THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: 07-352
Date: November 2007

CESR's review of the implementation and enforcement of IFRS in the EU

November 2007

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EXECUTIVE SUMMARY

1. The results of CESR's survey suggest that 20 out of 27 Member States had introduced an enforcement mechanism by 2006 that met, at least in part, the requirements laid down by CESR standards on enforcement. Also by 2006, 11 EU member states had introduced an enforcement mechanism that fully met the requirements laid down by CESR's Standards on Enforcement. It is worth noting that these 11 countries represent around 60% of all issuers using IFRS admitted to trading in Europe at the time. In an additional 9 member states, most of the CESR standards on enforcement were in place.

2. At the date this report is being produced a Competent Authority has been designated pursuant to article 24.1[1] of the Transparency Directive in 24 out of 27 Member States. Where it has been so designated, the Competent Authority is the CESR member in all but the case of 6 Member States (Czech Republic, Denmark, Ireland, Germany, Iceland and UK) where accounting enforcement is carried out in cooperation with other authorities designated under local legislation.

3. The number of issuers where a review of the 2005 financial statements was carried out varied from one country to another. On average, reviews were planned in 2006 of around 23% of all issuers admitted to trading in the EU who were users of IFRS and over 85% of those reviews planned were in fact completed. Those reviews planned but not completed were replaced by unplanned reviews of financial statements as part of the prospectus vetting procedures in the countries concerned.

4. On the whole, EU Enforcers agree that the implementation of IFRS in the consolidated accounts of over 7,000 EU issuers has presented a very significant challenge to preparers, auditors and regulators and one which through tremendous hard work from all participants has been achieved without major disruption to the markets or the reporting cycle. There has consequently been no evidence of a loss of market confidence during the transition period.

5. In general, EU Enforcers also believe that the move to IFRS has improved the quality of financial reporting in their jurisdiction, mainly due to increased transparency of disclosures and greater comparability between issuers.

6. Nevertheless, those EU enforcers that responded to the questionnaires did identify a number of areas in the 2005 financial statements where the level of compliance could be improved for example by requiring more extensive disclosure or by reducing the number of accounting options available (see section IV).

7. EU enforcers were also asked to report their experiences with the European Enforcement Coordination Sessions ("EECS"). These experiences were generally positive and suggested enforcers found the meetings a useful environment for discussing both the decisions they were making and issues that were emerging in their markets.

8. Cases discussed by the EECS are first entered onto a confidential CESR database which can be accessed by all European enforcers. As of August 2007, a total of 85 decisions have been entered onto the EECS database by 13 jurisdictions.

9. In April 2007, CESR published extracts from its database of enforcement decisions taken by European enforcers participating in EECS meetings with the intention that publishing such decisions together with the rationale behind them would help towards achieving consistent application of IFRS in the EU. CESR plans to publish further extracts from the database on a regular basis in the future.

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[1] Article 24.1 of the Transparency Directive: *"Each Member State shall designate the central authority referred to in Article 21 of Directive 2003/71/EC as central competent administrative authority responsible for carrying out the obligations provided in this Directive and for ensuring that the provisions adopted pursuant to this Directive are applied. Member States shall inform the Commission accordingly. However, for the purpose of paragraph 4(a) Member States may designate a competent authority other than the central competent authority referred to in this first paragraph."*

10. This report also provides an update on CESR's programme of cooperation with the SEC. Generally it is felt that progress is being made towards a useful mutual understanding of trigger points between CESR members and the SEC which should contribute to more targeted and useful exchanges of information taking place in the future.

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I. INTRODUCTION: OBJECTIVES AND METHODOLOGY

The aim of this report is to provide a review of the activities of CESR-Fin, its members and other related regulators ("European" or "EU enforcers"), acting through the Enforcement Coordination Sessions, in their capacities as enforcers of IFRS in the consolidated accounts of issuers admitted to trading in the EU for accounting periods ending on or after 31 December 2005. The report has not been produced in response to a formal request by the European Commission for advice, but is an initiative on CESR's own behalf to review and provide a record of European enforcers' experience with the enforcement of IFRS standards during the first year of their compulsory use in the consolidated accounts of EU listed issuers. The report also aims to record 'EU enforcers' compliance at the time with CESR's Standards on Enforcement.

While this report focuses on the application and enforcement of IFRS, readers should bear in mind that many EU jurisdictions were still in the process of implementing the necessary enforcement mechanisms during the period the report covers and that consequently the report merely provides a "snap shot" of what is in reality an on-going, continuous activity. The report has therefore been cautious about drawing any specific conclusions about IFRS implementation or enforcement because evidence of any particular trends may still be developing.

This report aims to:

- give an overview of the status of the implementation of enforcement activities in relation to 2005 IFRS financial statements within individual member states;
- present findings and some tentative conclusions coming out of these activities relating to IFRS and to the enforcement activities themselves; and
- provide some more general observations about the implementation of IFRS and its impact on EU markets.

Pursuant to article 10 of Regulation No 1606/2002 on the application of international accounting standards, the Commission is obliged to review the operation of Regulation 1606/2002 and to report its findings to the European Parliament and to the Council by 1 July 2007 at the latest. CESR understands the Commission has requested the production of an independent report to satisfy its obligations under article 10. CESR also understands that the report the Commission has requested will have a slightly different scope to the one CESR is presenting here, as that report will aim to provide the Commission with an assessment of:

- The first year of application of IFRS in accordance with the IAS Regulation;
- The application of fair value accounting in accordance with the amended Fourth Company Law Directive; and
- The cost to issuers of implementing the IAS Regulation.

Although potentially different in scope, there will inevitably be areas of crossover between the two reports, and consequently CESR thinks that the two reports will prove to be complementary.

The information upon which CESR's report is principally based derives from two questionnaires distributed to European enforcers in September 2006 and April 2007, in which they were asked to provide the following information in respect of their jurisdiction:

- A description of the enforcement process.
- The population of IFRS adopters under their supervision and the selection method they used for monitoring and review purposes.
- Their findings in respect of their review of 2005 IFRS financial statements.
- Their views on the work and role of EECS.
- Details of any reports published by them on their enforcement activities[2].

All but one of the enforcers written to responded to the questionnaire, although some respondents reported little experience in actively monitoring accounts during the period under review because their resources were employed in establishing the enforcement mechanism required under CESR Standard No 1.

[2] Links to these reports will be made available on CESR's website.

This report also contains a final section dealing with the programme of cooperation between CESR and the SEC. The content of this section of the report is largely derived from the minutes of meetings held between CESR members and the SEC, oral reports by members about the progress they have made in signing individual protocols of cooperation with the SEC and the CESR-SEC work plan which is included as Appendix 2 to this report.

II. DESCRIPTION OF THE ENFORCEMENT PROCESS IN THE MEMBER STATES

1. Enforcement activity in the Member States

The following table indicates the status of enforcement processes within the European Union in 2006:

Member States with full[3] enforcement activity in 2006 on 2005 Financial Statements	Member States with partial[4] enforcement activity in 2006 on 2005 Financial Statements	Member States with no enforcement activity in 2006
Belgium Cyprus Denmark Finland France Greece Italy Norway Portugal Spain UK	Bulgaria[5] Czech Republic Estonia Iceland Latvia Poland The Netherlands[6] Slovenia Malta Germany[7]	Austria Hungary Lithuania Luxembourg Romania[8] Sweden Slovakia Ireland

For those member states with no enforcement activity in 2006, the following progress on establishing an appropriate process has been reported:

Member States where enforcement activity will start **in 2007** on the **2007 Financial Statements (i.e. on interim accounts)**	Member States where enforcement activity will start **in 2008** on the **2007 Financial Statements**	Member States that are in the process of implementing their enforcement system
Sweden Ireland Luxembourg	Romania Lithuania Hungary	Slovakia Austria

[3] "Full enforcement activity" means full application of CESR Standard No1 (Ref: CESR/03-073) according to the responses submitted by members to the two questionnaires that were distributed for the preparation of this report and taking into account the conclusions of the report published by CESR's Review Panel in August 2006 (Ref: CESR/06-181).

[4] "Partial enforcement activity" means a jurisdiction has not implemented all of the requirements of CESR Standard No1 according to the responses submitted by members to the two questionnaires that were distributed for the preparation of this report and taking into account the conclusions of the report published by CESR's Review Panel in August 2006 (Ref: CESR/06-181).

[5] Bulgaria and Romania only joined the EU in 2007 and consequently were not EU members at the date this report is covering. However both countries responded to CESR's questionnaires and have been included in these tables for completeness.

[6] In 2006, accounting enforcement in the Netherlands was performed on a basis where cooperation with the enforcer was purely voluntary for companies. Full enforcement activity (i.e. enforcement activity backed up by powers that require cooperation from companies) commenced in 2007 in relation to financial statements produced for 2006 year ends.

[7] In the final report of the Panel that reviewed the implementation of CESR's Standard No1 on Financial Information (ref CESR/06-181), Germany was classified as "partially implemented" primarily because they were assessed as not having adequately implemented principles 17 and 18 of Standard No1. Germany however, pointed out that it interprets principles 16 to 18 differently to the Review Panel and does not believe that principles 16 to 18 of Standard No1 necessarily require an enforcer to compel disclosure of corrected information to the market when an infringement is discovered.

[8] Please refer to footnote 5 above.

2. Population under supervision

a. Scope

Number of 2005 IFRS adopters in the EU

Approximately **7.250** issuers with securities admitted to trading on a regulated market in the European Union have been identified as preparing consolidated accounts for their 2005 year ends using IFRS. Nearly **75% (5.460[9])** of those companies were equity issuers (for most of whom IFRS standards became mandatory with effect from 1 January 2005); the other entities concerned were bond or derivative issuers. Detailed figures on how these issuers divide up by country are given in appendix 1.

Approximately **5.400 or 75%** of these 7.250 companies were incorporated in member states which in 2006 had enforcement systems that were fully or in the main compliant with CESR's standard n°1 on enforcement of financial information in Europe (CESR/03-073).

Number of IFRS adopters sampled for review in 2006

At the outset of 2006, European Enforcers planned to review the 2005 IFRS financial statements of around **1.650** of the 7.250 issuers indicated above. This sample represented almost **23%** of the total number of issuers with securities admitted to trading in the EU in 2005 and over 27% of the total number of issuers which were incorporated in countries with an enforcement system that was at the time either fully or partially compliant with CESR's standard n°1 on enforcement - an ambitious work program for European regulators.

As a generalisation across all European enforcers, the planned scope of their reviews was between 20% and 40% of the issuers on their markets (by market capitalisation).

For the avoidance of doubt "review" in this context means a formal monitoring review performed by the enforcer to fulfil his role as an enforcer i.e. monitoring the compliance of the financial information presented with the full applicable reporting framework with a view to undertaking appropriate enforcement measures in cases where infringements of IFRS are discovered in the course of the review[10]).

Some **1.410** of these planned reviews were actually performed, representing some 85% of the original work plan. The main reason why the number of actual reviews performed is lower than those originally planned is that 4 enforcers were required to devote more of their monitoring resource than they had planned initially to the review of financial statements included in prospectuses (e.g. relating to IPOs), and therefore were not able to complete their proposed work programs.

Market capitalisation of IFRS adopters sampled for review in 2006

The total market capitalisation of the equity issuers whose 2005 IFRS financial statements enforcers planned to review as discussed above amounted to some **3 900 billion euros.** In general the issuers chosen represented between **25% and 65%** of the total market capitalization of the markets in the countries concerned. The percentage of issuers covered by enforcers by market capitalisation can be stratified as follows:

- Countries planning to cover more than 60% of their local market by capitalisation (Bulgaria, Czech Republic, Finland, Iceland, Latvia, Portugal and Spain).
- Countries planning to cover between 40% and 60% of their local market by capitalisation (Belgium, France, Estonia, Poland and The Netherlands).
- Countries planning to cover less than 40% of their local market by capitalization (Cyprus, Denmark, Germany, Greece, Italy, Norway, and UK).

The various percentages result from a number of applicable factors including size of the markets, resources available to the enforcers, etc. The market capitalization of the equity issuers chosen whose accounts were actually reviewed represented around **3 500 billion euros.**

Number of IFRS adopters included in thematic reviews by enforcers

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[9] The figures provided may not be exact as it has not been possible in all cases to eliminate double counting of issuers who have securities admitted to trading in two or more markets within the EU.

[10] Please refer to principle No2 of CESR Standard No1.

For the purposes of this report, a "thematic review" is defined as a review which in contrast to the full review discussed above only covers an area of thematic interest, for instance disclosures under a single standard (e.g. business combinations, fair values of investments, pensions etc.). Such a review by definition does not involve the reviewer monitoring all areas of the financial statements for compliance with the full accounting framework. Such thematic reviews might be prompted by various considerations including areas of consistent difficulty for issuers in previous years, areas where the required IFRS treatment differs significantly from the previous local GAAP or areas where issuers are being required to apply a standard for the first time.

Enforcers in two thirds of European states with an enforcement activity (either full or partial as defined) in 2006 - or 14 in total - indicated they conducted such thematic reviews on the IFRS accounts of a further **920 issuers.** Such reviews were conducted in addition to those issuers whose accounts were subject to the full reviews discussed above. Those European enforcers who conducted thematic reviews indicated that these reviews mainly concentrated on issues surrounding the transition to IFRS, for instance on the income statements and related disclosure produced by issuers adopting IFRS for the first time.

CESR therefore believes it is justified in concluding that a significant proportion of the total number of IFRS adopters in the EU was subject to review in 2006. CESR concludes this on the basis that nearly **1.410 entities (19%)** were the subject of a full monitoring review and a further **920 entities (13%)** were the subject of a thematic review by a European enforcer. This high level of overall review is a tribute to the commitment and effort made during 2006 by European enforcers to the monitoring function.

b. Selection methods

Assessment of the impact of material misstatements on market confidence and investor protection

EU enforcers use a combination of different criteria to assess the potential impact of material misstatements on market confidence and investor protection.

Nearly all EU enforcers use the market capitalisation of an issuer as indicative of the potential impact a misstatement in its accounts might have on the market. Market capitalisation is by far the most common selection criterion used by enforcers when choosing which issuers they should review. Share trading activity, volatility in the share price, the size of the issuer's shareholder base, an issuer's level of free float and the inclusion of the issuer's shares in an index are also popular criteria used by between 4 and 8 countries respectively. Other common criteria used to assess market impact are:

- the public profile of the company;
- the existence of major M&A or other operational activities likely or actually leading to the production of a prospectus;
- first admissions to trading;
- high levels of retail investor participation in the company; or
- the unusual nature of the securities the issuer has admitted to trading.

Methods used by EU Enforcers to collect detailed information on risk factors specific to particular entities

By far the most common methods used by enforcers for collecting detailed issuer specific information on risk factors are materials supplied by third parties about those issuers and reviews of the financial information published by those entities for the previous period. In addition, some enforcers perform a quick scan of all financial statements as soon as they are published and some enforcers make use of automatic notification devices.

Some enforcers indicated that they also make use of external, mostly public sources of information to gather risk factor information such as newspapers, analyst reports, and information from press agencies and commercial databases concerning corporate governance, mergers and acquisitions, and corporate fundraising activity.

Several enforcers make use of information provided by auditors. Such information can take different forms depending on national requirements so for example information contained in the narrative reports accompanying statutory audit reports produced by auditors in some jurisdictions; actual

warnings or public statements made by or required of auditors in some jurisdictions or information obtained through participation in the national professional bodies overseeing auditors in some jurisdictions where issues such as weaknesses in internal controls within issuers and quality control weaknesses over audits might well be discussed.

Other methods for collecting intelligence on specific entities mentioned by some enforcers are complaints received weaknesses in a company's history of compliance with accounting or other applicable regulations, and monitoring of an issuer's share-performance.

Entity specific factors used by the National Enforcer

	Yes	No
Audit related issues	20	3
Third party signals, including complaints	21	2
History of poor compliance with accounting or other applicable regulations	19	4
Corporate governance issues/previous weaknesses in an issuer's internal control environment	17	6
Significant or frequent business combinations and disposals	18	5
Significant changes in financial position and liquidity	18	5
Known adverse court and regulatory actions	18	5
Industry specific issues	16	7
Complex financial structures and unusual business trends	17	6
IPOs	15	8
Significant or frequent related party transactions	15	8
Information obtained through pre-clearance procedures	8	15

Reviews of financial statements where the auditors have issued a modified (i.e. not unqualified) opinion
All European enforcers automatically look at financial statements with a modified audit opinion to the extent that they become aware of them. However, there is not a requirement in all European states to inform enforcers that such an opinion has been issued.

Most European enforcers communicate during the review process with the issuer's auditor, either through a right of direct resort or because of voluntary involvement of the auditor by the company, and all agree that, on the whole, an ability to question the issuer's auditor during the course of a review provides valuable input to the process.

The frequency of the selection process, adjusting the sampling models, early review in the light of significant new events and reviewing the effectiveness of the selection process
Most enforcers run their selection procedures at least once a year and adjust their selection model or accelerate their reviews of issuers' accounts in response to significant new events.

First application of the current selection methodology
CESR has established that most European enforcers started using their current selection methodology in 2005 when relevant enforcement standards became applicable.

III. CESR'S EUROPEAN ENFORCERS COORDINATION SESSIONS: EECS

The European Enforcers Coordination Sessions (EECS) are a forum organised by CESR in which CESR members and other EU enforcers who are not members of CESR exchange views and discuss experiences on the enforcement of financial information. EECS aims to promote a high level of consistency amongst enforcers in their enforcement decisions. To this end, the EECS meets regularly (approximately 8 meetings per year) to:

- Analyse and discuss decisions taken or about to be taken by European enforcers on the enforcement of financial information requirements;
- Identify areas which are not covered by financial reporting standards or which may be open to conflicting interpretations for referral to the EU Roundtable where a decision can be made on whether such matters should be referred to the IASB or IFRIC; and
- Share and compare practical experience on the monitoring of the financial information of companies with securities offered to the public or who are in the process of having securities admitted to trading on a regulated market.

Cases discussed by the EECS are first entered onto a confidential CESR database which can be accessed by all European enforcers. CESR has issued guidance for EECS members to help them select cases that are suitable for submission to the database and subsequent discussion at EECS meetings.

Criteria for entering a decision onto the database
European enforcers may take various types of enforcement decisions, not all of which will be appropriate for submission to the database. The criteria laid down by CESR for use by European enforcers selecting decisions to be entered onto the database (c.f. CESR/04-257b) require enforcers to consider whether:

- a material misstatement in the financial information presented has been detected as defined by principle 16 of CESR Standard No 1;
- a dual, multiple or cross border listing is involved;
- the decision being entered would contradict an existing decision on the database;
- the decision being entered has the potential to have either an impact on the consistency of financial reporting across Europe or a major impact on a particular financial market;
- the decision being entered will be of general interest to other EU National Enforcers (this judgement is likely to be informed by EECS discussions);
- the decision being entered acknowledges a risk of significantly diverse treatments between different companies and/or jurisdictions;
- the decision being entered is likely to affect other issuers in a significant fashion;
- the decision being entered has been taken on the basis of applying the principles contained in IAS 1 or IAS 8 (i.e. because the issue is not covered by a specific standard); and
- the decision being entered has been overruled or supported by an appeals committee or Court.

Discussing decisions with other enforcers outside of EECS meetings
European enforcers do not exchange information with each other exclusively through EECS meetings. In some cases, the urgency of the matter may prompt informal discussions amongst two or more enforcers before the issue can be scheduled for formal discussion at EECS. There are also cases that warrant more extensive discussion between the enforcers affected, for example those concerning issuers who have securities admitted to trading in markets located in two different member states and where the detail of the case concerned cannot be fully accommodated within the time constraints of the EECS meetings.

Entries on the EECS database
As of the end of August 2007, a total of 85 decisions have been entered onto the EECS database by 13 jurisdictions. The majority of the decisions currently entered onto the database come from a limited number of enforcers. This situation arises for basically three reasons:

- when the database was created EECS members needed a certain period of time to become familiar with what sort of cases warranted entering onto it;

- the fact that the current EU enforcement process has only been in existence since the end of 2005 in some countries meant that a period of time needed to elapse for cases to reach a stage of completion such that they warranted reporting through to EECS; and
- only some enforcers actually give pre clearance[11] decisions, which given their shorter timescales and less involved procedural complexity were a significant early source of cases for the database.

Consultation of the database
European enforcers reported that they have found the database useful and have consulted it regularly prior to making decisions of their own. However, there was also a general consensus that the database is still in its early stages and in some cases enforcers might not find decisions similar to the cases they happened to be assessing. Over time however, CESR expects the database to become ever more useful to enforcers in making decisions as more and more precedents are included.

No member of EECS has reported making decisions that were not in line with those already on the database and the cases discussed in EECS usually received general support. Such level of general consensus for decisions would imply that CESR's objectives in creating EECS are being met and also that the database includes relevant cases.

Discussions at the EECS meetings
Most enforcers who brought issues believed the main value in discussing decisions at EECS was that the process allowed them to:
- refine the rationale for making the decision (even in cases where the decision had already been made by the local enforcer); and
- justify the decision more easily to their own issuers on the basis of support from other European enforcers.

Enforcers also indicated that they found EECS a valuable forum for discussing emerging issues and for taking advantage of other enforcers' particular knowledge of industrial sectors or technical areas of IFRS, both of which ultimately assisted them in making decisions.

Publication of enforcement decisions
In April 2007, CESR took the decision to publish extracts from its database of enforcement decisions taken by European enforcers participating in EECS meetings in line with its committment to do so in response to public comment on Standard No2 on Financial Information, 'Co-Ordination of Enforcement Activities'. CESR felt that publication of the decisions might provide assistance to issuers and users of financial statements and also contribute to the promotion of market confidence and supervisory convergence in the EU.

CESR intended that publishing enforcement decisions would give market participants an insight into how European enforcers analysed whether accounting treatments dealt with in specific cases were within the acceptable range of those permitted by the standards or by IFRIC interpretations. CESR was of the view that publishing such decisions together with the rationale behind them would also help towards achieving consistent application of IFRS in the EU.

Decisions dealing with straightforward accounting errors or where issuers had simply overlooked some of the detailed requirements of a particular standard, were not published, even where such decisions had been considered material breaches by the enforcer concerned and had led to sanctions being taken. The decisions published generally include a description of the accounting treatment or disclosure concerned and a summary of the decision taken by the enforcer including his or her underlying rationale.

[11] Some European Enforcers are prepared to provide an opinion on a particular accounting issue before an issuer's financial statements have been finalized and published. These decisions are made on the basis of information and assumptions supplied by the issuer which provide the context in which the issue is being raised. The information and assumptions supplied by the issuer are not on the whole challenged by the Enforcer. These decisions are identified as pre-clearance decisions.

In order to address concerns about confidentiality and privacy laws which vary between EU jurisdictions, the extracts published do not include the name of the issuer or the enforcer involved in the decision nor any other details that would enable the issuer or its jurisdiction to be identified.

CESR plans to publish further extracts from the database on a regular basis in the future.

IV. FINDINGS IN RESPECT OF THE IMPLEMENTATION OF IFRS BY EU ISSUERS

On the whole, European enforcers agree that the implementation of IFRS in the consolidated accounts of over 7,000 EU issuers has presented a very significant challenge to preparers, auditors and regulators and one which through tremendous hard work from all participants has been achieved without major disruption to the markets or the reporting cycle. There has consequently been no evidence of a loss of market confidence during the transition period.

In general, European enforcers also believe that the move to IFRS has improved the quality of financial reporting in their jurisdiction, mainly due to increased transparency of disclosures and greater comparability between issuers.

1. Recurring issues identified by CESR members

Notwithstanding the above statements, the survey undertaken by CESR of European enforcers and their Coordination Sessions identified a number of areas in listed issuers' 2005 financial statements where the level of compliance or disclosure could have been improved or where it was felt issuers had experienced difficulties in identifying acceptable applications under the standards concerned. The following examples are not intended to represent all the issues discussed at EECS nor all areas of inadequate disclosure identified by national enforcers; they are merely illustrative of some of the more significant difficulties encountered.

European enforcers have naturally made records of all of the issues relating to inadequate disclosures identified in their respective jurisdictions even where such issues have not resulted in a formal decision being entered onto the CESR database. In a number of jurisdictions local enforcers have issued reports giving details of the areas where they have most commonly identified problems. These reports have been shared amongst and discussed by EECS members and consequently the most significant issues detailed in those reports have been included in the following paragraphs:

- **IFRS 3 (Business combinations)**
  - Identification of an acquirer: IFRS 3 requires an "acquirer", defined as *the entity that obtains control of the other combining entities or businesses,* to be identified for all business combinations. IFRS 3 further states that in order to identify which entity is the acquirer, all facts and circumstances should be considered to determine which of the combining entities has the power to govern the financial and operation policies of the other(s).

    IFRS 3 also recognises the situation of a "reverse acquisition" where, in a combination effected through an exchange of equity interests, the proposed acquirer is in fact the entity whose equity interests have been acquired and where the issuing entity is technically the acquiree.

    ⇨ EU enforcers found that in some cases issuers had difficulties in identifying such situations correctly.

  - Insufficient information on factors affecting the recognition of goodwill: In some cases enforcers found that the notes required by IFRS 3 were insufficient particularly regarding the disclosure of information on factors affecting recognition of goodwill. This information is of value to users of the financial statements in gaining a clearer understanding of the nature and financial effect of business combinations and why a premium was paid on acquisition.

- Allocation of acquisition costs: enforcers found in some cases that issuers did not appropriately recognise identifiable and measurable intangible assets separately from goodwill in accordance with IAS 38. Enforcers also found that some issuers had recognised negative goodwill in situations where such recognition was not justified.

- **IAS 39 (Financial Instruments: Recognition and Measurement)**

IAS 39 deals with the accounting treatment of a wide range of financial instruments, which can be complex in nature, and consequently introduces a number of concepts that were not previously applied in a number of European jurisdictions prior to the adoption of IFRS. The sheer complexity of some of the transactions dealt with by this standard requires that, in some cases, very detailed treatments are necessary. The consequence of this is that the treatment of even some quite simple transactions might not be in compliance with the standard as a result of the use by issuers of approaches that are too simplistic. Common areas were such issues arose are:

- Identification of situations where an impairment loss on a financial asset should be recognised: enforcers found in some cases that issuers did not appropriately recognise situations where there was evidence that financial assets were impaired.

- Methods of calculating impairment on groups of financial assets: in several cases, enforcers found that methods used to estimate impairment losses on groups of financial assets did not take into account important requirements of the standard (e.g. the time effect on future cash flows, or using the best estimate of expected cash flows at the time of valuation, etc.).

- **IFRS 5 (Non-current assets held for sale and discontinued operations)**

EU enforcers found issuers had difficulties in application in the following areas:

- To what extent an investment has to be consolidated according to IAS 27 at the balance sheet date,
- To what extent non-current assets and related liabilities could be presented separately on the face of the balance sheet, in accordance with IFRS 5.38,
- Whether an issuer should disclose in the notes additional information on the operation, for instance when there is a residual interest.

- **IAS 1 (Presentation of Financial Statements)**

- Presentation of the Income Statement: IAS 1 does not specify a particular format for financial statements. The standard only lists the minimum number of headings to be disclosed in the balance sheet and the income statement. The standard allows additional lines or subtotals to be added if they assist users in understanding the accounts. Enforcers found that this had led to confusion for some issuers particularly where previous local GAAP had been very specific in this area.

- Use of performance indicators: many issuers included additional performance indicators (EBIT, EBITDA, etc.) in their financial statements. Given the lack of prescription in IAS 1, some issuers included performance indicators as intermediate balances on the face of the income statement, whereas other issuers included them only in the notes. Enforcers also found that such indicators were often not defined in the accounts and that the definition of the same indicator varied from one issuer to the next.

- The extent to which the general requirement to disclose the nature of estimates and assumptions applies to areas covered by other standards: Enforcers found issuers varied greatly in the extent to which they made disclosures in response to the requirements of IAS 1 paragraphs 113 and 116 (Management judgements and key sources of estimation uncertainty). Many companies did not appear to make any specific disclosures in accordance with IAS 1 although they did provide other specific disclosures on the same area required by other standards (e.g. by IAS 19 or IAS 37).

- Description of accounting policies: Enforcers have identified a tendency amongst some issuers to simply copy and paste extracts from the standards into the descriptions of their accounting policies. Some issuers included such "boiler plate" accounting policies on areas that do not apply to their financial statements. These practices do not help users identify relevant information. Enforcers agree therefore that an issuer's accounting policies should focus on the areas that are relevant to its business and should be adapted to its specific circumstances.

- **IAS 14 (Segment reporting)**: Enforcers found that many issuers maintained that both their operational and geographical activities consisted of only one segment even where this was clearly not the case. Some issuers offered up small size as the justification for reporting in this fashion although the standard does not provide an exemption from providing segmental disclosure based on the size of an issuer, because in some cases, previous local GAAP had offered such an exemption.

- **IAS 36 (Impairment)**: As goodwill is no longer amortised, IAS 36 requires it to be tested annually for impairment. Enforcers found compliance with the standard, for instance disclosure requirements regarding how impairment testing had been carried out or how any eventual impairment charge had been calculated, was insufficient in some cases.

- **IFRS 2 (Share-based payments)**: Enforcers found that several important disclosures required by IFRS 2 were often omitted by issuers (e.g. the assumptions used in the valuation model for stock option plans such as risk-free interest rates, expected dividend rates, expected rates of exercise of options etc.)

General trends and areas not covered by the Standards
European enforcers did not report any specific sectors where application difficulties were concentrated but most tended to the view that smaller companies were having the most problems in complying with the requirements of IFRS.

Most enforcers agreed that they had not identified any significant differences with regards to the quality of preparation between transitional, interim and year end accounts, although in some cases there seemed to be a general trend of improvement as issuers became more familiar with the requirements of IFRS and had the advantage of comparison with their peers.

Enforcers also identified some areas which they felt were not adequately covered by IFRS and which had led to some inconsistency in accounting treatments:

- **Business combinations under common control (IFRS 3 - Business Combinations)**: Business combinations involving entities or businesses under common control are explicitly excluded from the scope of IFRS 3 leading to varying treatments for such transactions in the accounts of issuers.

- **De facto control (IAS 27 - Consolidated and Separate Financial Statements)**: IAS 27 paragraph 13(c) states that "*Control* (of a subsidiary)…*exists when the parent owns half or less of the voting power of an entity (but) when there is power to appoint or remove the majority of the members of the Board of directors or equivalent governing body and control of the entity is by that board or body*".

  Preparers were faced with the question as to whether the "*power to appoint*" in paragraph 13(c) of IAS 27 required that an entity had the legal power to exercise more than half the votes available or whether the "*power to appoint*" was sufficient in itself i.e. is the fact that an issuer is able to dominate the voting because the remaining shares are held by parties who do not act in concert and are not organized such as they are likely to act in concert sufficient to constitute a power to appoint?

  Enforcers found that there was a divergence of practice in Europe as some preparers did not consider the position described above constituted a control relationship and hence did not consolidated entities falling into this category.

The matter was referred to IFRIC who decided not to take it forward. The IASB made a statement in its October 2005 Update on the application of IAS 27, referring to cases where an entity owns less than half of the voting rights in another entity. In this statement, the Board confirmed that "*an entity holding a minority interest can control another entity in the absence of any formal arrangements that would give it a majority of the voting rights*" i.e. in the IASB's opinion, the control concept in IAS 27 includes so-called *de facto* control, under the conditions set out in paragraphs 13 and seq. of IAS 27.

However, despite this statement, enforcers have still found divergent practices across Europe in these situations, largely because practices were not fully uniform in all EU jurisdictions before they adopted IFRS.

Inconsistency between standards
Finally, enforcers also identified areas of possible inconsistency between standards, parts of standards or between a standard and other regulation:

- **IAS 18 (Revenues) and IAS 37 (Provisions, Contingent Liabilities and Contingent Assets)**: Enforcers raised the issue with the IASB of whether or not a provision should be recognised on the sale of an extended warranty. The IASB has since recognised a potential inconsistency between IAS 18 and IAS 37 and decided to revise IAS 37 accordingly.

- **IAS 27 (Consolidated and Separate Financial Statements) and the 7th Directive** – Enforcers raised the issue of whether the "materiality" criterion of article 13.1[12] of the 7th Directive is relevant for deciding whether or not an issuer is required to prepare consolidated financial statements particularly in cases where an issuer only has subsidiaries which when taken together would not have a material impact on the accounts. The issue is still being discussed by the Commission and the Member States in the Accounting Regulatory Committee.

2. Overall assessment of the move by the EU to mandatory IFRS reporting in the consolidated accounts of issuers having securities admitted to trading on a regulated market

The questionnaire CESR circulated to European enforcers asked them to consider whether the implementation of mandatory IFRS reporting in the consolidated accounts of issuers with securities admitted to trading on an EU regulated market had had any discernible impact on the quality of financial reporting in their jurisdictions. Whilst some members inevitably replied that they thought it too early to assess the effects of the move to IFRS, the majority of respondents did express their preliminary opinions on the matter.

The majority of those who expressed a view indicated that in their opinion the move to IFRS had improved the quality of reporting in their Member State. However, a number of areas for possible improvement were mentioned by members, even by those who considered the effects of adopting IFRS had been largely positive. Those improvements identified would be to:

- Require more extensive and/or better quality disclosure in some areas (e.g. pensions or share-based payments);
- Remove or reduce the number of accounting options available in certain areas (e.g. options to use fair value or not) ;
- Provide suggested formats for the profit and loss account and balance sheet;
- Introduce more market realistic reporting on financial instruments (e.g. with regard to their valuation).

[12] Article 13.1 of the 7th Directive: "*An undertaking need not be included in consolidated accounts where it is not material for the purposes of article 16(3)".*

V. CESR'S COOPERATION WITH THIRD COUNTRY AUTHORITIES

1. Cooperation with the SEC

The objective of the CESR-SEC work plan[13] on the use of IFRS by internationally active issuers is to try to avoid a situation where decisions on IFRS treatments taken by the SEC and by a CESR member are inconsistent or contradictory. The work plan was published on CESR's website on 2 August 2006. Since that date, CESR and the SEC have been meeting regularly to discuss the implementation of the work plan.

Three meetings between CESR and the SEC have taken place so far mainly devoted to discussing how information could be exchanged between the SEC and individual CESR members on individual cases and between the SEC and CESR-Fin on broader accounting issues arising from enforcement and policy developments.

1) Exchange of information between the SEC and individual CESR members

Substantive issues discussed

The main areas of focus in relation to the exchange of information between the SEC and CESR have been:

- The comment letters the SEC has sent to EU issuers listed in the US;
- The timing of consultation with CESR members on matters arising out of the SEC's reviews of the financial statements of EU issuers listed in the US; and
- The interpretation of the work plan (e.g. triggers for mutual exchange of information).

On the first topic, it is worth explaining that the SEC sends comment letters to EU issuers listed in the US as a normal part of its review process. These comment letters ask the issuer concerned for further clarification or explanation of issues the SEC has found whilst reviewing its accounts. The SEC may be satisfied by the response it receives from the issuer and decide to close the review process or it may decide to carry on with the review possibly ending with the SEC asking the issuer to amend the existing filing or to alter the accounting treatment in its next filing.

CESR has conveyed the message to the SEC that, whilst respecting the requirements of the SEC's own operating procedures, CESR members would appreciate being informed as soon as possible when questions are being asked of EU issuers that might affect them as enforcers. Opening up an early dialogue in this fashion would help to avoid the possibility of conflicting regulatory decisions being taken later on in the process.

In addition to discussing this question of the timing of the consultation process between the SEC and individual CESR members, the SEC and CESR have also entered into a dialogue about how to identify matters which would trigger consultation between the SEC and a CESR member[14] in accordance with the work plan. In particular the discussions have concentrated on the first and third triggers (as defined in the Work Plan) and have led to the following proposals:

- In relation to the first trigger ("*the matter under IFRS is novel or unprecedented*" i.e. there is no IFRS guidance on the matter or such guidance is ambiguous), CESR has put forward the view that it is important that the SEC should consult the EU enforcer in the jurisdiction of the issuer concerned before reaching a final decision on whether an issue is novel or unprecedented.

[13] See Appendix 2

[14] According to section I.C.1 of the work plan the triggers are:

(i) it appears to the SEC staff or the CESR member that the matter under IFRS is novel or unprecedented;

(ii) the issuer informs SEC staff or the CESR member that the staff's view on the IFRS matter is in conflict with a position of the relevant CESR Member; or

(iii) it appears that the SEC staff or the CESR member view on the IFRS matter could result in a significant change to the financial statements.

- In relation to the third trigger (*it appears that the SEC staff view on the IFRS matter could result in a significant change to the financial statements*), the SEC and CESR have discussed whether or not the omission of disclosures clearly required by IFRS should be considered as one of the situations this trigger is designed to capture. CESR's position on this matter is that omitted disclosures may be extremely relevant to investors and therefore an exchange of information at the beginning of the enforcement process would seem appropriate.

Negotiation of the Protocol relating to exchanges of information
The SEC and CESR have agreed a standard protocol covering exchanges of confidential information on dual listed issuers. This protocol is to be executed between the SEC and each individual CESR member as soon as possible, in order to facilitate the implementation of the CESR - SEC Work Plan.

2) Exchange of information between the SEC and CESR-Fin

CESR-Fin has given the SEC details of the main areas of IFRS which in its opinion are causing issuers in the EU most difficulty in implementation.

The SEC has informed CESR that it has not completed enough of its IFRS enforcement process to identify recurring themes as yet given they are still waiting for issuers' responses to their comment letters in some cases. As far as those comment letters are concerned, the SEC has given CESR to believe that it can identify no overriding trends or dominant issues. The comments raised mostly relate to disclosures that appear to be missing, unclear or insufficient or to format and presentation (mainly in relation to the profit and loss account and the cash-flow statement) rather than to issues of measurement or disagreement with the actual accounting treatment.

2. Cooperation with other authorities

Given that ever more third countries are in the process of converging or adopting IFRS, CESR is analysing possible ways of strengthening its cooperation with the enforcers of such countries. In particular CESR is considering the possibility of inviting third country authorities to attend ad hoc meetings of EECS.

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APPENDICES

APPENDIX 1

Number of IFRS adopters listed on a regulated market in the EU by country (equity issuers and bond issuers)

CESR Members	Equity issuers[15]	Bond issuers[16]	Total
Austria	72	11	83
Belgium	144	2	146
Bulgaria	369	60	429
Cyprus	141	0	141
Czech Rep	66	24	90
Denmark	140	8	148
Estonia	16	6	22
Finland	135	15	150
France	680	200	880
Germany	768	172	940
Greece	356	0	356
Hungary	34	1	35
Iceland	23	8	31
Ireland	43	40	83
Italy	288	65	353
Latvia	13	4	17
Lithuania	43	4	47
Luxembourg	35	200	235
Malta	15	19	34
Norway	188	0	188
Poland	197	0	197
Portugal	50	28	78
Romania	N/C	N/C	N/C
Slovakia	N/C	N/C	N/C
Slovenia	60	6	66
Spain	190	120	310
Sweden	350	35	385
NL	165	25	190
UK	953	778	1731
TOTAL	**5 519**	**1 831**	**7 365**
NC: answer not provided			

[15] The number of equity issuers from Belgium, Cyprus, Denmark, Finland, France, Greece, Italy, Norway, Portugal, Spain and the UK represent around 60% of the total number of equity issuers in the EU.
[16] Some bond issuers may have decided to postpone the application of IFRS until 2007 according to article 9 of Regulation EC 1606/2002 of the European Parliament and of the Council.

APPENDIX 2

Extract from CESR/SEC work plan published in August 2006

"Use of IFRS and US GAAP by internationally active issuers.

A. GOAL: Through operational and supervisory cooperation between regulators charged with overseeing financial information disclosed by internationally active issuers:

- Promote the development of high quality accounting standards;
- Promote the high quality and consistent application of IFRS around the world, and as a result move toward achieving this milestone under the roadmap; and
- Recognising that IFRS are principles-based standards, give full consideration to international counterparts' positions regarding application and enforcement;
- Seriously endeavour to avoid conflicting regulatory decisions on the application of IFRS and US GAAP.

Working toward these goals should help create the conditions that eliminate the need for reconciliation of IFRS to US GAAP in the United States.

B. SEC STAFF / CESR-FIN NEXT STEPS: Establish confidential protocols for timely alert and exchange of information between the SEC staff and CESR-Fin, as follows:

1. The SEC staff and CESR-Fin will share views on the future development of IFRS and US GAAP including priorities, timetables and developments related to convergence. Further, they will discuss perspectives and efforts to facilitate consistent interpretation and application of IFRS across jurisdictions.
2. The SEC staff will apprise CESR-Fin of policy developments related to the elimination of the need for foreign private issuers filing in the United States to reconcile IFRS financial statements to US GAAP by 2009 at the latest.
3. CESR-Fin will apprise the SEC staff of policy developments related to the acceptance of US and the other national GAAPs in the European capital markets under the EU Transparency and Prospectus Directives.
4. The SEC staff and CESR-Fin (or its relevant member) will exchange information relating to the topical areas within IFRS and US GAAP that their experiences and issuer review work have shown to be the most troublesome in terms of high quality and consistent interpretation and application[17]. These matters may be candidates for referral items to IFRIC.
5. As needed, CESR-Fin may raise for discussion with the SEC staff issues arising in the US GAAP financial statements of non-US issuers whose securities are listed in the EU.

C. SEC / CESR MEMBER NEXT STEPS: Establish confidential protocols for timely alert and exchange of information between the SEC staff and individual CESR Members' staffs.

1. As part of its consideration of an EU-dually-listed/registered issuer's request to the SEC staff for a formal consultation on the application of IFRS to a matter affecting financial statements not yet filed with the SEC, the SEC staff will consult with the relevant CESR Member's staff on that matter. In addition, as part of its evaluation of an EU-dually-listed/registered issuer's application of IFRS to a matter affecting financial statements previously filed with the SEC and following consideration of the issuer's responses, the SEC staff will consult with the relevant CESR Member's staff on that matter if i) it appears to the SEC staff that the matter under IFRS is novel or unprecedented; ii) the issuer informs SEC staff that the staff's view on the IFRS matter is in conflict with a position of the relevant CESR Member; or iii) it appears that the SEC staff view on the IFRS matter could result in a significant change to the financial statements. These consultations will enable the SEC staff to understand and give full consideration to the relevant CESR Member staff's view on the application of IFRS to the

[17] Considering that in Europe, the review of financial statements is carried out by the respective Member State accounting enforcement authorities (EU National Enforcers), the contribution of CESR-Fin to this part of the discussion will be based on the regular coordination meetings held by CESR-Fin among EU National Enforcers (i.e., the European Enforcers Coordination Sessions – EECS).

matter. These consultations will be undertaken for the purpose of facilitating a solution that contributes to consistent application of IFRS by issuers18.

2. 2. As part of its consideration of a US-dually-listed/registered issuer's request to a CESR Member for a formal consultation on the application of US GAAP to a matter affecting financial statements not yet filed with the CESR Member, the CESR Member's staff will consult with the SEC staff on that matter. In addition, as part of its evaluation of a US-dually-listed/registered issuer's application of US GAAP to a matter affecting financial statements previously filed with a CESR Member and following consideration of the issuer's responses, the CESR Member's staff will consult with the SEC staff on that matter if i) it appears to the CESR Member's staff that the matter under US GAAP is novel or unprecedented; ii) the issuer informs the CESR Member staff that the staff's view on the US GAAP matter is in conflict with a position of the SEC; or iii) it appears that the CESR Member staff view on the IFRS matter could result in a significant change to the financial statements. These consultations will enable the CESR Member's staff to understand and give full consideration to the SEC staff's view on the application of US GAAP to the matter. These consultations will be undertaken for the purpose of facilitating a solution that contributes to consistent application of US GAAP by issuers[19].

D. MEETING SCHEDULE: Beginning in the second quarter of 2006, the SEC staff and CESR-Fin will meet at least semi-annually as part of the regular SEC-CESR dialogue to discuss these matters, with additional meetings as needed and agreed to review developments and progress. In particular, ad hoc meetings, telephone calls and other communications will be arranged as necessary to discuss technical issues arising in the course of the SEC staff's and CESR's respective independent reviews of issuer IFRS and US GAAP financial statements."

[18] In the event that the SEC staff and relevant CESR Member's staff, after consultation, ultimately reach different views on the application of IFRS to a particular matter, the SEC staff and relevant CESR Member's staff will consult regarding any communications regarding the matter to be made to the relevant issuer or others, as appropriate.

[19] In the event that the CESR Member's staff and SEC staff, after consultation, ultimately reach different views on the application of US GAAP to a particular matter, the CESR Member's staff and SEC staff will consult regarding any communications regarding the matter to be made to the relevant issuer or others, as appropriate.