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

**on the activities of the IFRS Foundation, EFRAG and IOB in 2015**

## **1. PURPOSE AND SCOPE OF THE REPORT**

Regulation No 258/2014 of the European Parliament and of the Council, which extended a Union programme to support specific activities in the field of financial reporting and auditing for the period from 1 January 2014 to 31 December 2020<sup>1</sup>, came into force on 9 April 2014 following its publication in the Official Journal<sup>2</sup>.

According to Article 9 (3) of the Regulation, from 2015, the Commission shall prepare an annual report on the activity of the beneficiaries of the programme, namely the the International Financial Reporting Standards (IFRS) Foundation, the European Financial Reporting Advisory Group (EFRAG) and the Public Interest Oversight Board (PIOB). The scope of the report is further defined in Article 9 (4, 5 and 6) of the Regulation.

The report covers the activities of the IFRS Foundation, EFRAG and PIOB in 2015. However, certain events that took place in 2016 were also mentioned where it was deemed useful for the purpose of this report.

## **2. IFRS FOUNDATION**

### **2.1. General principles against which new Standards have been developed**

#### **1.1.1. The International Accounting Standards Board's (IASB) Principle of Fair Presentation**

IAS 1, Presentation of Financial Statements, requires financial statements to present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Conceptual Framework. The application of IFRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

#### **1.1.2. The IASB's Due Process Principles**

The IASB's due process requirements for developing new Standards are built on the principles of transparency, full and fair consultation and accountability.

#### Transparency

Meetings of the IASB (as well as the IFRS Interpretations Committee) to discuss technical issues are open to the public, recorded and broadcast live via webcast. The technical staff Papers for these meetings are made available on the IFRS Foundation website, together with

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<sup>1</sup> The programme period with respect to EFRAG runs from 1 January 2014 until 31 December 2016. On 13 March 2016, the Commission proposed to extend it until 31 December 2020.

<sup>2</sup> OJ L 105/1, 8.04.2014

recordings and webcasts of the meetings. Summaries of the decisions reached in these meetings are also published.

### **Full and fair consultation**

The IASB also operates on the principle that wide consultation with interested parties enhances the quality of its Standards. This consultation can be carried out through various means, including individual meetings and fieldwork.

### **Accountability**

The IASB is committed to the principle of accountability and assesses the likely costs and benefits, or effects, of proposed new requirements throughout the development of a new or amended Standard. The IASB's views on the likely effects are approved and published by the IASB.

In November 2014, the IASB published the report of the Effects Analysis Consultative Group, which had been established to advise the IASB on best practice in the assessment of the likely effects of a new Standard and thus to seek to enhance the confidence in, and efficiency of, the processes. The recommendations, which build upon the IASB's already extensive methodology for undertaking an effects analysis, were implemented for the first time in the effects analysis published with the new standard IFRS 16 Leases.

The Commission has recently initiated a discussion on effects analysis for future IFRS with its fellow Monitoring Board members. This issue will be further discussed by the Monitoring Board in 2016.

## **2.2. The IASB's key achievements in 2015**

In 2015 the IASB finalised one major new Standard: IFRS 16 Leases, which was published in January 2016. In addition, the IASB continued to work on a number of other major projects, in particular Insurance Contracts, the Disclosure Initiative and the Conceptual Framework.

### **a) IFRS 16 Leases**

The Board issued IFRS 16 Leases, concluding its decade-long effort to overhaul the accounting for leases. IFRS 16 is a major revision of the way in which companies account for leases and requires all leases to be reported on a lessee's balance sheet as assets and liabilities. The new Standard aims to better reflect the actual consequences of economic transactions and provide much-needed transparency about companies' lease assets and liabilities, meaning that off balance sheet lease financing no longer goes unrecognised. It is expected to improve comparability between companies that lease and those that borrow to buy. Accompanying the Standard, the IASB has also published a separate and comprehensive effects analysis, which demonstrates that the related benefits outweigh the costs.

In June 2016, the Commission requested EFRAG to provide its endorsement advice on IFRS 16, supported by an impact analysis, including a cost-benefit analysis and an analysis of

broader economic impacts. This impact analysis should be independent, objective and Europe-focused.

b) *Other key project achievements*

The IASB has continued to work intensively to finalise the Insurance Contracts project and has now completed its technical deliberations. During redeliberations, the IASB has maintained extensive dialogue with all interested parties. This project is expected to bring much-needed transparency to the plethora of accounting practices currently used throughout the industry. The new standard will result in a more realistic depiction and better comparability of financial performance of the insurance industry around the world, which is especially important in the current period of economic volatility. The urgency of this project was underlined by a recent call from the Financial Stability Board for the IASB to finalise the Insurance Standard as soon as possible<sup>3</sup>. The IASB expects to publish the new Insurance standard at the end of 2016.

In December 2015, the IASB published for public comment proposals to amend the existing insurance contracts Standard, IFRS 4 in order to address the temporary consequences of the different effective dates of IFRS 9 *Financial Instruments* (effective date of 1 January 2018) and the new insurance contracts standard (which will replace IFRS 4 and have a later effective date). In this respect, some of the companies that issue insurance contracts, have expressed concerns about the need to implement two significant changes in accounting on different dates. They also highlighted that potential increased accounting volatility could arise in profit or loss if the new requirements for financial instruments were to be applied before the new requirements for insurance contracts. Consequently, the proposals of the IASB in this area aim to address these concerns and to balance them with the needs of users of financial statements. The IASB proposals envisage:

- permitting entities that predominantly issue insurance contracts the option to defer the effective date of IFRS 9 *Financial Instruments* until 2021 (the 'deferral approach')
- permitting entities that implement IFRS 9 with the option to remove from profit or loss some of the additional accounting mismatches and temporary volatility that could occur before the new insurance contracts standard is implemented (the 'overlay approach')

The relevant amendments are expected to be published by the IASB in September 2017.

### **2.3. Development of a Revised Conceptual Framework**

On 28 May 2015, the IASB published an Exposure Draft proposing changes to its Conceptual Framework. The Conceptual Framework describes concepts for general purpose financial reporting. Among other things, the Exposure Draft discusses prudence, reliability, an entity's business model, substance over form and long-term investment. In 2015, the IASB received a large number of comment letters on the Exposure Draft from different

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<sup>3</sup> <http://www.fsb.org/wp-content/uploads/September-Plenary-press-release.pdf>

stakeholders, which will be considered by the IASB when developing the revised Conceptual Framework with a view to finalising it in early 2017.

### **Prudence**

The Exposure Draft proposes to reintroduce prudence into the Conceptual Framework. Prudence is described as the exercise of caution when making judgements under conditions of uncertainty. It is acknowledged that prudence may lead to asymmetry in recognition of assets/income and liabilities/expenses. It is also worth noting that, although the term ‘prudence’ was taken out of the Conceptual Framework in 2010, the IASB has maintained that prudence is reflected in their standards.

In its comment letter EFRAG welcomed the IASB’s decision to re-introduce prudence into the Conceptual Framework and agreed with its basis for conclusions that prudence may lead to asymmetry in the recognition of assets/income and liability/expenses without introducing any undesirable bias in financial reporting. However, in EFRAG's view, these conclusions should be made clearer and be acknowledged in the Conceptual Framework.

### **Reliability**

Prior to 2010, the Conceptual Framework identified reliability as a characteristic of useful financial information. However, in 2010, the IASB replaced the notion of reliability with the notion that useful financial information should faithfully represent what it purports to represent (‘faithful representation’).

Some of the IASB’s stakeholders have expressed concerns about this change. In response, the Exposure Draft seeks to address aspects of what the IASB believes stakeholders were seeking in expressing their concerns about reliability. The description of faithful representation in the Exposure Draft is substantially the same as the description of reliability in the pre-2010 Conceptual Framework. The Exposure Draft describes a perfectly faithful representation as complete, neutral and free from error. The enhanced discussion in the Exposure Draft explains the factors that enable users to rely on financial information to provide a faithful representation of what it purports to depict. In the IASB’s view, this makes it unnecessary to reintroduce the term ‘reliability’.

In its comment letter, EFRAG supported the Conceptual Framework continuing to identify faithful representation and relevance as the two fundamental qualitative characteristics of useful financial information. However, it argued that the Conceptual Framework should acknowledge a trade-off between relevance and faithful representation (or reliability), with measurement uncertainty being included in ‘faithful representation’ (or reliability).

### **Business model**

The Exposure Draft identifies how financial statements can be made more relevant if the IASB considers, when developing its Standards, how an entity conducts its business activities. This change acknowledges the role the business model should play in determining how items are measured for the profit or loss account and balance sheet.

## Substance over form

The Exposure Draft reintroduces substance over form which is welcomed as it is necessary to portray the economic consequences of transactions.

### **Long-term investment**

When developing the Exposure Draft, the IASB reached the conclusion that the package of proposals in the Exposure Draft provides sufficient tools to enable the IASB to consider appropriately both the information needs of long-term investors and how an entity should account for long-term investments. The Commission welcomes the explicit consideration that the IASB has given to this topic and will pay attention to the question of whether long-term investors agree with the IASB's thinking on this matter.

## **3. EFRAG**

### **3.1. Consideration of the true and fair view principle and strengthening EFRAG's assessments of impact of new IFRS on the public good**

EFRAG provides its input throughout the standard setting process by commenting on IASB pronouncements and by providing proactive work to stimulate a debate in Europe on important accounting issues. The commenting and proactive activities are essential for ensuring that European views on the development of financial reporting are properly and clearly articulated in the standard setting process with the objective that the resulting standards are fit for Europe.

Following the governance reform implemented in 2014, EFRAG continued to carry out endorsement assessments on whether IFRS were meeting all technical criteria of the IAS Regulation, including the true and fair view principle, and also strengthened its assessment on whether new or proposed financial reporting requirements were conducive to the public good. In this respect, it needs to be stressed that the Commission intends to further clarify the concept of the public good criterion in the course of 2016<sup>4</sup>.

In 2015, EFRAG provided to the Commission its endorsement advice on two major standards, namely IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments*. In finalising the endorsement advice on IFRS 15 the EFRAG Board took into account the feedback of constituents and considered that the new standard was conducive to the European public good as it found that IFRS 15 could be expected to have a positive impact on the cost of capital whereas it had not identified any potential negative effect for the European economy. The final endorsement advice issued in March 2015 included this assessment.

In its request for endorsement advice concerning IFRS 9 *Financial Instruments*, the Commission after consulting the Member of the Accounting Regulatory Committee (ARC) identified a number of specific issues, including public good issues, that needed to be analysed by EFRAG. In particular, it asked for an assessment of this standard in the light of the concept

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<sup>4</sup> [http://ec.europa.eu/finance/company-reporting/docs/committees/arc/2016-06-27-european-public-good\\_en.pdf](http://ec.europa.eu/finance/company-reporting/docs/committees/arc/2016-06-27-european-public-good_en.pdf)

of prudence. It also asked for an assessment of the use of fair value, including with respect to the needs of long term investors, and whether the changes brought could have detrimental effects on financial stability. In September 2015, EFRAG submitted its endorsement advice on IFRS 9 Financial Instruments to the Commission. EFRAG's endorsement advice concluded that IFRS 9 was conducive to the European public good, except for the impact on the insurance industry of applying IFRS 9 before the finalisation of the forthcoming insurance contracts standard. Furthermore, EFRAG concluded that the application of IFRS 9 would lead to prudent accounting.

In 2015, EFRAG participated in the IASB consultation process and issued comment letters after public consultation on other IASB pronouncements, including the Conceptual Framework. In addition, EFRAG continued discussions on the IFRS 4 Insurance contracts project and actively participated in the consultations on the IASB's proposals to amend the existing insurance contracts standard, IFRS 4 in order to address the temporary consequences of the different effective dates of IFRS 9 *Financial Instruments* and the new insurance contracts standard.

### **3.2. Consideration of the diversity of accounting and economic models and views in the European Union**

Since its establishment EFRAG has put in place a transparent due process that was further developed over time. This due process allows all European constituents to put forward their views for consideration by EFRAG and ensures that the diversity of accounting and economic models and views in Europe are taken into account and that the new IFRS respond to the Union's needs.

As part of its due process EFRAG publishes draft positions for public consultation, undertakes field tests and other forms of effect analyses, organises outreach events (some of which are specifically aimed at users of financial statements) and undertakes special surveys<sup>5</sup>, publishes the results in feedback statements and publishes its final positions.

Meetings of the EFRAG Board and EFRAG Technical Expert Group are held in public and the agenda and summaries of the meetings are published on EFRAG's website as well as supporting agenda papers for meetings of the EFRAG Board. The discussions are furthermore supported by input received from EFRAG Consultative Forum of Standard Setters and the specialised EFRAG Working Groups. The input received from the EFRAG User Panel is essential to the work of EFRAG. The diversified composition of these groups as well as the EFRAG Board and EFRAG TEG both in terms of geographical and professional background, in addition to the due process, ensures that all different perspectives are properly taken into account by EFRAG.

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<sup>5</sup> In 2015, such surveys were conducted in order to support the assessment of IFRS 9

### **3.3. Implementation of the governance reform following recommendation of the Maystadt report**

The governance reform of EFRAG, which was implemented on 31 October 2014, increased the legitimacy and representativeness of the organisation and resulted in a more cohesive process for the participation of the EU in the standard setting process. It is worth highlighting that EFRAG reached all its conclusions in 2015 on a consensus basis without having to resort to voting.

Following its first year of operation, the new Board of EFRAG carried out its own performance and effectiveness review seeking also feedback from its member organisations. The review, which covered a mixture of strategic, governance and operational issues, demonstrated that on balance the new governance structure worked well, which resulted in increased credibility of the organisation. Several recommendations were adopted to further improve the effectiveness of EFRAG's activities in the future. In particular, the role of official observers (European Supervisory Authorities and the European Central Bank) in the Board decision making process has been strengthened.

On 30 June 2016, the Commission nominated Jean-Paul Gauzès, former Member of the European Parliament, as President of the EFRAG Board. The nomination of Mr Gauzès had been previously endorsed by the European Parliament and the Council. Mr Gauzès was formally appointed on 1 July 2016 by the General Assembly of EFRAG. His leadership is expected to give a new impetus to the reformed organisation.

The Maystadt report<sup>6</sup> encouraged EFRAG to pursue its efforts in order to produce impact assessments corresponding to the needs of users and of the European legislator. In this respect, EFRAG has made significant progress in developing its impact assessment capacity from 2016 onwards. The Commission staff has assisted EFRAG in this process through sharing its expertise in this area. The impact assessment on IFRS 16 *Leases*, which will be included in the endorsement advice on this standard, will be used as a pilot case to further build EFRAG's capabilities and experience in this area.

On 13 April 2016 the Commission proposed to Council and Parliament to extend the financing of EFRAG for the period 2017-2020<sup>7</sup>.

## **4. PIOB - DEVELOPMENTS IN THE DIVERSIFICATION OF FUNDING IN 2014**

The PIOB is in charge of overseeing the process leading to the adoption of International Standards on Auditing (ISAs) and other public interest activities of IFAC (The International Federation of Accountants). In order to properly carry out this important public-interest function it should be financed in such a way as to preserve its independence. Proper diversification of funding sources would help not only to preserve its continuity and guarantee that independence but also to reinforce the perception of independence. In the field of

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<sup>6</sup> [http://ec.europa.eu/finance/accounting/docs/governance/reform/131112\\_report\\_en.pdf](http://ec.europa.eu/finance/accounting/docs/governance/reform/131112_report_en.pdf)

<sup>7</sup> <https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/1-2016-202-EN-F1-1.PDF>



international standards for auditing the need for funding diversification was already recognised in the IFAC reform of 2003. That reform paved the way for the creation of the PIOB which, on that basis, is expected to be funded from different sources. This approach has always been defended since by the Monitoring Group, the international organisation responsible for monitoring the governance reform of international standard setting for auditing.

Since its creation in 2005 until 2010, when the Community funding programme established by Decision 716/2009/EC became operative, the PIOB, apart from some in-kind contributions, was financed exclusively by IFAC. The EU contribution in the period 2010-2015 has spurred a number of donors to also make their own contributions.

The funds made available by IFAC in a given year constitute a maximum IFAC guaranteed contribution which is made available to the PIOB without any further interference from IFAC. The purpose of non-IFAC contributions is to substitute and thus to reduce the IFAC contribution for that specific year. Ideally the IFAC funding portion of the total PIOB annual expenses should fall below 50%.

In year 2015, as shown in page in page 1 of its financial statements, the PIOB revenues amounted to EUR 1,532,907. IFAC provided EUR 930,154, which represents 60.67% of the total. The European Commission provided EUR 312,000 (EUR 272,000 in 2014), which represents 20.35% of the total. The Abu Dhabi Accountability Authority provided, as in 2014, EUR 120,000, which represents 7.82% of the total. IOSCO, also as in 2014, provided EUR 100,000, which represents 6.52% of the total. The Bank for International Settlements, compared to 2014, reduced its contribution to EUR 23,000, which represents 1.50% of the total. The UK Financial Reporting Council provided, as in 2014, EUR 40,000 which represents 2.60% of the total. The balance EUR 7,753 represents interest income.

The IFAC contribution of 60.67% of the total PIOB funding in 2015 is a little higher than in 2014 (58.19%). This is due, primarily, to the absence of contribution from the World Bank (EUR 35,832 in 2014) and to the decrease in the contribution from the Bank for International Settlements (EUR 23,000 instead of EUR 55,000 in 2014). This seems to reflect an ongoing trend all over the world for paucity of public funding due to enduring difficult economic conditions.

Article 9.5 of the Regulation stipulates that if funding by IFAC in a given year reaches more than two-thirds of the total annual PIOB funding, the Commission shall propose to limit its annual contribution for that year to a maximum of EUR 300,000. In year 2015, this has not been the case and therefore, as the critical threshold stipulated in the Regulation (66.66%) has not been reached by the IFAC funding, the Commission does not need to review its 2015 contribution to the PIOB.

## **5. CONCLUSIONS**

IFRS Foundation

The two major standards issued by the IASB in 2014, namely IFRS 9 *Financial Instruments* and IFRS15 *Revenue from Contracts with Customers*, are currently in the process of being endorsed in the EU following positive assessment of these standards by EFRAG. In 2015, the IASB finalised another major standard: IFRS 16 *Leases*, which was published in January 2016. In addition, the IASB continued to work on a number of other major projects, in particular Insurance Contracts, the Disclosure Initiative and the Conceptual Framework.

In respect of whether IFRS:

- take due account of different business models: IFRS 9 explicitly recognises the importance of business models in determining measurement of financial instruments and IFRS 15 is considered flexible enough to meet different business models. The Conceptual Framework gives business models more emphasis.
- reflect the actual consequences of economic transactions: IFRS 15 achieves this and IFRS 16 also seeks to better reflect the actual consequences of economic transactions and provide much-needed transparency about companies' lease assets and liabilities. IFRS 4 *Insurance Contracts*, currently finalised by the IASB, is also expected to provide a realistic depiction and better comparability of financial performance of the insurance industry across different constituencies. Furthermore, the Conceptual Framework will introduce the concept of substance over form, which is important for portraying economic transactions appropriately.
- are not overly complex: IFRS 9 is a complex standard however it has introduced simplifications in the accounting for financial instruments. In EFRAG's view, presented in the endorsement advice, IFRS 9 does not contain any complexity that may impair understandability. IFRS 15 is more complex than the standard it replaces but this is justifiable as the previous standard was no longer appropriate to reflect the complexity of modern day business transactions.
- avoid artificial short-term and volatility biases: IFRS 15 is effective in avoiding such volatility as it contains specific provisions that apply where there is uncertainty in recognising future revenue. As regards IFRS 4 *Insurance Contracts*, EFRAG will look at this aspect during the endorsement process following the publication of the standard by the IASB.

As far as the Conceptual Framework is concerned, the Commission reiterates its support to the re-introduction of the concept of prudence and will closely follow the development the Revised Conceptual Framework by the IASB following the comments period.

Finally, the Commission welcomes the comprehensive effects analysis, which accompanied the new standard IFRS 16 standard and invites the IASB to continue to develop their analysis of impact of new or amended standards.

### EFRAG

Following the implementation of its governance reform in 2014, EFRAG has been well equipped to strengthen the legitimacy of its positions and significantly contribute to the objective of Europe speaking with one voice.

EFRAG continued to take account in its endorsement assessments of whether IFRS were meeting all technical criteria of the IAS Regulation and strengthened its scope of assessment of whether new or proposed financial reporting requirements are conducive to the public good. This was demonstrated in its endorsement advice on two major standards IFRS 9 *Financial Instruments* and IFRS15 *Revenue from Contracts with Customers*, which EFRAG submitted to the Commission in 2015.

The Commission welcomes EFRAG's efforts to further develop its capacities with respect to the analysis of the effects of standards including macro-economic effects such as effects on financial stability or economic development in the EU. In 2016, the Commission will continue to monitor the development of impact assessment capacities of EFRAG.

Thanks to its extensive due process, EFRAG was in a position to provide adequate assessment of whether draft, new or amended international accounting standards responded to the Union's needs while taking into account the diversity of accounting and economic models and views in the EU.

#### PIOB

Regarding the PIOB, the diversification of funding sources has continued as the year before with the exception of the World Bank. The total portion of revenue sources provided by IFAC in 2015, as shown in page 1 of its financial statements, is 60,67% what is a little higher than in 2014 but still below the two-thirds threshold stipulated in the Regulation. This reflects the scarcity of public funding all over the world due to the prevailing public sector financial constraints. For the coming years, the Commission will continue monitoring the funding developments and will cooperate with other interested stakeholders, in particular with other Monitoring Group members, to ensure that the PIOB benefits from a clear, stable, diversified and adequate funding system so that it can accomplish its public interest mission in an independent and efficient manner.