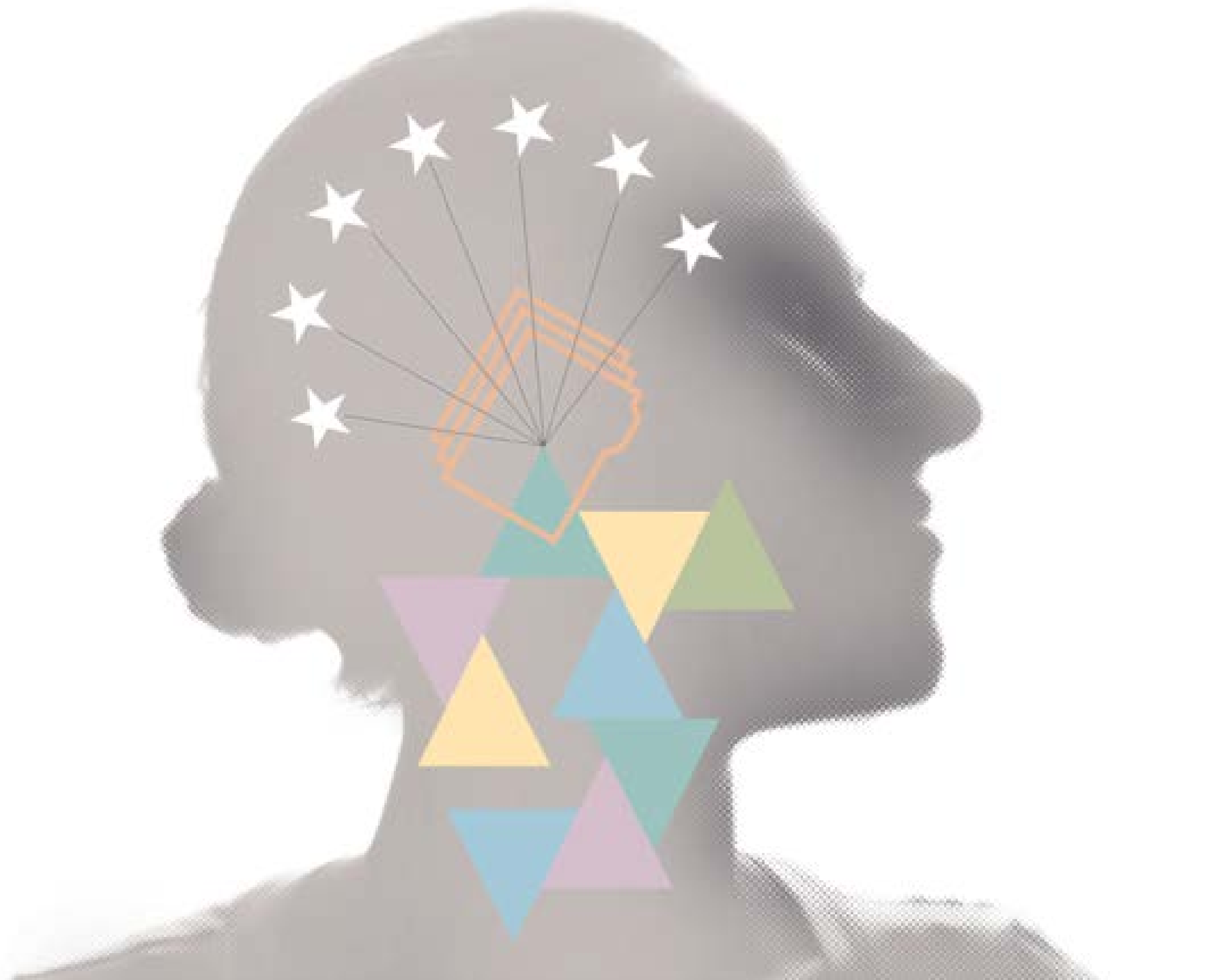
ICAEW THOUGHT LEADERSHIP
INFORMATION FOR BETTER MARKETS

Moving to IFRS reporting: seven lessons learned from the European experience



ICAEW and IFRS

ICAEW operates under a Royal Charter, working in the public interest. It is a professional membership organisation with a truly global reach.

ICAEW's members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. ICAEW ensures that these skills are constantly developed, recognised and valued. Since 2003, the world-leading ACA qualification has been based around International Financial Reporting Standards (IFRS) requirements. ICAEW has also produced online certificate-level IFRS learning programmes, available to all.

ICAEW has been a persistent champion of the creation of a single set of high-quality global accounting standards and their application by publicly-traded and other companies around the world. Indeed, it was former ICAEW President Sir Henry Benson (later Lord Benson) who spearheaded the movement to tackle diverse global accounting practices, leading to the setting up of the International Accounting Standards Board's (IASB) predecessor – the International Accounting Standards Committee (IASC) – in 1973.

In 1997, ICAEW published a far-sighted paper entitled *The International Dimension*. This paper helped to move the debate about global accounting standards centre stage in the UK at a time when few others had contemplated a future when UK GAAP (Generally Accepted Accounting Principles) would be replaced by standards set by an international organisation.

ICAEW made a significant contribution to the successful adoption of IFRS by UK-listed companies in 2004. ICAEW expertise in this area was reflected in its selection by the European Commission to deliver a comprehensive study in 2007 covering all aspects of first-time application of IFRS by EU member states. In 2008, ICAEW was commissioned by the United Nations to prepare a follow-up report on the UK experience of IFRS implementation.

In 2012, ICAEW published what has proved to be an influential report entitled *The future of IFRS*. In the light of the absence of any decision by the US Securities and Exchange Commission (SEC) about the use of IFRS in the US, the report took stock of the progress that had been made in developing a global financial language and identified barriers and challenges that needed to be overcome if the use of the standards was to continue to spread.

ICAEW also actively engages with policymakers and academics in the US on financial reporting matters. Each year, we organise a number of panel sessions at the American Accounting Association's (AAA) annual meeting. In August 2012, at the meeting in Washington DC, ICAEW brought together leaders in accountancy theory and practice to discuss 'The future of IFRS: where do we go from here?'

ICAEW's Financial Reporting Faculty shares the IASB's vision of widely-applied, high-quality, international accounting standards. The faculty works closely with the IASB, providing comprehensive responses to all of its consultations – on new and revised standards, and on governance and related matters – drawing on the experience of our members in the business, public practice and investment communities around the world. The faculty does not, however, offer its support to the IASB lightly. Where necessary, its responses are critical, especially where proposals are unduly complex, and offer practical suggestions for improvement.

The faculty is committed to providing its members with the practical help they need in today's complex world of financial reporting. The faculty provides its members around the world, ICAEW and non-ICAEW, with clear and accessible assistance across a spectrum of financial reporting issues, keeping them up to date with changing regulations and standards. Its specialist online resources range from technical briefings and factsheets, to apps, webinars, blogs and bespoke online standards trackers.

The faculty's thought leadership programme, *Information for Better Markets*, helps to set the agenda for the future development of financial reporting. As part of this programme, the faculty hosts an annual academic conference that brings together leading thinkers from around the world to discuss key issues affecting financial reporting. The event attracts an international audience, including business people, auditors and standard-setters and is followed by publication of the papers presented at the conference in the academic journal *Accountancy and Business Research*.

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Executive summary

INTRODUCTION

In July 2002, regulations were adopted requiring all European Union (EU) companies with securities traded on a regulated market to prepare their consolidated financial statements for accounting periods beginning on or after 1 January 2005 in accordance with IFRS. The intention of European policymakers was to make financial reporting by European listed companies more transparent and comparable and to enable EU capital markets to function more efficiently.

The European Commission has been undertaking a major assessment of the impact of the IAS Regulation that required the adoption of IFRS across the EU, marking the 10th anniversary of mandatory IFRS reporting in Europe. As part of this assessment, in August 2014 the Commission published a detailed questionnaire seeking views from stakeholders on the costs and benefits of applying IFRS.

In preparing the ICAEW response to the Commission's questionnaire, the Financial Reporting Faculty consulted widely with ICAEW members in the UK and elsewhere in the EU and beyond. We spoke to members in the business, academic, public practice and investment communities, garnering views from preparers, users and auditors of IFRS financial statements. Before reaching conclusions we decided to also examine the significant body of evidence on the topic now available from academic sources.

The results of our consultation and review exercises indicated among other things that lessons might be learned by jurisdictions outside Europe contemplating, or in the early stages of, IFRS adoption from the experience of the UK and other EU member states. The purpose of this report is to place those lessons in a global context and provide in a succinct and accessible way some practical insights and recommendations for policymakers, regulators, standard-setters and other interested parties in jurisdictions that have recently adopted IFRS or are considering introducing or extending the application of IFRS reporting.

Three appendices to this report revisit the key perspectives provided by our 2012 report *The future of IFRS*, assessing briefly what has been achieved since, and go on to update our comments on the role of IFRS in the global financial crisis and the adoption of IFRS by the US.

LESSON ONE: THE BENEFITS OF IFRS OUTWEIGH THE COSTS, BUT …

The evidence on the potential benefits of mandatory IFRS adoption in the EU indicates that there were overall benefits across a range of key economic phenomena: transparency, comparability, cost of capital, market liquidity, corporate investment efficiency and international capital flows.

The research evidence shows that, as might be expected, these benefits were distributed unevenly among different companies and different countries. Due to differences in institutional contexts and incentives, it is possible that for particular companies or countries there were negligible benefits, or even net costs rather than benefits. But the overall message is clear, and in line with the expectations of policymakers and many investors: even in a relatively short period of time, the move to IFRS has had important economic benefits for Europe.

Overall, our conclusion is that the benefits of IFRS adoption outweigh related costs significantly. However, switching to IFRS involves to some degree a leap of faith. It is always likely to be very difficult to determine just how far the benefits found to follow mandatory IFRS adoption are attributable directly to the change of financial reporting standards or to any concurrent changes in other institutions. This may make it difficult for local commentators to appreciate the wider and longer-term benefits likely to arise from the switch in accounting framework and result in a focus on short-term costs and implementation challenges.

LESSON TWO: COMPANIES LISTED ON REGULATED MARKETS SHOULD BE REQUIRED TO USE IFRS, OTHERS SHOULD NOT

Experience suggests that the EU's decision not to mandate IFRS reporting by private companies was a wise one. IFRS are, after all, developed primarily with those companies in mind that raise funds from the capital markets. However, the logic of omitting from the scope of the IAS Regulation listed entities that are not groups, and other public interest entities that are not listed companies, is open to question.

Beyond that, while much depends on the local institutional infrastructure, a differential reporting regime and a phased process of migration to the new accounting framework seem likely to be the optimal approach when moving to IFRS-based reporting, with separate standards for companies that are not listed, ideally based closely on the IFRS for SMEs.

In recent months a debate has begun in Europe about whether there is a case for allowing smaller companies listed on certain types of market to use a simplified, tailored accounting standard. The outcome of this debate is far from certain.

LESSON THREE: LOCAL VARIANTS OF IFRS SHOULD BE KEPT TO A MINIMUM

For jurisdictions on a journey towards IFRS adoption, making amendments to individual IASB standards or carving out aspects of IFRS that they dislike may seem like attractive options, with little cost. Likewise, it is easy for local standard-setters or regulators to give in to the temptation of issuing unnecessary local guidance or interpretations, rather than relying on the exercise of appropriate professional judgement. However, most investors do not have the time or the resources to study the intricacies of local variations from IFRS as issued by the IASB, or to easily understand the implications of carve-outs or amendments. They want to be confident that the IFRS brand has been adopted by jurisdictions in full.

Experience suggests that the full benefits of IFRS adoption can only be reaped if the standards are adopted in full and not accompanied by local interpretations or quasi-interpretations, except where local legal or cultural differences make them absolutely necessary. While it needs to be acknowledged that 100% uniformity may never be possible, as even a global language will encompass different dialects and accents, formal carve-outs should be kept to a minimum and wherever possible should have a limited life.

Despite the impression some may have, with few exceptions, this has been the approach taken by the EU.

LESSON FOUR: SOMETIMES COMPLEXITY IS UNAVOIDABLE

The complexity of IFRS reporting requirements may well discourage some countries from fully embracing international standards. However, we would encourage such countries to think again, especially in the context of listed companies. Simplicity or a reduced disclosure regime are not desirable if they mean that investors are less well informed or have to seek additional information to explain the numbers reported in the annual financial statements.

We live in a complex world: where it is avoidable, accounting complexity is unacceptable, but today's business transactions will often necessitate complex accounting solutions.

LESSON FIVE: NATIONAL STANDARD-SETTERS AND REGIONAL GROUPINGS ARE IMPORTANT

In an era of global standards and global markets, strong national standard-setters continue to be essential partners of the IASB. This is not likely to change. Both national bodies and, increasingly, regional groupings have a central role to play in undertaking coordinated research, field testing and outreach activities as full members of a unique global standard-setting partnership.

LESSON SIX: STRONG NATIONAL ENFORCEMENT IS CRITICAL

Any assessment of financial reporting cannot be undertaken without reference to the local professional and institutional infrastructure. Policymakers in jurisdictions thinking about introducing IFRS reporting should first consider how they will ensure that the standards are enforced robustly. While they can look for support from international and regional bodies such as the International Organization of Securities Commissions (IOSCO) and the European Securities and Markets Authority (ESMA), a strong national enforcement regime is essential to realise the potential benefits of adopting global accounting standards.

Experience in Europe has also demonstrated the vital importance of mechanisms for sharing and coordinating enforcement decisions as a means of complementing and reinforcing nationally-based enforcement arrangements.

LESSON SEVEN: ENDORSEMENT UNDERPINS LEGITIMACY

Despite concerns over the time and effort involved, the EU's endorsement process – involving member state representatives and the European Parliament – has proved a critical means of establishing the political legitimacy of IFRS in Europe.

The approach to endorsement taken around the world will vary according to local circumstances. But jurisdictions considering IFRS adoption should aim to develop mechanisms with clearly-defined and manageable timetables, necessitating the early engagement of key local stakeholders and involvement from the start by the body responsible for endorsement in the standard-setting process.

When considering the scope and relative importance of endorsement criteria, policymakers should ensure that the need of investors and other users for transparent financial information is not overshadowed by reference to wider social, prudential or economic policy objectives.

Introduction

THE ADOPTION OF IFRS IN THE EU

In July 2002, regulations were adopted requiring all EU companies with securities traded on a regulated market to prepare their consolidated financial statements for accounting periods beginning on or after 1 January 2005 in accordance with IFRS. The intention of European policymakers was to make financial reporting by European listed companies more transparent and comparable and to enable EU capital markets to function more efficiently.

Some 7,000 companies across the then-25 member states switched from national GAAPs to IFRS in 2004. There were some major challenges to overcome. Some stakeholders were – perhaps understandably – reluctant to jettison longstanding and proud national accounting traditions. National political factors and sensibilities meant that others embraced international standards somewhat reluctantly. However, as shown by the major study[1] that ICAEW prepared for the European Commission in October 2007, all things considered, the transition went remarkably smoothly.

The EU's bold and far-sighted decision to switch to international standards proved to be a catalyst for the spread of IFRS around the globe. In addition to EU member states, countries such as Australia, New Zealand and South Africa were among the first wave of IFRS adopters. Since then progress towards a single set of high-quality global accounting standards has been remarkable. Today, well over 100 countries around the world require the use of IFRS or standards based closely upon IFRS in the consolidated financial statements of some or all companies.

However, almost 10 years on, the adoption of IFRS in the EU remains controversial in some quarters, with some continuing – for a variety of reasons – to question whether the introduction of international standards has been beneficial and calling for a return to what they see as the 'good old days' when most EU jurisdictions had their own domestic accounting standards.

EVALUATING THE IMPACT OF THE IAS REGULATION

As required by Article 9.2 of Regulation 258/2014[2], the European Commission (the Commission) has been undertaking a major assessment of the impact of the IAS Regulation[3] that required the adoption of IFRS across the EU, marking the 10th anniversary of mandatory IFRS reporting in Europe. The object of the exercise is to assess the economic effects of the application of international accounting standards and to determine whether the IAS Regulation has met its stated goals. The Commission is also seeking to establish whether, a decade on, those goals are still relevant and to identify any areas for improvement.

As part of this assessment, in August 2014 the Commission published a detailed questionnaire seeking views from stakeholders on the costs and benefits of applying IFRS.

The great majority of the more than 200 responses received concluded that the introduction of IFRS has improved the quality and consistency of financial reporting in the EU. These findings are consistent with similar post-implementation assessments undertaken in other countries, for example in Canada[4] and South Korea.[5] However, the global importance of the findings of the forthcoming European assessment should not be under-estimated. Never before has such a comprehensive post-implementation study been undertaken in a significant capital market.

ASSESSING THE EVIDENCE

In preparing the ICAEW response to the Commission's questionnaire, the Financial Reporting Faculty consulted widely with ICAEW members in the UK and elsewhere in the EU and beyond. We spoke to members in the business, academic, public practice and investment communities, garnering views from preparers, users and auditors of IFRS financial statements.

The input received was informative and enlightening, but before reaching conclusions we decided to also examine the significant body of evidence on the topic now available from academic sources.

The faculty therefore undertook an extensive review of relevant empirical academic research, examining and analysing the findings of around 170 research papers on the effects of mandatory IFRS adoption in the EU. This mammoth exercise resulted in the publication in October 2014 of a preliminary report entitled *The effects of mandatory IFRS adoption in the EU: a review of empirical research*,[6] which was delivered to the Commission along with ICAEW's response[7] to the questionnaire.

The preliminary report – which provides an unparalleled assessment of the available evidence – has been widely acclaimed as shedding new light on the complex impacts of applying international accounting standards. Above all else it shows that, although the introduction of IFRS in the EU was a significant challenge, it has resulted in a number of important benefits. It was the subject of an event with the Commission and a range of key stakeholders in Brussels in January 2014. A final version of the report, reflecting about 200 research papers in total and further input since publication of the preliminary report, was published in April 2014.

A BROADER PERSPECTIVE

The results of our consultation and review exercises indicated, among other things, that lessons might be learned by jurisdictions outside Europe contemplating, or in the early stages of IFRS adoption, from the experience of the UK and other EU member states.

The purpose of this report is to place those lessons in a global context and provide succinct and accessible practical insights and recommendations for policymakers, regulators, standard-setters and other interested parties in jurisdictions that have recently adopted IFRS, or are considering introducing or extending the application of IFRS reporting.

What follows takes account of the reported experiences of our members, the results of our assessment of the academic evidence on the use of IFRS in the EU and aspects of the long-running debate about the scope of IFRS reporting in the UK. It reiterates and updates where appropriate some of the ideas and analysis first advanced in our 2012 report, *The future of IFRS*.[8] References to 'our' views and what 'we' think refer to the views of ICAEW, as formulated through discussions with ICAEW members experienced in the application of IFRS and use of IFRS financial statements and by reference to the available academic and other evidence.

Three appendices to this report revisit the key perspectives of *The future of IFRS*, assessing briefly what has been achieved since 2012 and updating our comments on the role of IFRS in the global financial crisis and the adoption of IFRS by the US.

We hope that this report provides a balanced assessment of what is needed to ensure the ongoing success of the IFRS project and that it can contribute to the global debate about the pros and cons of IFRS adoption. ICAEW would welcome any comments on this report and any insights on the issues it raises. These should be emailed to the authors, Dr Nigel Sleigh-Johnson FCA at nigel.sleigh-johnson@icaew.com and Eddy James FCA at eddy.james@icaew.com. For more information and additional resources visit icaew.com/ifrslessonslearned

1. Lesson one: the benefits of IFRS outweigh the costs, but ...

1.1 A UNIVERSAL FINANCIAL LANGUAGE

It is widely acknowledged that a universal financial language offers many potential advantages. Cross-border businesses should benefit from reduced preparation costs. Cross-border trading in securities should increase as investors find that they can more readily compare the performance of companies based in different countries. In turn, this should result in increased market efficiency and a reduction in the cost of raising capital by business, which ultimately helps to boost economic growth.

The rapid spread of IFRS in recent years means that these benefits are no longer theoretical. A growing body of research shows that they are increasingly evident in practice. This chapter summarises some of the key benefits and costs of IFRS adoption. It draws particularly on the work undertaken to prepare our review of the academic evidence, *The effects of mandatory IFRS adoption in the EU: a review of empirical research*.

1.2 BENEFITS

Transparency
Financial reporting is transparent to the extent that it allows readers to understand the reporting company's financial performance and financial position.

Research evidence to date differs on whether mandatory IFRS adoption improved the overall transparency of EU companies' financial reporting. On balance, however, it suggests that there was indeed an improvement, albeit one not experienced by all companies or in all countries. This is not surprising: the effects and perception of the impact of IFRS adoption within any individual country will vary, depending on, among other things, whether its national standards were similar or not to IFRS, the relative importance in economic terms of its listed sector and the extent to which its businesses trade beyond its borders.

ICAEW's assessment, taking account of the research and other evidence, including the views of ICAEW members we consulted, is that the application of IFRS since 2005 has significantly increased the transparency of financial reporting in most EU member states.
In particular:

- no member state had an accounting regime that included a comprehensive financial instruments standard, whereas IFRS does;
- accounting for share-based payments was not adequately addressed in most national GAAPs;
- detailed segmental reporting was not required by many national GAAPs, making it hard for users of financial statements to compare meaningfully a reporting entity's performance from period to period, and against its peers; and
- company law and other legal requirements often imposed restrictions that meant that the substance of transactions was not represented in the financial statements, for example in the presentation of non-equity or preference shares.

Overall, it seems clear that IFRS adoption has made it easier to understand companies' financial positions and performance, the primary objective of financial reporting. The degree of standardisation resulting from the common application of IFRS recognition and measurement requirements, coupled with the extensive IFRS disclosure regime, renders financial reporting easier to comprehend. Users no longer need detailed knowledge about multiple GAAPs and can much better understand the accounting principles, policies and judgements applied by those preparing the financial statements.

Accounting quality
The concept of 'accounting quality' is much used by academic researchers. It typically refers to a small group of financial reporting issues affecting the measurement of net income and of assets that are subject to impairment. Poor quality accounting is characterised by phenomena such as income smoothing, untimely recognition of losses and a greater readiness to recognise good news rather than bad news in the accounts.

It is often claimed that the introduction of IFRS has improved accounting quality in the EU. There is little firm evidence to support such a broad-brush statement, as the effects differ among companies and among countries, depending on the robustness of their pre-IFRS financial reporting regimes. The quality of enforcement also has a key role to play. However, some research evidence does suggest that there has been improvement in the quality of accounting under IFRS over time as preparers, auditors and users gradually accumulate the necessary experience to apply the standards more effectively. Emerging good practice and common understandings can also contribute to a stepwise enhancement in accounting quality.

Comparability
ICAEW's assessment is that across the EU and globally, IFRS adoption and convergence with IFRS have had a significant, positive effect on comparability of published financial information, especially by major international businesses – which is perhaps where the case for global standards is strongest.

As IFRS embody a significant number of accounting policy choices, complete comparability is not, however, to be expected and, not surprisingly, there is ample evidence among the research papers of continuing limitations in comparability. The evidence of continuing financial reporting differences also points to the importance of differences in institutional context and incentives among companies and countries. But while research evidence differs on whether mandatory IFRS adoption improved the comparability of the financial reporting of EU companies, on balance it supports the view that there was indeed an improvement.

We do not think it was expected that IFRS adoption would have a significant effect on the comparability of financial reporting within member states. For example, within the UK there has been some enhancement of comparability and some reduction, depending for example on where IFRS and prior UK GAAP respectively permitted options in accounting policies. But overall the increases in comparability have tended to occur in the more important areas of reporting, such as accounting for financial instruments, far outweighing any loss of comparability.

The cost of capital
Research evidence is not entirely conclusive on whether mandatory IFRS adoption reduced the cost of equity and debt capital for EU companies. On balance though, it suggests that there were reductions in the cost of equity capital and in the cost of bonds, albeit not experienced by all companies or in all countries. The effects of mandatory IFRS adoption in the EU on the cost of loans, as opposed to bonds, are unclear; this is perhaps unsurprising, as bank lenders rely less on published financial reporting information than participants in bond markets.

Our assessment, drawing on the views and experiences of our members, is that capital-raising in the EU has generally been made easier due to increased transparency, particularly in accounting for derivative financial instruments, and greater comparability and confidence in financial statements. Research data also suggests that access to international capital has become easier since IFRS adoption. But it is difficult for a company to isolate the effects of regulatory changes on its cost of capital. Some of the research evidence suggests a decline in the cost of capital following IFRS adoption. But inevitably, the academic evidence is mixed, and it is unclear to what extent concurrent institutional changes in the EU (which were significant, particularly in terms of enforcement) may have affected the outcome.

It is also important to note that the removal of the US requirement for foreign registrants to provide reconciliations from IFRS to US GAAP has facilitated access to the US capital market for EU companies as a direct consequence of the EU adoption of IFRS. This is a significant advantage for those wishing to access the deep and liquid US securities markets.

Market liquidity and cross-border investment

Research evidence, while somewhat inconclusive, suggests on balance that mandatory IFRS adoption increased the liquidity of the equity market for EU companies as a whole. The increase was not experienced by all companies or by all countries, and we are not aware of any research on the effects of mandatory IFRS adoption in the EU on liquidity in bond markets.

Researchers appear to agree that there was increased cross-border investment – both foreign direct investment and foreign portfolio investment – following mandatory IFRS adoption. They agree, again, that it was not experienced uniformly by all companies or all countries.

Other benefits

As well as frequently quoted benefits such as improved comparability, experience suggests that companies can experience wider, incidental benefits on switching to international standards. For example, reconsideration of processes, controls and business practices and accounting policies can lead to new ideas and better ways of doing things.

The use of common financial reporting standards in the EU and beyond has also resulted in better coordination across audit firms on a global basis. This in turn may have contributed to an increase in audit quality. Moreover, a single set of accounting standards across the EU has, in our view, been a substantial step towards creating a level playing field, not least by facilitating the creation of a cross-border pool of experienced IFRS professionals.

1.3 COSTS

Preparation costs

Different GAAPs involve different costs for preparers, depending on factors such as the complexity of the standards, the extent of the disclosures required, and whether their application involves the use of information (such as valuations) that would not otherwise be available.

Switching from one GAAP to another also imposes one-off costs as preparers learn about the new requirements and, where necessary, make changes to accounting systems. Mandatory IFRS adoption in the EU inevitably involved such one-off costs as the new accounting framework was implemented, but of greater interest perhaps would be firm evidence of higher recurring preparation costs when comparing IFRS and previous accounting regimes. Unfortunately, there is a lack of academic research in this respect.

ICAEW's 2007 report does provide estimates for initial and recurring preparation costs, including external audit costs, involved in IFRS implementation. One point of interest is that they show proportionately higher costs for smaller publicly-traded companies, reflecting economies of scale for larger companies.

While some companies will undoubtedly have experienced an increase in preparation costs over the past decade, it would be wrong to assume that this is purely a consequence of the move to IFRS in 2004. Many respondents to the Commission's 2014 survey on the effects of mandatory IFRS adoption suggested that there were other important reasons why such costs had tended to increase, including the increasing complexity of the business world, more robust accounting enforcement and harmonisation initiatives, such as the introduction of a single financial services market through the Markets in Financial Instruments Directive (MiFID) and related measures introduced as part of the Commission's Financial Services Action Plan.

Other potential costs

There are, potentially, other negative effects of IFRS adoption. For example, accounting-based debt covenants and management compensation contracts may have been subject to renegotiations when IFRS was introduced, and the increased use of fair value measurements for some financial instruments may have affected the risk management strategies of some companies. These effects may have resulted in higher costs for some companies. However, such topics are not heavily researched, so there is little evidence on the extent and frequency of such costs.

Cost reductions

All things considered, our assessment is that IFRS adoption has led to cost reductions for companies by comparison with national GAAPs. These and other benefits of applying global and generally principles-based, robust accounting standards should be substantial and for the long term, and will tend to increase over time as more jurisdictions and businesses move to IFRS reporting.

Inevitably, the trade-off between costs and benefits works out differently for different companies, for different sectors and different users, and perhaps for different jurisdictions. The balance between costs and benefits will depend on whether, among other things, the company operates in multiple jurisdictions and has a listing in the US. There may well be cases where IFRS adoption has involved net costs.

Implementation over the next few years of IFRS 15 *Revenue from Contracts with Customers* and the final version of IFRS 9 *Financial Instruments* will present significant new challenges for some EU companies, and will inevitably involve some new costs. However, it is widely anticipated that implementation of the new standards will lead overall to a significant improvement in financial reporting.

LESSONS LEARNED

The evidence on the potential benefits of mandatory IFRS adoption in the EU indicates that there were overall benefits across a range of key economic phenomena: transparency, comparability, cost of capital, market liquidity, corporate investment efficiency and international capital flows.

The research evidence shows that, as might be expected, these benefits were distributed unevenly among different companies and different countries. Due to differences in institutional contexts and incentives, it is possible that for particular companies or countries there were negligible benefits, or even net costs rather than benefits. But the overall message is clear and in line with the expectations of policymakers and many investors: even in a relatively short period of time, the move to IFRS has had important economic benefits for Europe.

Overall, our conclusion is that the benefits of IFRS adoption outweigh related costs significantly. However, switching to IFRS involves, to some degree, a leap of faith. It is always likely to be very difficult to determine just how far the benefits found to follow mandatory IFRS adoption are attributable directly to the change of financial reporting standards or to any concurrent changes in other institutions. This may make it difficult for local commentators to appreciate the wider and longer-term benefits likely to arise from the switch in accounting framework and result in a focus on short-term costs and implementation challenges.

2. Lesson two: listed companies and other public interest entities should be required to use IFRS, others should not

2.1 SCOPE OF THE IAS REGULATION

The obligation to use IFRS set out in the IAS Regulation applied from 2005 to the consolidated financial statements of EU companies with securities traded on a regulated market in the EU. There are around 7,000 such entities. In the UK, stock exchange rules extended this requirement from 2007 to the group accounts of the 1,104[9] companies listed on the secondary market, AIM.

2.2 EXTENDING THE USE OF IFRS TO INDIVIDUAL ENTITY ACCOUNTS

ICAEW argues that there is a strong case for the extension of the IAS Regulation to require the individual entity accounts of listed companies that do not prepare consolidated accounts to comply with IFRS, rather than national GAAP. It seems an anomaly that, subject to member state requirements, such companies are not required to comply with IFRS and so may prepare financial reporting information that is not comparable with that of other listed companies. This is unhelpful to users of that information.

The original limitation of the scope of the IAS Regulation to consolidated accounts owed much to a desire to avoid complications with national legal requirements on distributable profits and taxation, which apply in all EU countries to individual entity accounts. These considerations present significant obstacles to the extension of mandatory IFRS reporting, but experience suggests that they are not insurmountable. One solution might be for such companies to report under IFRS for market purposes but to be granted an option to prepare local GAAP accounts for other legal and regulatory purposes.

While this suggestion implies some limitation of member states' existing powers, we believe that they should continue to have the ability to extend the application of IFRS to other types of entity where doing so is deemed suitable given local circumstances.

2.3 EXTENDING THE USE OF IFRS TO OTHER PUBLIC INTEREST ENTITIES

ICAEW has also suggested that the merits of extending the requirement to comply with international accounting standards to certain other public interest entities should be explored. These might include unlisted credit institutions, unlisted insurance undertakings and other public and private sector undertakings considered to be of significant public interest.

2.4 SMALLER LISTED COMPANIES

The UK's Financial Reporting Council (FRC) – which among other things reviews the quality of corporate reporting – has noted that it sees a higher number of poorer quality accounts produced by smaller listed and AIM companies than by their larger counterparts. Its 2014 annual report[10] noted that such entities often struggle to account for complicated transactions.

In response to these concerns, the FRC has recently inaugurated a project aimed at driving a step change over three years in the overall quality of reporting by companies in this section of the market. The initial phase of this project involves gathering and assessing evidence of the root causes of issues and exploring ways in which the FRC can support companies to make improvements. Subsequent phases will see the FRC implementing possible supporting actions and, finally, assessing whether the quality of reporting has improved as a result. Countries thinking of extending the use of IFRS to smaller companies listed on non-regulated markets may wish to monitor the progress of this ambitious project.

In response to similar concerns in other European markets, some have argued for the introduction of an EU-wide simplified accounting standard tailored to companies listed on certain markets. Indeed, the February 2015 Commission Green Paper *Building a Capital Markets Union*[11] highlights the potential benefits – and cost savings – associated with such a development. ICAEW has some serious concerns about this proposal.

Financial reporting by smaller listed companies is likely to be the subject of considerable debate across the EU in the coming months and years.

2.5 PRIVATE COMPANIES

Since 2005, the IAS Regulation has allowed EU member states to require or permit private companies to apply IFRS. This option has not been widely taken up, for a variety of reasons. In some jurisdictions local tax rules, company law and other regulations are seen by boards as significant barriers to adoption.

While in the UK, the use of the option for private companies to use IFRS has been rare, a new standard based closely on the IFRS for SMEs has been developed, replacing current UK GAAP with effect for accounting periods commencing on or after 1 January 2014. The scope of that standard will be extended from 1 January 2016 to small companies, with some relaxations for such companies to the presentation and disclosure requirements of the standard. Like AIM companies in 2007, those implementing IFRS-based standards for the first time will be able to draw on a pool of chartered accountants and other IFRS professionals already well-versed in the requirements of international accounting standards and experienced in their practical application.

The extensive debate and consultation in the UK about the proposed reform of accounting standards for private companies, including small companies, shone much light on the likely costs and benefits of bringing the UK regime broadly into line with international principles. It was concluded that:

- mandatory IFRS application for companies should not be extended beyond the scope of the IAS Regulation;
- the IFRS for SMEs is suitable for application by all other companies, albeit with some modifications to reflect the UK reporting environment and practices and a reduction in disclosure for small entities;
- an optional standard should be introduced with measurement and recognition requirements consistent with IFRS but reduced disclosure requirements for use, for example, by subsidiaries of IFRS reporters; and
- following on from EU legislation in 2012 that provided significant exemptions from the EU Accounting Directives for 'micro-entities', a second optional standard should be provided for companies with a turnover of £632,000 or less, based on the new UK standard for private companies, but with some very significant simplification of its measurement requirements (including a prohibition on fair value accounting and an exemption from accounting for deferred tax) and very little by way of disclosure.

Thus, while in terms of recognition and measurement, financial reporting by the entire spectrum of UK reporting entities will, finally, be aligned broadly with international standards from 2016, the key outcomes of extensive policy debates are clear:

- the full suite of IFRS is a suitable set of standards for all listed companies;
- the full suite of IFRS is not suitable for all unlisted companies ie, those businesses that do not raise funds on the capital markets; and
- universal alignment of accounting principles is desirable, with the IFRS for SMEs as the natural starting point

3. Lesson three: local variants of IFRS should be kept to a minimum

3.1 EU-ADOPTED IFRS ARE VIRTUALLY IDENTICAL TO IFRS AS ISSUED BY THE IASB

ICAEW has encountered an entrenched belief outside Europe that the EU has made significant changes to IFRS. This belief is misplaced, but it seems difficult to eradicate and might lend support to those in other jurisdictions who do not support IFRS adoption or convergence.

This belief may have been prompted by the so-called 'carve-out' in 2004 of certain requirements of IAS 39 relating to macro hedging. In reality, this carve-out affects only a small number of European banks and has not caused significant problems for the many other entities within the scope of the IAS Regulation. It might be helpful in this context for European companies to state where applicable, for the avoidance of doubt, that their financial statements not only comply with 'IFRS as adopted by the EU' but also with the standards issued by the IASB. Furthermore, many, including ICAEW, think that every effort should be made in the context of the forthcoming debate over endorsement of IFRS 9 and the IASB's continuing work on macro hedging to create the circumstances in which the carve-out can be ended.

There have, however, been problems for some companies, caused by delays in adopting new and amended standards in the EU. To some degree this has been the result of the sometimes rather slow pace of the endorsement process, discussed below, including in relation to relatively minor amendments. Given the European Financial Reporting Advisory Group's (EFRAG) early involvement in the development of new standards, during which time relevant arguments and debates are well-aired in Europe, it is unfortunate for the final endorsement process to take so long that it risks missing the standard's stated implementation date (itself usually a generous period after the final standard's publication).

3.2 THERE IS NO CASE FOR SEPARATE EUROPEAN ACCOUNTING STANDARDS

There are still calls from some quarters for the development of a separate set of European accounting standards, perhaps based on, but not identical to, IFRS.

The responses to Philippe Maystadt's enquiries about IFRS in 2013 on behalf of the Commission suggest that few key European stakeholders support such a move. The risks of assigning the Commission or some newly-created EU standard-setting body more leeway to modify international standards far outweigh any potential benefits. Indeed, there is a widespread view that any move in the direction of European standards would undermine investor confidence and damage severely Europe's capital markets, perhaps irreversibly, not least as experience suggests that the EU would find it challenging to create and maintain with any degree of success a common set of high-quality and widely-accepted accounting standards.

Such a development would, in our view, only impede progress towards economic growth in Europe and international financial reporting harmonisation. The IFRS 'brand', recognised by capital market participants around the world, cannot be trifled with without a risk of devaluing it entirely, endangering the whole global IFRS project. The EU should remain a powerful commentator on IFRS developments, but providing the Commission with more discretion to modify the IASB's standards would most likely damage rather than enhance European influence.

It is highly unlikely, nonetheless, that we will ever see everybody around the world using IFRS as published by the IASB. It is inevitable – albeit undesirable – that countries will from time to time be unable or unwilling to adopt individual standards without amendment. If it is accepted that jurisdictions will wish to retain ultimate political sovereignty in this area, this is a reality that is not going to disappear tomorrow. But we expect continuing and growing pressure from both markets and international regulators and development agencies for such countries to align their own standards as closely as possible with IFRS. Indeed, recent experience has shown that countries that initially make changes to IFRS tend to revert in time to full compliance in order to realise the full benefits of applying internationally-recognised standards.

3.3 AUTHORITATIVE LOCAL GUIDANCE AND INTERPRETATIONS SHOULD BE KEPT TO A MINIMUM

Companies in the early stage of IFRS implementation face many challenges, particularly in jurisdictions where the former accounting framework relies heavily on a detailed body of rules. This can lead to a clamour for additional guidance, as was the case in Europe in the run-up to the switch to IFRS. However, as few of the issues involved are likely to merit the publication of formal interpretations by the IFRS Interpretations Committee, there can be a temptation for national authorities to issue authoritative guidance or interpretations to supplement the requirements of IFRS.

Europe, after some initial wavering, stepped back from the brink. Local authoritative guidance and formal interpretations have been a rarity, and ICAEW continues to believe firmly that authoritative guidance on the application of IFRS should be a matter solely for the IFRS Foundation. The alternative is likely to be inconsistent authoritative interpretations, leading to less comparable financial reporting and a more complex body of accounting literature.

In some ways, this conclusion may seem counter-intuitive, as local prescription may seem likely to make things more comparable and less complex by, say, requiring all investment properties to be measured at fair value or requiring all banks to create provisions of x% against their loan books. And within national boundaries that may be true. But if each country issues its own guidelines and rules, international comparability and investor confidence would become progressively weaker. Moreover, in some cases, prescribing or limiting what companies can or cannot do would make it impossible to claim compliance with IFRS as issued by the IASB.

Having said that, the IFRS Foundation itself should avoid a proliferation of interpretations, as that would dilute the primarily principles-based nature of IFRS and might well stymie over time the emergence of good practice and common market-driven understanding. Sometimes less is more, and the experience in Europe seems to underscore this.

Professional judgement will always need to be used when applying financial reporting standards to complex, uncertain or new transactions or events. Putting in place what amount to ever more detailed rules will never overcome this and in the end becomes self-defeating, as more rules lead to more opportunities for underlying principles to be circumvented. Amending standards too regularly – and amending new standards too soon – similarly may prove to be more harmful then helpful.

Prudential and other regulators are important stakeholders in the financial reporting process, as we observe in the following section, but can have a distinct focus, not necessarily aligned at all times with the interests of investors. A clear division between the responsibilities of standard-setters and regulators is therefore of high importance. Experience suggests that it will sometimes be necessary for regulators to clarify the interaction of IFRS with local law or regulation, and occasionally to take account of very significant cultural differences. But regulators should avoid straying into the area of general interpretation of IFRS or the development of authoritative application guidance.

If regulators see a need to go beyond clarifying the interaction with local requirements, they should do so only after liaising closely with the IASB. Acting in isolation not only detracts from the international nature of IFRS, it also results in divergence in application. In some cases, too much regulation may even make communication with investors poorer rather than better. For example, some think that the European Securities and Markets Authority's (ESMA) proposed guidelines on alternative performance measurement – which suggested that non-GAAP measures should be presented with less prominence than GAAP information – may make it harder for companies to tell their underlying economic story.

Non-authoritative views and practical examples and illustrations regarding how IFRS might be interpreted are a different matter; everyone is entitled to express their own views on accounting matters.

3.4 100% UNIFORMITY MAY NEVER BE POSSIBLE

Differences in IFRS implementation that arise from differences in corporate governance, auditing and regulatory regimes will no doubt persist for a long time to come. We do not live in a homogeneous world, and just have to accept that. We should not expect that even a single set of global standards will mean complete uniformity across the planet. Local differences – some deliberate, some accidental – seem likely to be a feature of the world for the foreseeable future.

But we can expect their significance in a financial reporting context to decline over time as both regulatory and market forces tend to push further towards globalisation. Perhaps, therefore, we should not be overly concerned about local differences in how IFRS are applied, provided they remain relatively minor in nature, or perhaps result simply in differences in presentation. It should not be forgotten that previous national GAAPs were not free from inconsistency of application.

Dialects and accents within one national 'language' always existed. Is it realistic to expect IFRS to be any different, especially given their global reach?

LESSONS LEARNED

For jurisdictions on a journey towards IFRS adoption, making amendments to individual IASB standards or carving out aspects of IFRS that they dislike may seem like attractive options, with little cost. Likewise, it is easy for local standard-setters or regulators to give in to the temptation of issuing unnecessary local guidance or interpretations, rather than relying on the exercise of appropriate professional judgement. However, most investors do not have the time or the resources to study the intricacies of local variations from IFRS as issued by the IASB, or to easily understand the implications of carve-outs or amendments. They want to be confident that the IFRS brand has been adopted by jurisdictions in full.

Experience suggests that the full benefits of IFRS adoption can only be reaped if the standards are adopted in full and not accompanied by local interpretations or quasi-interpretations, except where local legal or cultural differences make them absolutely necessary. While it needs to be acknowledged that 100% uniformity may never be possible, as even a global language will encompass different dialects and accents, formal carve-outs should be kept to a minimum and, wherever possible, should have a limited life.

Despite the impression some may have, with few exceptions, this has been the approach taken by the EU.

4. Lesson four: sometimes complexity is unavoidable

4.1 LENGTHIER FINANCIAL STATEMENTS

Listed companies in the EU have seen a relentless growth in the length and complexity of their financial statements in recent years. The blame for this growth is often laid at the door of IFRS. Some commentators claim that international standards are too complex. Moreover, the lengthy and often very detailed disclosures that IFRS requires have attracted much criticism.

4.2 MODERN BUSINESS IS COMPLEX

Complexity in financial reporting has, however, more than one cause. In particular, few would deny that the transactions that entities undertake have become more complex in recent decades, especially in relation to financial instruments. As financial reporting seeks to faithfully portray the economic substance of transactions, it too has inevitably become more complex. While there are arguments to suggest that accounting developments can encourage the development of more complex financial products, there seems little doubt that much of the complexity that exists in financial reporting reflects the complexity of modern business and finance.

Some areas of IFRS financial reporting – such as accounting for financial instruments – can certainly be difficult to understand. However, this is often because the transactions reported are themselves complex and difficult to understand: not many people fully understand the more complex types of derivatives. Financial reporting could be made simpler by ignoring the complexity of what it attempts to portray, but we do not think that this would be sensible or helpful to users. For example, it would be possible to make the financial reporting of derivatives easier to understand by reverting to the pre-IFRS practice of not recognising them on-balance sheet and deferring the recognition of gains or losses until they are settled, but clearly this would not be at all helpful to investors.

Complexity can, however, result from the need to apply unclear or inappropriate accounting requirements to relatively simple transactions or arrangements. This aspect of complexity is unacceptable. Indeed, ICAEW continues to urge the IASB to strive to minimise complexity in its standards, and to redouble efforts to eliminate unnecessary disclosure. The IASB also needs to hold fast to the vision of principles-based standards that require a reasonable degree of judgement in their application. But, overall, the degree of complexity in IFRS reporting may not be as unreasonable as some suggest.

4.3 DISCLOSURE OVERLOAD

Much has been written in Europe and elsewhere about 'disclosure overload' in recent years, with some preparers contending that the time has come to re-evaluate what financial statement disclosures are really needed. A number of commentators have suggested that it would be possible to simply 'take a red pen' to swathes of IFRS disclosures, eliminating many existing requirements at a stroke.

The IASB is aware of concerns over disclosure overload. It is undertaking a broad-based initiative to explore how disclosures in IFRS financial reporting can be improved and has instigated a number of research projects under the umbrella of its 'disclosure initiative'. It is hoped that this holistic approach will ultimately lead to the development of a set of principles for disclosure in IFRS financial statements.

However, it is important to consider the other side of the coin. In our experience, investors and analysts value the contents of audited annual financial statements as a natural starting point for analysis, as a regular point of reference, and as a source of validation of financial results and position. They typically want more disclosure, not less. The recent work of the UK FRC's Financial Reporting Lab has, as much as anything, drawn attention to the diversity of the information needs of investors and their varying views on the best way to improve presentation, clarity and conciseness in listed company financial reports. The scope for unforeseen consequences of a rush to cull disclosures is potentially enormous.

Addressing this conundrum remains critical to the future success of IFRS. The disclosure initiative is a good step in the right direction, and is widely supported. But it's only a partial solution to a deep-seated problem.

LESSONS LEARNED

The complexity of IFRS reporting requirements may well discourage some countries from fully embracing international standards. However, we would encourage such countries to think again, especially in the context of listed companies. Simplicity or a reduced disclosure regime are not desirable if they mean that investors are less well informed or have to seek additional information to explain the numbers reported in the annual financial statements.

We live in a complex world: where it is avoidable, accounting complexity is unacceptable, but today's business transactions will often necessitate complex accounting solutions.

5. Lesson five: national standard-setters and regional groupings are important

5.1 A NEW ROLE FOR A NEW ERA

As the use of IFRS has spread across the globe, questions have inevitably been asked about what role should be played by national standard-setters in countries where global standards have been adopted.

Ten years ago, some were suggesting that national standard-setters would not be needed in Europe in the new era of global standards and that they would simply wither on the vine. However, the reality is that they continue to have a number of vitally important roles to play, including undertaking research, providing guidance on the IASB's priorities, encouraging stakeholder input from their own jurisdictions into the IASB's due process and identifying emerging issues. Some have also made the case for national bodies continuing, for example, to develop local standards for not-for-profit organisations or micro-entities.

The need for strong national standard-setters is, perhaps, greater today than ever before.

In the UK, the case for retaining a national standard-setter has been debated at length since 2005, with the resounding conclusion that a well-resourced national body remains critical for setting standards for UK entities other than listed companies and for influencing the debate at international level.

5.2 REGIONAL BODIES HAVE AN INCREASINGLY IMPORTANT ROLE TO PLAY

The emergence of regional bodies such as EFRAG, the Asian-Oceanian Standard-setters Group (AOSSG), the Group of Latin-American Accounting Standard Setters (GLASS) and the Pan African Federation of Accountants (PAFA) provides the IASB with the opportunity of not only working with individual national standard-setters, but increasingly with regional groupings too.

Together with national standard-setters, these regional groupings of national standard-setters and others have the potential to play an important role in undertaking coordinated research, field testing and outreach activities, thereby contributing to shaping the global debate by sharing experience. Efforts should continue to ensure that this potential is realised, which can only improve both the overall quality of IFRS and consistency of application.

It is early days, but it seems unlikely that regional groupings could – or should – completely displace national standard-setters as key partners of the IASB. The efficiency of the standard-setting process will clearly be enhanced where coherent and broadly-agreed regional views can be reached and presented to the IASB. But this process should not dilute the richness of the debate or deny national standard-setters with a minority point of view a fair hearing. In many cases, it may continue to be better for regional groupings to present a balance of views to the IASB rather than attempt to agree upon a single solution.

In our view this remains the case in Europe, notwithstanding the efforts of EFRAG to present a single European voice when responding to IASB proposals. ICAEW strongly supports the overall objective of better coordinating the views of Europe on IFRS developments and recent reforms to improve the effectiveness of EFRAG. However, this should not be at the expense of reducing the richness, in both breadth and depth, of the European contribution to the international debate during the development of the standards. We encourage organisations across Europe to work closely with the newly-constituted EFRAG in developing their submissions to the IASB, although organisations like ICAEW will no doubt continue, where appropriate, to submit their own views on IFRS proposals directly to the IASB. This approach should ensure that the views of all jurisdictions and key stakeholders are heard and understood – experience shows that anything less invariably leads to tensions and dissatisfaction in the long run.

5.3 FROM BI-LATERAL AGREEMENTS TO A MULTI-LATERAL MODEL

The creation of the Accounting Standards Advisory Forum (ASAF) in 2013 was designed to formalise and streamline relationships between the IASB and representatives from the global standard-setting community.

In our view, the creation of this new body is a major step in the right direction. It provides a formal mechanism through which national standard-setters from Europe and the rest of the IFRS world and regional bodies can contribute constructively towards the achievement of the IASB's goal of developing globally accepted high-quality accounting standards by bringing local perspectives to the IASB's technical work and offering feedback on important issues.

Ever closer involvement with key national standard-setters and regional groupings – as well as with securities regulators, auditors and national accounting institutes – should help over time to transform the IASB into a truly global and accountable organisation. This, in turn, should help to engender an increased sense of ownership among stakeholders in Europe and around the world, perhaps reducing the likelihood of local amendments, interpretations and carve-outs.

LESSONS LEARNED
In an era of global standards and global markets, strong national standard-setters continue to be essential partners of the IASB. This is not likely to change. Both national bodies and, increasingly, regional groupings have a central role to play in undertaking coordinated research, field testing and outreach activities as full members of a unique global standard-setting partnership.

6. Lesson six: strong national enforcement is critical

6.1 THE IMPORTANCE OF STRONG ENFORCEMENT

Any assessment of financial reporting cannot be undertaken without reference to the local professional and institutional infrastructure. In particular, the EU experience shows that robust enforcement, including that exercised by the courts, is an essential corollary of good financial reporting. Without the introduction of appropriate enforcement mechanisms for IFRS reporting, alongside, among other things, high standards of professional education and training, corporate governance and auditing, there will be no certainty that the accounting information reported by listed companies is either reliable or comparable.

6.2 THE ROLE OF REGULATORS

The IFRS Foundation can improve understanding of IFRS and equip preparers with the skills needed to apply principles-based standards through its educational initiatives. It is also responsible for issuing standards that can be enforced consistently. But it is not responsible for ensuring consistent application of those standards around the world. The job of enforcing IFRS is – quite rightly – left to regulators. The IFRS Foundation must therefore rely on bodies such as IOSCO and ESMA to coordinate enforcement of its standards internationally.

National regulators around the world and regional and international umbrella organisations therefore have a critical role to play in the new era of global financial reporting. First steps have been taken in this regard, but there is still more to do. If they are to be more effective, they need to work together very closely not only with the IFRS Foundation, but also with each other. Only by routinely exchanging information, sharing perspectives and comparing experiences can they ensure that enforcement is consistent on a global scale. In this connection, it is widely agreed in Europe that ESMA plays an important role by providing an effective conduit for the transmission of information around the EU on the enforcement of IFRS and facilitating a broad consistency of approach among national regulators. Doing so encourages improvement in EU jurisdictions with less rigorous monitoring and enforcement mechanisms.

At the same time regulators should seek to avoid unintended consequences. In particular, they need to ensure that, by their actions and style, they do not encourage disclosure of immaterial items or stifle the exercise of the professional judgement that underpins the application of principles-based standards.

6.3 ENFORCEMENT IN THE EU

The IAS Regulation requires EU member states to take appropriate action to ensure compliance with IFRS. In other words, enforcement is the primary responsibility of each individual member state.

ESMA has an important role in encouraging consistency and coherence in enforcement across the EU through, among other things, reporting the results of thematic reviews and setting common enforcement priorities. But there are some calls for a more centralised approach to enforcement within the EU. Critics say that inconsistent application is inevitably built into a system in which some national regulators tell preparers how they should comply with specific requirements of IFRS, while others do not. They also point out that further inconsistencies occur because companies will often decide how to choose from the options available under IFRS by reference to what used to be done under their previous GAAPs.

While acknowledging that the quality of enforcement does vary from member state to member state, ICAEW does not support any enhancement of ESMA's powers or role at the expense of those of member states. Experience suggests that an effective enforcement regime should be based on the operation of effective national enforcement bodies. They understand the specific requirements of the national regulatory framework and, as a result, are best placed to tailor their enforcement approach accordingly. National regimes also tend to be speedier and more efficient in delivering judgements.

Guidance designed to promote more consistent enforcement of financial information is, of course, welcome, particularly to help ensure that regulators remain even-handed, for example between domestic and foreign companies listed in their country. It is appropriate that ESMA continues to encourage coordination and cooperation and to issue best practice guidelines for national enforcers. However, any regional guidelines must pay due regard to the diversity of national markets and enforcement regimes.

ESMA also maintains a database of enforcement decisions by national enforcers across the EU. It regularly publishes extracts from this database with the aim of providing preparers and users of financial statements with relevant information on the appropriate application of IFRS and informing market participants about which accounting treatments European national enforcers may consider as compliant with IFRS. Publication of these decisions, together with the rationale behind them, should contribute to the consistent application of IFRS in the EU. Regulators in jurisdictions which have recently adopted IFRS, or which are in the process of doing so, may wish to consider sharing information in this way.

LESSONS LEARNED

Any assessment of financial reporting cannot be undertaken without reference to the local professional and institutional infrastructure. Policymakers in jurisdictions thinking about introducing IFRS reporting should first consider how they will ensure that the standards are enforced robustly. While they can look for support from international and regional bodies such as IOSCO and ESMA, a strong national enforcement regime is essential to realise the potential benefits of adopting global accounting standards.

Experience in Europe has also demonstrated the vital importance of mechanisms for sharing and coordinating enforcement decisions as a means of complementing and reinforcing nationally-based enforcement arrangements.

7. Lesson seven: endorsement underpins legitimacy

7.1 THE ENDORSEMENT PROCESS

IFRS are adopted on a standard-by-standard basis for use in the EU. Under this process – referred to as 'endorsement' – each individual standard, amendment and interpretation is considered separately and a decision made on whether to adopt or reject it. This contrasts with the process in some other jurisdictions – such as South Africa – where all standards and amendments are immediately effective as and when issued by the IASB.

It is instructive to understand the various steps that endorsement involves in the EU. The procedure is:

- the IASB issues a standard;
- EFRAG consults formally with constituents, advises on endorsement and examines the potential impact;
- the Commission drafts an endorsement regulation;
- the member state representatives that make up the Accounting Regulatory Committee (ARC) vote and give an opinion;
- the European Parliament and Council examine the standard; and
- the Commission adopts the standard and publishes it in the Official Journal.

According to the Commission, this process typically takes eight months to complete. However, in some cases it has taken much longer, and such lengthy delays can create uncertainty over whether or not a standard will be endorsed. In some cases, this may lead to companies deferring changes to systems and processes that are needed to comply with the new requirements until such time as the outcome of the endorsement process is certain. Where major systems changes are needed – which may well be the case when it comes to implementing the new and upcoming standards on revenue recognition, financial instruments and leasing – such delays could result ultimately in companies incurring higher costs than would otherwise have been the case.

Moreover, where the endorsement mechanism has led to delayed effective dates in the EU – most notably for the five new and revised standards on interests in other entities (ie, IFRSs 10–12 and revised versions of IAS 27 and 28) – this can create problems for international groups. They may find that the standards that are applicable in the various jurisdictions in which the group operates have become unhelpfully 'out of sync'. This is not a course of action to be taken lightly.

Non-endorsement – as opposed to changes to effective dates – is in many ways seen in Europe as the option of last resort, an option most stakeholders hope that the EU never has to use. Nonetheless, the threat of non-endorsement remains, in practice, an effective means of ensuring that Europe's voice continues to be listened to very attentively by the IASB. However, rather than risk undermining the legitimacy of a new standard by threatening to deploy the 'nuclear option' at the eleventh hour, in our view it is always preferable for Europe to be proactively involved in the standard-setting process from the outset and willing to accept in the final analysis the results of rigorous and inclusive global due process.

While the process for reaching endorsement decisions is rather complex and protracted, overall it has been essential as a means of establishing the legitimacy of IFRS in the EU. Moreover, it has resulted in few decisions not to endorse a standard or to apply an effective date that differs from that set out in a new IFRS, both of which are undesirable outcomes. Nonetheless, we believe that it should be possible to expedite the final endorsement process of a completed standard through earlier and more constructive engagement over proposed and pending new standards between the IASB and key European stakeholders, including MEPs and the reformed EFRAG, and indeed between key European stakeholders.

7.2 ENDORSEMENT CRITERIA

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 favourable to the 'public good' in Europe; and
- meet basic criteria on the quality of information required for financial statements to serve users ie, statements must be understandable, relevant, reliable and comparable and must provide the financial information needed to make economic decisions and assess stewardship by management.

The influential 'Maystadt Report',[12] submitted to the Commission in October 2013, considered ways in which the EU could enhance its role in international accounting standard-setting. The recommendations of the report on the endorsement process – now in the process of being implemented – discussed in particular the possibility of expanding the 'public good' criterion to make it clear in the law that any accounting standards adopted should neither jeopardise financial stability in the EU nor hinder the EU's economic development.

The majority of stakeholders consulted by Maystadt, including ICAEW, argued that the existing criteria had operated successfully and saw no good reason to legislate to add new or expanded criteria for endorsement. After all, the receipt of transparent, faithfully represented financial information by capital providers is fundamental to their investment decisions and as such can be seen to underpin the efficient operation of financial markets. While financial reporting is of interest to a broad range of stakeholders, accounting solutions should be determined principally to meet the objective of satisfying the information needs of investors – the primary users of annual financial statements under the IASB's Framework – not according to other social or economic policy objectives.

To the extent that economic development and financial stability should be considered during the endorsement process, this falls squarely within the existing requirement to consider the 'public good'. EFRAG is now considering how to do this more rigorously. However, we agree with those in Europe who argue that financial stability and prudential supervision should always be delivered primarily through regulatory regimes, not through seeking to influence or change financial reporting. That would disadvantage investors without the power to request additional or different information from companies; in contrast, prudential regulators can always demand more or different information.

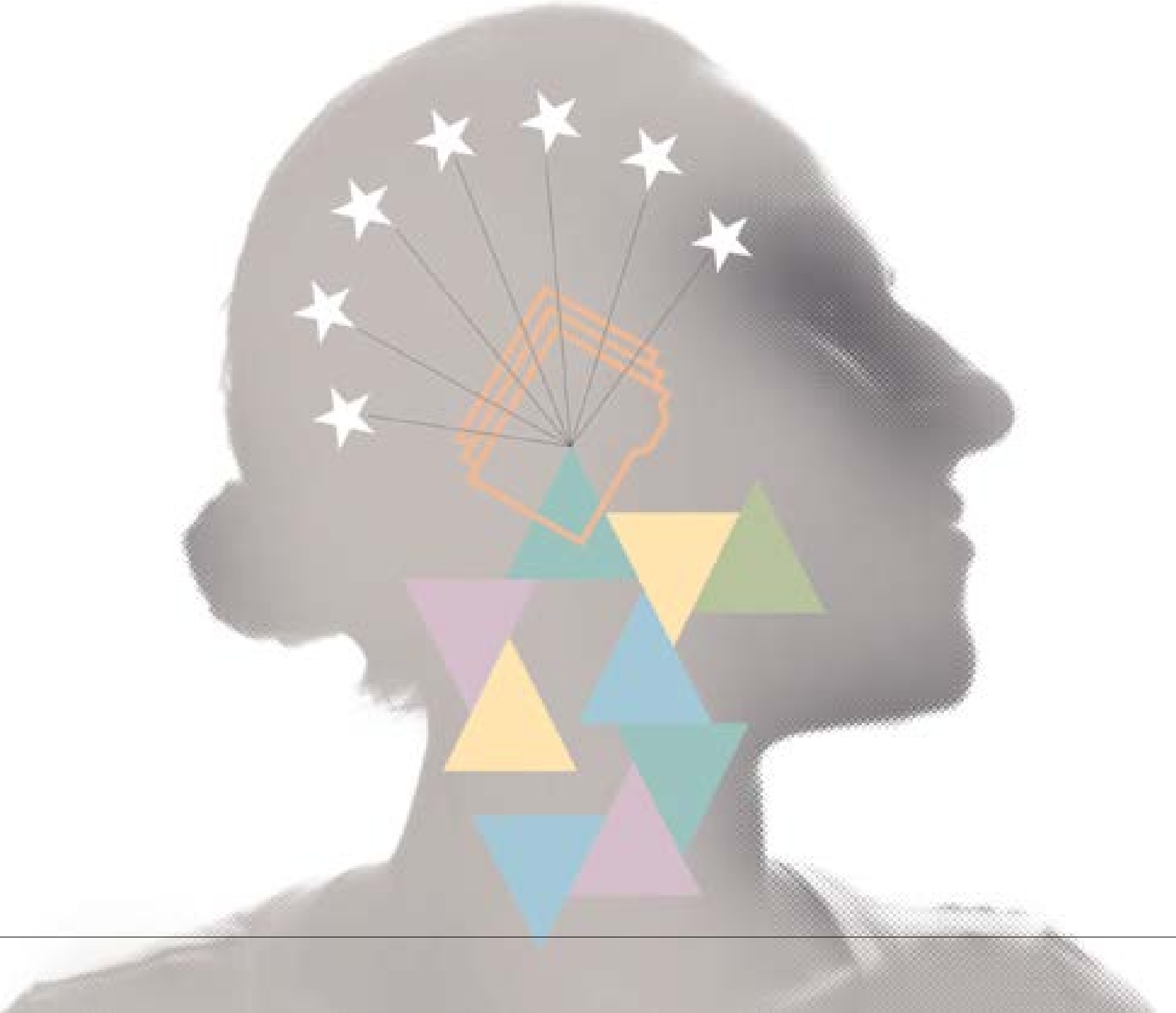
LESSONS LEARNED

Despite concerns over the time and effort involved, the EU's endorsement process – involving member state representatives and the European Parliament – has proved a critical means of establishing the political legitimacy of IFRS in Europe.

The approach to endorsement taken around the world will vary according to local circumstances. But jurisdictions considering IFRS adoption should aim to develop mechanisms with clearly defined and manageable timetables, necessitating the early engagement of key local stakeholders and involvement from the start by the body responsible for endorsement in the standard-setting process.

When considering the scope and relative importance of endorsement criteria, policymakers should ensure that the need of investors and other users for transparent financial information is not overshadowed by reference to wider social, prudential or economic policy objectives.

Appendices



Appendix 1: The future of IFRS – perspectives and progress

In December 2012, ICAEW published what has proved to be an influential thought leadership report entitled *The future of IFRS*, part of the Information for Better Markets initiative. In the light of the absence of any decision by the SEC about the use of IFRS in the US, the report took stock of the progress that had been made in developing a global financial language and identified barriers and challenges that needed to be overcome if the use of the standards was to continue to spread. It also provided our perspectives on how things could be moved forward and commented on the role of IFRS in the global financial crisis and the longer-term prospects for the US migrating to IFRS reporting.

The report attracted a great deal of attention from policymakers and other stakeholders around the world as they pondered the future of the project to create a global set of accounting standards.

Almost two and a half years later, it seems apposite to look briefly in the context of this new report at what has been achieved and how thinking has evolved since the publication of that seminal report.

This, and the following appendices, therefore revisit the report's key perspectives, assessing briefly what has been achieved since 2012, and go on to update our comments on the role of IFRS in the global financial crisis and the adoption of IFRS by the US.

A1.1 IMPROVE G20 LEADERSHIP

Our perspectives
Standard-setters create the standards, but adoption is determined by governments. The G20 should end its calls for convergence and play a more active role in promoting adoption of IFRS. As a minimum, all listed companies should be given the option of reporting under IFRS.

Where are we now?
We observed in our report that more than two-thirds of the G20 required or allowed their listed companies to prepare financial statements using IFRS or national standards based closely upon IFRS.

While no additional G20 members have adopted IFRS since, some welcome progress has been made. In Japan, for example, companies are increasingly switching to IFRS on a voluntary basis. In fact, almost 25% of Japanese companies by market capitalisation now use IFRS or have plans to do so. Meanwhile, good progress is being made in India, where the government recently announced a convergence programme that, from 2017, will see listed Indian companies moving to a new set of standards that are much more aligned with IFRS.

There is still a long way to go, and regrettably financial reporting seems to have slipped down the G20's agenda in recent years. But beyond the G20 nations, the use of IFRS continues to spread. The IASB's latest research suggests that 114 countries now require the use of IFRS for all or most publicly-listed companies, with another 12 countries permitting its use. For most of these jurisdictions, IFRS is now just business as usual.

A1.2 GET REGULATORS BEHIND IFRS

Our perspectives
The IASB needs more active and consistent support from regulators, including IOSCO. Regulators worldwide should collaborate to deliver consistent enforcement, while ensuring that the exercise of professional judgement is not stifled.

Where are we now?
Since publication of *The future of IFRS*, the IFRS Foundation has agreed to a set of protocols with both IOSCO and ESMA to deepen cooperation in support of their shared commitment to the highest standards of financial reporting globally. However, in many parts of the world much remains to be done to build the strong national institutions needed to ensure consistent and appropriate enforcement of IFRS around the globe.

A1.3 END CONVERGENCE

Our perspectives
The 10 years of work to align IFRS with US accounting standards has brought the two sets of standards much closer together. But it is time for the IASB to listen more closely to its other global stakeholders.

Where are we now?
In March 2013, the IFRS Foundation announced the inaugural membership of ASAF; a new technical advisory body consisting of members of the global accounting standard-setting community. The 12 members of ASAF are drawn from around the globe and represent key national standard-setters and regional organisations: AOSSG, EFRAG, GLASS and PAFA.

The creation of ASAF confirmed a significant shift in the IFRS Foundation's modus operandi. The era in which they cooperated with national standard-setters via a series of bilateral arrangements has ended. Rather than working individually with standard-setters in countries such as Brazil, China, Japan and – most notably – the US, the IASB has begun to work collectively with standard-setters and regional organisations via a single multilateral agreement signed by all ASAF members. Not all major standard-setters are represented, and there is, no doubt, scope to debate how, for example, the IASB responds to concerns raised at ASAF meetings and how far ASAF members should consult with other local standard-setters. But it seems unlikely that the recent review of the first two years of ASAF's existence will indicate that root and branch reform is necessary.

Importantly, the US standard-setter retains a place at the table, despite calls in some quarters for the Financial Accounting Standards Board (FASB) to be excluded from the governance structures of the IFRS Foundation until the US signs up fully to IFRS.

It is also apparent that the IASB is listening more closely to the views of its other stakeholders from around the globe. For example, recent amendments to the accounting for bearer plants might not have happened without the work undertaken by Malaysia and other members of AOSSG. Similarly, the research project on business combinations under common control was inspired by the work of the Italian standard-setter, EFRAG and the standard-setters which form the IASB's emerging economies group. There are a number of similar stories.

It appears that, while the influence of the FASB is likely to loom large for some time to come, the IASB is slowly but surely evolving into a truly global standard-setter.

A1.4 MINIMISE COMPLEXITY

Our perspectives
The IASB must remain committed to principles-based standards that require a reasonable degree of judgement in their application and should seek to simplify its standards wherever possible. The complexity of some IFRS requirements may discourage some countries from fully embracing the standards.

Where are we now?
Since our report was published, the debate about the complexity of financial statements has only become more intense as companies' financial statements grow ever thicker and, perhaps, impenetrable. Much of the attention has focused on what is sometimes referred to as 'disclosure overload' and the weighty tomes that it produces.

Reducing complexity is not something that can be done overnight; this is a long-term process. But the IASB's disclosure initiative is now underway and seeks to address some of these issues, while the recent discussion paper on the conceptual framework also had much to say on complexity.

ICAEW has also continued to contribute to the debate, with our paper on *Financial Reporting Disclosures: Market and regulatory failures*[13] analysing the issues and suggesting a package of reforms to tackle the problem.

A1.5 ACCEPT LESS THAN 100% UNIFORMITY

Our perspectives
The goal of the IFRS project should be ensuring that financial reporting facilitates international investment and trade by meeting the evolving needs of international businesses and investors, rather than necessarily achieving complete uniformity across the globe.

Where are we now?
The jurisdictional profiles published by the IFRS Foundation suggest that there is, perhaps, more uniformity than many had imagined. The evidence suggests that countries adopting IFRS have made few modifications to the standards published by the IASB, and that where changes were made, they were generally regarded as temporary steps in the jurisdiction's journey to IFRS reporting.

It might be argued that inconsistencies in application are inevitable and that unevenly-applied global standards create far greater comparability than an equally unevenly-applied multitude of diverging national standards. However, concerted efforts are needed to drive down the variations in how the standards are applied in different jurisdictions. For example, the IFRS Foundation needs to continue to encourage consistency through its work with IOSCO and other regulators around the globe. But, ultimately, the best way to ensure consistent application is for the IASB to produce high-quality, principles-based standards that are capable of being applied and enforced on an international basis.

A1.6 INNOVATE THE IASB INSTITUTION

Our perspectives
The IASB must take advantage of the pause in momentum towards US adoption of IFRS to evolve into a truly global and accountable organisation. It must decentralise its responsibilities, experimenting with ways of demonstrating that it is a global body that belongs to and is responsive to its national stakeholders, without embedding inefficiencies or layers of due process that in time might paralyse effective decision making.

Where are we now?
The opening of an IFRS Foundation office in Japan in November 2012 means that the IASB now has a significant presence outside Europe for the first time. More international offices may follow in time.

As discussed above, the creation of the ASAF and the signing of protocols with IOSCO and ESMA are important steps forward. By working to improve channels of communication with national standard-setters, regional organisations and regulators, the IASB has evidenced a commitment to the development of a more effective feedback mechanism. The board has also continued to develop its approach towards post-implementation reviews and effects studies, and is experimenting with 'Transition Resource Groups'.

In all these areas there has been progress, albeit there is still much work to be done. There are, however, some less positive signs too. For example, major projects have become delayed as the IASB board struggles to complete the leasing and insurance projects, sometimes seeming to seek to please all of the people, all of the time. There is a still a danger that re-exposure drafts – something unheard of only a few years ago – could become customary. While due process is very important, it must not lead to stagnation and inertia.

Arguably, many of the issues that have arisen on major projects could have been avoided if better research had been undertaken upfront. This concern may be addressed, in part at least, by the creation of the IFRS Research Centre,[14] launched by the IASB in April 2013. It aims to support the establishment of a dedicated research capability that will draw upon a combination of internal and external intellectual resources, including engagement with the academic community.

It is, again, still early days, but in the longer term better early-stage research may lead to a significant and sustainable improvement in the standard-setting process.

Appendix 2: IFRS and the global financial crisis

In our 2012 report, we drew attention to continued speculation about whom or what had caused the global financial crisis, and the fact that some claimed that accounting standards had a role to play and that they somehow contributed to, or even caused, the crisis. Within the EU, a number of these critics pinned the blame squarely on IFRS.

The increased use in financial reporting of fair value measurements – and their allegedly pro-cyclical nature – had perhaps received the most attention. We noted that in practice, there was no compelling evidence that the use of fair value accounting had any significant role in causing or exacerbating the crisis, despite the many claims and assertions made in this context.

Detractors also frequently claimed that the 'incurred loss model' used by banks to calculate the extent of their bad debts resulted in them providing too little, too late in the run-up to the financial crisis. Again, we noted that research evidence did not suggest that this did indeed have a major impact.

Finally, some claimed that in the run up to the crisis, banks inflated their performance by transferring billions of dollars of under-performing assets into unconsolidated special purpose entities. This may perhaps have been true in the US, and this issue may have highlighted significant weaknesses in US GAAP. However, we observed that the IASB's model for consolidation was not fundamentally flawed in this way.

We concluded, on the contrary, that the improved transparency and comparability provided by IFRS had helped to maintain confidence in UK and other financial markets, so far as this has been possible in the light of the financial crisis, the sovereign debt crisis, the euro crisis and the prolonged economic recession. All in all, we suggested that IFRS had weathered the economic storm well and that differences in accounting throughout the EU in the absence of IFRS would have damaged confidence still further.

Our recent review of relevant academic literature confirms that there is little or no evidence to suggest that IFRS caused or exacerbated the global financial crisis, no 'smoking gun' that should concern those jurisdictions looking to switch to international accounting.

But the IASB cannot be complacent. After all, no set of standards is perfect. In common with many regulatory bodies, the board has rightly sought to look again at a number of its key requirements to ascertain what lessons can be learned in the wake of the crisis. The wait has been protracted in some cases, but new and revised standards have addressed issues that were centre stage during and after the financial crisis, including fair value measurement, off-balance sheet activities, financial instruments and revenue recognition. Some of the changes respond to calls for financial reporting to provide more forewarning of risks building in the financial system.

While concerted efforts to improve IFRS should continue, the improved transparency and comparability provided by IFRS are more likely to help prevent future crises rather than contribute to them. However, the political will to accept and embrace improvements in standards needs to continue if proposed new standards on leasing and, in particular, insurance, are to come to fruition. IFRS offers the best hope of a solution to the multiplicity of accounting models for insurance accounting, which at present does little service to users of accounts; a breakthrough is required in 2015 in this systemically important area.

Appendix 3: US GAAP – looking ahead

There is currently no timetable for a final US decision on IFRS adoption. In *The future of IFRS*, we noted that SEC had been distracted by pressing issues other than international convergence. As matters such as the Dodd-Frank Act took up much of SEC's time and energy, any decision about IFRS had slid down the list of priorities. The decision that was expected by the end of 2011 was deferred, and the final SEC staff report on the IFRS work plan published in July 2012 did not contain a recommendation on whether, how or when the US should transition to IFRS.

Although the era of convergence between IFRS and US GAAP as a priority for both boards has come and gone, the US still has representation on the IASB board and other IFRS Foundation governance structures. We remain supportive of this continuing active involvement. It would make no sense for the IASB to stop working with one of the world's major economies and one of its foremost and most powerful standard-setters, or to accept lightly any trend towards divergence in relation to previously-converged standards such as IFRS 14.

But many are beginning to question whether the US will ever be willing to make the leap of faith necessary to leave behind their proud tradition of national standard-setting. In December 2014, SEC chief accountant James Schnurr said that the IASB and the FASB should 'continue to strive where practicable for aligned high-quality global standards'. These comments echoed earlier remarks by SEC chair Mary Jo White. But both have made it clear that the needs of US investors will always come first and foremost when the possibility of permitting or requiring US registrants to adopt IFRS is considered.

Various different approaches have been discussed over the years, ranging from the outright adoption of IFRS by all US registrants to allowing companies to voluntarily disclose IFRS-based financial reporting information in addition to the US GAAP-based information used for SEC filings. But whatever route the US decides to take, it is surely time to provide investors and major corporations in the US and around the world with some clarity about the intentions of the SEC, and we believe that our analysis of lessons learned in Europe – in particular on the role of national standard-setters, enforcement and endorsement (lessons 5-7) and on complexity (lesson 4) as well as the scope of IFRS reporting (lesson 2) – may be reassuring to those who believe that IFRS reporting has a future in the US. It is, of course, for the US to assess for itself the costs and benefits of a move to IFRS (lesson 1), and perhaps lesson 3 – on avoiding local variants of IFRS – presents particular challenges to those keen to the see the US join the global IFRS community.

The global standard-setting environment may, of course, continue to be a competitive one for the foreseeable future. US GAAP may still be viewed as an alternative to IFRS both within and perhaps beyond the US, and it is feasible for international capital markets to cope with two kinds of global accounting system – IFRS for most, including Europe, and US GAAP for the US. Interestingly too, the FASB – which along with the SEC has vast experience of standard-setting and significant resources – has of late been more active on the international stage, and plans are afoot to strengthen the FASB's thought leadership role.

However, despite its strengths and resilience, US GAAP is not a truly international framework for financial reporting. IFRS have the unique advantage of being designed for an international audience, of being developed in an environment free from legal and other national constraints. The standards benefit from the neutrality that this brings to the standard-setting process. This, arguably, contrasts with US GAAP, which has its roots in a very specific regulatory and legal system and a tradition of political intervention that makes it less suitable for application by entities beyond the confines of the US.

Perhaps as importantly, while both IFRS and US GAAP encompass both principles and rules, it seems fair to say that the US has seen the development of a body of accounting requirements that are more prescriptive, complex and extensive than is ideal. This needs to be avoided in an international context. A principles-based approach to standard-setting is fundamental to the success of IFRS as the standards are increasingly adopted by jurisdictions with differing traditions of reporting and regulation.

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