Fitness check on EU framework for public reporting

IFASS 3 October 2018

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RAAD VOOR DE JAARVERSLAGGEVING

Why discuss it today?

Regulation 1606/2002

Consolidated accounts need to be prepared in accordance with IAS/IFRS adopted by the EU from 2005 onwards.

- Direct effect on companies
- No need for national legislation
- Compulsory for all listed companies (debt/equity)
- Member state options (single company accounts, unlisted companies)

Europe wanted

- To enhance comparability of financial statements
- In order to contribute to a better functioning of the internal market. This required:
  - A single set of high quality international accounting standards
  - For the preparation of consolidated financial statements
    - Accepted internationally
    - Truly global
    - Convergence towards a single of global accounting standards

Expected benefits from IFRS adoption

- Improved financial reporting
  - increased market liquidity
  - reduced cost of capital
- Reduced accounting discretion
- Less costly for investors to compare across markets and countries
- Facilitate cross border investment and integration of capital markets

Were the objectives met (1)?

- The implementation of IFRS has been a **resounding success overall**
- IFRS statements retain a strong national identity
- IFRS implementation has required extensive judgments in selection and application of accounting principles, restricting consistency and comparability
- Companies do not seem confident that IFRS financial information is sufficient or appropriate in all cases to properly communicate their performance to the markets
- IFRS financial statements are significantly more complex and this complexity threatens to undermine the decision-usefulness of IFRS

Source: Observations on the Implementation of IFRS, Ernst & Young, 2006

Were the objectives met (2)?

THE ACCOUNTING REVIEW
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American Accounting Association
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Does Mandatory Adoption of International Financial Reporting Standards in the European Union Reduce the Cost of Equity Capital?

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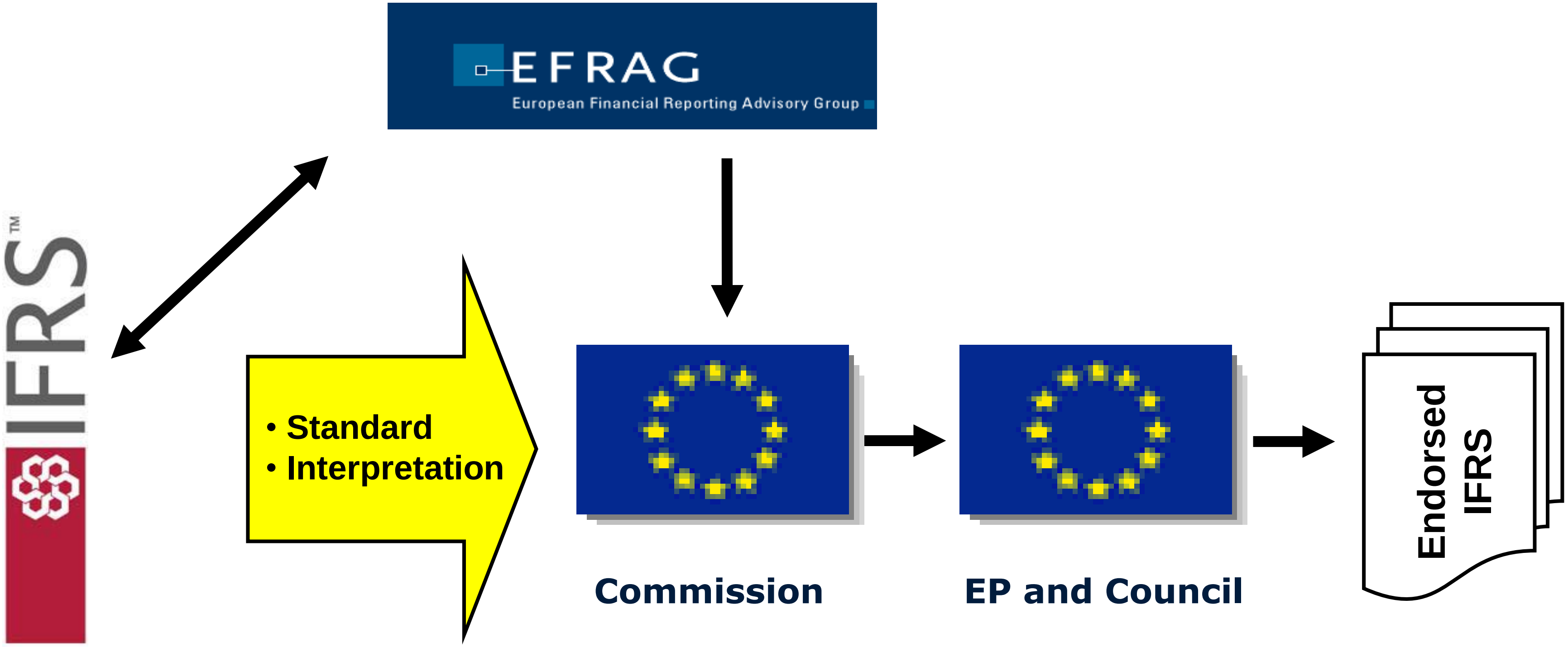
ABSTRACT: This study examines whether the mandatory adoption of International Financial Reporting Standards (IFRS) in the European Union (EU) in 2005 reduces the cost of equity capital. Using a sample of 6,456 firm-year observations of 1,084 EU firms during the 1995 to 2006 period, I find evidence that, on average, the IFRS mandate significantly reduces the cost of equity for mandatory adopters by 47 basis points. I also find that this reduction is present only in countries with strong legal enforcement, and that increased disclosure and enhanced information comparability are two mechanisms behind the cost of equity reduction. Taken together, these findings suggest that while mandatory IFRS adoption significantly lowers firms' cost of equity, the effects depend on the strength of the countries' legal enforcement.

Europe could be satisfied, but

- EU carve-outs in IAS 39
- Delayed implementation of a.o. IFRS 10, 11 and 12
- Top-up for IFRS 4 amendment w.r.t. IFRS 9 implementation

The endorsement mechanism



Endorsement criteria

- three cumulative endorsement criteria
  - not contrary to the 'true and fair view'
  - conducive to the European public good, and
  - standard meets the criteria of understandability, relevance, reliability and comparability required of financial information which is needed for making economic decisions and assessing the stewardship of management

2013 Maystadt Report

- Recommendations for enhancing the EU’s role in international accounting standard-setting
- New governance structure of EFRAG
  - board that is responsible for EFRAG positions
  - EFRAG President appointed by the EU
  - EC, EU supervisory authorities and ECB as observers
  - Board decisisons are based on advice from the Technical Expert Group (TEG)
  - Determination whether IFRS requirements are conducive to the ***European Public Good***

“IFRS are the best choice at the moment….its global character is unquestionably the most significant. All the stakeholders interviewed acknowledge that it has improved the quality, comparability and reliability of financial information.”

Source: Report by Philippe MAYSTADT – October 2013

2015 Commission evaluation of Regulation 1606/2002

- Key findings:
  - IFRS is successful in creating a common accounting language for capital markets
  - There is no well-defined alternative to IFRS
  - Objectives of the Regulation remain relevant
  - Companies were mostly positive (benefits outweigh costs)
  - Investors largely supported IFRS for transparency and comparability
  - Most stakeholders considered that the endorsement process worked well

Possible improvements:

- Coherence of standards with EU law
- Consider powers of supervisory authorities
- IASB to strengthen impact analysis and consideration of needs of long-term investors

High-Level Expert Group on Sustainable Finance

- To help develop an overarching and comprehensive EU roadmap to sustainable finance
- Advice on how to 'steer the flow of capital towards sustainable investments'
- Chaired by Christian Thimann of AXA

'Sustainable finance' generally refers to the process of taking due account of environmental and social considerations in investment decision-making, leading to increased investments in longer-term and sustainable activities.

Source: EC Action Plan: Financing Sustainable Growth

Other cross-cutting recommendations
(in the report of the High-Level Expert Group)

- Update EU directives to require:
  - Greater emphasis on integration of non-financial information
  - Discussion of the governance of long-term and sustainability risks and opportunities
- Investigate alternatives to fair value/mark-to-market accounting for long-term investment portfolios
- Change Regulation 1606/2002
  - Sustainability and long-term investment objectives as endorsement criteria
  - Provide the power to adjust specific aspects of IFRS standards
- Ensure that IFRS 17 on liabilities matches the accounting standard for the asset side

EC Action Plan: Financing Sustainable Growth

- Fitness check on public reporting (Q1/2 2018)
- Revise guideline for NFI (Q2 2019)
- Establish a European Corporate Reporting Lab as part of EFRAG
- Require disclosure by investors on how they consider sustainability factors in their strategy and investment decisions
- Request EFRAG to assess impact of new IFRSs on sustainable investments and explore potential alternative accounting treatments for long-term investments (Q4 2018)
- Explore how adoption process of IFRSs can allow specific adjustments

The fitness check

- Public consultation that closed end of July
- Answers/results are not yet published by EC
- Some are in the public domain
- Feedback statement is expected in October
- Next steps will be:
  - Discussion in September Accounting Regulatory Committee
  - Conference in November
  - Staff working document on fitness of the EU framework in 2019

Question 19

- Given the different levels of commitment to require IFRS as issued by the IASB around the globe, is it still appropriate that the IAS Regulation prevents the Commission from modifying the content of IFRS?

Pro EU modification:

- ➢ European sovereignty
- ➢ Other jurisdiction also have the ability to amend
- ➢ Uneven level playing field

Con EU modification:

- ➢ International comparability
- ➢ Access to international capital markets
- ➢ Cost for international companies
- ➢ Authority of the IASB
- ➢ Inefficient (need for a European standard setter)

Question 19 – which answers?

- Against EU modification
  - Germany
  - UK - FRC
  - Netherlands
  - 10 smaller member states
  - ESMA
  - EIOPA
  - EBA
  - ECB
- In favour EU modification
  - France

Underlined: known
Not-underlined: expected

Question 22 (1)

- The True and Fair view principle should be understood in the light of the general accounting principles set out in the Accounting Directive . By requiring that, in order to be endorsed, any IFRS should not to be contrary to the true and fair view principle, a link has been established between IFRS and the Accounting Directive. However, the principle of true and fair view is not laid down in great detail in the Accounting Directive, nor is it underpinned by e.g. a European Conceptual Framework that would translate these principles into more concrete accounting concepts such as recognition and measurement, measurement of performance, prudence, etc. **Do you think that an EU conceptual framework should underpin the IFRS endorsement process?**

Question 22 (2)

Pro:

- Clarifies endorsement criteria
- Helps EFRAG
- Provides a legal basis

Con:

- EU should not act as accounting standard setter
- Why codify an open norm that works well
- Principles are already in the regulation
- Difficult to enforce and confusing when there are two conceptual frameworks

Question 23

- The EU has not endorsed the IASB Conceptual Framework for Financial Reporting. The conceptual framework is a set of concepts used to develop IFRSs but can also be helpful in interpreting how IFRS standards have to be understood and applied in specific circumstances. This could enhance a common application of IFRSs within the EU. Should the EU endorse the IASB Conceptual Framework for Financial Reporting?

Pro:

- More clear and complete guidance
- Help interpretation and common application

Con:

- Create legal ‘pitfalls’
- Separate legal status required?
- Not needed because the EU is not a standard setter

The future will tell

- Whether Europe deviates from IFRS as issued by the IASB
- What this means for the authority of the IASB
- Whether this is a first step back to national differences

RAAD VOOR DE JAARVERSLAGGEVING

fd.
het financieele dagblad

Maandag 17 september 2018 • Nummer 219 • 32 pagina's
'Al het geene tot het financieele eenige betrekking heeft' – sinds 1796

Tegenslag
'Ik was de kroonprins, maar werd keihard gepasseerd'
PAGINA 18 & 19

Femke de Vries
'Wetgever doet er goed aan kritisch te kijken naar de drempels voor kla...

Overzicht

ACCOUNTANCY

Ernstige zorgen over Brussels gemorrel aan boekhoudregels

Beursbedrijven en beleggers verwerpen EU-plan om van IFRS-standaard af te wijken

Jeroen Piersma
Amsterdam

Beursgenoteerde bedrijven en grote beleggers in Nederland zijn faliekant tegen een plan van de Europese Commissie om internationale boekhoudregels ...

weten helemaal niets in het plan te zien.
Begin oktober moet duidelijk worden hoe de krachtsverhoudingen in Europa liggen, als alle reacties op het plan van de Commissie openbaar worden. Begin volgend jaar zou Brussel dan een besluit ...

144
Wereldwijd gebruiken 144 ...

ken van de regels in andere IFRS-landen. En daarmee gaat het kernidee van IFRS, wereldwijde vergelijkbaarheid van jaarrekeningen, verloren, zeggen de tegenstanders van het Commissieplan. IFRS geldt overigens alleen voor beursgeno-...

Serious concerns about Brussels tinkering with accounting rules