



COMMENTS ON THE FUTURE ENDORSEMENT OF IFRS POST-BREXIT

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ICAEW has discussed with BEIS and other stakeholders the future endorsement of IFRS post-Brexit and has set out in this representation letter to BEIS our current thinking on this matter.

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INTRODUCTION

1. ICAEW believes that the future endorsement of IFRS post-Brexit is a critical matter for the UK that has not yet attracted sufficient public debate. With this in mind, in September 2017 ICAEW published its own report ('the ICAEW report'), *Brexit: the implications for financial reporting*. In the ICAEW report we emphasise that trust in financial reports of listed companies underpins investor confidence in capital markets as well as economic growth and stability, and accordingly recommend that:

The UK government and other stakeholders should explicitly recognise the economic importance of financial reporting in considering the policy implications of Brexit.

2. In writing the ICAEW report, we collected views from a diverse mix of stakeholders on what we believe are the key financial reporting issues associated with the UK's departure from the EU. The report has attracted considerable attention from ICAEW members and other stakeholders in the UK and overseas, and ICAEW has continued to discuss with stakeholders the options for the future endorsement of IFRS post-Brexit, including with government.
3. We continue to urge BEIS to undertake a formal public consultation in order to obtain a wide range of perspectives on this issues. In the meantime we set out below some of the common views we have heard during recent discussions, including on the implications of the various endorsement options for the competitive position of UK companies.

THE USE OF IFRS IN THE UK

4. There remains a broad consensus among stakeholders we have spoken to that UK listed companies will continue to follow IFRS post-Brexit. Indeed, a key recommendation in the ICAEW report is that 'the UK should continue to adhere to internationally accepted standards', given its status as a major global financial centre. The reasons for this are as follows:

IFRS provides a high quality universal reporting language with multiple benefits. Indeed, ICAEW's work in recent years has underlined the economic benefits of using high-quality international standards. In 2015, we published the highly influential report 'Moving to IFRS reporting: seven lessons learned from the EU experience of IFRS', drawing particularly on the work undertaken earlier that year to prepare our detailed study of the academic evidence, 'The effects of mandatory IFRS adoption in the EU: a review of empirical research'.

Both reports noted that the benefits of adopting IFRS were distributed unevenly among different companies and different countries due to differences in institutional contexts and incentives. But they also concluded that, overall, the move to international standards has – among other things – improved transparency, comparability, market liquidity and international capital flows. Importantly, there are also signs that it has reduced the cost of capital'.

5. There is, however, some ambiguity at present as to what will happen during an expected transition period following UK's departure from the EU. Given that EU exit is now less than 12 months away, it has been suggested that the UK should adopt IFRSs as endorsed by the EU at the date of exit and also during the transition period. We would recommend that any transitional arrangements are clarified as soon as possible

– particularly as it is likely that decisions on the endorsement of IFRS 17 will need to be taken during this period.

6. This approach would allow more time to consider, and consult on, the financial reporting consequences of Brexit and help to ensure that any decisions taken are well informed and effective.

OPTIONS FOR ADOPTION OF NEW STANDARDS

7. As mentioned above, ICAEW supports the view that IFRS should continue to be adopted by listed companies post-Brexit. On this basis, we explore the following three options for the adoption of new standards as per the ICAEW report:
 - Option 1. EU-adopted IFRS continue to be applied by UK listed companies, with the UK able to participate in the deliberations of EFRAG and accepting the decisions of the EU endorsement process.
 - Option 2. UK listed companies are required to use IFRS as issued by the IASB, without any further intervention by UK authorities.
 - Option 3. The introduction of a national endorsement mechanism and UK-specific endorsement criteria.

8. The ICAEW report sets out the key features of each option including the main advantages and disadvantages. We refer BEIS to section 4 of our report for more detail in this respect.

9. In short, ICAEW recommends in its report adopting ‘IFRS as endorsed by a new UK process’ (option 3), as follows:

We find the arguments for introducing some form of UK endorsement mechanism and endorsement criteria to be, on balance, persuasive. Transitional provisions may be necessary to allow for the design and orderly implementation of new arrangements and to minimise uncertainty for business.

10. In the report, we suggest that the design of the UK mechanism should draw on the experience of Europe, but also on the experience of countries such as Australia and Canada, where the process is generally regarded as light touch, that is to say uncomplicated in nature, with a strong emphasis on an on-going assessment of IASB due process.
11. One of the perceived benefits of a UK endorsement mechanism derives from the EU experience of endorsement, where the threat of non-endorsement by the EU has in the past weighed very heavily with the IASB and led to different standard-setting outcomes. There are concerns that this influence may be lost if the UK were to adopt IFRS as issued by the IASB or IFRS as issued by the EU. Some of those we have spoken to have however emphasised that in trying to retain the UK’s international influence in this way, there is also a risk of undermining it. To date, much of the UK’s international influence has come from engagement with the IASB and the quality of comments and thought leadership it provides. With this in mind, they stress that the UK should above all continue to make every effort to influence the development of new standards during the due process steps of the IASB, rather than using the threat of non-endorsement. If the UK has the right of ‘veto’, it is argued, constituents might be less focused on the need to influence the IASB.

12. We have also heard a strong view that arguments in favour of anything less than word for word endorsement must be weighed very carefully against the loss of the benefits of international alignment, that widening the gap between IASB-IFRS and EU-IFRS by creating another accounting language (UK-IFRS) would only create complexity and barriers to comparability. This very important matter is discussed in more detail below.

IMPACT ON COMPETITIVENESS OF UK BUSINESSES

13. In our view the requirement for listed companies to follow IFRS is important for the efficiency of capital markets, improving transparency, comparability, market liquidity and international capital flows. Any divergence from IASB-IFRS or EU-IFRS may therefore create a competitive disadvantage for UK businesses.
14. Trying to balance the need for US listed companies to use IASB-IFRS and for UK requirements to be as consistent as possible with the EU, to ensure listed companies can access EU markets, will not be a straightforward task. This would be further complicated by the creation of UK-IFRS significantly different from both IASB-IFRS and EU-IFRS. The comparability issues that follow could be highly detrimental to UK businesses.

UK ENDORSEMENT CRITERIA

15. Under the IAS regulation, any IFRS to be adopted in the EU must:
- be consistent with the ‘true and fair’ view required by the EU’s Accounting Directive;
 - be conducive to the public good in Europe; and
 - meet basic criteria on the quality of information required for financial statements to serve users, ie, they must be understandable, relevant, reliable and comparable and must provide the financial information needed to make economic decisions and assess stewardship by management.
16. In the ICAEW report, we argue that the EU endorsement criteria in the IAS Regulation are a suitable starting point for UK criteria. We also suggest that there are opportunities to consider how the EU criteria could be simplified through consideration of each of their components. We stand by these views, and set out below the further views we have heard in this respect.
17. While the latest iteration of the IASB’s Conceptual Framework is yet to be finalised, the principles of relevance, faithful representation, comparability and understandability (although not reliability) as well as fair presentation are all included. These principles were confirmed by Martin Moore QC in 2008 as being equivalent to a true and fair view, which lies at the core of UK financial reporting and so should remain as a criterion. We have heard the view that, as a result, it is unnecessary for the criteria to refer both to the need for a standard to result in information that is relevant, comparable and understandable, and to not be contrary to the notion of true and fair. Similarly, it is questioned whether a reference to reliability on the basis that it does not appear explicitly in the Conceptual Framework is necessary.
18. We have also heard concerns that the criterion requiring consideration of ‘the public good’ is open to interpretation by particular interest groups. It is pointed out that there have been many instances (such as accounting for pensions, share-based payments and leases) where interested parties have described catastrophic economic consequences that would follow a new accounting requirement. Experience shows that

those scenarios did not play out as some feared. While it is true to say that accounting often does influence behaviour, in these examples they would argue that the revisions to the accounting standards removed an accounting anomaly, rather than created one, and provided more meaningful information on which to base sound economic decisions, without regard to any particular accounting advantage.

19. Over time a clearer view of what constitutes the “public good” in a UK context will need to be developed, perhaps based on consideration of long-term economic impacts and the quality of reporting. It should not be a means of achieving other policy objectives. The comments in the ICAEW report are relevant here:

In our view, to the extent that economic development and financial stability should be considered during the endorsement process, this falls squarely within a requirement to consider public interest. UK financial stability and prudential supervision should be delivered primarily through regulatory regimes, not through seeking to influence or change financial reporting in ways that would reduce the transparency of information available to investors. This would particularly disadvantage investors without the power to request additional or different information from companies.’

THE ENDORSEMENT DECISION: ALL OR NOTHING?

20. Given the politics surrounding the UK’s departure from the EU, it is likely that the UK will wish to retain ultimate sovereignty on endorsement. However, in the ICAEW report we warn against providing the body responsible for endorsement with the opportunity to modify or add to the requirements of any new standards or interpretations on the basis that the disadvantages of making local changes tend to outweigh the anticipated benefits. We state that:

Experience has shown that countries that initially make changes to IFRS tend to revert in time to full compliance, acknowledging that the full benefits of switching to internationally-recognised accounting standards are only realised by complete alignment with IFRS. Anything less tends to be less attractive to investors, most of whom do not have the time or resources to study the intricacies of local variations from IFRS, or to easily understand the implications of carve-outs or amendments. Investors want to be confident that the IFRS brand has been adopted by jurisdictions in full.

21. As such we recommended that:

An endorsement mechanism should, in exceptional circumstances, allow the applicable UK authority not to adopt new standards or interpretations. Further debate should take place in the UK over the potential for facilitating other, very limited modifications, for example, adding to required disclosures. But the IFRS brand, recognised by capital market participants around the world, should not be trifled with lightly.

22. We remain of this view. We would highlight, however, that in on-going conversations with stakeholders we are aware of a strong view that these exceptional circumstances should be limited to delaying the effective date of an accounting standard, which may on occasion be necessary to remain aligned with EU endorsement decisions.

ENDORSEMENT BODY

23. In the ICAEW report we argue that the FRC is best placed to act as an endorsement body, for the following reasons:

We think that the Financial Reporting Council will be best placed to engage at each stage of the standard-setting process, with the IASB, EFRAG, other national standard setters and UK constituents. In our view, this is a precondition for a smooth and timely path to endorsement. The FRC's current role means that it has a lot of relevant expertise and experience in this area, which another body would need to replicate. The FRC should be able to monitor and elicit UK stakeholder views on IASB proposals and standards effectively, drawing on input from preparers, the accounting profession, market regulators, prudential supervisors and, in particular, investors. It should be able to develop appropriate processes for impact assessment, keeping costs and complexity to a minimum.

24. ICAEW's thinking on this remains unchanged. However, we recognise that there are concerns about such an arrangement. Some have argued that the ability of one organisation to both set the rules and regulate compliance with them may create an undesirable concentration of power. This is of course already the case in relation to UK GAAP, but this is seen as involving a lower level of public interest than listed company reporting.

25. Arguably, this independence issue creates an argument in favour of establishing a different, independent UK endorsement body for IFRS. On the other hand, as acknowledged in the ICAEW report, there is limited time to put such a model in place. In considering whether or not the FRC is best-placed to act as the endorsement body, at least for the time being, we suggest the government should apply the following three criteria:

- Is there sufficient time to set up a new body?
- Will the creation of a new body involve inefficiencies and/or prove prohibitively costly?
- Will the staff of the new body possess sufficient relevant skills and experience?

26. Consideration also needs to be given to the level of government involvement in the endorsement process. We refer to this matter in the ICAEW report, as follows:

While careful consideration of the resourcing, governance and other implications of the endorsement arrangements will be needed to ensure appropriate accountability and a robust and transparent process, we do not think that government should intervene in the endorsement process. Accounting standards should always be high-quality and neutral, providing the foundation for transparent and comparable financial statements that clearly reflect economic reality and improve investor confidence in the reliability and transparency of published financial information. Experience has shown that intervention by government is generally not conducive to the production of high quality financial reporting standards. Indeed, the confidence of investors is likely to be undermined by endorsement decisions seen to be influenced by pressure from governmental organisations, perhaps following lobbying by particular interest groups.

27. We remain of this view. However, some we have spoken to believe that some form of ultimate government oversight would be appropriate, perhaps along the lines of the model adopted in Australia. Legislation might for example afford government the right in certain closely-defined circumstances to override any decision to adopt, or not adopt, a new standard. Such involvement may assist with retaining the UK's influence at the IASB, and might also allay some concerns about the role of the FRC.