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DEPARTMENT OF ECONOMICS
"S. COGNETTI DE MARTIIS"
UNIVERSITY OF TURIN

Lungo Dora Siena, 100A - 10153 Torino (Italy)
Tel. (+39) 011 6704043 - Fax (+39) 011 6703895
URL: http//www.de.unito.it

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The Effect of the European Regulation 1606/2002 on Market Efficiency: Early Empirical Evidence and Some Suggestions for Future Research and Policy-Making Discussion

Vera Palea

Dipartimento di Economia "Cognetti de Martiis"

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THE EFFECT OF THE EUROPEAN REGULATION 1606/2002 ON MARKET EFFICIENCY: EARLY EMPIRICAL EVIDENCE AND SOME SUGGESTIONS FOR FUTURE RESEARCH AND POLICY-MAKING DISCUSSION

By Vera Palea*

University of Turin, Department of Economics Cognetti de Martiis

Abstract

The European Regulation 1606/2002 has required European firms listed on the European stock markets to prepare, starting from 2005, their consolidated financial statements according to the international accounting standards IAS/IFRS. The purpose of such a regulation is to ensure a high degree of transparency and comparability of financial statements and, hence, an efficient functioning of the European capital market.
This paper investigates whether such a purpose can be considered as reached by focusing on the firms' cost of capital. It shows that early evidence documents beneficial effects from the IAS/IFRS adoption, even though such effects vary due to differences still persisting in the European countries' institutional frameworks and firms' incentives. The paper also makes some suggestions for future research and policy-making discussion.

Keywords: European Regulation 1606/2002, Financial Reporting, IAS/IFRS, market efficiency, cost of capital.

JEL CLASSIFICATION: M41, G10

*Corresponding Author: Vera Palea, University of Turin, Italy, Department of Economics "Cognetti de Martiis", Campus Luigi Einaudi, Lungo Dora Siena 100. E-mail: vera.palea@unito.it

1. INTRODUCTION

One of the main concerns of Regulators is over the "fairness" of capital markets, which should avoid adversities and inequalities for investors stemming from informational deficiencies. From this perspective, financial reporting is expected by regulators to play a fundamental role in reducing information asymmetries.

Good financial reporting provides a favourable climate for capital markets because of its effect on the perceived fairness of such markets. Investors are more willing to invest funds in markets if there is greater disclosure and less risk of fraud or misrepresentation about the productive opportunities of the firm issuing securities. The subsequent marketability of securities is also a function of the perceived fairness of capital markets. A rich and comprehensive information system makes investors less concerned about information asymmetries at the time they buy and sell their securities and therefore more willing to invest. On the contrary, information asymmetries negatively affect capital markets with damages for economic growth, job creation and personal wealth.

Good financial reporting, in which markets have confidence, is a fundamental building block for successful capital markets. Good financial reporting rests on standards that are consistent, comprehensive and based on clear principles which enable financial reports to reflect the underlying economic reality.

One important step in the modernization process of the existing financial reporting model in Europe is represented by the European Parliament and Council Regulation No. 1606, 19 July 2002, which mandated the adoption of the international accounting standards IAS/IFRS in the European Union from 2005 onwards. Regulation 1606/2002 mandates IFRS for listed consolidated financial statements with a member State option to apply IFRS for the other reporting entities. Appendix 1 reports the state of the IAS/IFRS implementation by the European Union member states.

The ultimate goal of Regulation 1606/2002 is to "*ensure a high degree of transparency and comparability of financial statements and hence an efficient functioning of the (…) capital market*".

A higher degree of transparency in financial reporting is expected to lower the estimation risk premium which arises in case of information asymmetries and, therefore, to reduce the firm's cost of capital. As claimed by Neel Foster, former member of the Financial

Accounting Standards Board (FASB), "*more information always equates to less uncertainty. In the context of financial information, the end result is that better disclosure results in a lower cost of capital*" (Foster 2003).

Moreover, accounting standardization at the European level is expected to reduce possible errors in cross-country comparison of European companies due to different financial reporting systems. The adoption of the same financial reporting standards within the European Union should in fact improve comparability. This should eliminate accounting measurement errors in assessing firms' risk, thus reducing cross-country differences in the cost of capital. As stated by Regulation 1606/2002, the IAS/IFRS adoption in the European Union is therefore expected to *"enable Community companies to compete on an equal footing for financial resources available in the Community capital markets, as well as in world capital markets"*.

The IAS/IFRS adoption in the European Union is one of the most important events in the history of financial reporting and makes IAS/IFRS the most widely accepted accounting standards in the world. Therefore, there is a compelling need for policy makers and regulators to understand the implication of their adoption.

Appendix 2 reports the current use of IAS/IFRS in the countries of G20.

Academic research is a valuable resource for standard setting and policy-making purposes. It can help standard setters and policy makers structure their thinking about financial reporting issues and provide evidence that inform the debate on them.

Accordingly, the purpose of the paper is to identify, consider and evaluate existing research on the effects of the IAS/IFRS adoption on market efficiency. Its findings should serve to assess whether Regulation 1606/2002 has reached its objectives, to inform future policy making decisions and to identify some avenues for future research.

This paper tackles two main issues. Firstly, whether the mandatory adoption of IAS/IFRS has led to a higher degree of transparency in financial statements and therefore to a reduction in the cost of capital. Secondly, whether the IAS/IFRS adoption at the European level has actually increased cross-country comparability, thus enabling firms to compete on an equal footing for financial resources available in the capital markets.

By considering accounting literature published in leading accounting journals and selected working papers, this paper shows that empirical evidence suggests an overall

reduction in the cost of capital for firms switching to IAS/IFRS. Adopting IAS/IFRS generally increases market liquidity, decreases transaction costs for investors, lowers cost of capital, and facilitates international capital formation and flows.

However, beneficial effects vary according to the countries' institutional settings and firms' incentives. For instance, differences still persist among European countries in the level of protection of shareholders' rights, in strength of legal enforcement, in the degree of tax alignment and in the importance of the equity market, which all play a key role in shaping financial reporting quality.

The paper is organized as follows. Section 2 introduces the theoretical link between financial reporting and the firm's cost of capital. Section 3 reports evidence on the effects of the IAS/IFRS mandatory adoption in the European Union on the cost of capital, whereas Section 4 provides some evidence on the effects of the IAS/IFRS adoption on cross-country comparability. Section 5 concludes and makes some final remarks.

2. THE THEORETICAL LINK BETWEEN FINANCIAL REPORTING AND THE FIRM'S COST OF CAPITAL

As mentioned, the purpose of Regulation 1606/2002 is to provide investors with high quality information, improving capital market efficiency and lowering the cost of capital.

Market efficiency is a central feature of capital markets and deals with the relation between security prices and information. It deals with how capital markets process information in general, and financial reporting information specifically.

Securities markets are efficient if security prices "fully" reflect all the information available. Fama (1970) delineates three major forms of market efficiency: weak, semi-strong and strong. The market is efficient in the weak form if prices fully reflect information regarding the past sequence of prices. The market is efficient in the semi-strong form if prices fully reflect all publicly available information, including financial statement data. The market is efficient in the strong form if prices fully reflect all information, including inside information.

Market efficiency in the semi-strong form provides the best climate for mandating disclosure. In fact, motivation for requiring disclosure is essential to bring private information into public domain. Once data are placed in the public domain, semi-strong

form market efficiency provides the assurance that such data will be fully reflected in prices.

However, improved financial reporting also plays a key role in case of market inefficiencies. When share prices are mispriced relative to the prices they would have if markets were fully efficient, better reporting reduce the extent of investors' behavioural biases. Rational investors discover mispricing over time and take advantage of it, driving prices towards fundamental values. Financial reporting therefore reduces inefficiencies by making the mispricing area between inefficient market price of firms and efficient market price as small as possible (Lee 2001, Scott 2009).

While the claim that a higher degree of transparency in financial statements improves market efficiency and results in a lower cost of capital has intuitive appeal, there is little theoretical work on the mechanism through which improved financial reporting reduces the cost of capital.

In general, the economic theory underlying studies on the relationship between financial information and the cost of capital can be sketched as follows. Information asymmetries create costs by introducing adverse selection into transactions between buyers and sellers of firm shares. In real institutional settings, adverse selection typically manifests in reduced levels of liquidity for firm shares (Copeland and Galai 1983, Kyle 1985, Glosten and Milgrom 1985). To overcome the reluctance of potential investors to hold firm shares in illiquid markets, firms must issue capital at a discount. Discounting results in fewer proceeds to the firm and, hence, in a higher cost of capital. A commitment to an increased level of disclosure reduces the possibility of information asymmetries arising either between the firm and its shareholders or among potential buyers and sellers of firm shares. This, in turn, reduces the specific component of the cost of equity related to information asymmetries – the so called estimation risk premium – and thereby the discount at which firm shares are sold (Diamond and Verrecchia 1991, Baiman and Verrecchia 1996).

Empirical research uses bid-ask spreads, trading volume in firm shares and share price volatility as proxies for information asymmetries. The relation between these proxies and the firm's cost of capital is well established in theory (Stoll 1978, Glosten and Milgrom 1985, Admati and Pfleiderer 1988) and several studies provide evidence that information

asymmetry and illiquidity are reflected in stock returns (Amihud and Mendelson 1986 and 1989, Brennan and Subrahmanyam 1996).

The bid-ask spread is commonly thought to measure information asymmetry explicitly. Less information asymmetry implies less adverse selection, which in turn implies a smaller bid-ask spread. Trading volume captures, instead, the willingness of some investors who hold firm shares to sell and the willingness of others to buy. This willingness to transact in firm shares should be inversely related to the existence of information asymmetries (Easley *et al.* 1996 and Grammig, Shiereck and Theissen 2001). Finally, the use of share price volatility as a proxy for information asymmetry involves that smooth transitions in share prices, hence low levels of volatility, suggest the absence of information asymmetries between the firm and shareholders or among investors (Lang and Lundholm 1993).

With regard to the notion of "increased levels of disclosure", the theory is sufficiently broad so as to allow either an increase in the quantity of disclosure or an increase in the quality of disclosure, or both. In addition, the theory makes no distinction as to how the information asymmetries arise (e.g. between a firm and its shareholders, among potential buyers and sellers of firm shares). The only requirement is that information asymmetries manifest themselves as a higher premium in the price at which trades are executed.

Academic research has developed different models to explain the mechanisms through which increased disclosure reduces the cost of capital.

Some of them suggest an indirect link between disclosure and firms' cost of capital based on market liquidity and adverse selection in the secondary market (e.g. Grossman and Stiglitz 1980, Easley and O'Hara (2004). In the model provided by Grossman and Stiglitz, for instance, an uninformed investor will buy information as long as the marginal benefit of doing so equals the marginal cost. Because investors demand a higher cost of capital to compensate for costly information acquisition, cost of capital will be lower if there is information about firm value available at little or no cost. Since financial statement information is universally available at little or no cost, the Grossman and Stiglitz model suggests that the more informative financial information is, the lower the cost of information acquisition will be. As a result, there will be more informed traders, less information asymmetry and lower cost of capital.

Some other studies explain the link between financial reporting and cost of capital in terms of risk associated with mis-estimation of firms' return distribution parameters (Klein and Bawa 1976, Barry and Brown 1985, Coles and Loewenstein 1988, Clarkson and Thompson 1990, Handa and Linn 1993, Jorgensen and Kirschenheiter 2007). A common feature of these models is that the estimation risk associated with a firm's payoff distribution is priced by investors. Therefore, higher financial reporting quality lowers a firm's cost of capital by reducing such an estimation risk.

Finally, Lambert *et al*. (2007) provide a model consistent with the Capital Asset Pricing Model which demonstrates that improved accounting information affects the firm's beta factor, both directly and indirectly. The direct effect occurs because higher financial reporting quality affects the market participants' assessments of the distribution of future cash flows. The indirect effect occurs because higher quality financial reporting affects the firm's real decisions, which in turn influence its expected value and the covariances of firm cash flows. Lambert *et al*. also show that an increase in the quality of mandated disclosures move the cost of capital closer to the risk-free rate for all firms in the economy. In addition to the effect of an individual firm's disclosures, there is also an externality from the disclosures of other firms, which provides a rationale for disclosure regulation.

Some studies specifically focus on the relation between cost of capital and conditional conservatism in accounting. This is a key issue as the IAS/IFRS adoption reduces conservatism in accounting compared to the fourth and seventh Directives.

Conditional conservatism imposes stronger verification requirements for the recognition of economic gains than economic losses, thus resulting in earnings that reflect losses faster than gains. This is referred to as the asymmetric timeliness of earnings (Basu 1997). Analytical work demonstrates that more accurate bad news reporting reduces the discount that investors apply to firm value in the presence of uncertainty as well as the volatility of future stock prices which, in turn, lower the shareholders' investment risk (Guay and Verrecchia 2007 and Suijs 2008).

3. THE EFFECTS OF THE IAS/IFRS MANDATORY ADOPTION IN THE EUROPEAN UNION ON THE COST OF CAPITAL

As mentioned, the mandatory IAS/IFRS adoption in the European Union is expected to reduce the cost of capital by increasing financial disclosure. IAS/IFRS typically require greater disclosure than domestic accounting standards. Greater disclosure mitigates the adverse selection problem and enhances liquidity, thereby reducing the cost of equity through lower transaction costs and/or stronger demand for a firm's securities (Amihud and Mendelson 1986, Diamond and Verrecchia 1991, Easley and O'Hara 2004). Moreover, firms with greater information disclosure have lower forward-looking betas, which leads to a lower cost of equity (Barry and Brown 1985, Lambert *et al*. 2007). As a result, enhanced disclosure is expected to decrease a firm's cost of capital in absolute term.

Empirical research on the relation between financial reporting under IAS/IFRS and the cost of capital has largely been based on the IAS/IFRS voluntary adoption (e.g. Leuz and Verrecchia 2000, Cuijpers and Buijink 2005, Daske 2006, Kim and Shi 2010, Kim, Tsui and Yi 2011). The distinction between commitment and voluntary disclosure is quite relevant as the former is independent of the content of the information, whereas the latter is a decision taken by the firm. As a result, although findings on the voluntary IAS/IFRS adoption provide useful insights, they cannot be generalized in the case of mandatory adoption. Voluntary adopters self-select to follow IAS/IFRS after considering the related costs and benefits, with the cost of capital effects being only one of them. Instead, mandatory adopters in the European Union had to switch to IAS/IFRS because this was required by Regulation 1606/2002.

One of the first studies on the effects of the mandatory IAS/IFRS adoption in Europe is provided by Palea (2007), who focuses on the bank industry showing that, in the period immediately subsequent to the IAS/IFRS mandatory adoption, banks experienced a reduction in the cost of equity as derived from the Gordon model. Along the same lines, Li (2010) estimates the cost of equity from the models by Claus and Thomas (2001), Gerbhardt *et al*. (2001), Gode and Mohanram (2003) and Easton (2004), finding that in 2005 mandatory adopters experienced, on average, a significant reduction in the cost of equity of 47 basis points. Additional analysis suggests, however, that mandating IAS/IFRS has a significant cost of equity impact only in countries with strong

enforcement mechanisms, consistent with the institutional setting being an important factor for effective accounting changes.

The role played by the institutional setting in determining the effects of the IAS/IFRS adoption has been highlighted by several studies. Daske *et al.* (2008), for instance, analyse the effects of adopting IAS/IFRS in 26 countries, both in Europe and worldwide, and document an increase in market liquidity around the time of the IAS/IFRS adoption. They also find a decrease in firms' cost of equity and an increase in equity valuation, but only if prior effects to the adoption date are accounted for. Taken as a whole, their evidence suggests modest, but economically significant capital market benefits around the IAS/IFRS mandatory adoption. However, such market benefits occur only in countries where firms have incentives to be transparent and where legal enforcement is strong, thus indicating that enforcement regimes and firms' reporting incentives play a major role in achieving capital market benefits from the IAS/IFRS adoption. Capital market effects of IAS/IFRS adoption are also found to be larger for firms in countries with lower quality domestic standards and that differ more from IAS/IFRS. This result is in line with Armstrong *et al*. (2010) who find that the positive reaction to IAS/IFRS adoption is larger for firms with lower levels of information quality prior to IAS/IFRS implementation and higher pre-adoption information asymmetry.

Likewise, Landsman *et al*. (2012) focus on countries adopting IAS/IFRS both in Europe and worldwide, and examine the information content of earnings announcements as measured by abnormal return volatility and abnormal trading volume. Findings suggest that information content of earnings announcements increased in 16 countries that mandated IAS/IFRS relative to 11 that maintained domestic accounting standards, although the effect of the mandatory adoption depended on the strength of legal enforcement in the adopting country.

Florou and Kosi (2011) focus instead on the cost of corporate debt. By using a global sample of public and private debt issues completed during 2000-2007, they find that mandatory IAS/IFRS adopters are more likely to issue public bonds than to borrow privately. Moreover, IAS/IFRS adopters pay lower bond yield spreads, whereas no significant effect on the cost of private loans is found. They document that the mandatory IAS/IFRS adopters are more likely to raise debt from a larger pool of capital at a lower

cost. Furthermore, the mandatory IAS/IFRS adoption is beneficial primarily for bond investors, who rely more on financial statements and have much less monitoring and renegotiating privileges compared to private lenders. However, also for debt financing the positive consequences of adopting IAS/IFRS differ according to countries' enforcement rules.

Overall, empirical evidence suggests that mandatory financial reporting under IAS/IFRS provides beneficial effects on the cost of capital, although such effects differ according to countries' institutional settings and firms' incentives.

4. HAS REGULATION 1606/2002 LEVELLED THE PLAYING FIELD FOR EUROPEAN FIRMS?

The IAS/IFRS adoption in the European Union is expected to reduce the cost of capital not only in absolute, but also in relative terms. As mentioned, according to Regulation 1606/2002 accounting standardization at the European level should increase cross-country comparability, which – in its turn – should *"enable Community companies to compete on an equal footing for financial resources available in the Community capital markets, as well as in world capital markets"*.

Accounting standardization is expected to reduce possible errors in comparing European companies due to different financial reporting systems. The adoption of the same financial reporting standards within the European Union should eliminate accounting measurement errors in pricing firms and therefore reduce differences in the cost of capital.

Indeed, previous research has shown that financial reporting standardization reduces the expertise required to foreign investors when interpreting financial statements prepared under different accounting standards. As the value of one firm is correlated with that of another firm, the information disclosed by firms in one country becomes more comparable and, hence, more useful in valuing firms in another country (Barth *et al*. 1999). Such effects are consistent with Covrig *et al*. (2007), who find that average foreign mutual fund ownership is higher among IAS/IFRS adopters as they provide more information or information in a more familiar form to foreign investors. Similarly, Amiram (2009) documents that foreign equity investment increases after the IAS/IFRS

adoption, particularly for countries with low corruption and strong investor protection. Chen *et al*. (2009) and Màrquez-Ramos (2011) show that also foreign direct investment increases following the IAS/IFRS mandatory adoption, although the size of this effect depends on country institutions.

Actually, a spontaneous harmonization within European "global players" was already in process before the mandatory IAS/IFRS adoption. Companies competing in international markets had entered an harmonization process since the 1980s independently of the formal political process (Thorell and Whittington, 1994, Cañibano and Mora, 2000). Land and Lang (2003) also document an increase in comparability over time of financial reporting data of firms from Australia, Canada, France, Germany, Japan, the United Kingdom, and the United States.

An attempt to investigate the capital market consequences of the IAS/IFRS adoption in the European Union in terms of cross-country comparability of financial statements has been carried out by Li (2010). By using the number of inconsistencies between IAS/IFRS and local standards as a measure of enhanced comparability, she finds evidence consistent with enhanced comparability influencing the cost of equity. Along the same lines, Yip and Young (2012) document an increased financial reporting comparability following IAS/IFRS adoption on the basis of three alternative measures for comparability (i.e. the similarity of accounting functions that translate economic events into accounting data, the degree of information transfer, and the similarity of the information content of earnings and book value).

Liao *et al*. (2012) focus on comparability of earnings and book values in France and Germany as they represent the European Union's major economies and largest capital markets. They also have similar social-economic institutions, which research has indicated affect a firm's accounting measures. Findings document an increase in comparability in the year subsequent to IAS/IFRS adoption, which however decreased in the years that follow as over time managers tended to implement IAS/IFRS differently. Such findings also suggest that comparability is largely affected by legal enforcement and firm incentives.

Several studies have tested the cross-country effects of the mandatory IAS/IFRS adoption by using comparability measures based on de Franco *et al.* (2011). The comparability

measure developed by de Franco *et al*. reflects the idea that if the same economic events are accounted for homogeneously by two firms, the two firms should have comparable financial reporting systems. Empirically, the authors proxy for economic events and the output of financial statements by using stock returns and earnings, respectively: the more similar the mapping between earnings and returns across firms, the more comparable the financial reporting systems.

Cascino and Gassen (2012) find that the overall effect of mandating IAS/IFRS on comparability is marginal as financial reporting is systematically shaped by firm-, region-, and country-level incentives. Their results are in line with Lang *et al*. (2010), who find that the IAS/IFRS mandatory adoption increases earnings co-movement, but does not improve true cross-country comparability.

In contrast, André *et al*. (2012) report a decline in analysts' forecast errors as comparability increases, which suggests that comparability increases the usefulness of financial information and facilitates investors in valuing firms more accurately. With a global approach, Barth *et al*. (2012) investigate whether the adoption of IAS/IFRS by non-US firms increases the comparability of financial information and find that, after their adoption, IAS/IFRS and US GAAP firms exhibited higher value relevance comparability, although some differences still persist.

Taken as a whole, empirical literature suggests beneficial effects from the IAS/IFRS adoption on cross-country comparability, although legal enforcement and firms' incentives play a determinant role. Full convergence in financial reporting therefore seems difficult to achieve due to a number of firm- and country-specific factors. Regulation 1606/2002 has eliminated differences among European countries in financial reporting standards, but the same degree of uniformity does not exist in countries' institutional frameworks and in firms' incentives to issue high-quality financial reporting. Such findings are consistent with previous research which already documented the key role played by institutional characteristics in shaping financial reporting quality (e.g., Ali and Hwang, 2000; Ball, Kothari, and Robin, 2000; Burgstahler, Hail, and Leuz, 2006; Bushman and Piotroski, 2006). They are also in line with empirical literature which document differences existing among European countries in their level of protection of shareholders' rights, in the strength of the system of legal enforcement, in the level of

ownership concentration, in the degree of tax alignment, or in the importance of the equity market (e.g., Hung, 2001; La Porta *et al.* 2006, La Porta *et al.* 1998).

5. CONCLUSIONS AND FINAL REMARKS

Regulation 1606/2002 mandating the IAS/IFRS adoption in the European Union aims at increasing the level of transparency and comparability in financial statements so as to improve market efficiency.

A higher level of transparency in financial reporting is expected to lower the estimation risk premium which arises in case of information asymmetries and, therefore, a firm's cost of capital.

An increased cross-country comparability in financial statements, through accounting standardization at the European level, is expected to reduce possible errors in comparing European companies due to different financial reporting systems. The adoption of the same financial reporting standards within the European Union should eliminate accounting measurement errors in firm risk assessment and therefore lead to a convergence in the cost of capital among European firms, *ceteris paribus*.

This paper shows that, according to extant research, firms have experienced beneficial effects from the IAS/IFRS mandatory adoption in the European Union. Early evidence supports the notion that adopting IAS/IFRS increases market liquidity, decreases transaction costs for investors, lowers cost of capital, and facilitates capital formation and flows. Evidence therefore suggests that firms implementing IAS/IFRS gain a comparative advantage on the capital markets over firms still adopting based on the European Directives.

Empirical findings also show that financial reporting standardization has had positive effects for firms. Firms have in fact experienced beneficial economic consequences from increased integration at the European level, although a full convergence in financial reporting has not been fully achieved due to some differences still persisting in the regulatory framework.

In drawing conclusions, this paper however argues that some remarks and suggestions for future research and policy-making debate are necessary.

The first remark is that empirical research on the effects of the IAS/IFRS adoption generally covers the period subsequent to the IAS/IFRS adoption, whereas it does not include the recent financial crisis.

This paper therefore claims that, in order to fully evaluate the effects of the IAS/IFRS adoption on the cost of capital, more analysis is needed. Empirical research which covers a longer period including both up- and downturns is important to draw definite conclusions.

For instance, one of the mechanisms through which IAS/IFRS are expected to affect the cost of capital is fair value accounting. Fair value accounting is one of the main differences between IAS/IFRS and the European directives. Fair value accounting is supposed to ensure a higher degree of transparency of financial statements, which should lead to a higher value-relevance of accounting data and a better capability of financial markets to reflect the actual value of a firm. Fair value accounting should increase the quantity of private information brought into public domain and thereby lead to a more efficient resource allocation and capital formation. However, critics argue that fair value accounting has significantly contributed to the financial crisis and exacerbated its severity all around the world. They claim that fair values based on models are not reliable and that they introduce too much volatility also in "normal times", contributing to the pro-cyclicality of the financial system.

As a result, the effects of financial reporting under IAS/IFRS during economic downturns and their link with fair value accounting are key issues, especially with respect to the bank sector, and deserve further investigation.

As mentioned, this paper also highlights that financial reporting standardization has led to a more equal competition for European firms on the capital markets, although effects are lower than expected due to differences still persisting in countries' regulatory settings.

Taking into account such findings, this paper argues that further standardization in the regulatory framework, such as in investors' protection, market supervision and regulation, tax regulation, or corporate governance standards, could therefore contribute to build a more integrated capital market, which is also one of the explicit goals of

Regulation 1606/2002. This is also a key issue which deserves further scrutiny and discussion both at academic and policy-making levels.

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APPENDIX 1 - Implementation of Regulation 1606/2002 in the EU and EEA (at 07/02/2012)

European Commission	Austria	Belgium	Bulgaria	Cyprus	Czech Rep.	Denmark
Status of the implementation of IAS/IFRS	Final law	Final law	Final law	Final law	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your Member State (MS) use the option to **permit** IAS in the **annual accounts** for listed companies?	No	No	No	No	No	Fin. entities: Yes Other entities: Yes, for annual accounts for listed companies which do prepare consolidated accounts.
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	No	Yes, for real estate investment companies (SICAFI/BEVAK)	Yes	Yes	Yes	Fin. entities: No Other entities: Yes for annual accounts for listed companies which do not prepare consolidated accounts.
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, all companies	Yes, all companies	Yes, for SMEs[1]	No	Yes All types of companies	Yes, all types
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	No	Yes, for credit institutions, and investment firms	Yes, for all other types of companies, except SMEs and entities in liquidation and insolvency	Yes, all companies	No	No
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	No	No	Yes, for SMEs	No	No	Yes, all types
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	No	No	Yes, for all other types of companies, except SMEs and entities in liquidation and insolvency	Yes, all companies	No	No
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	Yes	Yes	No	No	No	Fin. entities: No Other entities: Yes
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	Yes	Yes	No	No	No	No
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	Yes, consolidated accounts since 1998	Yes, cons. accounts for all companies	a) Yes, mandatory for listed companies, banks, insurance and investment undertakings from 1.01.2003 b) Other companies - voluntary application from 01.01.2003	Yes (a) Requirement of the Institute of Certified Public Accountants of Cyprus for all companies since 1981 (b) Requirement of the Stock Exchange legislation for listed companies since 2003	Yes all types of companies	Yes for 2004. The annual and consolidated accounts for all companies except for financial companies

[1] Bulgarian SMEs must use the same accounting framework (IAS or national GAAP) for both annual and consolidated accounts

European Commission	Estonia	Finland	France	Germany	Greece	Hungary	Ireland
Status of the implementation of IAS/IFRS	Final law	Final law	Final law	Final law	Final law	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **annual accounts** for listed companies?	No	Yes[2]	No	No, but additionally to still required local GAAP	No	No, but additionally to still required local GAAP	Yes
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	Yes	No	No	No	Yes	No	No
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes All types other than below	Yes[3], all types	Yes	Yes, all types	Yes, some companies[3]	Yes, all types of companies within the scope of Accounting Act	Yes, all types
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes. Credit institutions, insurance undertakings, financial holding companies, mixed financial holding companies, investment firms	No	No	Yes, companies, which have filed for a listing	Yes, banks, and other financial institutions	No	No
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, all types other than below	Yes[2,3]	No	No, but additionally to still required local GAAP	Yes, some companies[3]	No, but additionally to still required local GAAP	Yes, all bar companies not trading for gain
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes. Credit institutions, insurance undertakings, financial holding companies, mixed financial holding companies, investment firms	No	No	No	Yes, banks, and other financial institutions	No	No
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	No	Yes	Yes	Yes	No	Yes	Yes
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	No	No	N/A	Yes	No	No	No
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	Yes All types 01.01.2003	1. Listed companies consolidated accounts 30.9.2003 2. Other companies (not insurance companies): all accounts 2004	No	Yes, cons. acc. option for listed companies (as from 1998) and for unlisted comps from 2003	31.12.2004 Yes, some companies[3]	No, but additionally to still required local GAAP	No

[2] Finland: Not insurance companies
[3] Finland and Greece: Companies, which are audited by certified auditors

European Commission	Italy	Latvia	Lithuania	Luxemburg	Malta	Netherlands
Status of the implementation of IAS/IFRS	Final law	Final law	Final law	Final law[4] Law proposal	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **annual accounts** for listed companies?	No, even for insurance companies	No	No	Yes	No	Yes
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	Yes[5], except for insurance companies	Yes	Yes	No	Yes	No
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, except for small enterprises and required companies	Yes, all types (except for banks, insurance commercial companies and other supervised financial institutions)	Yes, all types, except banks and other credit institutions, insurance compagnie	Yes, all types	Yes, all other than those listed below	Yes, all types
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, for some companies[6]	Yes, banks, insurance commercial companies and other supervised financial institutions	Yes, for banks and other credit institutions	No	Yes, for banks, insurance companies, certain other supervised financial institutions and larger companies deemed significant in the local economy	No
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, except for insurance, small enterprises and required companies	No	Yes, all types, except banks and other credit institutions, insurance compagnie	Yes, all types	Yes, all other than those listed below	Yes, all types
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, some companies[7]	Yes, banks, insurance commercial companies and other supervised financial institutions	Yes, for banks and other credit institutions	No	Yes, for banks, insurance companies, certain other supervised financial institutions and larger companies deemed significant in the local economy	No
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	No	No	No	Yes	No	No
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	No	No	No	Yes	No	No
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	No	Yes, banks, insurance companies, other supervised financial institutions had to use IAS before 2005	Yes, for banks and other credit institutions since 1997	Derogations on an individual basis	Yes all types of companies	No

[4] Luxembourg: final law for banks and insurance companies; law proposal for common law companies
[5] Italy: Listed insurance enterprises must comply with IASs only if they do not draw up consolidated accounts
[6] Italy: Supervised financial companies; companies with financial instruments widely distributed among the public; insurance companies
[7] Italy: Supervised financial companies; companies with financial instruments widely distributed among the public

European Commission	Poland	Portugal	Romania	Slovakia
Status of the implementation of IAS/IFRS	Final law	Final law	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **annual accounts** for listed companies?	Yes	Yes	No, but for purposes of information only. Annual financial statements that are in line with the Accounting Regulations conform to the Fourth Directive are required in the relation with the Government authorities.	Yes, if not companies of public interest[8]
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	No	Yes if the statutory accounts are the only accounts that they published to the market. Also credit institutions, other financial institutions and insurance undertakings applying local GAAP (which is consistent with IAS/IFRS), have to provide additional disclosures on the changes and impacts that would result from applying IAS/IFRS.	Yes, for credit institutions	Yes, companies of public interest[8]
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, 1) companies having filed for admission to public trading; 2) any parent comp. being a subsidiary of another parent undertaking preparing its consolidated accounts in line with IAS	Yes, all types	Yes. According to the Order of the minister of public finance no. 3055/2009 in force, the entities applying the Accounting Regulations conform to the European Directives, excepting the credit institutions and the entities whose securities are admitted to trading on a regulated market, and which have the obligation to draw up consolidated financial statements, may apply in this regard either IFRS or Accounting Regulations conform to the Seventh Directive.	No
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, banks	Yes, for credit institutions and other financial institutions in 2006	Yes, for credit institutions.	Yes, any type of companies
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, 1) companies having filed for admission to public trading; 2) companies whose parent undertaking prepares its consolidated accounts in line with IAS	Yes, companies within the scope of consolidation of an entity who applies IAS/IFRS and also insurance undertakings not within a scope of consolidation. Credit institutions and other financial institutions are excluded	No, but for purposes of information only. Financial statements that are in line with the Accounting Regulations conform to the Fourth Directive are required in the relation with the Government authorities.	Yes, for those listed companies and merchants with securities except banks, which are not those of public interest[8]
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	No	No	Yes, for credit institutions	Yes, for all companies of public interest[8]
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	Yes	No	Yes (starting with the financial statements for 2007 financial year)	No
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	No	No	Yes (starting with the financial statements for 2007 financial year)	No
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	No	Derogations on an individual basis	Yes (starting with the financial statements for 2001 financial year), but for purposes of information only.	No

[8] Companies of public interest mean the banks, Export- Import Bank of Slovak Republic, insurance companies excepting health insurance companies, stock exchange, Office of Slovak Assurors, Slovak Railroads, reinsurance companies, asset management

companies and the companies, that at least in two consecutive reporting years fulfil at least two from following three preconditions: gross amount of asset over 5 billions of Slovak Crowns (approximately 149.000.000,- EUR), net turnover over 5 billions of Slovak Crowns and average number of employees over 2000.

European Commission	Slovenia	Spain	Sweden	UK
Status of the implementation of IAS/IFRS	Final law	Final law	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **annual accounts** for listed companies?	Yes	No	No	Yes
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	No	No	No	No
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, for companies, other than banks and insurance companies, if so decided by the assembly of the company, but for the minimum period of 5 years	Yes, all types	Yes, all types	Yes, all types of companies except for the charity sector
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, for banks and insurance companies	Yes, for groups in which there is a listed company.	No	No
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, for companies, other than banks and insurance companies, if so decided by the assembly of the company, but for the minimum period of 5 years	No	No	Yes, all types of companies except for the charity sector
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, for banks and insurance companies	No	No	No
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	Yes	Yes, except for banking sector companies	Yes	No
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	No	No	No	No
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	No	No	No	No

European Commission	Iceland	Liechtenstein	Norway
Status of the implementation of IAS/IFRS	Final law	Final law	Final law
Article 5(a) of the IAS Regulation **LISTED COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **annual accounts** for listed companies?	Yes, for the years 2005 and 2006	Yes	Yes
2. Does your MS use the option to **require** IAS in the **annual accounts** for listed companies?	Yes, from 2007	No	No. Required for listed companies that do not prepare consolidated accounts from the financial year starting after 1. January 2011.
Article 5(b) of the IAS Regulation **OTHER COMPANIES** **1.** Does your MS use the option to **permit** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	Yes, for medium sized and big companies	Yes, all types	Yes, all types
2. Does your MS use the option to **require** IAS in the **consolidated accounts** for other companies? If yes, what type of companies?	No	No	No
3. Does your MS use the option to **permit** IAS in the **annual accounts** for other companies? If yes, what type of companies?	Yes, for medium sized and big companies from 2005	Yes, all types	Yes, all types
4. Does your MS use the option to **require** IAS in the **annual accounts** for other companies? If yes, what type of companies?	No. If the consolidated groups are permitted to use IAS in their consolidated accounts(according to question 1 in 5(b)), the annual accounts of each subsidiary are required to use IAS from 2007	No	No
Article 9 of the IAS Regulation **(a)** Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose debt securities only were admitted on a regulated market of any MS?	Yes	No	Yes
(b) Did your MS use the option to **defer** the application of IAS **until 2007** for companies whose securities were admitted to public trading in a non-member State and which, for that purpose, had been using internationally accepted standards since a financial year that started prior to the publication of the IAS Regulation in the OJ?	Yes	No	Yes
Miscellaneous Was earlier adoption (before 2005) of IAS allowed? If yes, for what type of companies/ from when?	No	31.12.2002 Yes, all types	No

Source: http://ec.europa.eu/internal_market/accounting/docs/ias/ias-use-of-options_en.pdf

APPENDIX 2 - Current use of IAS/IFRS in the countries of G20

Country	Status for listed companies as of December 2011
Argentina	Required for fiscal years beginning on or after 1 January 2012
Australia	Required for all private sector reporting entities and as the basis for public sector reporting since 2005
Brazil	Required for consolidated financial statements of banks and listed companies from 31 December 2010 and for individual company accounts progressively since January 2008
Canada	Required from 1 January 2011 for all listed entities and permitted for private sector entities including not-for-profit organisations
China	Substantially converged national standards
European Union	All member states of the EU are required to use IFRS as adopted by the EU for listed companies since 2005
France	Required via EU adoption and implementation process since 2005
Germany	Required via EU adoption and implementation process since 2005
India	India is converging with IFRS at a date to be confirmed.
Indonesia	Convergence process ongoing; a decision about a target date for full compliance with IFRS is expected to be made in 2012
Italy	Required via EU adoption and implementation process since 2005
Japan	Permitted from 2010 for a number of international companies; decision about mandatory adoption by 2016 expected around 2012
Mexico	Required from 2012
Republic of Korea	Required from 2011
Russia	Required from 2012
Saudi Arabia	Required for banking and insurance companies; full convergence with IFRS currently under consideration
South Africa	Required for listed entities since 2005
Turkey	Required for listed entities since 2005
United Kingdom	Required via EU adoption and implementation process since 2005
United States	Allowed for foreign issuers in the US since 2007; US SEC committed to global accounting standards and IFRS best placed to meet that need in the US, awaiting decision regarding use of IFRS for domestic companies

Source: www.ifrs.org