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

**on the progress achieved in the implementation of the reform of EFRAG following the
recommendation provided in the Maystadt report**

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1. PURPOSE AND SCOPE OF THE REPORT

The Regulation of the European Parliament and of the Council, which extends 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 2020¹, came into force on 9 April 2014 following its publication in the Official Journal².

The general objective of the Union programme is to improve the conditions for the effective functioning of the internal market by supporting the transparent and independent development of international financial reporting and auditing standards.

Article 3 of the Regulation stipulates that the beneficiaries of the programme in the field of financial reporting are:

- the European Financial Reporting Advisory Group (EFRAG),
- the International Accounting Standards Committee Foundation (IASCF) legally succeeded by the IFRS Foundation

In the field of auditing, the beneficiary is:

- the Public Interest Oversight Board (PIOB).

According to Article 9 (1) of the Regulation, by 31 March 2014, the Commission shall submit the first report to the European Parliament and to the Council on necessary governance reforms in the area of accounting and financial information in respect of EFRAG, taking into account, inter alia, the developments following the recommendations set out in the special advisor's report and on the steps that EFRAG has already taken to implement those reforms.

The scope of this report only covers the implementation of the reform of EFRAG following Philippe Maystadt's³ report, which set out recommendations for such reform and was discussed by the ECOFIN Council on 15 November 2013.

2. BACKGROUND INFORMATION

The main purpose of accounting is to assist stakeholders in making better business decisions by providing them with adequate financial information. The accurate and timely financial information is indispensable in making sound investment decisions and running business organisations, while it also allows business owners to measure the effectiveness of their operations.

As capital markets are global, harmonisation of financial reporting and audit standards 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

¹ In view of the pending reforms, the programme period with respect to EFRAG (European Financial Reporting Advisory Group) runs from 1 January 2014 to 31 December 2016.

² OJ L 105/1, 8.04.2014

³ Philippe Maystadt served in the Belgian government as Minister for Economic Affairs, Minister of Finance and Deputy Prime Minister. He was also President of the European Investment Bank from 2000 to 2011. In March 2013, Mr Maystadt was appointed as a special advisor to Commissioner Barnier in order to evaluate the current system of adoption of the IFRS in the EU with a view to enhancing the European contribution to the development of global, high quality accounting standards.

sufficiently high level of harmonisation in the financial reporting of listed companies in the EU. Consequently, instead of introducing its own set of regional financial reporting standards, the EU 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 on several occasions⁴. The Union showed leadership in the process in 2002 when it adopted international accounting standards (IFRS)⁵ issued by the International Accounting Standards Board to be used by companies listed in the EU when drawing up their consolidated financial statements. Pursuant to the IAS Regulation⁶, 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.

In a global economy, there is a need to converge standards between jurisdictions and develop international standards under a transparent and democratically accountable process. Given the importance of accounting standards for financial markets, the Union has a key role to play in the international standard-setting process. To ensure that the interests of the Union are respected and that global standards are of high quality and compatible with EU law, it is essential that the interests of the Union are adequately represented.

With a growing number of countries moving towards and adopting IFRS, Europe's relative weight in the international standard setting process is decreasing. EFRAG⁷ is a private body and the technical adviser to the European Commission in accounting matters. It has taken up the role of providing technical and credible input upstream in the IASB's standard setting process.

In March 2013, Commissioner Barnier appointed Philippe Maystadt as a special adviser with the mandate to examine ways of reinforcing the EU's contribution to the development of International Financial Reporting Standards (IFRS) and improving the governance of the European bodies involved in this process. Mr Maystadt held a series of interviews and consultations before drafting his final report. Three different options were identified in the report for strengthening the European Union's influence in international accounting standard-setting: transformation of EFRAG, transfer of responsibilities of EFRAG to ESMA or replacement of EFRAG by an EU Agency. Mr Maystadt's report recommended the restructuring EFRAG.

3. CONTEXT AND OVERVIEW OF REFORMS OF EFRAG

3.1 Current status of EFRAG

The European Financial Reporting Advisory Group (EFRAG), which was set up in 2001, is a non-profit international association ("IVZW/AISBL") established under Belgian law 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

⁴ Repeated calls since the 2009 London declaration; last time in Los Cabos, 2012

⁵ For the purposes of this paper, the term 'international accounting standards' refers to IAS, IFRS and IFRIC

⁶ 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

⁷ European Financial Reporting Advisory Group

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.

EFRAG currently operates through an independent Technical Expert Group (TEG), supported by a User Panel and various Working and Advisory Groups. The “early stage” proactive work is coordinated by the Planning and Resource Committee (PRC), at which the major European National Accounting Standard Setters (NSS) have a seat.

The work of EFRAG is overseen by an independent Supervisory Board. Its main duties include selecting the membership and overseeing the work of the Technical Expert Group and the Planning and Resource Committee; monitoring cooperation with National Standard Setters; and ensuring proper funding for EFRAG.

The existing EFRAG Supervisory Board consists of senior professionals and leaders with an interest in the global development of financial reporting who reflect an appropriate professional balance (including users, preparers and accountants) and geographical spread. The Supervisory Board also includes three public policy members; the European Commission and the European Securities and Markets Authority are observers at its meetings. The Supervisory Board is appointed by the EFRAG General Assembly.

3.2 Key considerations for EFRAG reform in line with the Maystadt recommendations

The recommended option of transforming EFRAG essentially involves the appointment of a high-level Board⁸, which would enhance the organisation so as to meet three identified objectives: to bring to EFRAG’s positions an institutional legitimacy in addition to the legitimacy that its due process provides; to have a different and supplementary set of skills to develop its positions and to involve National Standard Setters more fully in the organisation and to allow for their participation in all stages of the decision-making process.

The key elements of the Maystadt report’s recommendations for EFRAG reform are the following:

Clarify the remit of EFRAG

According to the Maystadt report, the remit of EFRAG should be focused on the application of IFRS and should not cover non-listed companies, in particular SMEs, which do not apply IFRS.

Funding of EFRAG

As far as the funding of EFRAG is concerned, the Maystadt report mainly suggests assessing the legal possibility of establishing a system of compulsory contributions/levies paid by listed companies that use and benefit from IFRS. Pending the legislation of such a levy system, the report recommends that Member States organise a national funding mechanism (if they have not already done so).

⁸ The new Board would effectively replace the current Supervisory Board of EFRAG

Structure of EFRAG

General Assembly

The report recommends extending the General Assembly within EFRAG's current legal form (international non-profit association - AISBL), to include National Funding Mechanisms and other private and/or public organisations that contribute financially or in kind. The General Assembly will exercise oversight over the decision-making Board, including the nomination of the Board members.

Supervisory Board

According to the Maystadt report the current Supervisory Board should be replaced with a high-level Board, which would approve the comment letters addressed to the IASB and the endorsement advice letters to the Commission, relying on the work of a technical group. The new Board would be composed of members belonging to three pillars and would be appointed by the General Assembly:

- European public institutions (4 members proposed by ESMA, EBA, EIOPA and the ECB, respectively);
- Stakeholders (5 members: industrial and trading companies; financial institutions; accounting professionals; users);
- National Standards Setters (NSS) (7 members, with the implicit agreement that the NSS of the four largest Member States will always be represented).

The Maystadt report recommends that the Board would also include a President who would be proposed by the Commission with the approval of the Council and of the Parliament. Furthermore, the Commission would nominate one observer with speaking rights to the Board. The Board would make consensus-based decisions.

In line with the Maystadt report, prospective Members of the Board should have a good understanding of financial reporting and its implications, in particular, on economic growth and financial stability. To this end, the report recommends developing ex-ante criteria to provide a benchmark for institutions, organisations and national standard setters proposing candidates.

Finally, the report recommends separating the role of the President of the Board, who would be the public spokesperson of EFRAG, from the role of Chief Executive Officer responsible for the daily management of the organisation including the chairmanship of the TEG.

Technical Expert Group (TEG)

It was recommended that the future TEG becomes an advisor to the Board instead of having full authority to determine the positions of EFRAG. The modified TEG would prepare the projects submitted for the approval of the Board. The Board would provide the TEG with guidance and feedback. The TEG would continue to be composed of experts who should be active practitioners with diverse professional experience and geographical origins. The members of the TEG would be appointed in a transparent manner by the Board. The TEG would continue to be supported by the existing EFRAG staff.

Impact assessments

In line with the Maystadt report, EFRAG is encouraged to pursue its efforts in order to produce impact assessments corresponding to the needs of users and of the European

legislators, in cooperation with the national standards setters. These impact assessments analyse the effects of the standard, check whether the standard improves the quality of financial information and explore alternative options in comparison with the ones considered by the IASB. Furthermore, EFRAG and the other European bodies concerned are also encouraged to work in a more coordinated manner when performing “*field tests*”.

Consultative Forum of Standard Setters (CFSS)

The report recommends maintaining the quarterly meetings between EFRAG and representatives of all national standard setters (including Norway and Switzerland). They are important for the cooperation of the European national standard setters, particularly for smaller Member States. In addition they serve today as preparatory meetings for European participants in the IASB Accounting Standards Advisory Forum.

The recommendations in the Maystadt report gained a broad support at the ECOFIN Council meeting on 15 November 2013. The Commission considers these as a benchmark in the implementation of EFRAG reforms.

3.3 Position taken by the European Central Bank and European Supervisory Authorities towards the new structure of EFRAG

In a joint letter to the Commission of 20 January 2014, x the three European Supervisory Agencies (ESAs), namely the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) expressed concerns with respect to the planned reform of EFRAG. The ESAs stressed the importance of their involvement in the endorsement process but pointed out that the body to be entrusted with such responsibilities should serve the public interest and, thus, its decision-making processes should be centred around public authorities.

The ESAs informed the Commission that in the absence of changes to the mixed governance structure and to the proposed voting model, they would ask for observer status rather than full participation in the new EFRAG Supervisory Board. In a letter of 24 January 2014, the European Central Bank took a similar view.

The Commission noted the concerns expressed by the three ESAs and the European Central Bank and considered that these organisations should play an important role in EFRAG by participating at least as observers to the Board.

3.4 Mr Maystadt’s special mandate for to follow-up the implementation process

On 4 February 2014, Commissioner Barnier agreed with Philippe Maystadt that his mandate as Special Adviser should be continued in order to supervise the implementation of the reform of EFRAG.

It has been recognized that the detailed and timely implementation of these reforms requires significant co-ordinated efforts from the public and private organisations involved in the process.

As Mr Maystadt has been supervising and facilitating the overall process by attending key meetings with stakeholders and providing strategic advice on core issues, he is well placed to ensure the implementation of EFRAG reforms.

4 PROGRESS IN IMPLEMENTING THE REFORMS

4.1 *Progress achieved to date*

As regards clarifying the remit and the related focus of EFRAG to IFRS, the Commission notes that this has been already reflected in the draft annual programme of activities of EFRAG for 2014. The Commission will reflect this in the prospective grant agreement with EFRAG for 2014 and the following years and ensure that the actual scope of the activities of EFRAG is in line with that remit.

As far as the funding of EFRAG is concerned and, in particular, the possibility of establishing a system of compulsory levies paid by listed companies, the Commission has focused its efforts on implementing parts of the reform that are achievable in the short term. Similarly, no formal steps have yet been taken to encourage the Member States that do not already have a National Funding Mechanism⁹ to establish one.

In line with the report, the implementation of recommendations related to the structure of EFRAG, carrying out impact assessments and organising CFSS meetings falls under the responsibility of EFRAG. EFRAG's General Assembly (comprising the seven EFRAG Member Organisations) had to approve amendments to the EFRAG statutes and the EFRAG internal rules that reflect these recommendations. It also needed to approve the extension of the membership of EFRAG to National Funding Mechanisms and to European organisations that are not currently members of EFRAG.

The EFRAG Supervisory Board has taken the necessary steps, beginning with a meeting on 20 November 2013, to prepare the amendments to EFRAG by-laws for consideration and approval by the General Assembly. The EFRAG Member Organisations have expressed their support for the reform of EFRAG, on the basis of the recommendations in Mr Maystadt's final report of November 2013.

Following the establishment of the task force responsible for the implementation of reform within the Supervisory Board of EFRAG in January 2014, significant progress has been made, with interactions in meetings with existing Member Organisations, potential new members, and National Standard Setters (and/or National Funding Mechanisms). As a result, on 24 March 2014, the Supervisory Board approved a full set of amended statutes and internal rules to be proposed to the General Assembly in its current composition subject to comments of EFRAG Member Organisations and the National Standard Setters (and/or National Funding Mechanisms).

The amended statutes and internal rules were finally approved by the General Assembly of EFRAG on 16 June 2014.

Based on Mr Maystadt's recommendations the main amendments to EFRAG's statutes and internal rules relate to the following issues:

- Extension of membership of the General Assembly to include National Funding Mechanisms and other private or public organisations.
- Criteria, commitments and rights for membership of the General Assembly.
- A minimum of two year financial commitment for members of the General Assembly.

⁹ However, the Commission raised the possibility of setting up such funding mechanisms with the Member States at the Accounting Regulatory Committee Meeting held in Brussels on 8 April 2014.

- Voting rights in the General Assembly, inspired by the notion that no single organisation should be able to block the operations of EFRAG.
- Tasks of the General Assembly.
- Nominating Committee with an advisory role on certain aspects of the nomination and selection process.
- Profile and criteria of the Board.
- Role of the President of the Board.
- Responsibilities of the Board.
- Fallback procedures for the Board for cases where no consensus can be reached.
- Responsibilities of EFRAG TEG.
- Profile and criteria for the membership of EFRAG TEG.

4.2 Departures from Mr Maystadt's recommendations

Although the core ideas behind the recommendations for the EFRAG reforms have been respected, it is important to highlight some departures from the recommendations of the Maystadt report. These concern the following issues:

Composition of the new Board

Contrary to Mr Maystadt's recommendation, taking into account the views expressed by some Member States notably during the ECOFIN Council in November 2013, the balance between National Standard Setters in the Board has been addressed by granting an additional seat to the 'smaller'¹⁰ Member States. Furthermore, following the decision of the European Supervisory Authorities and the European Central Bank not to accept full membership of the Board, these organisations will be granted the status of observers to the Board. As a result, it was recognized that certain modifications to the composition of the Board would be needed to achieve a balance between the National Standard Setters and private stakeholders. Consequently, three additional seats would be allocated to private stakeholders.

Decision-making in the Board

Considering the views expressed by the majority of stakeholders, and in accordance with the Maystadt report whereby the new Board would strive for consensus-based decisions, a fall-back mechanism would be put in place for cases where no consensus could be reached. This would take the form of a vote where a qualified majority of two thirds of Members would be needed to make a decision¹¹.

Combining the functions of CEO of EFRAG and Chairman of EFRAG TEG

Currently the CEO of EFRAG is also the Chairman of the TEG. The Maystadt report suggests that this arrangement continues also in the future. However, during the discussions on the reform, several Members of the current Supervisory Board were of the opinion that these two functions should be separated. Consequently, the statutes only envisage a possibility (but not a requirement) of combining the two functions.

¹⁰ As mentioned, the National Standard Setters from four largest Member States will always be represented.

¹¹ If, in exceptional cases, a qualified majority could not be found, the President of the Board could present his conclusions based on an indicative vote whereby the majority view would be presented as the position.

4.3 *Prospective timetable*

As mentioned above, the amended statutes and internal rules of EFRAG were approved by the General Assembly of EFRAG on 16 June 2014. However, in order to ensure a smooth transition process, these amended statutes and internal rules will come into force on 31 October when the new General Assembly will be in a position to meet and appoint the new Board of EFRAG. Also further new members of EFRAG could be admitted at this date.

5 CONCLUSIONS

On the basis of the above, it can be concluded that overall EFRAG has made promising progress in implementing the reforms following the key recommendations of the Maystadt report. In order to carry out the key changes, the statutes and the internal rules of EFRAG have been modified to reflect the necessary amendments to its structure and operations.

In this respect, it should be recognized that the level of detail of these amendments goes beyond the recommendations provided in the Maystadt report (e.g. the methodology of allocation of voting rights in the General Assembly, the profile criteria for Board Members, the responsibilities of the Board and TEG). A collective effort has been made by different stakeholders participating in the process to find an agreement acceptable to all parties. To this end, the extension of Mr Maystadt's mandate has proved significant considering his expertise and involvement in the process.

As regards the expected departures from Mr Maystadt's original recommendations, the most substantial change results from the ECB and the three ESAs accepting only observer status rather than full Board membership. As this resulted in just two pillars of members of the Board, a new balance was found by granting an additional three seats to private stakeholders.

The Commission will continue to closely monitor the implementation of the reform of EFRAG and will duly report on that to the European Parliament and the Council. In line with the new Regulation establishing a Union programme to support specific activities in the field of financial reporting and auditing for the period of 2014-2020, from 2015 the Commission will prepare an annual report on the activity of EFRAG, which will cover its progress in the implementation of its governance reforms¹².

¹² According to the Regulation, the annual report should be submitted to the European Parliament and the Council no later than 30 June each year.