



Brexit



IMPLICATIONS FOR
FINANCIAL REPORTING

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 to 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 IFRS requirements, and ICAEW has developed online IFRS learning programmes, available to all. The expertise of our members is deployed in every IFRS jurisdiction around the globe.

ICAEW's Financial Reporting Faculty influences the international debate over financial reporting through its programme of thought leadership activities and its close relations with the international accounting academic community. Activity includes a regular series of thought leadership papers published as part of its **Information for Better Markets** programme. Influential reports have included *Business models in accounting* and *Measurement in financial reporting*. More recently, the Faculty has been working on a series of public policy papers. The reports in this series are intended to contribute to a better understanding of the role of accounting in society, so that policy making is more soundly based. They are aimed at all who have an interest in public policy debates surrounding whether, and how, financial reporting should be regulated.

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. It has worked in the public interest to further the debate about financial reporting in the decades since former ICAEW President Sir Henry Benson (later Lord Benson) spearheaded the movement to tackle diverse global accounting practices. This movement ultimately led to the establishment of the IASB's predecessor - the International Accounting Standards Committee (IASC) - in 1973, the inaugural meeting of which was held at Chartered Accountant's Hall in London.

In 1997, ICAEW published a far-sighted paper entitled *The International Dimension: Implications for the UK financial reporting framework of the changing role of International Accounting Standards*. 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 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 2005. ICAEW expertise in this area was recognised in 2007 when it was selected by the European Commission to deliver a **comprehensive study** covering all aspects of first time application of IFRS by European Union member states. The study was delivered in 2007 and followed up by presentations by ICAEW staff around the world. Then, in early 2008, the United Nations commissioned ICAEW to prepare a **follow-up report on the UK experience of IFRS implementation**, which was the subject of an ICAEW presentation to the UN in Geneva in October that year.

ICAEW actively engages with IFRS policymakers, academics and other stakeholders around the world. The Financial Reporting Faculty provides comprehensive responses to IASB consultations as well as requests for comments on key IFRS matters issued by the EU and the SEC, drawing on the experience of ICAEW members globally in the business, public practice, investment and regulatory communities. The Faculty's IFRS-related reports and thought leadership activity have been especially influential in recent years, as discussed in the case study below.

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Executive summary

INTRODUCTION

In this report we emphasise the economic importance of financial reporting and suggest that the implications of Brexit for financial reporting have not yet attracted sufficient public debate.

We offer policy recommendations that act on the one hand as a basis for conversations about the longer-term impact of Brexit on reporting in the United Kingdom, and on the other as an illustration of the challenges that significant national economies face in using international standards.

This report forms one part of an ongoing programme of work by ICAEW designed to respond to the challenges of the UK's decision to leave the European Union. We note that the short term and distinctive endorsement issues surrounding the IASB standard on insurance contracts, IFRS 17, will be addressed by ICAEW separately.

THE USE OF IFRS BY UK LISTED COMPANIES

We examine the case for IFRS reporting by UK listed companies.

We note that the rapid spread of IFRS-based reporting in recent years means that the benefits of using international standards are no longer theoretical or merely asserted: a growing body of research shows that they are increasingly evident in practice.

We suggest that, at a time when the IASB's standards are increasingly regarded as the benchmark for reporting by listed companies around the world, a move away from IFRS would risk making the UK a less attractive market for investors. We conclude that, as a major global financial centre, the UK should continue to adhere to internationally-accepted standards.

THE SCOPE OF IFRS REPORTING IN THE UK

We consider the scope of IFRS reporting in the United Kingdom.

We conclude that, while efforts should continue to eliminate unnecessary complexity in IFRS standards and to ensure that the IFRS disclosure regime is proportionate, there remains a strong case for requiring all companies that raise funds from the public to be subject to the full rigours of IFRS reporting.

INFLUENCING INTERNATIONAL ACCOUNTING

We examine how the UK, as a major user of IFRS, can continue to exercise a level of influence on the development of reporting practice and standards commensurate with its position as a global financial centre. Apart from the influence that might be yielded by different approaches to the adoption of IFRS, we identify two main areas of focus: institutional participation, and more general influencing activity.

We suggest that upon completion of the Brexit process, the case should be made by the UK authorities for UK participation on both the IFRS Foundation Monitoring Board and the IASB's Accounting Standards Advisory Forum.

In terms of influencing activity, we argue that the UK financial reporting community needs to up its game with regard to the development and sharing of accounting thinking and practice. Indeed, it should aim to become a leading member of the unique global standard-setting partnership that has emerged from the widespread adoption of IFRS.

OPTIONS FOR ADOPTION OF NEW STANDARDS

We consider the principal options for IFRS adoption available to the UK as an IFRS jurisdiction outside of the EU. We consider whether the UK should simply accept the standards issued in future by the IASB, establish a national IFRS endorsement mechanism, or continue in some way to participate in the existing EU mechanism. We also examine the main advantages and disadvantages of each option.

We argue that the case for introducing a UK endorsement mechanism are, on balance, persuasive.

We recognise that the time and resources involved in establishing and operating a separate national endorsement mechanism are likely to be significant, and to some degree at least, would duplicate the EU processes and structures. However, almost all developed economies that have adopted IFRS have instituted some form of national endorsement mechanism. Moreover, those we have spoken to have mainly supported establishing some form of UK endorsement mechanism as a critical means of establishing the legitimacy of IFRS reporting in the UK.

We recognise that transitional arrangements may be necessary to allow for the design and orderly implementation of new arrangements and to minimise uncertainty for business. We call for the UK government to ensure that, in the near future, proposals on the future adoption of new IFRS standards are developed for public comment.

We suggest that, whatever approach is taken to endorsement, the UK should seek to remain closely engaged with relevant EU institutions in debates over accounting developments, given that decisions by the EU will continue, directly or indirectly, to affect UK interests.

A UK ENDORSEMENT MECHANISM - KEY FEATURES

We explore the possible features of a UK mechanism for the endorsement of future IFRS standards and changes to existing standards, using the various steps that endorsement involves in the EU as a guide to determine what works well in practice, and what doesn't.

We argue that a new national mechanism could function more smoothly and far more quickly than the EU's, and that indeed this should be regarded as a key prize available to the UK from the change in endorsement arrangements. The UK should develop a simple, cost-effective and efficient mechanism for the endorsement of new and amended IFRS requirements, with due emphasis on accountability and due process but with few separate stages and clearly-defined timetables. The process for reaching endorsement decisions in the EU has proved rather complex and protracted. The UK now has the opportunity to learn from experience in Europe and in countries such as Canada and Australia.

When considering the scope and relative importance of new UK endorsement criteria, we suggest that the current EU criteria should be the starting point, as close alignment would reduce the likelihood of divergence of outcome. The criteria could, however, be improved and simplified.

We emphasise that accepting that jurisdictions will wish to retain ultimate political sovereignty in this area does not necessarily mean providing the body responsible for endorsement with the opportunity to modify or add to the requirements of a new IFRS standard or interpretation. We argue that the disadvantages of making local changes to international standards - including so-called carve-ins and carve-outs - tend to outweigh the anticipated benefits.

We conclude that an endorsement mechanism should render the applicable UK authority able to reject new standards or interpretations in exceptional circumstances. While the case should be explored for facilitating other, very limited modifications (for example, adding to required disclosures), we stress that the IFRS brand should not be trifled with lightly.

Our assumption is that responsibility for making endorsement decisions will lie with the Financial Reporting Council. We suggest that the government consults on the key features of the new arrangements, including accountability, governance and related issues.

BEYOND IFRS: UK GAAP, COMPANY LAW AND WIDER CORPORATE REPORTING

We examine the case for changes beyond IFRS reporting, and in particular changes to UK accounting law.

We note that there are strong incentives for minimising change to the UK accounting regime during the next few years, and argue that the need for continuity and stability for business should take precedence over changes to the law during the first few years of post-EU Britain.

In the long run, we suggest that Brexit provides an opportunity for a more profound review of UK company law, rationalising and simplifying the scope and content of the accounting and related provisions, and revisiting the balance between law and standards with a deregulatory outcome in mind.

POLICY RECOMMENDATIONS AND NEXT STEPS

Finally, we invite comments on the contents of this report and its 16 policy recommendations, which can be sent to nigel.sleigh-johnson@icaew.com.

We explain that we expect to publish a follow-up report, or reports, in 2018, drawing on these outputs and activities, and that the Financial Reporting Faculty also plan to hold webinars and events to encourage debate.

We will continue to collaborate with the government, FRC and other bodies on the reporting consequences of the UK's departure from the EU.

Introduction

With formal negotiations on the departure of the United Kingdom from the European Union underway, it is important for financial reporting policy makers and their constituents to consider more earnestly the implications of that process for financial reporting in the UK, and indeed for the rest of the world.

This critical matter has not yet, in our view, attracted sufficient public debate.

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

Trust in the financial reports of listed companies underpins investor confidence in the capital markets. It supports economic growth and financial stability. With this in mind, this report sets out our current thinking on some of the key issues arising from Brexit, drawing on the extensive experience of ICAEW and its members in respect of financial reporting and standard-setting in the UK, Europe and internationally.

The report considers in particular: the use of IFRS in the UK; international influence; methods by which IFRS standards might be adopted into UK law; as well as some wider, non-IFRS reporting issues. It also acknowledges that thinking will evolve as events unfold during the Brexit process.

On the one hand, our policy recommendations are offered as a basis for conversations about the longer-run impact of Brexit on UK reporting. On the other hand, they provide an illustration of the challenges that national economies – broadly similar in size to the UK – face in using international standards, and possible ways of addressing those challenges. In short, our recommendations highlight how, in this particular context, national sovereignty and globalisation can be reconciled, learning from the experience of other jurisdictions, and the EU in particular. The US Securities and Exchange Commission published a **series of reports** between 2010 and 2012, explaining these challenges from a US perspective.

The short term and distinctive endorsement issues surrounding the recently-issued standard on insurance contracts, IFRS 17, will be addressed separately by ICAEW, and are not within the scope of this report.

This report forms one part of an ongoing programme of work by ICAEW designed to respond to the challenges of the decision of the UK to leave the EU, including those faced by its members based in the EU27. ICAEW resources and commentary can be accessed at icaew.com/brexit. ICAEW is co-ordinating the accountancy sub-group of the Mutual Market Access Working Group within the Professional and Business Services Council, analysing the implications of Brexit and potential solutions for mutual market access in accountancy services and accountancy education and professional qualifications.

1. The use of IFRS by UK listed companies

In this section we consider the case for IFRS reporting by listed companies.

Since 2005, around 7,000 companies listed on regulated markets across the EU have been required to prepare their consolidated financial statements in accordance with EU-adopted International Financial Reporting Standards (IFRS). In addition, many other companies across Europe follow IFRS, either voluntarily or because their country has adopted IFRS for some or all reporting entities not listed on regulated markets. In the UK, for example, from 2007 stock exchange rules extended this requirement to the group accounts of over 1,000 companies then listed on the secondary market, AIM. All other UK companies (except charitable companies) have the choice of following IFRS under company law.

The intention of European policymakers in deciding to mandate the use of IFRS was to make financial reporting by European listed companies more transparent and comparable and to enable EU capital markets to function more efficiently. Since then, it has been widely acknowledged that a universal financial reporting language offers companies and countries many potential advantages. For example, 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-based reporting in recent years means that these benefits are no longer theoretical or merely asserted. A growing body of research shows that they are increasingly evident in practice.

Indeed, ICAEW's work in recent years has underlined the economic benefits of using high-quality international standards. In 2015, we published the highly influential report *Moving to IFRS reporting: seven lessons learned from the EU experience of IFRS*, drawing particularly on the work undertaken earlier that year to prepare our detailed study of the academic evidence, *The effects of mandatory IFRS adoption in the EU: a review of empirical research*. Both reports noted that the benefits of adopting IFRS were distributed unevenly among different companies and different countries due to differences in institutional contexts and incentives. But they also concluded that, overall, the move to international standards has - among other things - improved transparency, comparability, market liquidity and international capital flows. Importantly, there are also signs that it has reduced the cost of capital.

In addition, an evaluation by the European Commission on the impact of the first 10 years of IFRS reporting in Europe, *COM (2015)301*, reached similar conclusions.

It is widely anticipated that, following its departure from the EU, a key focus of the UK will be efforts to re-invigorate international trading relationships and improve its attractiveness to international investors. Consequently, a move away from IFRS for UK listed company reporting does not seem probable, nor desirable. Indeed, at a time when the IASB's standards are increasingly regarded as the global benchmark for reporting by listed companies, such a move would risk making the UK a less attractive market for investors from around the world, as well as for overseas companies contemplating listing in London.

The equivalence rules on financial reporting in the EU's Transparency and Prospectus directives will also make the use of IFRS critical both for any UK company wishing to list on an EU-regulated market, and for the not inconsiderable number of EU27 companies listed or wishing to list in London. Similar considerations apply to UK companies listed or seeking a listing in the United States, which accepts only fully-IFRS compliant financial statements for foreign private issuers.

As a major global financial centre, the UK should continue to adhere to internationally accepted standards.

2. The scope of IFRS reporting in the UK

In this section we consider whether the scope of IFRS reporting in the UK should be revisited.

The United Kingdom will be free to alter the scope of IFRS reporting once the IAS Regulation no longer applies following the UK's departure from the EU, i.e. it could alter the types of entity and reports for which IFRS are mandatory. However, the case for change in the near future seems weak in view of the extensive debate about this issue in the UK in recent years, in the context of the introduction of a new UK GAAP for private companies and other UK GAAP reporters. It was widely agreed that mandating IFRS application by law is appropriate for listed companies, but that for other reporting entities the use of IFRS should be optional only.

Following on from this conclusion, in our 2015 report *Moving to IFRS reporting: seven lessons learned from the European experience*, we suggested that there was a case for extending the scope of mandatory IFRS reporting to the individual entity financial statements of listed companies that do not prepare consolidated accounts. If the IAS Regulation no longer applies in the UK post-Brexit, there will be an opportunity to consider this issue and whether it is unhelpful to users for some UK listed companies to publish financial reporting information that is not comparable with that of other listed companies.

There continues to be some debate in the EU about the case for reduced reporting obligations for smaller listed companies. We have also heard some argue that the requirement under the rules of the London Stock Exchange for companies listed on AIM to apply IFRS acts as a disincentive to prospective new entrants, and so should be reviewed. We note, however, that while there is always room for improvement to the IASB's standards, the FRC reported last year that it had found general support for 'a common reporting framework for all quoted companies' and little appetite for the use by smaller UK listed companies and AIM companies of anything other than full IFRS.

We believe that there is a strong case for requiring all companies that raise funds from the public to remain subject to the full rigours of IFRS reporting. Efforts should, however, continue to eliminate unnecessary complexity in IFRS standards and to ensure that the IFRS disclosure regime is proportionate. We also think that the option to apply IFRS should remain available in UK law for all non-charitable companies, including subsidiaries of listed IFRS reporters.

3. Influencing international accounting

In this section we examine how the UK, as a major user of IFRS, can continue to exercise an appropriate degree of influence on the development of reporting practice and standards.

The UK financial reporting community - including the FRC, ICAEW and other professional accounting institutes, accounting academics and the leading professional firms - has long been influential in the development of international accounting standards, the thinking that underpins IASB standard-setting and the theory and practice of corporate reporting more generally.

UK approaches to accounting issues have often had a powerful impact within Europe and internationally, from topics as diverse as proportionate accounting for small companies to enhanced narrative and non-financial reporting to notions like comply or explain and the importance of innovation and experimentation in corporate reporting. The steadfast support for IFRS by the UK, as a key member of the EU, has also made UK support important to the IASB.

This international influence over reporting is now at risk. As departure from the EU draws closer, a key challenge is therefore how to ensure that the voice of the UK as a global financial centre is heard loud and clear in international debates, specifically at the IASB, but also in the wider world. That is to say, efforts should be redoubled to ensure that the UK enjoys a level of influence commensurate with its position as one of the world's foremost capital markets and that it takes full advantage in the coming years of opportunities to expand its influence.

Apart from the influence that might be yielded by different approaches to adoption of IFRS, discussed in Section 4 below, we see two main areas of focus: institutional participation, and more general influencing activity.

INSTITUTIONAL PARTICIPATION

The IFRS Foundation has a three-tier governance structure, based on an independent standard-setting board of experts (the IASB), governed and overseen by Trustees from around the world who are in turn accountable to an oversight board of public authorities, the IFRS Foundation Monitoring Board.

The Monitoring Board was set up in 2009 with the aim of 'providing a formal link between the Trustees and public authorities' in order to enhance the public accountability of the IFRS Foundation. It consists of capital markets authorities responsible for setting the form and content of financial reporting. The current members of the Monitoring Board are IOSCO, the European Commission, the Financial Services Agency of Japan, the US SEC, the Brazilian Securities Commission, the Financial Services Commission of Korea, and the Chinese Ministry of Finance.

On completion of the Brexit process, the UK authorities should make the case for UK participation on the IFRS Foundation's Monitoring Board, given the status of the UK as a major IFRS jurisdiction and global capital market.

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. The creation of this new body provided 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. It did so by bringing local perspectives to the IASB's technical work and offering feedback on important issues.

The FRC is not currently represented on the ASAF.

On completion of the Brexit process, the UK authorities should also make the case for UK participation on the IFRS Foundation's Accounting Standards Advisory Forum (ASAF).

INFLUENCING ACTIVITY

The UK financial reporting community should up its game in terms of the development and sharing of accounting thinking and practice, aiming to become a leading member of the unique global standard-setting partnership that has emerged from the widespread adoption of IFRS. Therein lies the most viable route to sustainable global influence.

In our 2015 *Lessons Learned* report, we argued:

‘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...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.’

Both this and the related analysis in our 2015 report remain highly relevant at a time when questions are being raised about globalisation and the UK moves closer to departure from the EU.

Establishing global leadership in IFRS is likely to involve the FRC and other UK bodies doing more to support relevant academic research and produce high quality, timely and distinctive thought leadership reports. Specific consideration should be given as to whether the FRC should continue to support EFRAG’s proactive activities, and thereby maintain its influence on EU accounting developments.

Collaboration between the FRC and other key national standard setters around the world will also be important.

A case study in influencing the international debate: recent ICAEW initiatives

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

In 2015 ICAEW published a detailed and highly acclaimed review of the academic evidence on the economic impact in Europe of the adoption of IFRS, *The effects of mandatory IFRS adoption in the EU: a review of empirical research*, as well as *Moving to IFRS reporting: seven lessons learned from the EU experience of IFRS*. Both reports remain highly relevant to those jurisdictions who have recently transitioned to global standards, or are looking to do so in the near future. Financial Reporting Faculty staff have delivered presentations on their findings in Brussels and Japan in 2015, in Indonesia, Vietnam, Singapore, Malaysia and Myanmar in 2016, and in Saudi Arabia in 2017.

ICAEW actively engages with regulators, policymakers, national professional institutes and academics from around the world on financial reporting matters. We also meet regularly with senior representatives of the IASB, EFRAG, the US SEC and other international bodies with an interest in IFRS reporting. We host panel sessions at the influential annual meeting of the American Accounting Association (AAA), where the topics discussed are often IFRS-related. For example, in August 2012, at the AAA 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?* In August 2017, one topic was *What did the IASB-FASB convergence project achieve?*

ICAEW also provides comprehensive responses to IFRS-related consultations issued by the IASB, SEC, EU and UK authorities, and contributes to the development of EFRAG and Accountancy Europe (formerly FEE) responses. We host events at which IASB proposals are discussed, for example on the *Principles of Disclosure* proposals in June 2017. In recent years we have also held joint conferences with the IFRS Foundation. In 2016 and 2017 these focused on the topic of *IFRS 16 Leasing*.

4. Options for adoption of new standards

In this section we consider whether the UK, as an IFRS jurisdiction outside of the EU, should simply accept the standards issued in future by the IASB, establish a national IFRS endorsement mechanism, or continue in some way to participate in the existing EU mechanism.

Under the IAS Regulation 1606/2002, 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. Our understanding is that the EU has the ability to take out certain provisions from the standards or select an alternative effective date, but not to amend or add new requirements.

After Brexit, the IAS Regulation is unlikely to still apply in the UK. However, our understanding is that UK law effectively incorporates the requirements of the IAS Regulation in the Companies Act 2006, in order to put into effect the member state choices the Regulation contains, and that the Listing Rules and Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) incorporate the requirement for listed companies to follow IFRS. On the face of it, therefore, changes to primary legislation and the FCA rules would be required to move the UK away from the IAS Regulation regime. Much will depend on the overall approach taken in the negotiations.

Nevertheless, once a formal decision is taken to continue to apply IFRS, the UK has a wide range of policy options to choose from in respect to future IFRS standards and changes to existing standards. The meaning of the phrase ‘IFRS adoption’ can vary enormously in practice. At one end of the spectrum, it can refer to a straightforward requirement in national law for all or certain categories of company to follow the standards as issued by the IASB. In some jurisdictions, all standards and amendments are immediately effective as and when issued by the IASB. At the other end of the spectrum, some jurisdictions permit voluntary adoption by some categories of companies, or require or permit reference to a version of IFRS that is not current or complete. In between are arrangements like those of the EU, where there is a presumption of adoption of each new or revised standard but which is still subject to the outcome of a formal process of legal endorsement.

We do not attempt in this short paper to detail all of the options and pro and cons of each of the longer-term policy choices available to the UK for the adoption of new IFRS standards, particularly given that some of the pros and cons are highly uncertain. In our view, beyond any transitional arrangements, there are three principal options to be considered, each necessitating changes to UK law. These are summarised below.

Principal options for adoption of new standards post-Brexit

- 1 EU-adopted IFRS continue to be applied by UK listed companies, with the UK able to participate in the deliberations of EFRAG and accepting the decisions of the EU endorsement process.
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- Option 1 provides continuity and means that EU and UK reporting standards will not diverge in the future. Some companies, those without US listings in particular, may prefer to stay aligned with EU-adopted IFRS to prevent a competitive disadvantage.
 - This option could be achieved in the UK relatively easily in legislative terms, and would avoid the costs involved in operating a separate national endorsement mechanism.
 - However, this option is thought by many to convey significant disadvantages, over and above any sensitivities about leaving authority in this area with the EU. For one, it locks the UK into a decision-making process which can be slow-moving and cumbersome – as discussed below – and over which, in practice, UK influence is likely to diminish, and with it UK influence at the IASB. Furthermore, on some occasions there will also be considerable uncertainty over the outcome of the process and the UK may be bound to decisions with which it does not agree.

- A variant of this option would see the UK accept EU endorsement decisions but without any formal influence over EU decision making. This seems unlikely to be acceptable to most UK businesses and other IFRS stakeholders.

2 UK listed companies are required to use IFRS as issued by the IASB, without any further intervention by UK authorities.

- Option 2 entails an approach applied by many smaller economies around the world. It too could be achieved in the UK relatively easily in legislative terms. It would also avoid the operating costs and uncertainties associated with some existing endorsement mechanisms.
- The absence of a mechanism for rejecting a new standard could, however, lead to a reduction in UK influence over IASB decision-making. It would also remove a safeguard against the possibility of having to accept decisions from the IASB considered by the UK to be unacceptable, perhaps following a decline in the quality of the IASB's due process or technical independence (accepting that, in an extreme case of disagreement with the IASB, the UK could rescind its law).
- Those supporting this option emphasise the importance of jurisdictions influencing the standard-setting process at an early stage, and in engaging actively in IASB due process and in prior research and thought leadership activities.
- A UK decision to invariably accept the outcome of IASB due process may serve to improve the sense of the UK as a key global partner of the IASB in its mission to facilitate comparable and high-quality international reporting.

3 The introduction of a national endorsement mechanism and UK-specific endorsement criteria.

- Supporters of option 3 question the advisability of the UK, as a major capital market and IFRS jurisdiction, mandating adoption of international standards by its leading businesses (and many non-UK businesses listing in the UK) with no clear means of recourse should the standard-setting process at some point go awry. They therefore support a national mechanism.
- The strength of a threat of non-endorsement by the UK is uncertain, especially as IFRS reporting is adopted by more countries and companies around the world. But experience shows that the threat of non-endorsement by the EU has in the past weighed very heavily with the IASB and led to different standard-setting outcomes.
- On the other hand, the time and resources involved in establishing and operating some form of separate national endorsement mechanism are likely to be significant, and to some degree at least, would be likely to duplicate the EU processes and structures.
- As with option 1, there would also be considerable uncertainty over the outcome of the process on some occasions. Furthermore, compared to the alternative options, there would be a higher chance of divergence from EU-adopted IFRS and – a critical point for UK companies also listed in the US – divergence from IFRS as issued by the IASB.

Almost all developed economies that have adopted IFRS have instituted some form of national endorsement mechanism as noted in the 2011 SEC staff paper *Work plan for the Consideration of Incorporating IFRS in to the Financial Reporting System for U.S. Issuers* and more recently in the academic paper *Have Canada, Japan and Switzerland Adopted IFRS?* by CW Nobes and SA Zeff. Perhaps not surprisingly, while there are different views about the precise form of any

new mechanism, those we have spoken to have mainly supported option 3. They recognise that, in establishing a UK endorsement mechanism, this option would bring with it the potential disadvantages noted above, but see a national mechanism as a critical means of establishing the legitimacy of IFRS. They note, too, that the EU endorsement process has resulted in few decisions not to endorse a standard or to apply an effective date that differs from that set by a new IFRS, and that the complexity of the process and the associated costs and uncertainties could be kept to a minimum, as we discuss below.

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

In Section 5 we discuss the potential features of a proportionate and efficient national endorsement mechanism. An eventual decision about the UK's approach to IFRS adoption will have significant implications for future UK reporting and even for the future success of IFRS internationally, and the importance of the issues involved should not be dismissed lightly.

The UK government should ensure that, in the near future, proposals on the future adoption of IFRS standards and interpretations are developed for public comment. The consultation document should explore the key policy options, with reference to practice in the EU and in other IFRS jurisdictions; make recommendations for the UK; and allow adequate time for debate about those recommendations and their implications.

If a national endorsement mechanism and endorsement criteria are established, there is a possibility that over time different endorsement decisions will be taken by the EU and by the UK, resulting in divergence between the IFRS reports of UK and EU listed companies. In such circumstances the IFRS financial statements of UK companies wishing to list in the EU might not be deemed equivalent for the purposes of the EU's Prospectus and Transparency directives. It will be important, therefore, for the UK to remain as closely engaged as possible with EFRAG and other European stakeholders.

In any case, the interaction between UK, EU and US laws and regulations in this area will need to be looked at very closely as the shape of the post-Brexit settlement becomes clearer.

The UK should remain closely engaged with relevant EU institutions in debates over accounting developments, given that decisions by the EU will continue, directly or indirectly, to affect UK economic interests. This may also reduce duplication of costs and effort. The ways in which the UK might continue to participate in EFRAG processes should be explored, for example through observer status for the UK on the EFRAG Technical Experts Group (TEG) and/or the EFRAG Board.

5. A UK endorsement mechanism – key features

In this section we explore the possible features of a UK mechanism for the endorsement of future IFRS standards and changes to existing standards, taking the various steps that endorsement involves in the EU as a guide to what works well in practice, and what doesn't.

EU ENDORSEMENT - THE MECHANISM

The formal EU procedure for endorsement is broadly:

- The IASB issues a standard.
- The European Commission issues a request for endorsement advice from EFRAG.
- EFRAG consults formally with constituents, advises on endorsement and examines the potential impact.
- The European Commission drafts an endorsement regulation.
- The member state representatives that make up the Accounting Regulatory Committee (ARC) vote and give an opinion (this step is expected to be modified in the near future).
- The European Parliament and Council have the right to examine and oppose the standard and the draft endorsement regulation.
- The European Commission formally adopts the standard and publishes it in the *Official Journal*.

This complex process can take a substantial period of time to run its course. Furthermore, it can create significant uncertainty over whether or not a standard will in due course be endorsed, whether application will be possible in line with the standard's effective date, and whether endorsement might involve EU modification, including in relation to the effective date of the standard. In some cases, this uncertainty can 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. Ultimately, where major systems changes are needed, this can result in companies incurring higher costs than would otherwise have been the case.

A new national mechanism could, in our view, function more smoothly and far more quickly, and indeed this should be regarded as a key prize available to the UK from the change in endorsement arrangements. While effective due process will lend legitimacy to the adoption of new IFRS standards in the UK, the number of stages involved in the process following the publication of a standard or interpretation by the IASB could be far fewer. Consensus and momentum once a standard has been finalised may, moreover, prove easier to build in the UK than in the EU. Close and early liaison between the UK endorsement body and both EFRAG and the IASB during the standard-setting process may also help, building in an element of front-loading to the assessment effort.

The design of the UK mechanism should draw on the experience of Europe, but also on the experience of countries such as Australia and Canada, where the process is generally regarded as light touch in nature, with a strong emphasis on an on-going assessment of IASB due process.

The UK should develop a simple, cost-effective and efficient mechanism for the endorsement of new and amended IFRS requirements, with appropriate emphasis on accountability and due process but with few separate stages and clearly-defined timetables.

We explain below why we think that intervention by government in the process should be avoided.

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

The influential [Maystadt Report](#), submitted to the European 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 mostly implemented – discussed in particular the possibility of expanding the public good criterion to make it clear in 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 Philippe Maystadt, including ICAEW, argued that the existing criteria – while not perfect – 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 IFRS financial reports are of interest to a broad range of stakeholders, their requirements should be determined principally to meet the objective of satisfying the information needs of investors and other capital providers – the primary users of annual financial statements under the IASB's Framework – and not according to other social or economic policy objectives.

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

The current EU endorsement criteria should be the starting point for considering the scope and relative importance of new UK criteria, bearing in mind that close alignment between the UK and EU criteria would reduce the likelihood of divergence in the outcome of the endorsement processes. The opportunity should be taken to consider how the EU criteria could be improved and simplified, in ways that do not detract from a clear focus on the need of investors for transparent financial information.

THE ENDORSEMENT DECISION: ALL OR NOTHING?

Accepting that jurisdictions will wish to retain ultimate political sovereignty in this area does not necessarily mean providing the body responsible for endorsement with the opportunity to modify or add to the requirements of a new IFRS standard or interpretation.

This is a complex issue, and requires proper debate by UK stakeholders. But in our view the disadvantages of making local changes to international standards – including so-called carve-ins and carve-outs – tend to outweigh the anticipated benefits.

Indeed, we have heard a widespread view that any move in the direction of UK standards aligned but not identical to international standards would tend to undermine investor confidence and damage the UK's capital market. There may, arguably, be exceptions to this, for example, adding some additional disclosure requirements where deemed strictly necessary or deferring the effective date of implementation of a standard on sound cost-benefit grounds. However, we are not convinced by arguments we have heard for allowing endorsement bodies to strike out explicit (but not implicit) options in IFRS.

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

Local variations can also cause particular problems for companies with dual listings.

If IASB governance and due process are high quality, and the UK ensures that it continues to have its say, and is heard, it should be possible to accept the outcome of that process.

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

ENDORSEMENT - BY WHOM?

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

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

For the avoidance of doubt, we do not think that primary responsibility should lie with market regulators or prudential supervisors either. Regulators are important stakeholders in the financial reporting process, and it makes sense to ensure as much as possible that the accounting numbers are a sound starting point for regulators. However, regulators often have a distinct focus, not necessarily aligned with the interests of investors, who are the primary users of annual financial statements under the IASB Framework. Consequently, in our view market regulators and prudential supervisors should have no particular influence over the determination of the detailed requirements of accounting standards for general purpose financial reporting.

Our assumption is that responsibility for making endorsement decisions will lie with the FRC. We suggest that to ensure that the endorsement process is robust and transparent, the UK government consults on the key features of the new arrangements, including accountability, governance and related issues.

6. Beyond IFRS: UK GAAP, company law and wider corporate reporting

In this section we examine the case for changes beyond IFRS reporting, and in particular changes to UK accounting law.

The majority of private companies in the UK use UK GAAP rather than EU-adopted IFRS. It may seem, therefore, that they will be less affected by Brexit than their listed counterparts, but in reality much of the financial reporting regime under which they operate is based on EU regulations. Indeed, most UK company law is now derived from EU legislation, and many of the recent changes to small and micro-entity reporting have been driven by developments in Brussels.

In light of this there will only need to be a small number of consequential changes made to existing UK standards and related legislation in the short term on the UK's departure from the EU. An early overhaul of the accounting obligations of private companies and other UK GAAP reporters seems highly unlikely. The UK government has many other post-Brexit legislative priorities. The UK has, moreover, only recently restructured its financial reporting regime. Indeed, many small and micro-entities have only recently implemented the new requirements for the first time.

Nonetheless, there are some specific provisions from recent EU directives that are now reflected in UK law which directly impacted UK standards and were not supported by the UK. Some have been regarded as harmful to UK financial reporting, such as the restriction on small company disclosures introduced as a result of the 2013 accounting directive. There are examples, too, of recent changes to UK law that arguably did not improve reporting by larger companies. Removing them would be de-regulatory and eliminate unnecessary costs for UK business.

The need for continuity and stability for business should take precedence over changes to the law during the first few years of post-EU Britain, although we do not rule out short term fixes that would demonstrably benefit UK business. Despite some examples of unsatisfactory EU-derived accounting law, there are strong incentives for minimising change to the UK accounting regime during the next few years.

WHAT ABOUT THE MEDIUM TO LONG-TERM?

It is possible that the outcome of the Brexit negotiations will mean that UK accounting law remains aligned with EU law, and that the opportunities to effect change will be small. On the other hand, if the UK is no longer subject to EU legislation and regulation, it will be free to undertake a root and branch review of its financial reporting regime, including all aspects that find their origin in EU directives.

In practice, however, any such review seems unlikely for a substantial period of time. Reform of company law is unlikely to be near the top of the government's to-do list. How much change would result in practice is, moreover, difficult to predict. In many respects the UK has had a significant influence in shaping the EU accounting directives over the decades, and radical change would not be the inevitable outcome - the primary UK accounting standard, FRS 102 is, after all, a UK invention, based on international standards.

Nonetheless, in time there may well be scope to remove much of the detail on the content of financial statements from UK company law. At its simplest, the many inconsistencies in terminology between the law and FRS 102 could be eliminated. At the other end of the spectrum, there is an opportunity to realise the vision long held by ICAEW of an accounting regime that consists of a high-level legal framework, with the underpinning detail left to accounting standards. This would, in one fell swoop, remove current duplication and other inefficiencies, and provide significant simplification and cost savings for business.

The government should, in due course, seize the opportunity Brexit provides for a more profound review of UK company law, rationalising and simplifying the scope and content of the accounting and related provisions, and revisiting the balance between law and standards, with a deregulatory outcome in mind. This should involve close consultation with the accountancy profession and other financial reporting stakeholders in order to minimise the risk of unintended consequences.

In the meantime, the potential for change to corporate reporting in its widest sense will continue to be explored by the profession, academics and other interested parties.

The Financial Reporting Faculty's June 2017 thought leadership report, *What's next for corporate reporting: time to decide?*, set out the key decisions needed to drive reporting forward. In some respects, the report and its on-going impact illustrates the opportunities for the UK to influence the international agenda. In other respects, it draws attention to the need for continued close engagement with the EU beyond narrow endorsement issues.

For example, one key focus of the report is the use of technology in reporting. Some UK companies may still be affected by the requirements currently under development by the European Securities and Markets Authority (ESMA) for a European Single Electronic Format (ESEF), which will specify the electronic format in which the IFRS consolidated financial statements of issuers on European regulated markets will have to be prepared from 2020. Decisions taken in Brussels on electronic reporting might, moreover, be viewed as a benchmark for progress in the UK in this fast-moving area of corporate reporting.

In the coming years, UK stakeholders should seize the opportunity for innovative thinking about the use of technology for the reporting and filing of financial information. This could reap benefits for both government and business.

7. Policy recommendations and next steps

RECOMMENDATIONS

- 1** The UK government and other stakeholders should explicitly recognise the economic importance of financial reporting in considering the policy implications of Brexit.
- 2** As a major global financial centre, the UK should continue to adhere to internationally accepted standards.
- 3** We believe that there is a strong case for requiring all companies that raise funds from the public to remain subject to the full rigours of IFRS reporting. Efforts should, however, continue to eliminate unnecessary complexity in IFRS standards and to ensure that the IFRS disclosure regime is proportionate. We also think that the option to apply IFRS should remain available in UK law for all non-charitable companies, including subsidiaries of listed IFRS reporters.

- 4 On completion of the Brexit process, the UK authorities should make the case for UK participation on the IFRS Foundation's Monitoring Board, given the status of the UK as a major IFRS jurisdiction and global capital market.
- 5 On completion of the Brexit process, the UK authorities should also make the case for UK participation on the IFRS Foundation's Accounting Standards Advisory Forum (ASAF).
- 6 The UK financial reporting community should up its game in terms of development and sharing of accounting thinking and practice, aiming to become a leading member of the unique global standard-setting partnership that has emerged from the widespread adoption of IFRS. Therein lies the most sustainable route to sustainable global influence.
- 7 We find the arguments for introducing some form of UK endorsement mechanism and endorsement criteria to be, on balance, persuasive. Transitional provisions may be necessary to allow for the design and orderly implementation of new arrangements and to minimise uncertainty for business.
- 8 The UK government should ensure that, in the near future, proposals on the future adoption of IFRS standards and interpretations are developed for public comment. The consultation document should explore the key policy options, with reference to practice in the EU and in other IFRS jurisdictions; make recommendations for the UK; and allow adequate time for debate about those recommendations and their implications.
- 9 The UK should remain closely engaged with relevant EU institutions in debates over accounting developments, given that decisions by the EU will continue, directly or indirectly, to affect UK economic interests. This may also reduce duplication of costs and effort. The ways in which the UK might continue to participate in EFRAG processes should be explored, for example through observer status for the UK on the EFRAG Technical Experts Group (TEG) and/or the EFRAG Board.
- 10 The UK should develop a simple, cost-effective and efficient mechanism for the endorsement of new and amended IFRS requirements, with appropriate emphasis on accountability and due process, but with few separate stages and clearly-defined timetables.
- 11 The current EU endorsement criteria should be the starting point for considering the scope and relative importance of new UK criteria, bearing in mind that close alignment between the UK and EU criteria would reduce the likelihood of divergence in the outcome of the endorsement processes. The opportunity should be taken to consider how the EU criteria could be improved and simplified, in ways that do not detract from a clear focus on the need of investors for transparent financial information.
- 12 An endorsement mechanism should, in exceptional circumstances, allow the applicable UK authority not to adopt new standards or interpretations. Further debate should take place in the UK over the potential for facilitating other, very limited modifications, for example, adding to required disclosures. But the IFRS brand, recognised by capital market participants around the world, should not be trifled with lightly.
- 13 Our assumption is that responsibility for making endorsement decisions will lie with the FRC. We suggest that to ensure that the endorsement process is robust and transparent, the UK government consults on the key features of the new arrangements, including accountability, governance and related issues.

- 14 The need for continuity and stability for business should take precedence over changes to the law during the first few years of post-EU Britain, although we do not rule out short-term fixes that would demonstrably benefit UK business. Despite some examples of unsatisfactory EU-derived accounting law, there are strong incentives for minimising change to the UK accounting regime during the next few years.
- 15 The government should, in due course, seize the opportunity Brexit provides for a more profound review of UK company law, rationalising and simplifying the scope and content of the accounting and related provisions, and revisiting the balance between law and standards, with a deregulatory outcome in mind. This should involve close consultation with the accountancy profession and other financial reporting stakeholders in order to minimise the risk of unintended consequences.
- 16 In the coming years UK stakeholders should seize the opportunity for innovative thinking about the use of technology for the reporting and filing of financial information. This could reap benefits for both government and business.

Next steps

The Financial Reporting Faculty welcomes comments on the contents of this report and its recommendations. They can be sent to nigel.sleigh-johnson@icaew.com.

We recognise that thinking will evolve in this area and will consider the comments received and encourage further discussion of this report's findings, alongside any proposals from government and the FRC. We expect to publish a follow-up report or reports in 2018, drawing on these outputs and activities, and possibly including updated recommendations.

The Faculty also plan to hold webinars and events to encourage debate and will continue to collaborate with the government, FRC and other relevant bodies on the reporting consequences of the UK's departure from the EU. A panel session addressing the issues raised by this report will be held on 22 November 2017 as part of the Faculty's [annual IFRS conference](#) in London.

FINANCIAL REPORTING FACULTY

The Faculty is one of the largest global networks of financial reporting professionals. It is committed to providing its 5,000 members – ICAEW and non-ICAEW – with the practical help they need in today's complex world of financial reporting. It keeps its members up to date with changing regulations and standards through clear and accessible assistance across a spectrum of financial reporting issues.

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