of the EU *acquis*.

When EFRAG is successful in its pro-active work, the European context is taken into account in the course of developing international accounting standards. This means that the European Community will play an active role in the international standard setting process – instead of passively being bound to adopt accounting standards that are designed for the need of other jurisdictions, companies with backgrounds different from that of the European ones.

In addition, it will also ease the EU's international relations in the field of accounting. The argument for accepting the European entities financial reports in third countries will be well-founded. This applies in particular to the US, where a number of large European players raise funds. As a bonus, if European accounting standards fully correspond to the international accounting standards, decisions on whether third country accounting practices are equivalent to those of the EU is more easily taken.

3.3.2.3. Ensure fair burden sharing within the EU in the financing of EFRAG

A third operational objective is to ensure fair burden sharing within the EU in EFRAG's financing.

Putting in charge one single European body to represent the European interest at the international standard setting level also brings the need of ensuring fair burden sharing. EFRAG used to be mainly financed by its members and the contributions provided by the Member States' national funding mechanisms come mainly only from the four largest constituencies. The previous PAAinE mechanism worked also on the basis of contributions only from the largest Member States, which results in placing unintentionally the others in an unfair free-rider position. Naturally, financing means greater influence – thus a truly European voice is difficult to be formed when only certain (big) Member States put up the money for a particular pro-active project.

Since EFRAG took up the pro-active work, it is able to represent the interest of all Member States – not only the largest ones that can raise sufficient funds to also individually operate a lobby-procedure at the IASB/IFRS Interpretations Committee. Thus, a single, truly European voice can be developed.

In addition, currently the Supervisory Board members and TEG members are not remunerated for their work even if it takes up a considerable share of their time (this is true in particular for TEG members who work 30-60 hours per months for EFRAG on average). The fact, that not even their travelling and accommodation costs are reimbursed, makes recruitment from smaller Member States even more difficult. EFRAG's budget should be expanded in order to be able to carry such additional costs.

3.3.2.4. Ensure that the relevant bodies are adequately equipped with the financial means to carry out EU or EU-related public interest mandates or activities

A fourth operational objective is that EFRAG is adequately equipped with the financial means to carry out its EU public interest mandate of pro-actively influencing the international standard setting process.

Technical competence is the best way of increasing EU influence in the IASB. To build respect and status, EFRAG needs to give top quality advice and provide technically sound opinions. EFRAG needs to engage staff at a solid basis and have a critical mass of experts. Only a critical mass of experts is able to manage the workload and match the expertise and personnel of our international counterparts. We need professionals that are appropriate for this work both in quantity and quality. We need the best people to be able to speak the technical language that the IASB/IFRS Interpretations Commitee speaks. The experience of our European experts has to meet that of their US colleagues. When trying to attract and recruit the best quality people, EFRAG competes with the private sector including leading audit networks. This implies the need to pay competitive salaries[62], which represent EFRAG's main cost. Should EFRAG not be able to afford to pay the best people, the objective of developing a powerful European voice would not be met.

3.4. Available Policy Options

3.4.1. Baseline scenario (no action): Discontinuing the EU funding

Under this scenario, EFRAG returns to its old funding model: it would be financed by its founding organisations and the national funding mechanisms operating in some of the Member States. The Community is not involved in the organisation's financing.

While this scenario has no implications for the Community budget, its disadvantages clearly overshadow the advantages of this option. If the number of EFRAG's staff is decreased, the absence or leave of one colleague may make it impossible to continue to work on a whole project, as they have no back-ups. The decrease of the funding will undermine the fulfilment of the objectives described above under point 3.3.

[62] EFRAG already encounters problems in attracting people from Germany and the UK because of its net salary levels.

Also, considering that the same people have to work on issuing the endorsement advice and developing the pro-active input at the same time, clearly the first would be prioritised. This prioritising is understandable if we consider that providing the Commission with endorsement advice is EFRAG's original objective as agreed by their founding (and funding) organisations. Providing endorsement advice is even a task which is more measurable, visible and also, more pressing since if this is not done, the adoption of accounting rules within the European Community would come to a complete halt. Clearly, in case of a collision of duties, less attention and time would be left for the pro-active work. It is even possible that from time to time the pro-active projects underway have to be set aside in order to be able to manage the workload of advising the European Commission on the endorsement of the already issued standards. So the objective of developing a single and influential European accounting voice is not met.

This option does not solve the problems of passive adoption, non-equivalence and carve-outs either. At the same time, we would give up Europe's influence and would leave it to other jurisdictions to get involved in the international standard setting process.

The absence of Union funding would also be seen by others as demonstrating the weakness and the low-standing of EFRAG. Discontinuation would send a bad political signal. Thus, in the end, this scenario would worsen EFRAG's current reputation and status as opposed to just not improving it.

3.4.2. Renewing the co-financing under the Community budget

Continuing the current EU co-funding is a solution worth considering.

A grant agreement without a call for tender is a viable option. Following Article 121 of the Financial Regulation[63], grants can be used *to finance the functioning of a body which pursues an aim of general European interest or has an objective forming part of, and supporting, a Union policy*.

The grant is designed to co-finance the functioning (basically the staff costs) of EFRAG (operating grants). By definition, such co-financing has no direct link to any deliverables. On the other hand, the Commission contributes only to financing the actual costs incurred by EFRAG without allowing for a profit margin.

This option has clear advantages. Co-funding from the European Union ensures that the missing resources can be brought up to achieve the objectives above (see chapter 3.1.2 above on the experiences of the current Programme) and a stable solution providing for continuity in the funding of EFRAG. It is possible to extend the grant in time and transfer it into long-term financing. The independence and thus the credibility of EFRAG are enhanced, while a level playing field is ensured for all listed companies irrespective of their nationalities.

[63] Regulation (EU, Euratom) No 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union

This option enjoys the support of the European Parliament and the Council as highlighted several times by the ECOFIN Council and by the European Parliament.[64]

The articulation of a single European voice is of a broader European interest, thus, coordinated actions at European level should be able to count on support from the European budget.

3.4.3. Increase voluntary contributions from the member organisations

EFRAG could ask for an increase in the contributions of its member organisations. This option would not solve the current problems. EFRAG's level of independence would, if not decreased, at least be perceived to be decreased by the general public. In addition, since EFRAG's independence had to be increased in line with its public interest activities, individual stakeholders financing EFRAG had to give up much of their previous (prior to the 2008 enhancement) influence in EFRAG. In this context, it does not seem reasonable to expect them to double their current amount of contribution to EFRAG's budget. Adding to that the prevailing economic downturn and crisis, it is already a challenge to maintain their current level of contributions; and it is almost impossible to expect additional funding from those organisations.

3.4.4. Setting up national funding schemes (public financing or levy over industry)

National funding mechanisms have been designed to support the various accounting standard setting activities (e.g. standard setting at national level, influencing the international standard setting process) for the benefit of the stakeholders of one particular country. The private and public funding systems for national standard setters (i.e. national funding mechanisms) are equally common[65]. In case of private funding systems, the accountancy profession and preparers (industry) together with the stock exchanges are the most common providers of funding where the national funding system works on a non-voluntary basis. There are also some cases of mixed funding systems where government participates in a mainly private system or private contributions are paid to mainly government funded standard setters.

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64 See in particular (i) ECOFIN Council conclusions of 8 July 2008, pp 12-13, available on http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/101742.pdf and (ii) ECOFIN Council conclusions of 15 July 2003, Item 7, available on http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/76683.pdf

See in particular (i) Report of the European Parliament on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) (2006/2248(INI)) ("Radwan Report") 5 February 2008, pp 7 and 11, available on http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0032+0+DOC+PDF+V0//EN&language=EN and (ii) Written question n° E-3992/08 by Klaus Heiner Lehne (PPE-DE) to the Commission, available on http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+WQ+E-2008-3992+0+DOC+XML+V0//EN&language=EN (with answer available on http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2008-3992&language=EN)

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-407.786+02+DOC+PDF+V0//EN&language=EN

65 In Northern Europe standard setters are primarily financed by the private sector; whereas in Southern Europe, there is mainly public financing.

However, counting on the increased contribution only from this source has considerable disadvantages. National funding mechanisms exist currently only in some Member States[66]. Setting these up is time-consuming, whereas the need for a sound EU representation at the international accounting level is urgent. And even if such funding mechanisms were set up in all Member States, this solution would not lead to an appropriate increase in EFRAG's budget. Reluctance to levy a tax, lack of political willingness to create another tax-like system, mean that these funding mechanisms cannot sufficiently increase their contribution to the work of EFRAG. This option also implies that the Member States would be entitled to decide on the level of their national contribution. Since those contributing more expect a bigger influence, it would mean a danger to EFRAG’s independence. This may result in a lack of level playing field for listed companies of different nationalities.

While Member States are reluctant to increase the levies on national levels, imposing an EU-wide tax-like levy is not a feasible option. It would require unanimous support from the Member States. There is no provision in the Treaty that would allow the Community to impose a fee on private companies in favour of another private body or association.

3.4.5. Setting up a dedicated EU Agency

Establishing a *new agency* could also be an option to be considered. The Commission would set up an Advisory Accounting Agency (replacing EFRAG), financed directly from the Community budget. This agency would take over all current tasks of EFRAG. However, the setting up of an agency is time-consuming. The need for financing the pro-active accounting work is urgent; therefore, this scenario would lead to missing our unique opportunity to get involved in the international accounting standard setting at the right time. Later we may not have the chance to do so as more and more jurisdictions are moving to IFRS and the EU’s relative weight at the IASB is anyway shrinking.

In addition, the establishment of an agency is unlikely to be possible without Community funding comparable in amount to the financial contribution to the EFRAG funding foreseen under the preceding option as an agency would ultimately be funded entirely from the Community budget. Moreover, the Commission's management of the financial contribution to and/or co-ordination with an Agency would imply administrative costs for the Commission which would also be comparable to that associated with a financial contribution to the EFRAG budget.

3.4.6. "Internalize" functions within the Commission

Under this scenario, the technical expertise provided by EFRAG would be carried out internally by the services of the European Commission.

Besides the difficulties this scenario would represent from a human resources point of view (as it would imply a substantial recruitment of accounting experts), it is not desirable as the Commission would find itself in the situation where it would have to take

[66] National funding schemes have been established to date in six Member States (France, Germany, Italy, Sweden, Denmark and the United Kingdom). Such schemes are being currently set up in the Netherlands, Finland and Spain.

the decision to endorse accounting standards on the basis, inter alia, of a technical advice which by its nature should be seen as independent. It is thus not desirable that the missions of EFRAG are carried out "in-house" by the Commission.

If only the pro-active work would be taken up by the Commission, experts in appropriate quantity and quality would have to be recruited. The implication for the Union budget is likely to be even bigger than providing only co-financing to these activities.

3.4.7. Comparison of options

The table below is used to compare the relative merits of the above options based on a qualitative assessment as reliable data are not available.

In the case of EFRAG the criteria are considered equally important in testing the cost-effectiveness of each option.

The option "status quo" (option 1) used as the baseline with maintained budgetary intervention from the Union is compared to the five other options based on the four following main criteria:

- The degree of achieving the objectives described above,
- Political consequences of the implementation,
- Feasibility, and
- Implication for the EU budget.

ASSESSMENT OPTIONS	**Achievement of objectives**	**Political consequences of implementation**	**Feasibility** **Straightforward**	**Implication for EU budget** **Positive** **(+ to +++)**	**Overall Assessment** **Positive**
Option 1 Discontinuing the EU	- - -	- - -	*N/A*	+ +	- - -
Option 2 Maintaining the EU co-financing	+ + +	+ + +	+/-	- -	+ + +
Option 3 Increase contributions from the	+/-	- -	+/-	+ +	-

Option 4 Setting up national	+/-	-	- - -	+ +	-
Option 5 Setting up dedicated EU	+ + +	- - -	+/-	+ +	+/-
Option 6 Internalizing EFRAG's	+/-	+/-	+/-	+ +	+/-

Option 1, which leaves the funding of EFRAG to the private member organisations and the big Member States, can be assessed as the worst case scenario from the EU perspective as that would make impossible the achievement of a single European financial reporting voice. The funding would be sufficient for EFRAG only to focus on its endorsement advice-issuing role. Most likely the national funding mechanisms would pull out of EFRAG's financing and the big Member States would develop and submit their own views to the IASB with a doubtful amount of advance previous coordination with each other. Most importantly, the discontinuation of the EU co-financing would give the political signal that EFRAG has lost its credibility, importance and high-standing. Thus this option would be detrimental not only to EFRAG's funding but also would make it impossible to fulfil its pro-active influencing role. Therefore, this option should be discarded.

On the contrary, the strongest benefits are to be expected from option 2, maintaining the status quo. Providing EFRAG with co-funding from the EU budget has the following important advantages:

- it continues to give a positive political signal and support EFRAG's high standing;
- it considerably **enhances EFRAG's independence** from the stakeholders and support its current governance structure that aims at increasing EFRAG's public oversight and accountability,
- it provides a more **stable** source of funding also in the long-term compared to annually approved member contributions,
- it **increases EFRAG's general recognition** and gives its opinion the necessary weight and importance at the international scene,
- it also signals to all parties concerned the **EU public interest** and role of EFRAG and encourage other public bodies and

institutions to contribute to EFRAG's financing.[67]

In sum, maintaining Community co-funding of EFRAG clearly represents the quickest solution which is also in line with EFRAG's public interest activities and international role.

3.4.8. Method of implementation for the selected option

Further to the above, the optimal solution combines certain of the above options. The solution could be co-financing EFRAG via operating grants from the Community budget and at the same time raising additional resources from third parties. EFRAG is mobilising the following additional resources:

- staff allocations by national accounting standard setters, either detached to EFRAG or to participate in joint working groups (in the long-run these in-kind contributions may be transformed into cash contributions);

- additional cash contributions from national funding mechanisms and/or the private organisations that founded EFRAG, including negotiations to increase the number of countries contributing[68];

- co-funding from the Community budget.

Based on the financial rules governing the management of the Union budget, financial support from the Union budget could be provided either in the form of operating grants (i.e. contributing to the overall budget of a body) or in the form of action rants (i.e. co-financing specific targeted activities of a body).

In the case at hand, the aim is to finance mainly the pro-active work of EFRAG; therefore the option of co-financing EFRAG via action grants has also to be considered. However, the activities of EFRAG are highly interdependent. The same experts do the pro-active work and the tasks related to endorsement advice. Therefore, it seems almost impossible to determine which costs should be considered as eligible for financing and which relate to activities that would not be the subject of the Community funding. Consequently, it is rational to co-finance EFRAG via an operating grant.

EFRAG, as a possible eligible beneficiary for an operating grant, complies with the requirements laid down in Article 121(1)(b) of the Financial Regulation[69]. This is an organisation which has an objective forming part of, and supporting, the Union policy in the field of financial reporting.

67 Since the EU co-funding started in 2010, two new Member States started to contribute (DK and DE). An EEA country, NO also joined the contributors. The Member States that are expected to start financing EFRAG in the near future: ES, NL and FI. EFRAG took up contact with Poland with the aim of starting a national funding mechanism there.

68 Funding from Spain, the Netherlands and Finland is envisaged to start in the coming years.

69 Regulation (EU, Euratom) No 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union

Since EFRAG is in a de facto monopoly position as described in Article 190 (1)(c) RAP[70], these grants may be awarded to EFRAG without a call for proposals.

3.4.9. Volume of appropriation, human resources and other administrative expenditure

At present the operating costs of EFRAG are financed from three main sources: its European member organisations, the national funding mechanisms of certain Member States and the European Union. In addition, stakeholders contribute in-kind to the operation of EFRAG by providing the organisation with experts who are on their payroll but who work for EFRAG part-time or full-time. Occasionally, EFRAG receives voluntary contributions from stakeholders.

The current budget of EFRAG is presented in the following table.

Income Statement	**Year**	**Year**
(in-kind contributions are not included)	**2010**	**2009**
Members' Contributions	825	825
National Funding Mechanisms	1063	1020
Voluntary Contributions	50	63
European Commission grant	2252	0
Total Contributions	**5469**	**2407**
Personnel costs	-3135	-1458
Building	-300	-217
Travel	-150	-87
Special events	-20	0
Publications	-28	-19
Meeting costs	-47	-44
Other costs	-213	-166
Expenses in kind	*-1279*	*-499*
Operating Profit or Loss	**297**	**-83**
Financial Result	15	19
NET PROFIT or LOSS	**312**	**231**

Source: EFRAG annual report 2010[71]

[70] Commission Delegated Regulation (EU, Euratom) No …/… of 29.10.2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union

Please note that the above figures are all cash-based accounts, and they exclude the *in-kind contributions* of the stakeholders and the maintained in-kind contributions of the national standard setters. Based on the data received from EFRAG, these are estimated to reach approximately €1.3 million annually.

The table above shows that apart from the EU grant, EFRAG is dependent on the funding received from four large Member States (UK, FR, IT and DE). A discontinuation of the EU co-funding may affect as a minimum the perception of its independence and role as the ‘European accounting voice’.

As the figures show clearly, the bulk of the budget is spent on staff costs. Since these depend on the actual pace of recruitment, these figures cannot be set precisely, and thus the exact amount of the Union contribution cannot be predicted precisely.

In the 2014-2020 period, the depth of involvement of EFRAG's current activities[72] is expected to develop further. In the past years EFRAG has started several new activities in order to build closer relationship and contacts with European stakeholders: outreach events, direct outreach private workshops and meetings, field tests, post-implementation reviews etc. Most likely, EFRAG will need to invest additional time and effort in those activities so as to fully share the IASB due process and to have a deeper and more relevant understanding of issues encountered in practice. From 2012 onwards EFRAG is developing an active and broad systematic outreach to users so that the investor and other capital provider community can exercise an appropriate influence on EFRAG TEG technical positions.

In addition to the existing activities, EFRAG is planning to get engaged in educational activities. Principle-based standards create new difficulties in implementation and understanding that may benefit from being supported by some educational effort. The ultimate goal is to respond to the criticism (mainly from the US) and support the consistent application of the standards all over Europe.

With a view to consistent application, EFRAG and ESMA should get engaged in coordinated activities which may also require new staff and some resources from EFRAG.

For the sake of independence, EFRAG should also consider start to reimburse travel and accommodation costs incurred by TEG and Supervisory Board members associated with their attendance at meetings at EFRAG's premises in Brussels.

Despite the above, taking into account the current context of austerity in public spending both at national and EU level, EFRAG's budget, the requested and the proposed EC grant reach the following amounts:

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71 http://www.efrag.org/WebSites/UploadFolder/1/CMS/Files/EFRAG%202010%20ANNUAL%20REVIEW%2012%20May%202011%20.pdf

72 EFRAG is engaged a wide range of activities, from research activities to endorsement advice associated to the development of IFRS, from early-stage influencing through commenting on draft standards to field testing. EFRAG is also becoming gradually the natural forum in Europe where all forms of accounting or financial reporting issues are being developed.

Million €	2013	2014	2015	2016	2017	2018	2019	2020	TOTAL
EFRAG total expenses (EFRAG projections)	7.0	7.5	7.9	8.2	8.4	8.7	8.9	9.0	65.6
EU co-financing (EFRAG request)	3.2	3.5	3.9	4.0	4.1	4.3	4.4	4.4	28.6
EU co-financing (DG MARKT proposal)	3.1	3.162	3.225	3.290	3.356	3.423	3.491	3.561	23.507

Note: Minor deviations may be caused because of the rounding up; for exact amounts please refer to the Legislative Financial Statement of the draft Regulation

Volume of appropriation

Considering the additional tasks and activities that EFRAG is about to take on, the additional reimbursement of costs, it is reasonable to expect a natural, incremental increase of the organisation. The expected inflation rate is approximately 2%. Therefore, it seems rational to calculate with a 5-7% increase in EFRAG's budget annually.

At the current juncture, taking into account the sovereign debt crisis, it is proposed that the current level of funding in real terms is kept with the possibility to increase the co-financing due course. Any decrease in the funding would be politically detrimental, as it would send the wrong message to our international and European counterparts. It would endanger EFRAG's standing and role as the single European accounting voice. It could also cause the contribution of other funders decrease, a downsizing in the staff – and ultimately it may jeopardize the functioning of EFRAG and the fulfilment of its public interest role.

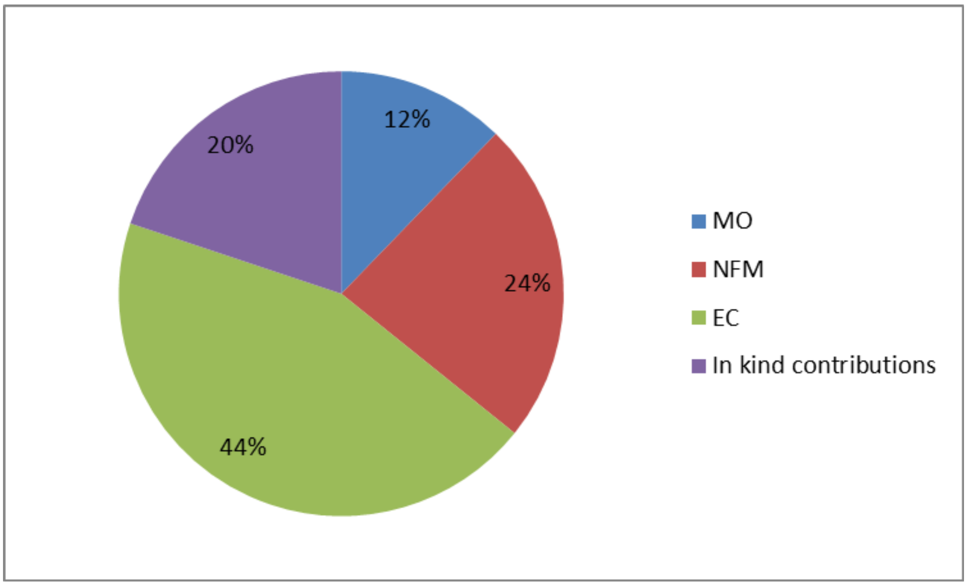
It is considered reasonable that the Community intervention contributes approximately € 3.4 million on average annually, corresponding to somewhat less than 50% of the EFRAG's projected total expenses. The current contribution of the European member organisations and national standard setters would not be reduced – they would be maintained or, if possible, increased. Moreover, the proposed EFRAG co-funding would be part of a Community programme which is intended to last for seven years (2014–2020) in order to be aligned with the duration of the financial perspectives. As described earlier, it is expected that this level of Community funding would signal to all parties concerned the Community interest in international solutions and encourage other public bodies and institutions to increase their contributions to EFRAG.

Expected impact of community funding

In the coming years, EFRAG's current 3-tier financing structure is planned to be maintained: contributions from the industry (Member Organisations), the National Funding Mechanisms of Member States and the European Commission's grant.

The main sources of EFRAG financing (expressed in %) in 2012 are illustrated in the pie chart below. It is expected that the share of the various financing sources will remain stable.

Sources of EFRAG's financing 2012



Source: EFRAG data

Impact on human resources and other administrative expenditure

Taking into consideration that the envisaged funding would finance operating costs, this will entail related administrative work by the European Commission. Since DG MARKT already has in place most of the administrative resources for managing such a significant amount of money compared to our budget line, there will be no need for additional specialist financial officers. Additional financial training for existing staff starting to deal with the file may be envisaged, which is estimated under section 1.4.8. of the general section of the ex ante evaluation.

3.5. Conclusion

In view of the above, considering the public interest role that EFRAG plays at present in the endorsement of the international accounting standards the *acquis*, and as the single accounting voice of the EU, pro-actively influencing the international standard setter, it is rational and important that this organisation is supported also financially by European public money in carrying out its tasks. Therefore, it is proposed to continue to provide EFRAG from 2014 with a co-financing of on average approximately €3.4 million annually via operating grants. This would mean a total amount of €23.5 million in the whole period of 2014-2020.

The Community contribution inter alia: (i) provides a stable funding that enables EFRAG to carry out its public interest activities (ii) demonstrate Community interest in international solutions, and (iii) incite other public bodies or institutions to provide funds to EFRAG.

3.6. Follow-Up: Arrangements for Monitoring, Reporting and Evaluation

In order to make sure that the Community money is spent to the purposes it was targeted at and in a cost-effective way, the Commission closely monitors EFRAG's operation by participating in its various bodies and by monitoring the fulfilment of its work programme. EFRAG's governance is periodically reviewed (every five years) in order to ensure that the organisation is still capable of fulfilling its public interest mission in an independent, transparent and an accountable way.

The Commission will closely monitor the application and evaluate the impact of the proposed funding to make sure that the money has been used in accordance with the principles of economy and cost-effectiveness. To this end, the Commission will:

- analyse the EFRAG annual reports;
- evaluate the financial statements and the auditor's report;
- discuss matters with other fund providers;
- use the Supervisory Board meetings, in which the Commission will be an observer, to discuss and clarify funding issues;
- arrange visits to the EFRAG premises when deemed necessary to verify budgetary systems and controls.

Evaluation should also include the assessment of the quality and efficiency of EFRAG's technical work, and should be based on its work programme and the issued documents.

- *Efficiency* would be measured by scrutinizing whether EFRAG delivered the documents (e.g., comment letters, input to the IASB's discussion papers) envisaged in its work-programme.

- *Quality* could be measured by delivering the documents on time and possibly by examining the percentage of EFRAG's comments taken into consideration by the IASB.

Finally, in line with current financial regulations and practices, the programme as a whole will be properly evaluated in order to determine its possible renewal in 2020.

We do not see any feasible and appropriate solution to make the "common European voice" in accounting well-founded (and funded) without sufficient Community support.

3.7. Glossary of Acronyms

EFRAG: European Financial Reporting Advisory Group

IASB: International Accounting Standards Board

IFRIC: Interpretations issued by the IFRS Interpretations Committee

IFRS Foundation: International Financial Reporting Standards Foundation

AISBL: Association internationale sans but lucratif (international not-for profit association)

PAAinE: Proactive Accounting Activities in Europe

TEG: Technical Expert Group of EFRAG

Annex: The difference EFRAG made in the financial reporting arena

It is worthwhile to examine whether EFRAG makes a difference and has effectively influenced the IASB. Undeniably, significant convergence is formed around the positions defined by EFRAG. It is difficult to judge to what extent this is due to EFRAG's influence or other factors (such as coincidence). However, EFRAG's views are widely shared as the following examples illustrate.

- On the IAS 37 revision in relation to the measurement of liabilities, EFRAG questioned at an early stage whether an expected value measurement technique should be extended to all liabilities, including litigations. The IASB decided to resume its work at a later stage and expose a full redraft of the revised proposals. The IASB is addressing when, and to what extent, expected value measurement techniques should be used and when other measurement techniques may be more appropriate.

- The IASB no longer requires a single statement of comprehensive income and decided not to go ahead with the project acknowledging that a debate on performance reporting is needed. When he IASB attempted to force a single comprehensive income statement as the price to pay for relevance in the Financial Instruments and Employee Benefits Projects, EFRAG objected strongly when the IASB attempted to force a single comprehensive income statement and advocated that the IASB should launch a fundamental debate of what difference there should be between a net income and other items of comprehensive income (OCI), and whether elements of OCI should be recycled. EFRAG identified in its comment letter to the IASB on the IASB agenda consultation that enhancing the Conceptual Framework is crucial. In enhancing the Conceptual Framework performance reporting including OCI should be a priority. In the various forms of feedback that the IASB has given to date on the agenda consultation performance reporting including OCI is indeed identified as a priority.

- The IASB work on derecognition has been limited to disclosures.

- The IASB has revised the measurement of financial liability proposals following EFRAG claiming that reflecting changes in own credit risk in net income is not meaningful.

- There are indications that the EFRAG recommendations on the reporting entity in relation to the definition of control and the application of joint control as part of the revision of the Conceptual Framework will be followed.

- The IASB met EFRAG concerns in relation to IAS 12 concerning the scope of the exception to the measurement principles which is now limited to investment properties measured at fair value rather than to all property, plant and equipment and intangible measurement using the revaluation model of IAS 16 or IAS 38.

- EFRAG's recommendations in relation to IFRS Interpretation Committee's Rejection Notices have been followed. Following EFRAG's comment letters on put options written over non-controlling interests and the calculation of value in use under IAS 36 impairment of assets the IFRS Interpretation Committee has amended the text of the rejection notices.

- EFRAG's recommendations in relation to the amendments to IAS 19 have been partly followed in relation to risk sharing features of certain pension plans. EFRAG urged the IASB to undertake a comprehensive review of employee benefit accounting that deals with defined contribution and defined benefit plans which an employer and employees share certain risks.

- In the deliberations on the core projects which the IASB notable the re-deliberations of the Revenue Recognition and the Leases projects included all significant issues EFRAG has raised. The results of EFRAG's outreach activities were presented to the IASB in the public joint IASB–EFRAG meeting in June 2011. Subsequently the IASB has decided to re-expose the Lease project, meeting one of EFRAG's most prominent requests, and the Revenue Recognition project.

- On Financial Instruments, in particular on Impairment (need for simplification of the model) and the Fair Value Option (exception for inclusion of changes in own credit risk in other comprehensive income that would result in an accounting mismatch such as would be the case in the specific Danish mortgage bank asset liability management model) there are indications that EFRAG recommendations have been followed.

- The IASB decided in the summer of 2011 to defer the effective date of IFRS 9, meeting EFRAG's recommendations.

- IASB and FASB have confirmed in spring 2011 that the June 2011 date was a target not a deadline. A target date should not take priority over a thorough and robust due process. The decisions by the IASB and FASB made to extend the timetable for some additional months satisfy recommendations that EFRAG has been expressing in various ways and forms since the end of 2010 and gives European stakeholders the comfort that their concerns will be properly addressed.

- The IASB decided in autumn of 2011 to open IFRS 9 for "limited modifications". The IASB and FASB have agreed to investigate opportunities for convergence in classification and measurement for financial instruments. EFRAG expressed in its comment letter on IFRS 9 concern unequal treatment of bifurcation of derivatives and prepared a paper on bifurcation of embedded derivatives for both financial assets and financial liabilities. There are indications that the approach suggested by EFRAG will be followed.

- EFRAG called for the issuance of Review Drafts before finalisation of IFRS in order to give a chance to constituents to assess whether their major concerns have been solved appropriately and to find whether there are any implementation issues and drafting issues that could be addressed before the final standard is issued. In April 2011 IASB announced, following EFRAG's recommendations, the publication of Review Drafts for public, large scale, fatal flaw review where re-exposure is not necessary.

- EFRAG and the UK ASB issued in January 2011 a Discussion Paper on Considering the effects of Accounting Standards. The IFRS Foundation Due Process Committee made decisions which meet the EFRAG recommendations. The IASB agenda consultation results show a strong call for evidence based agenda setting. This echoes the comments made by EFRAG for fully developed agenda proposals supported by evidence that further development of IFRS is needed (improvement of an existing standard is needed, or a gap in financial reporting standards needs to be filled) and that benefits justify the development and implementation efforts.

- IASB's involvement in EFRAG's outreach activities across Europe has been influential in IASB's deliberation on existing projects and in shaping the IASB's thinking about future projects:
  - Outreach on financial statement presentation in 2010
  - Outreach on EDs on Leasing and Revenue Recognition in the first half of 2011
  - Outreach on IASB agenda consultation in the second half of 2011

- EFRAG's input to the IASB agenda consultation and the results of the outreach activity can be well recognised in the first feedback on the outcomes of the agenda consultation:
  - Completion of the four current core projects as a priority
  - Request for a period of calm (stability)
  - Completing the revisions of the Conceptual Framework, addressing performance as priority, including the treatment of OCI (see above)

- EFRAG is running several proactive projects that directly feeding into the IASB's priorities as identified in the IASB agenda consultation
  - Need for evidenced based agenda setting (research led approach whereby projects will only be added to the standard setting phase when the problem is properly defined and identified solutions are feasible, of high quality and implementable) (see above)
  - Business Combinations under Common Control (EFRAG issued a Discussion Paper in autumn 2011 in partnership with the OIC on Accounting for Business Combinations under Common Control).
  - Framework for Notes to the Financial Statements (EFRAG proactive project in partnership with the ASB and ANC): FASB decided in second half of 2011 to join forces with EFRAG on the project. The IASB has now made public statements that it is commencing work on this project and is keenly awaiting the output of our project.

- EFRAG's evolving relationship with the FASB in the EFRAG proactive project in partnership with the ASB and ANC on a Framework for Notes to the Financial Statements is a clear recognition of EFRAG' s standing in the global standard setting community. It also represents another means of influencing the development of global financial reporting.

- In relation to the Questions and Answers issued as implementation guidance in relation to IFRS for SMEs EFRAG expressed concerns about the level of detail, the narrow scope of the issues and the number of Q&As the IASB SME Implementation

Group is addressing. The IASB has considered its approach and in its February 2012 Update the IASB SME Implementation Group announced that it does not expect to issue many, if any, additional draft Q&As before the start of the comprehensive review of IFRS for SMEs.

4. CONTINUATION OF THE EU CO-FUNDING OF THE PUBLIC INTEREST OVERSIGHT BOARD (PIOB) FOR THE PERIOD 2014-2020

4.1. Background

Unreliable financial reporting seriously constrains investments or divestments on financial markets. Inefficient or underperforming financial markets carries out a heavy toll on companies and other productive actors, having as a result a significant negative impact on the whole economy.

Audit as a public interest activity

Many decades ago it became mandatory for companies, in many jurisdictions all over the world, to have their financial statements audited. The purpose of an audit is to give reasonable assurance to the public, notably to shareholders and other investors, that financial statements are free from material misstatements and provide a true and fair view of a company's financial position.

It was also decided that audit services, in spite of its public interest nature, should be provided by private auditors and audit firms and not by public authorities or regulatory agencies.

In the EU, Community legislation[73] requires a company's financial statements to be audited by statutory auditors[74] who should provide an independent opinion about a company's financial position, as reflected in the financial statements. This will be particularly important in the case of auditing public interest entities[75] (e.g. listed companies, banks and insurance companies).

Need for International standards for auditors

Investors today increasingly invest or divest, directly or indirectly (e.g. through investment funds), in companies of all sizes (whether listed or not) incorporated in foreign jurisdictions and, therefore, regulators, standard setters, issuers, and other stakeholders can no longer view financial markets from an exclusive domestic perspective.

Auditing standards are standards to be followed by auditors when fulfilling their professional responsibilities in the audit of financial statements and related data. International standards for auditors are developed by independent committees of the International Federation of Accountants (IFAC), which is the global, private organization

[73] Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies; Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts; Council Directive 86/635/EEC of 8 December 1986 on the annual and consolidated accounts of banks and other financial institutions; Council Directive 91/674/EEC of 19 December 1991 on the annual and consolidated accounts of insurance undertakings.

[74] As defined in Article 2.2 of Directive 2006/43/EC (the 8th Company Law Directive)

[75] As defined in Article 2.13 of Directive 2006/43/EC (the 8th Company Law Directive)

representing the accounting profession. The most relevant IFAC committee is the IAASB (the International Auditing and Assurance Standards Board) which develops ISAs (International Standards for Auditors).

Article 26 of Directive 2006/43/EC (the 8th Company Law Directive) foresees the possibility of adopting the ISAs in the EU if developed and adopted with proper due process, public oversight and transparency subject to a regulatory comitology procedure (thus involving Member States and the European Parliament).

Investors benefit the most from an independent audit opinion when this opinion is based on high quality standards. The financial scandals which took place years ago (e.g. Enron and WorldCom in the US or Parmalat in Italy) called into question the work of auditors and their independence. This created a global movement towards reinforcing oversight of auditors by public authorities. At international level a reform of IFAC was deemed necessary. As part of such reform, the Monitoring Group[76] in co-operation with IFAC, decided to create the PIOB (Public Interest Oversight Board) to carry out the oversight of the standard setting activities of, inter alia, the IAASB[77].

The main objective of the PIOB is to ensure that IFAC standard setting activities are responsive to the public interest.

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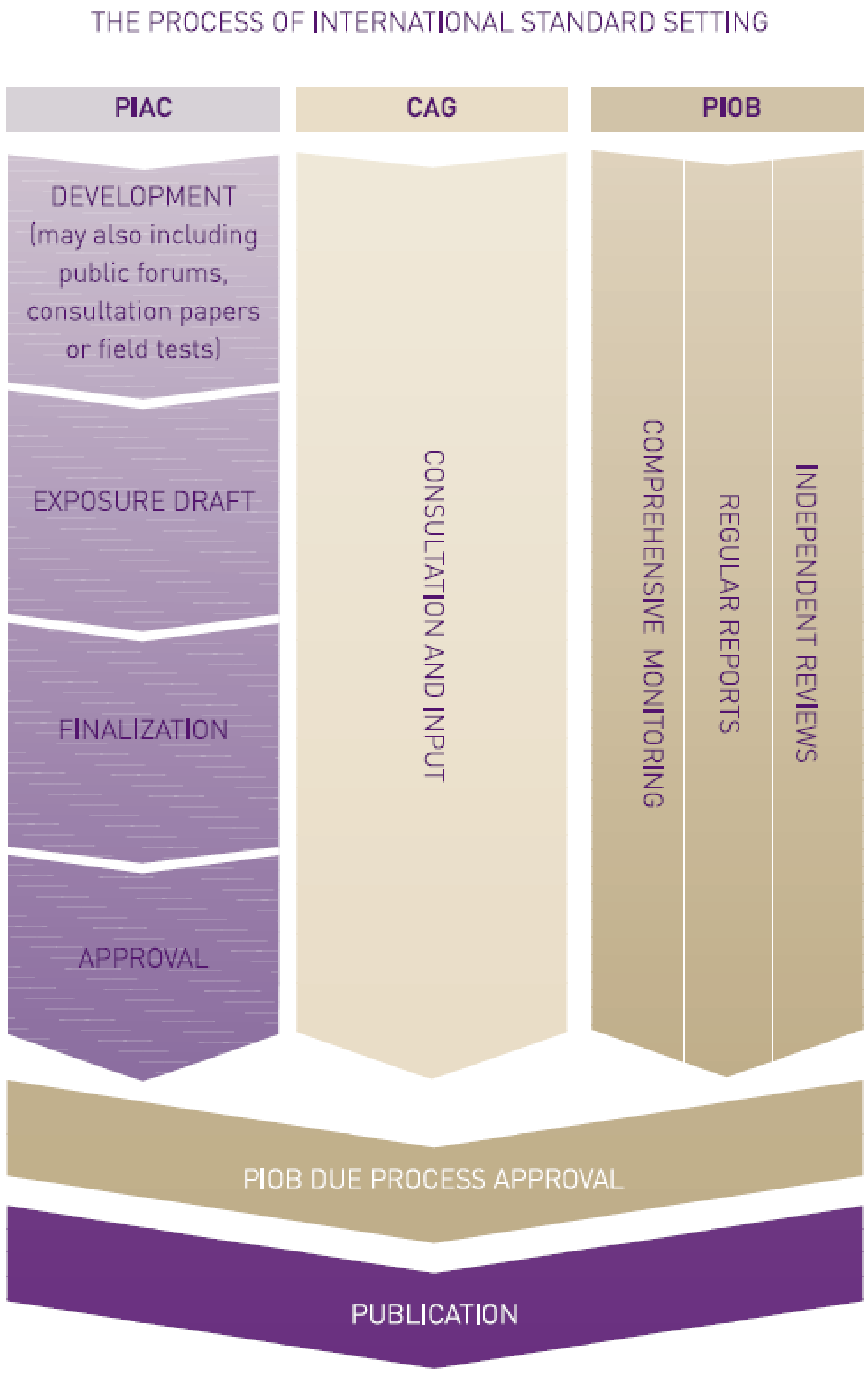
76 The Monitoring Group (MG) is the international organization responsible for monitoring the implementation of IFAC Reform. The MG nominates PIOB members and engages in dialogue with the international accountancy profession, receives operating and financial reports from the PIOB, and updates the PIOB regarding significant events in the regulatory environment. The current members of the MG are the BCBS, IAIS, IOSCO, the FSB, the IFIAR, the World Bank and the European Commission.

77 The PIOB also carries out the oversight of the two other standard setting committees of IFAC, namely, the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB). These three committees form part of IFAC's Public Interest Activity Committees (PIACs). Consultative Advisory Groups are constituted to provide advice, including technical advice, to each of the IAASB, IAESB and IESBA. Regular interaction between each CAG and its respective standard setting board is part of the board's formal consultation processes. The PIOB oversees the work of each CAG.



Source: Third public report of the PIOB, page 10 – May 2008[78]

In the US the Sarbanes-Oxley Act was adopted. At EU level the 8th Company Law Directive of 1984 was modernised and expanded in 2006 (Directive 2006/43/EC) to

[78] The PIOB public reports are annual reports published in May of the following year (the latest is the sixth public report published in May 2012; it can be found in http://www.ipiob.org/sites/default/files/public_reports/PIOB_Sixth_Public_Report.pdf

require, among other things, the creation of national public oversight bodies and of publicly controlled external quality assurance systems for auditors.

On 30 November 2011 the European Commission adopted new proposals[79] in the field of auditing to take into account the lessons learned in the financial crisis and with the objective of increasing audit quality across the board and all over the EU.

At world level a new forum denominated IFIAR[80] was created in 2006 by national independent auditors' oversight bodies to exchange experiences and co-ordinate activities.

The European Commission continues fully involved in the works of the IAASB, and to a lesser extent in the works of the IESBA, as observer with right to the floor. The European Commission is also a member of the IAASB CAG.

The PIOB started its operations on 1 March 2005. On 15 December 2005 (registered on 8 February 2006) a non-for-profit Spanish Foundation offering legal personality to the PIOB was set up in Madrid. The Foundation is governed by a Board of Trustees in which each member of the PIOB is a trustee. The PIOB has been renewed in March 2011 for another three-year period.

The Monitoring Group (MG) is responsible for the selection and appointment of the PIOB members, including its Chairman. This is done through the Nominating Committee of the Monitoring Group which includes all MG members. The Nominating Committee makes a collective decision to nominate not only individual members of the PIOB but also the entire Board in order to guarantee that the PIOB as a whole is appropriately qualified to complete its mission satisfactorily. Two[81], out of the ten, PIOB members were appointed by the European Commission in February 2008 and renewed in March 2011. The Nominated Committee is bound by a Memorandum of Understanding (MoU) signed by all MG members on 9 April 2008.

The PIOB has a small full time secretariat made up of the Secretary-General, an assistant and two advisors. For the 10 PIOB members, it is a part-time job.

The diagram below, extracted from the Third PIOB Public Report, provides a mapping of the PIOB work in the context of ensuring a strong "international public interest". In this representation, the international public interest is ensured all along the on-going flow of activities that move through various phases starting by a credible setting up of international auditing standards, followed by their adoption, implementation, monitoring and evaluation in order to enhance the confidence of the users of accountancy services (e.g. investors) and eventually of the whole financial system.

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79 See http://ec.europa.eu/internal_market/auditing/reform/index_en.htm

80 See https://www.ifiar.org

81 Sir Bryan Nicholson and Professor Kai-Uwe Marten

<u>Source</u>: Third Public Report of the PIOB, page 22 – May 2008

Main PIOB activities include the following:

- Activities related to the implementation and monitoring of due process in the development and adoption of international auditing standards issued or under preparation by the IAASB;
- Activities related to the implementation and monitoring of due process in the development and adoption of other IFAC public interest activities such as those in the field of Ethics (IESBA) and Education (IAESB);
- Activities intended to ensure that due process is followed in the IFAC's compliance programme;
- Conferences, workshops and other events aiming at stimulating debate or raising awareness about international auditing standards among stakeholders;

– Running of its Secretariat, including the remuneration of its members and the organisation of their missions.

As summarised by its Chairman; "*The PIOB pays special attention to how the procedures and deliberations in the PIACs reflect the public interest, by ensuring that an open and free debate takes place, that all opinions are heard, and that the arguments put on the table in the consultations, especially in the CAGs, are taken into account. Apart from an overall check, these steps ensure that the standards as finally adopted reflect the public interest, embodied in the diversity of opinions as expressed in the standard-setting process*"[82].

4.2. Problem definition

To guarantee that the standard setting process in IFAC is responsive to the public interest, it is subject to the independent oversight of a public body (the PIOB).

This standard setting model is supposed to profit from both: (i) the knowledge and experience of the standard setting committees of IFAC and (ii) a public oversight designed to ensure that public interest is safeguarded all around the process comprising the proposal, development and adoption of international standards for auditors.

However, and because of the private character of IFAC, the Monitoring Group members considered important from the very beginning to make sure that the governance rules of the new standard setting arrangement, including the funding of the PIOB, should be sound and effective to ensure acceptance and wide applicability of the international auditing standards.

Specifically, given the particular mandate of the PIOB, it is considered essential to ensure its financial independence and to avoid, in particular, any real or perceived risk of conflict of interests with the audit profession.

PIOB Funding diversification

Funding contributions to the PIOB were, therefore, expected to come from a variety of stakeholders from all over the world but primarily from the other members of the Monitoring Group. However, the usual difficulties associated to international co-funding arrangements have been exacerbated in recent times by the financial restrictions facing all international bodies and institutions due to the negative prevailing financial and economic climate. As a result, at present, only IFAC and the EU have a co-finance programme for the PIOB

On the basis of EU financing Decision of 16 September 2009, the EU contribution to the PIOB in 2010 fiscal year was €286.231. Such an amount represented 22% of the PIOB's total eligible expenses (€1.301.050). The EU contribution to the PIOB in 2011 fiscal year

82 PIOB 7th Public Report, May 2012, page 3

was €288.991,78, which also represents 22% of the PIOB eligible expenses for that year (€1.313.599).

The EU financing Decision, and in particular Article 9.4, requires that the PIOB should not continue to benefit from Community funds if, after the first 2 years thereof they have not made significant progress towards ensuring neutral (i.e. independent from the audit profession) ,funding arrangements form a majority of their total funding, including from third-country participants. The Decision also requires the Commission to report to the European Parliament and the Council on such progress.

In a letter sent by Commissioner Michel Barnier on 22 July 2011 to the European Parliament (Ms Sharon Bowles, Chairperson of the ECON Committee) and to the Council (Mr Jan Vincent Rostowski, Polish Minister of Finance) it is explained the Commission experience in PIOB funding and the progress made in involving other relevant parties:

It is indicated, in particular, the PIOB co-funding experience by the EU has been up to now positive. The European Commission has had the opportunity to visit the PIOB premises twice (March 2010 and April 2011) and to verify their financial controls. The European Commission also trained its staff on EU budgetary procedures. From a practical point of view the activities involved in the management of the operating grant for the 2010 and 2011 fiscal years have been a very useful learning experience for both sides. This has paved the way for a straight and more efficient management of future funding contributions.

The EU co-financing of the PIOB has become an example for other potential contributors. As a result, several international institutions are expected to provide funds to the POIB already for the 2013 fiscal year[83]. Moreover, the Monitoring Group, the PIOB and IFAC have created a Task Force to select and convince a group of donors from all over the world to provide funding to the PIOB on a stable and long-term basis.

The new Monitoring Group chairman, Ethiopis Tafara, has also pledged to continue and reinforce the PIOB diversification funding efforts. In view of this there should not be any obstacle for the continuation of the EU contribution to the PIOB funding all over the 2010-2013 funding programme.

Linking public oversight with independent funding is a traditional policy measure also enshrined in Community legislation. For instance, Article 32(7) of the 8th Company Law Directive when referring to the principles of public oversight in the field of auditing stipulates that: *"The system of public oversight shall be adequately funded. The funding…shall be secure and free from any undue influence by statutory auditors and audit firms".* The same principles are repeated in the same Directive in Article 29.1(c) and (b) when referring to external quality assurance systems and they are further

83 Indeed, the EU contribution to the PIOB is inciting other stakeholders to provide funding as well. It has been reported that several organisations such as IOSCO and the BIS are ready to provide sizable funds to the PIOB for the 2013 fiscal year.

developed in Articles 8 and 9 of the 2008 Commission Recommendation on Quality Assurance[84].

An independent PIOB, in view of its special mandate, will be uniquely positioned to ensure that due process, oversight and transparency have been respected in the proposal, development and adoption of the international standards for auditors.

4.3. Objectives

The main strategic and operational objectives expected to be achieved by the proposed funding arrangement for the PIOB are the following:

4.3.1. Strategic objective

The strategic objective is to ensure a stable, diversified, sound and adequate funding to enable the PIOB to carry out its public interest mission in an independent, efficient and satisfactory way.

It is widely accepted that the best way to achieve independent funding for the PIOB, or similar bodies, is to have a well-diversified array of contributors mainly from public sources at global level which will reduce, accordingly, the current IFAC contribution. This is also the desire from the beginning of the PIOB which indicates that: *"in the opinion of the PIOB…it is in the public interest – both real and perceived- that the current funding arrangements be diversified and expanded…"*[85].

4.3.2. Operational objectives

4.3.2.1. Avoid excessive reliance of the PIOB on voluntary funding from interested parties thus ensuring credibility and independence of its work

The key objective is to avoid any real or perceived risk of conflict of interest with other parties and in particular with IFAC.

4.3.2.2. In addition to the above, boost the international reputation, attractiveness and acceptance of the standards

Because of the private character of IFAC, the Monitoring Group members considered important from the very beginning to make sure that the governance rules of the new standard setting arrangement, including the funding of the PIOB, should be sound and effective to ensure acceptance and wide applicability of the international auditing standards.

84 Commission Recommendation 2008/362/EC of 6 May 2008 on external quality assurance for statutory auditors and audit firms auditing public interest entities

85 Page 5 of the First Annual Public Report of the PIOB – May 2006

4.3.2.3. Achieve the above objectives within a reasonable period of time considering both the EU and international context

The last operational objective is to achieve the above objectives within a reasonable period of time. Whereas the IFAC contribution has always been considered a good solution for the short term, or as a transitory situation, there is a consensus in the Monitoring Group that a diversified and stable funding for the PIOB is the only reasonable way forward.

4.4. Policy options

The following two options have been considered with a view to compare how the objectives identified in chapter 3 are fulfilled and whether they constitute good value for money.

4.4.1. Option 1: Baseline scenario: Discontinuing the EU co-financing (i.e. no action)

Under this scenario the EU will not provide further funding one the current programme expires on 31 December 2013. This implies that we will return to the pre-2010 situation. IFAC, representing auditors and accountants from all over the world, will continue providing most of the funds to the PIOB.

Such an approach clearly risks damaging the image of the PIOB. Moreover, the heavy reliance on a single contributor should always be considered more risky than funding coming from a more diversified basis.

4.4.2. Option 2: Continuing the Grant Programme

Under this scenario the EU will update and extend the current programme for the period 2014-2020 building on the lesson and experiences learned up to now in our co-funding of the PIOB.

From a global perspective, a contribution from the Commission will also incite other institutions, and in particular those represented in the Monitoring Group, to provide a fair portion of public funding to the PIOB.

Such support to the PIOB funding will signal to other international actors that the European Union is engaged in finding global solutions for the benefit of all parties concerned.

4.4.3. Comparison of options

The matrix below is used to compare the relative merits of two competing options based on a qualitative assessment as reliable data are not available.

One should consider as a **first priority** the need to **achieve the objectives** set out for the PIOB, as this is the most crucial issue at the moment (avoid reliance on voluntary funding from interested parties, boost attractiveness and acceptance of ISAs).

A **second priority** should be the criteria of **feasibility** (from a legal and or political point of view). The fact that the PIOB is an international, not-for-profit organisation in charge of the oversight of an international standard setter may entail a certain degree of complexity to the analysis.

A **third priority** should be the **time needed for implementation**

A **fourth priority** should be the **implications for the EU budget**.

ASSESSMENT / OPTIONS	1. Achievement of objectives High (+++) Medium (+/-) Low (- - -)	2. Feasibility Straightforward (+++) Medium (+/-) Complex (- - -)	3. Time needed for implementation High (+++) Medium (+/-) Low (- - -)	4. Implication for EU budget Positive (+ to +++) Negative (- to - - -)	Overall Assessment Positive (+ to +++) Negative (- to - - -)
Option 1 **Baseline scenario: Discontinuing the EU co-financing (no action)**	_ _ _	+ + +	+++	+ + +	-- -- --
Option 2 **Continuing the Grant Programme**	+++	+/--	+ /--	---	+++

Comparing the two cases:

Option 2 is, on the whole, clearly superior to option 1:

- it would preserve PIOB's operational independence from the audit profession by ensuring that a significant portion of its funding comes from public sources,
- it enhances the European stance in international bodies and in particular in those responsible for monitoring and setting up international standards,
- it would signal to all parties concerned the Community interest in international solutions and encourage other public bodies and institutions to provide funds to the PIOB,
- it would enhance the reputation of the PIOB by international standard users, securities issuers and investors,

In summary then, in terms of the pursued public interest objectives, the continuation of Community co-funding of the PIOB, via the European Commission, clearly represents the less risky solution and would yield the most positive returns.

4.4.4. Method of implementation for the selected option

As a general rule, financial support from the Community budget could be provided either (i) by contributing to the overall budget of the body (via operating grants) or (ii) by co-financing specific targeted activities of the body (via action grants).

Concerning publicity rules, the possibility of providing a grant following a call for proposal should be excluded from the outset since the beneficiary (the PIOB) is in a situation of legal monopoly in accordance with Article 190 (1)(c) RAP[86].

In view of the public policy objectives and the type of beneficiary, it is considered that a direct financial contribution from the EU budget by way of an operating grant, as it was already the case in the EU 2010-2013 PIOB funding Programme, constitutes the best solution to address the proposed funding.

Indeed the choice to provide an operating grant to the PIOB seems the most appropriate because:

- Whereas some organisations work on an activity-based budgeting (ABB) system, the PIOB, given its size and mandate, operates on a cash budget basis which is not conceived for the monitoring of the implementation of specific activities;
- Unlike a grant for action, which helps to co-finance a one-off action over a given period of time, an operating grant allows co-financing of the whole institution's functioning from a much broader perspective.
- It will ensure continuity to the current 2010-2013 PIOB funding Programme.

Regarding the PIOB as a possible eligible beneficiary, it continues complying with the requirements laid down in Article 121(1)(b) of the Financial Regulation[87]. This is an

86 Commission Delegated Regulation (EU, Euratom) No …/… of 29.10.2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union

organisation which has an objective forming part of, and supporting, the Union policy in the field of auditing and is a non-profit organisation (legally speaking has been authorised and is regulated as a Spanish not-for-profit foundation).

Volume of appropriations, human resources and other administrative expenditure

At present the operating costs of the PIOB are covered primarily by IFAC and the EU.

IFAC has committed to fund the operating expenses of the PIOB up to a limit of €1.317.000 per year. The EU, under the 2010-2013 Programme has committed to provide up to a maximum of €300.000 per year.

The amount of money provided by the EU fully replaces the amount of money otherwise to be provided IFAC.

In the table below are indicated the amounts of the key components of the PIPOB expenses in the most recent years:

PIOB Expenses by activity	***Year***	***Year***
(in euro)	***2011***	***2010***
Board-related operating costs		
Oversight Programme	**671.374**	**666.408**
External relations Program	**149.496**	**320.291**
Monitoring Group	**157.428**	**---**
Foundation Board Meetings	**122.585**	**107.697**
Other on-going operating costs	**216.052**	**210.027**
Total Expenses	**1.316.934**	**1.304.423**

Source: **PIOB 2011 Annual Accounts**

Whereas some expenses are fixed or highly predictable (e.g. the members' remuneration), other parts of the PIOB budget have far greater variability which cannot be fully predicted or confidently priced in advance. These concern notably:

- The inflation which affects almost every budget category;

[87] Regulation (EU, Euratom) No 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union

- The variability of certain categories of costs (e.g. the total travel needs are difficult to foresee) due in particular to the volatility of the Euro/United States Dollars (USD) exchange rate and the geographical origin of the future PIOB members
- The outcome of the public consultations[88] launched by the Monitoring Group and the PIOB on 28 March 2012 which may entail further responsibilities for the PIOB.

In order to determine a precise volume of the Community contribution several considerations have to be taken into account. In particular:

- The amount to be proposed has to be proportionate to the pursued objectives,
- The EU weight in international affairs has to be fairly respected (this is often measured either by its geographical weight, wealth share, share of global economy, or share of international capital markets what makes a proportion between 1/4th and 1/3rd of the total),
- The possible PIOB budget fluctuations due to inflation or new responsibilities
- The experience accumulated up to now in the 2010-2013 Programme

In view of the above, it is proposed to keep the same level of co-financing as in the previous programme (300.000 Euros per year) adjusted by a reasonable expected annual rate of inflation (2%) from 2014 onwards. We also took into account the EU weight in the international financial and economic systems which imply a level of co-financing around 22% of total eligible expenses, what is similar to the previous programme. This represents a base funding of 306.000 Euros in 2014 and a total for the seven year programme of 2.274.891 Euros.

The proposed EU funding would reduce accordingly, by the same amount, the potential IFAC contribution.

Whereas the proposed EU funding would still leave IFAC providing more than half of total funding, it is expected that such a level of Community commitment would encourage, as indicated earlier, other public bodies and institutions to provide stable funds to the PIOB to the point where IFAC contribution is not so relevant.

Finally, in terms of workload implications, the proposed funding will certainly continue implying some related administrative work in the relevant services of the European Commission.

4.5. Conclusion

In view of the above and in order to ensure both the PIOB credibility and its key role in enhancing audit quality, it is considered important for the Community to continue contributing fairly to the funding of the PIOB and reduce accordingly the IFAC contribution.

Specifically, it is proposed to provide the PIOB, starting in 2014, the sum of 306.000 Euros, updated by an annual inflation rate of 2%, making a total contribution of 2.274.891 Euros for the whole 2014-2020 period.

[88] See http://ec.europa.eu/internal_market/auditing/news/index_en.htm

The Community contribution will, among other things: (i) demonstrate Community interest in international solutions, and (ii) incite other public bodies or institutions to provide stable funding to the PIOB.

4.6. Follow-up: Arrangements for monitoring, reporting and evaluation

The Commission will closely monitor the application and evaluate the impact of the proposed funding to make sure that the money has been used in accordance with the principles of economy and cost-effectiveness. To this end, the Commission will:

- Analyse the PIOB (annual) Public Reports
- Evaluate the PIOB Financial Statements and the Auditor's Report
- Discuss matters with other possible fund providers
- Use the Monitoring Group meetings, where the Commission is a member, to discuss and clarify funding issues
- Arrange visits to the PIOB premises when deemed necessary to verify financial systems and controls

Finally, in line with current financial regulations and practices, the programme as a whole will be properly evaluated in 2019 in order to determine its possible renewal.

GLOSSARY

Basel Committee on Banking Supervision (BCBS): the international body comprised of central banks and banking supervisory authorities from certain key markets that formulates and encourages convergence towards broad supervisory standards, guidelines and statements of best practice.

Consultative Advisory Group (CAG*):* the group constituted to provide advice, including technical advice, to each of the IAASB, IAESB and IESBA. Regular interaction between each CAG and its respective standard setting board is part of the board's formal consultation processes. The PIOB oversees the work of each CAG.

Financial Stability Board (FSB): The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

International Auditing and Assurance Standards Board (IAASB): the independent standard setting board that develops international standards and other pronouncements dealing with auditing, review, other assurance, quality control and related services. The PIOB oversees the work of the IAASB.

International Association of Insurance Supervisors (IAIS): the global organization that represents insurance regulators and supervisors, issues global insurance principles, standards and guidance papers, provides training and support on related issues, and promotes effective insurance supervisory regimes.

International Accounting Education Standards Board (IAESB): the independent standard setting board that develops international standards and other pronouncements dealing with education, practical experience and tests of professional competence for accreditation, and the nature and extent of continuing professional education for professional accountants. The PIOB oversees the work of the IAESB.

International Ethics Standards Board for Accountants (IESBA): the international standard setting board that develops ethical standards and other pronouncements for use by professional accountants. The PIOB oversees the work of the IESBA.

International Federation of Accountants (IFAC): the global organization representing the accountancy profession. IFAC is committed to protecting the public interest by developing high quality international standards, promoting strong ethical values, encouraging quality practice, and supporting the development of all sectors of the profession around the world. The IAASB, IAESB and IESBA are three of IFAC´s independent standard setting boards.

IFAC Reform: the introduction in 2003 of processes for oversight and monitoring designed to strengthen IFAC international standard setting, achieve convergence to international standards and ensure that the international accountancy profession is responsive to the public interest.

International Forum of Independent Audit Regulators (IFIAR): a forum of national audit regulators from several jurisdictions that conduct inspections of auditors and audit firms. Among its objectives are the sharing of knowledge and practical experience, promotion of collaboration and consistency in regulatory activity and engagement with other organizations with an interest in audit quality.

International Organization of Securities Commissions (IOSCO): the cooperative forum for securities regulatory agencies and international standard setter for securities markets.

Monitoring Group (MG): the regulatory and international organizations responsible for monitoring the implementation of IFAC Reform. The MG nominates PIOB members and engages in dialogue with the international accountancy profession, receives operating and financial reports from the PIOB, and updates the PIOB regarding significant events in the regulatory environment. Members of the MG are the BCBS, IAIS, IOSCO, the FSB, the IFIAR, the World Bank and the European Commission.