Effects of using International Financial Reporting Standards (IFRS) in the EU: public consultation

Fields marked with * are mandatory.

Impact of International Financial Reporting Standards (IFRS) in the EU: public consultation

Purpose of the consultation

The European Commission is holding a public consultation to seek views from all interested parties on their experience of Regulation 1606/2002 ("the IAS Regulation"). The results of this public consultation will feed into the European Commission's evaluation of the IAS Regulation.

Background

Applying internationally accepted standards - the International Financial Reporting Standards (IFRS) – means standardising companies' financial reporting to make financial statements more transparent and comparable. The ultimate aim is for the EU capital market and the single market to operate efficiently.

Scope of the IAS Regulation

The IAS Regulation states that the IFRS must be applied to the consolidated financial statements of EU companies whose securities are traded on a regulated EU market. EU countries may extend the application of IFRS to annual financial statements and non-listed companies (view an update on the use of options in the EU). The Transparency Directive (2004/109/EC), as subsequently amended, also stipulates that all issuers (including non-EU ones) whose securities are listed on a regulated market located or operating in an EU country must use IFRS.

Impact of the IAS Regulation

The implementation of IFRS in the EU has had an impact on cross-border transactions, trade, the cost of capital, investor protection, confidence in financial markets and stewardship by management. However, it is difficult to differentiate their impact from that of other significant factors, including other regulatory changes in the EU and internationally.

Developments since adoption

Over 100 countries now use IFRS. These accounting standards have been increasingly discussed at international level (e.g. G20, Basel Committee) and with various interested parties in the EU, especially in the wake of the financial crisis.

Several initiatives concerning technical issues and governance are under way at both international and EU level. In the EU, the Maystadt report's recommendations are being implemented. These are designed to strengthen the EU's contribution to achieving global and high quality accounting standards by beefing up the role of the European Financial Reporting Advisory Group (EFRAG), which advises the Commission on IFRS matters.

Current Commission evaluation

The Commission is evaluating the IAS Regulation to assess:

- IFRS's actual effects
- how far they have met the IAS Regulation's initial objectives
- whether these goals are still relevant
- any areas for improvement.

This consultation is part of the evaluation process. The questionnaire was drafted with the help of an informal expert group which is to assist the Commission throughout the process.

Target group(s)

Any interested party – commercial, public, academic or non-governmental, including private individuals.

Especially: capital market participants and companies preparing financial statements or using them for investment or lending purposes (whether or not they use IFRS).

Consultation period

7 August — 31 October 2014 (12 weeks).

How to submit your contribution

If possible, to reduce translation and processing time, please reply in one of the Commission's working languages (preferably English, otherwise French or German).

Contributions will be published on this website with your name (unless – in your response – you ask us not to).

N.B.: Please read the specific privacy statement to see how your personal data and contribution will be dealt with.

Reference documents and other, related consultations

- IAS/IFRS standards & interpretations
- IFRS Foundation
- European Financial Reporting Advisory Group (EFRAG)
- Commission reports on the operation of IFRS

Results of public consultation & next steps

The results will be summarised in a technical report and will feed into the evaluation report to be presented by the Commission in line with Article 9.2 of Regulation 258/2014.

Questions

Please note that some questions do not apply to all groups of respondents.

Who are you?

1. In what capacity are you completing this questionnaire?

If it's *not* on behalf of an organisation, please indicate that you are a "private individual".*

- Company preparing financial statements *[some specific questions for preparers marked with 'P']*
- Company using financial statements for investment or lending purposes *[some specific questions for users marked with 'U']*
- A company that both prepares financial statements and uses them for investment or lending purposes *[some specific questions for preparers and users marked with 'P' and 'U']*
- Association
- Accounting / audit firm
- Trade union / employee organisation
- Civil society organisation / non-governmental organisation
- Research institution / academic organisation
- Private individual
- Public authority *[one specific question for public authorities marked with 'PA']*
- (selected) Other

1.11. Other - please specify*

A group of nine UK organisations are making a joint submission. The participating institutions include individual asset management firms, pension funds and associations as follows:
- Sarasin & Partners LLP
- Royal London Asset Management
- Threadneedle Investment Management
- GO Investment Partners
- RPMI Pailpen
- USS Investment Management Ltd
- London Pension Fund Authority
- Local Authority Pension Fund Forum
- United Kingdom Shareholders Association

2. Where is your organisation/company registered, or where are you are located if you do not represent an organisation/company? Select a single option only.*

- ( ) EU-wide organisation
- ( ) Global organisation
- ( ) Austria
- ( ) Belgium
- ( ) Bulgaria
- ( ) Croatia
- ( ) Cyprus
- ( ) Czech Republic
- ( ) Denmark
- ( ) Estonia
- ( ) Finland
- ( ) France
- ( ) Germany
- ( ) Greece
- ( ) Hungary
- ( ) Ireland
- ( ) Italy
- ( ) Latvia
- ( ) Lithuania
- ( ) Luxembourg
- ( ) Malta
- ( ) The Netherlands
- ( ) Poland
- ( ) Portugal
- ( ) Romania
- ( ) Slovakia
- ( ) Slovenia
- ( ) Spain
- ( ) Sweden
- (x) United Kingdom
- ( ) Norway
- ( ) Iceland
- ( ) Liechtenstein
- ( ) Other European country
- ( ) Other

3. What is the name of the organisation or authority you represent? If you are part of a group, give the name of the holding company as well.*

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See response to Q1.11 above
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4. In the interests of transparency, we ask organisations to supply relevant information about themselves by registering in the Transparency Register (http://ec.europa.eu/transparencyregister). If your organisation is not registered, your submission will be published separately from those of registered organisations. Is your organisation registered in the European Parliament/Commission Transparency Register?*

- ○ Yes
- ● No

5. In the interests of transparency, your contribution will be published on the Commission's website. How do you want it to appear?*

- ● Under the name supplied? (*I consent to the publication of all the information in my contribution, and I declare that none of it is subject to copyright restrictions that would prevent publication.*)
- ○ Anonymously? (*I consent to the publication of all the information in my contribution except my name/the name of my organisation, and I declare that none of it is subject to copyright restrictions that would prevent publication.*)

Relevance of the IAS Regulation

Objective

6. The rationale for the IAS Regulation, imposing internationally accepted standards - the International Financial Reporting Standards (IFRS) - was to make companies use the same set of accounting standards, thus ensuring a high level of transparency and comparability of financial statements. The ultimate aim was to make the EU capital market and the single market operate efficiently.

In your view, are the Regulation's objectives still valid today?*

- ● Yes
- ○ No
- ○ No opinion

6.1. Comments.

The aims of transparency and comparability are desirable, but they should be a lower priority than:
• The "protection of investors and the maintenance of confidence in the financial markets" (para 4) and
• The provision of a "true and fair view" (TFV) and being "conducive to the European public good" as identified also in the IAS Regulation (para 9), and required in related EU Directives (specifically the 4th and 7th Directives).

We believe that, as currently implemented, the endorsement process for accounting standards to be approved for use in the EU (as prescribed by the IAS Regulation) has failed to protect investors, or maintain confidence in the financial markets, as required. Moreover, it has failed to deliver a TFV, or deliver for the public good. We believe this has occurred due to a failure of those overseeing endorsement of IFRS to understand (and perhaps also the IAS Regulation to make clear) the vital objective of capital maintenance as a legal condition that must be met for an accounting standard to ensure a TFV. In short, we believe the objective of capital maintenance has been side-lined in the rush to achieve international comparability. This has been damaging for long-term investors, and the public good, and is not consistent with EU Company Law.

Capital maintenance is a vital objective for accounts
The requirement for accounts to provide a basis for capital maintenance is long-standing, and can be found in the EC's 2nd Directive. This requirement underpins Directors' duties to ensure no distributions are made out of capital (Article 15, 2nd Directive), and related obligations to ensure that a company is solvent and a going concern.

Capital maintenance is a fundamental objective of "true and fair view" (TFV) accounts
Requirements that accounts must provide a TFV (4th and 7th Directives) are closely aligned with the goal of capital maintenance, and "the protection of members and third parties" (para 5, 4th Directive). These Directives are clear that a core accounting principle to achieve this is prudence, which in turn requires the inclusion of foreseeable losses, and the exclusion of unrealised gains (4th Directive Article 31(1)(c)). The implication of these principles is that "profit" includes only realised gains. On the basis of prudent accounts, directors can then ensure they will fulfil their own obligations not to distribute out of capital (2nd Directive noted above).

ECJ judgements affirm the link between TFV, prudence and capital maintenance
The above interpretation of requirements for accounts has been

repeatedly confirmed by the European Court of Justice (notably ECJ C-322/12: État belge; ECJ C-275/97: Bauunternehmung and ECJ C234/94: Tomberger).

a) État belge 2013, C-322/12: This case reaffirms that the purpose of accounts is member and third party protection, that historic cost accounting and prudence are the corollary of that objective, and that is the standard for accounts to ensure a TFV. On that basis the ECJ ruled out revaluing shares in the balance sheet above acquired cost.

b) Tomberger 1996, C234/94): This case highlights 1) accounts must present a TFV (para 3 and 4); 2) TFV requires prudence (para 5) and 3) the dividend cannot be received by the parent, and booked, unless the accounts of the subsidiary gave a TFV (para 23).

c) Bauunternerhmung 1999, C-275/97): This case reaffirms that TFV is the primary requirement of the Act. Overstating net assets and profits, by not using prudence is contrary to the TFV. Likely losses that will manifest after the balance sheet date must be included.

This view of the goal of accounts is validated by the legal opinion provided by QC Bompas (2013) in the UK*. It is also supported by UK case law. Prominent examples include: Queens Moat House plc appeal 2001 and the Caparo House of Lords Case 1990.

[*There are two legal opinions on the topic of TFV in the UK. The Bompas QC Opinion disagreed with the interpretation of an earlier opinion by Moore QC (2008). While we agree with Bompas that there are fundamental flaws with the Moore opinions (2008 and more recent version in 2014), both QC's agree that accounts must ensure capital maintenance, and show a breakdown of distributable and non-distributable reserves. They differ only on whether this must be disclosed to shareholders.]

IAS Regulation is consistent with capital maintenance, but implementation has failed
It is our view that, while the IAS Regulation is in theory consistent with ensuring capital maintenance by emphasising the TFV requirement, the actual endorsement process has led to the approval of individual standards that are not. The endorsement failures, in our mind, need to be tackled by amending the IAS Regulation to make explicit the centrality of capital maintenance as an objective of accounts as required in the 2nd, 4th and 7th Directives, and the link between achieving a TFV and maintaining capital.

IFRS standards are not consistent with TFV or capital maintenance
Turning to individual IFRS that have fallen short, of critical importance was the approval of IAS1, which allowed the approval of the IFRS Framework. Neither the old Framework nor the revised IFRS's Conceptual Framework (2010) identify capital maintenance as a primary objective for accounts. Consequently, the IFRS have never had a reason to prioritise prudence as an accounting principle. Indeed, the IASB revised the IFRS Conceptual Framework in 2010 to replace prudence with "neutrality" to avoid "bias" in accounting.**

[**There is considerable legal uncertainty in our mind as to the role of the revised Conceptual Framework, which was not approved via the EC Endorsement process. According to Bompas QC's recent legal opinion, it is his view that the old IFRS Framework is the applicable Framework for reference, since this was in place when IAS 1 was approved. This leads to uncertainty as to all new standards approved under the new IFRS Conceptual Framework (2010). This uncertainty is further compounded by the fact that the IASB repeatedly state that whichever framework applies it is, itself, not an accounting standard.]

This means that IFRS accounts can neither reliably provide a TFV of a company's performance or financial position, since profits and capital may be overstated, nor can IFRS accounts provide a reliable basis for directors of companies to discharge their obligations under the 2nd Directive. While the IASB has recently proposed reintroducing prudence, unless this is clearly linked to the ultimate goal of capital maintenance it is hard to see how we can rely on IFRS to ensure consistency with the 2nd, 4th or 7th Directives***.

[*** http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/May/AP10I-Conceptual%20Framework.pdf]

Turning to other standards, IAS 39 offers a stark example of how IFRS is not in line with either the 4th Directive Article 31(1)(c)(aa) or the equivalent requirement of the 7th Directive, which require that only realised profits are booked to ensure prudence. IAS 39 allows unrealised mark to market "profits" and mark to model "profits" in the profit and loss account. (para 47-48A, and 55 in principle allow unrealised profits). This is exactly the problem that the ECJ has picked up in several cases, most recently ECJ C322/12 State of Belgium vs GIMLE (see above).

Similarly, while the 4th Directive Article 31(1)(c) requires that all foreseeable liabilities and potential losses should be included in accounts to ensure prudence, these are excluded under IAS 39 "Financial Instruments: Recognition and Measurement". Para 59 states: "Losses expected as a result of future events, no matter how likely, are not recognised". While IFRS9 will introduce from 2018 an improvement with respect to loan loss provisioning, the forward looking element is limited to twelve months, and thus inadequate.
In principle, IFRS offers an "over-ride option" in IAS 1 to ensure consistency with high level accounting principles. The idea is that individual standards can be over-ridden where they result in an outcome that is in "conflict with the objective of financial statements set out in the Framework" (para 23 of IAS 1). The problem is that because the Conceptual Framework prioritises neutrality over prudence it is currently at odds with Accounting Principles required in Company Law. Therefore, no over-ride would be possible if accounts do not present a prudent or TFV, since these are not requirements in the Framework.

IFRS has run contrary to the public interest – example of the financial crisis

It is our view that a move away from these core accounting principles via the introduction of IFRS without sufficient amendment has contributed to economic instability in the EU and elsewhere. Consequently, it has not fulfilled the requirement to under the IAS Regulation to protect the public interest. This is most notable in the way IFRS has permitted – and even encouraged – an excessive build-up of risks in the banking sector in the run up to the financial crisis. Accounts are critical because they are the basis on which performance is measured, and executives incentivised.

Loan loss provisioning encourages risk-taking

In the UK, IFRS replaced the UK GAAP's "expected loan loss provisioning" with "incurred loan loss provisioning".

Under UK GAAP (prior to convergence with IFRS), accounts were expected to hold loans at no more than realisable value, meaning that it was necessary to estimate "likely" loan losses / defaults on different pools of loans dependent on their level of recovery risk. That was achieved by "general provisions" for bad debts. The riskier the pool of loans, the higher the provision. Decisions about appropriate provisioning were audited. This approach was considered prudent, and it was aligned with key accounting principle of "accruals" and "matching" (i.e. recognising revenue as it is earned, not necessarily paid, and matching it with the associated costs).

Under IFRS, however, an incurred loan loss provisioning approach was adopted, which required that only actual defaults be recognised as a cost of the loan. No estimates for future losses were permitted. The intention was to tackle management manipulation of provisions to smooth earnings. However, in tackling what was is in effect a problem of implementation and audit (management manipulation of accounts) by changing the standards, we are left with a standard that is not prudent, and does not comply with accruals and matching principles.

The incurred loan loss provisioning approach feeds through to bank executive incentives for risk-taking. In boom years, where accounts do not provision for future likely loan losses, banks will earn the highest "profit" on the riskiest (and highest margin) loans. Banks with the riskiest loan books, and who grow these most quickly, will see profits rise faster than competitors. Executives will also likely see their bonuses rise commensurately.

As the banks' equity increases, moreover, banks are able to extend their lending even further, thereby fuelling the boom. When the economy turns, of course, the process goes into reverse. Banks with few provisions for bad debts then have to recognise large losses. In effect, under IFRS the

profits for banks' loan books are all front-ended, and the losses come through all at once in a downturn.

What is particularly damaging is how the accounting standard feeds through to incentives for risk-taking, which accentuates the boom and bust, with enormous costs for macro-economic stability**.**

[**While the problem with incurred loan loss provisioning has been recognised by the IASB, and is currently being reviewed to ensure a limited form of expected future losses, the proposed replacement model only considers loan losses (in most circumstances) 12 months ahead. This falls short, in our view of the required life-time expected loss approach. It is also at odds with the US FASB decision to move to full life-time expected losses. Consequently, it also fails to achieve the stated goal of comparability.]**

Excessive use of mark to market (MTM) encourages risk-taking
Under IFRS, the use of MTM (and mark to model) for valuing trading and available for sale assets has been significantly expanded. This is particularly evident with respect to accounting for financial instruments (IAS39 until 2009/2010, and now IFRS 9 and 13). Market prices are viewed to be "neutral", and the best way to value banks' assets. However, the approach faces two critical flaws.

First, if the crisis taught us anything, it is that markets are not perfect, and the prices at any one time may be biased for a number of reasons. This is particularly true in illiquid and volatile markets. Indeed, in such markets the sale of the assets held by banks to realise the value quoted on the balance sheet may itself lead to a price drop. In other words, the prices quoted on the balance sheet would not be realisable in practice. Balance sheet valuations are then, as the CEO of Royal Bank of Scotland remarked during the crisis, "Alice in Wonderland numbers" (Preliminary Announcement, February 2012). Depending on the day that you value the assets, you might come up with very different numbers. Where there is no acceptable market price according to IFRS rules, then companies can "mark to model" (for Level 3 assets), which introduces enormous scope for subjectivity and manipulation.

Moreover, using MTM so extensively (under UK GAAP a more restricted and considered use of MTM was permitted for the most liquid assets – see the British Bankers' Association SORP) fails to meet the prudence test. The profits which flow through the Profit and Loss account as a result of revaluation of assets (which are not in fact sold) are viewed as "real profits" and may be used as a basis for determining distributions. However, if these profits turn out not to have been real (e.g. are reversed when markets turn) and were never realised (i.e. never actually converted into cash), the distributions (which were made in cash) may have been made out of capital. This is, of course, not permitted under Company Law. Furthermore, the unrealised profits then feed into the company's equity, which is in turn used as a basis to ascertain a company's "going concern" status.

The extensive use of MTM also feed executives' incentives for risk-taking. In an upward moving market, the more assets banks hold in their trading books, the more "paper profits" they will make, and the higher their bonus payments. As with incurred loan loss provisioning, the higher profits feed the banks equity base (and Tier 1 capital), off which they are able to buy more of these trading assets thereby pushing up the prices. The more risky assets, of course, will tend to generate the highest returns. In a downturn, the process reverses. In short, MTM is pro-cyclical.

The examples above highlight why we believe the move to IFRS, and specifically the move to neutrality as a guiding principle in accounting, has led to excessive incentives for risk-taking in banks, and is not in the public interest. If anything, the spread of IFRS globally, could accentuate global economic instability, rather than improving financial market efficiency.

In summary

In summary, the requirement for a TFV, supported by the requirement for prudence, in the 4th and 7th Directives is vital since this underpins the reliable (and not over-stated) reporting of capital to shareholders, and provides a basis on which Directors can fulfil their capital maintenance responsibilities as set out in the 2nd Directive: not to distribute out of capital. The goals of internationally comparability should not take precedence over these fundamental objectives of accounts.

Indeed, we would like to see the IAS Regulation to explicitly require that the IFRS adopted in the EU are consistent with the ultimate goal of capital maintenance and responsible long-term stewardship. Moreover, the Regulation should explicitly set out that prudence should be a core accounting principle, to ensure that accounts include foreseeable losses, and exclude unrealised gains (as per the 4th and 7th Directives). Unrealised gains should be clearly separated and disclosed to shareholders, and accounts should provide a breakdown of distributable and non-distributable reserves.

These changes are also in the public interest (as required by Article 3(2) of the IAS Regulation). It is our view that a move away from these core accounting principles via the introduction of IFRS without sufficient amendment has contributed to economic instability in the EU and elsewhere. This is most notable in the way IFRS has permitted - and even encouraged - an excessive build-up of risks in the banking sector in the run up to the financial crisis.

7. The IAS Regulation refers to IFRS as a set of global accounting standards. Over 100 countries use or permit the use of these standards. The US, for instance, allows EU companies listed in the US to report under IFRS. However, it continues to rely on its "generally accepted accounting principles" (GAAPs) for its domestic companies' financial statements, while the EU requires IFRS to be used for the consolidated accounts of EU listed companies.

Has the IAS Regulation furthered the move towards establishing a set of globally accepted high-quality standards?*

- ○ Yes
- ● No
- ○ No opinion

7.1. Please explain.

As per our response to Q6, the IAS Regulation has not delivered accounts that protect investors or accounts that are in the public interest, so we do not believe they can be described as "high quality standards". Unless the goal of capital maintenance is made clear, and accounts required to provide a breakdown of distributable and non-distributable reserves as well as realised and unrealised income, then the application of IFRS within the EU or outside could be damaging.

Scope

8. The obligation to use IFRS as set out in the IAS Regulation applies to the consolidated financial statements of EU companies whose securities are traded on a regulated market in the EU. There are about 7,000 such firms.
In your view, is the current scope of the IAS Regulation right (i.e. consolidated accounts of EU companies listed on regulated markets)?*

- ○ Yes
- ● No
- ○ No opinion

8.1. How would you propose it be changed?*

- ☐ By making IFRS compulsory for the individual annual accounts of listed companies on regulated markets
- ☐ By making IFRS compulsory for the consolidated accounts of large non-listed companies
- ☐ By allowing any company to opt for reporting under IFRS
- ☑ Other

8.1.1. Other - please specify.*

> **As highlighted elsewhere (e.g. Q6), we are of the view that the IAS Regulation has not been properly implemented, and needs to be urgently amended to ensure that IFRS adopted in the EU are consistent with requirements in EU Company Law for accounts to provide a basis for capital maintenance by ensuring that directors do not distribute out of capital. This in turn requires that standards are prudent so that capital and/or performance is not overstated and accounts therefore provide a TFV. This is vital for investor protection and stewardship. Until these changes are made, the scope of the IAS Regulation should be - if anything - reduced.**

9. National governments can decide to extend the application of IFRS to:
- individual annual financial statements of companies listed on regulated markets
- consolidated financial statements of companies that are not listed on regulated markets
- individual annual financial statements of companies that are not listed on regulated markets.

In your view, are the options open to national governments:*

- ○ Appropriate
- ○ Too wide
- ○ Too narrow
- ◉ No opinion

Cost-benefit analysis of the IAS Regulation

10. Do you have pre-IFRS experience/ experience of the transition process to IFRS?*

- ◉ Yes
- ○ No

11. In your experience, has applying IFRS in the EU made companies' financial statements more transparent (e.g. in terms of quantity, quality and the usefulness of accounts and disclosures) than they were before mandatory adoption?*

- ○ Significantly more transparent
- ○ Slightly more transparent
- ○ No change
- ◉ Slightly less transparent
- ○ Significantly less transparent
- ○ No opinion

11.1. Please elaborate.

In some areas, IFRS has provided more information and consistency. Overall, however, our view is that the application of neutrality over prudence, and the lack of a link to capital maintenance, has meant that – particularly for financial institutions – been significantly detrimental to providing a TFV of companies' performance and capital position (how we would define "transparency").

Prior to 2005, the UK GAAP had already transitioned towards IFRS, so the actual adoption of IFRS was not a significant change in that year. However, when looked at over a longer time frame, the change has been significant and detrimental to transparency. The failure with IFRS arises at three levels:

a) Failure of IFRS to include the capital maintenance purpose of accounts, and in particular the creditor and shareholder protection requirement to account for inter alia distributable profits and distributable reserves required by the 2nd Directive, for which the TFV is the required standard.

b) Failure of IFRS to require prudence as a fundamental accounting principle, as required for the preparation of accounts for a TFV under Article 31(1)(c) of the 4th Directive, and the equivalent requirement of the 7th Directive and confirmed as necessary by the European Court of Justice (notably ECJ C-322/12: État belge; ECJ C-275/97: Bauunternehmung; and ECJ C234/94 Tomberger). While the IASB has proposed to restore prudence to the Conceptual Framework in May 2014, unless this is linked to the goal of capital maintenance it remains unclear what prudence means exactly.

c) Failure of individual IFRS to follow statutory accounting principles, including in particular:

i. IAS 39 allowing unrealised mark to market "profits" and mark to model "profits" in valuations, contrary to the requirement of prudence to only include realised profits required under Article 31(1)(c)(aa) of the 4th Directive, and the equivalent requirement of the 7th Directive, and

ii. IAS 39, but not only IAS 39, not accounting for all foreseeable liabilities and likely losses irrespective of the time in which they arise, contrary to the requirement of prudence under Article 31(1)(c)(bb) of the 4th Directive, and the equivalent requirement of the 7th Directive.*

* The IASB has agreed to amend IAS39 to specifically address the criticism that loan-loss provisioning at banks was pro-cyclical and failed to ensure proper matching of costs to income from loans. However, in our view, the proposed approach is only a partial solution since it only moves towards a 12-month expected loan-loss provision (in most circumstances), rather than all foreseeable losses associated with the loans.

12. In your experience, has applying IFRS in the EU altered the comparability of companies' financial statements, compared with the situation before mandatory adoption?

	Significantly increased	Slightly increased	No change	Slightly reduced	Significantly reduced	No opinion
In your country	○	○	○	○	○	●
EU-wide	○	○	○	○	○	●
Compared with non-EU countries	○	○	○	○	○	●

13. Have financial statements become easier to understand since the introduction of IFRS, compared with the situation before mandatory adoption?*

- ○ Yes, in general
- ○ Yes, but only in certain areas
- ○ No, in general
- ● No, except in certain areas
- ○ No opinion

13.1. In which areas?*

Financial statements have become less reliable for long-term investors interested to understand the underlying performance, including the breakdown of realised and unrealised income, as well as the capital strength of the entity. Two particular areas of concern have been with IAS39 relating to rules around mark-to-market valuations and, for banks, loan-loss provisioning. Please refer to response to Q6.

13.2. Please elaborate.

A notable problem area for IFRS is the extensive reliance on fair-value measurement to determine income. Requirements fair-value accounting have been particularly problematic in banks, where a large proportion of income is derived through mark-to-market measurements and thus understanding what has been realised is impossible. This then feeds through to uncertainty as to the distributable reserves. We believe this runs contrary to objectives to protect investors and promote stewardship. As the accounting numbers are also often the basis for remunerating executives, they can lead to inappropriate decision-making in companies, with damaging ramifications for economic stability (as outlined in our response to Q6).

14. Has the application of IFRS in the EU helped create a level playing field for European companies using IFRS, compared with the situation before mandatory adoption? *

- ( ) Yes
- ( ) Yes, to some extent
- ( ) No
- (•) No opinion

15. Based on your experience, to what extent has the application of IFRS in the EU affected access to capital (listed debt or equity) for issuers in domestic and non-domestic markets that are IFRS reporters?

	Made it a lot easier	Made it easier	No effect	Made it more difficult	Made it a lot more difficult	No opinion
Domestic capital	( )	( )	( )	( )	( )	(•)
EU capital other than domestic	( )	( )	( )	( )	( )	(•)
Non-EU capital	( )	( )	( )	( )	( )	(•)

16. In your experience, has the application of IFRS in the EU had a direct effect on the overall cost of capital for your company or the companies you are concerned with? (Please distinguish - as far as possible – the impact of IFRS from other influences, e.g. other regulatory changes in the EU and the international credit crunch and crisis.)*

- Cost has fallen significantly
- Cost has fallen slightly
- No effect
- Cost has risen slightly
- Cost has risen significantly
- (selected) No opinion

17. In your view, has the application of IFRS in the EU improved protection for investors (compared with the situation before mandatory adoption), through better information and stewardship by management?*

- Yes, to a great extent
- Yes, to a small extent
- It had no impact
- (selected) No, protection for investors has worsened
- No opinion

17.1. Please provide data/ examples if available.

We have detailed in other responses (notably Q6 and 11) our strong belief that the application of IFRS without amendment has been detrimental to investor protection and stewardship. To reiterate, IFRS does not prioritise a core investor protection: capital maintenance. Consequently, it does not prioritise prudence as a core accounting principle; the need for visibility of realised and unrealised income; nor clarity about distributable and non-distributable reserves. Yet, without information on these, investors that provide long-term equity capital cannot determine how safe their capital is, or how effective management has been in stewarding their capital. Moreover, it is hard to see how directors are in a position to ensure they do not distribute out of capital.

The damage done by IFRS was made clear by the financial crisis, as set out in our response to Q6. While accounts had been showing rising profits, a strong build up in bank reserves and thus capital strength at European banks, in fact the underlying economics was poor. The cost of risky loans was not being appropriately recognised, allowing executives' to book profits, which were not real. Moreover, the ability to recognise mark-to-market gains as income, without differentiating what had been realised as cash or near cash, masked the heavy dependence of banks on unrealised profits. These profits (on both risky loans and MTM assets) fed into the banks' reserves, and provided a basis for further loan growth, and fuelling the boom. The excessive build-up of debt only became evident once the economy turned, and the process went into reverse.

Currently, in October 2014, the EU has still not recovered its end of 2007 level of GDP, and is at risk of falling into a triple-dip recession. While there were clearly a number of factors at play in the build-up of risk in the global economic system prior to 2007, IFRS was a contributory factor, and this needs to be explicitly recognised and the fault-lines addressed.

18. In your view, has the application of IFRS in the EU helped maintain confidence in financial markets, compared with the likely situation if it had not been introduced?

(N.B.: the “enforcement” section of this questionnaire deals with how IFRS are/ were applied.)*

- ( ) Yes, to a great extent
- ( ) Yes, to a small extent
- ( ) It had no impact
- (x) No, confidence in financial markets has decreased
- ( ) No opinion

18.1. Please provide data/ examples if available.

While IFRS has sought to reduce the risk of account manipulation at individual companies, it has done so at the expense of the broader objective of TFV accounts, and thus reduced confidence in accounts. The problem was neatly summed up by the CEO of the Royal Bank of Scotland during the crisis, IFRS provided "Alice in Wonderland numbers" (Preliminary Announcement, February 2012). In our view IFRS have turned what was a company-specific risk of manipulation or even fraud into a system-wide problem of over-stated profits and understated losses in the boom years with far-reaching and damaging impacts for economic growth. Please see our responses to Q6 and 11 for a fuller discussion of the underlying problems.

Perhaps the strongest piece of evidence that the market remains sceptical of accounts is in the banking sector, where the share price to book value for most of the largest banks remains below 1. In essence these valuations suggest enormous uncertainty around the banks' futures, as well as uncertainty as to how healthy the loan books really are. Separating out these different causes is difficult, but we believe that there is considerable scepticism over bank accounts.

It is also clear that IFRS has not solved the problem of management manipulation. These range from lease accounting shenanigans, to problems with revenue recognition (e.g. Autonomy plc and Tesco plc's revenue recognition issues), to the inappropriate use of mark-to-market valuations, to uncertainty over distributable reserves (e.g. the recent admission by Betfair plc that it distributed out of capital in 2011-2013). There is also empirical research showing how banks use the loan-loss provision and realized gains and losses on sales of investments to manage reported earnings*.

*See, for instance, Bratten, B., M. Causholli, and L. Myers, "Fair value accounting, auditor specialisation and earnings management: evidence from the banking industry", March 2013.

19. Do you see other benefits from applying IFRS as required under the IAS Regulation?*

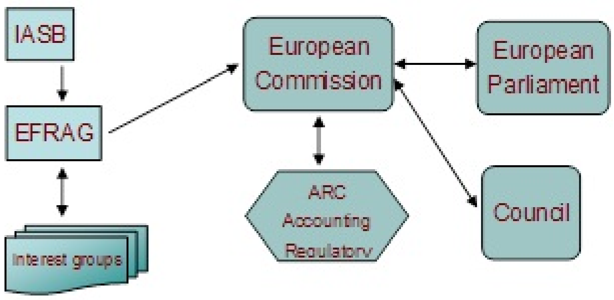
- ○ Yes
- ○ No
- ◉ No opinion

20. In your experience, on balance and at global level, how do the benefits of applying IFRS compare to any additional costs incurred – compared with the situation before mandatory adoption, bearing in mind the increasing complexity of businesses that accounting needs to portray?*

- Benefits significantly exceed the costs
- Benefits slightly exceed the costs
- Benefits and costs are broadly equal
- Costs slightly exceed the benefits
- Costs significantly exceed the benefits
- No opinion

Endorsement mechanism & criteria

The EU's IFRS endorsement process



In the EU, IFRS are adopted on a standard-by-standard basis. The procedure is as follows:

- The International Accounting Standards Board (IASB) issues a standard.
- The European Financial Reporting Advisory Group (EFRAG) holds consultations, advises on endorsement and examines the potential impact.
- The Commission drafts an endorsement regulation.
- The Accounting Regulatory Committee (ARC) votes and gives an opinion.
- The European Parliament and Council examine the standard.
- The Commission adopts the standard and publishes it in the Official Journal.

This process typically takes 8 months.

Endorsement criteria

Under Article 3.2 of the IAS Regulation, any IFRS to be adopted in the EU must:

- be consistent with the "true and fair" view set out in the EU's Accounting Directive
- be favourable to the public good in Europe
- meet basic criteria on the quality of information required for financial statements to serve users (i.e. statements must be understandable, relevant, reliable and comparable, they must provide the financial information needed to make economic decisions and assess stewardship by management).

In his October 2013 report, Mr Maystadt discussed the possibility of clarifying the "public good" criterion or adding 2 other criteria as components of the public good, namely that:

- any accounting standards adopted should not jeopardise financial stability
- they must not hinder the EU's economic development.

He also suggested that more thorough analysis of compliance with the criteria of prudence and respect for the public good was needed.

21. In the EU, IFRS are adopted on a standard-by-standard basis. The process, which typically takes 8 months, is as follows:

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- The Commission adopts the standard and publishes it in the Official Journal.

Do you have any comments on the way the endorsement process has been or is being conducted (e.g. in terms of the interaction of players, consistency, length, link with effective dates of standards, outcome, etc.)?*

We feel strongly that the endorsement process has failed to ensure proper scrutiny of IFRS to ensure a TFV, investor protection and promoting economic stability. Specifically, as detailed in our response to Q6, we believe that EFRAG have not understood the meaning of TFV, and the important role accounts play in delivering capital maintenance, as set out in the 2nd Directive. The capital maintenance objective is also critical for long-term stewardship by both executives and investors. It is also important to ensure sustainable economic growth. Pease refer to our response to Q6 above.

While we have not been involved in the detailed negotiations, we also have had concerns over the independence of the endorsement process from the large audit firms, who we consider a vested interest group. Clearly, EFRAG has a heavy representation from the audit industry, which we believe means the process is at risk of being captured. There has also been insufficient long-term investor representation. We are supportive of the Maystadt proposals in this regard.

22. Under Article 3.2 of the IAS Regulation, any IFRS to be adopted in the EU must:

- be consistent with the "true and fair" view set out in the EU's Accounting Directive
- be favourable to the public good in Europe
- meet basic criteria on the quality of information required for financial statements to serve users (i.e. statements must be understandable, relevant, reliable and comparable, they must provide the financial information needed to make economic decisions and assess stewardship by management).

Are the endorsement criteria appropriate (sufficient, relevant and robust)?*

- ( ) Yes
- ( ) Yes, to some extent
- (x) No
- ( ) No opinion

22.1. *In his October 2013 report, Mr Maystadt discussed the possibility of clarifying the "public good" criterion or adding 2 other criteria as components of the public good:*

- *that any accounting standards adopted should not jeopardise financial stability*
- *that they must not hinder the EU's economic development.*

Please give any suggestion(s) you may have for additional criteria.

- [ ] Not jeopardising the EU's financial stability
- [ ] Not hindering economic development in the EU
- [ ] Not impeding the provision of long-term finance
- [ ] More explicit reference to the concept of prudence
- [ ] Consistency with other adopted IFRS
- [ ] Criterion concerning simplicity/proportionality
- [x] Other

22.1.1 Other - please specify.*

As set out in our response to Q6, we believe the IAS Regulation should explicitly require a focus on capital maintenance to deliver on the requirements of the 2nd Directive, the TFV, and underpin long-term stewardship. It should explicitly require that shareholders have visibility of the split between distributable and non-distributable reserves, as well as realised and unrealised income. This will in turn support public goals of financial stability.

23. There is a necessary trade-off between the aim of promoting a set of globally accepted accounting standards and the need to ensure these standards respond to EU needs. This is why the IAS regulation limits the Commission's freedom to modify the content of the standards adopted by the IASB.

Does the IAS Regulation reflect this trade-off appropriately, in your view? *

- ○ Yes
- ● No
- ○ No opinion

23.1. If not, do you think the IAS Regulation should allow the Commission more leeway to modify standards adopted by the IASB? What conditions should be stipulated?*

It is important that the EC retains the authority and scope to ensure accounting standards adopted into the EU are consistent with our legal framework. Ultimately, the accounting system requires a political decision around the goals of accounts and the trade-offs referred to in this question. These judgements should not be outsourced to an international accounting entity that is not accountable to democratically elected leaders in the EU.

It is our view that the goal of international comparability must come after the fundamental purpose of accounts to provide the necessary information on a company's capital strength and performance. International convergence to the right standard is desirable, but international convergence to the wrong standard would serve to undermine financial and economic stability. We would thus support change to how IFRS is adopted in the EU as described previously (Q6 etc), and then encourage the EU to promote these changes to IFRS internationally.

24. Have you experienced any significant problems due to differences between the IFRS as adopted by the EU and the IFRS as published by the IASB ("carve-out" for IAS 39 concerning macro-hedging allowing banks to reflect their risk-management practices in their financial statements)? *

- ( ) Yes
- ( ) No
- (•) No opinion

Quality of IFRS financial statements

25. What is your overall opinion of the quality (transparency, understandability, relevance, reliability and comparability) of financial statements prepared by EU companies using IFRS?*

- ( ) Very good
- ( ) Good
- ( ) Moderate
- (•) Low
- ( ) Very low
- ( ) No opinion

25.1. Please provide any additional comments you think might be helpful.

Please refer to our response to previous questions, especially Q6.

26. Given that firms have complex business models and transactions, how would you rate financial statements prepared in accordance with IFRS in terms of complexity and understandability?*

- ( ) Very complex & difficult to understand
- (•) Fairly complex & difficult to understand
- ( ) Reasonable
- ( ) Not complex or difficult
- ( ) No opinion

26.1. Please provide any further comments you think might be helpful, specifying any particular areas of accounting concerned, if appropriate.

We have identified some key areas where IFRS actually reduces visibility for shareholders. Of particular concern is the extensive use of mark-to-market and mark-to-model, without much disclosure around the valuations, and - particularly - what portion of profits is realised versus unrealised. This then means shareholders are in the dark as to what constitutes distributable or non-distributable reserves. These are very significant shortfalls.

27. How would you rate financial statements prepared using IFRS in terms of complexity and understandability – compared with other sets of standards you use?

	IFRS information is easier to understand than...	IFRS information is neither easier nor more difficult to understand than …	IFRS information is more difficult to understand than …	No opinion
Information under your local GAAPs	○	○	●	○
Information under any other GAAPs	○	○	○	●

27.1. What are your local GAAPs?

UK GAAP

27.2. Please identify other GAAPs you are using as a basis for comparison.

27.3. Please provide any additional comments you think might be helpful.

28. How do IFRS compare with other GAAPs in terms of providing a true and fair view of a company's (group's) performance and financial position?

	IFRS are better than...	IFRS are equivalent to...	IFRS are worse than...	No opinion
Your local GAAPs (as identified under question 27)	○	○	●	○
Any other GAAPs (as identified under question 27)	○	○	○	●

28.1. Please provide any additional comments you think might be helpful.

Please see response to Q6 and 11. We do not believe that IFRS can be relied upon to provide a TFV.

29. How often is it necessary to depart from IFRS under “extremely rare circumstances” (as allowed by IFRS), to reflect the reality of a company’s financial performance and position in a fairer way?*

- Often
- Sometimes (selected)
- Hardly ever
- Never
- No opinion

29.1. Please provide additional comments and examples of departures from IFRS that you have seen.

This goes to the heart of the problem. We believe that over-riding IFRS should be viewed as a legitimate and even essential where accounts do not provide a TFV, as defined in EU Company Law. This means where the profits include unrealised income and are overstated, and where there is a risk that distributable reserves are overstated by included unrealised profits, then it is vital companies depart from IFRS rules. However, as currently required by IFRS, the only over-ride possibility is with respect to its own Conceptual Framework. In short, there is currently no practical over-ride possibility to ensure consistency with EU Company Law. Please see our answer to Q6 for a fuller description of what Company Law requires and the problems with the IFRS over-ride.

30. How would you rate the extent to which IFRS allows you to reflect your company's business model in your financial statements?*

- This is not an issue
- IFRS are flexible enough
- IFRS should be more flexible, so different business models can be reflected
- No opinion (selected)

Enforcement

Since 2011, the European Securities and Markets Authority (ESMA) has been coordinating national enforcers' operational activities concerning compliance with IFRS in the EU. ESMA has taken over where the Committee of European Securities Regulators (CESR) left off.

Enforcement activities regarding companies listed on regulated markets are defined in the Transparency Directive (2004/109/EC , as subsequently amended).

31. Are the IFRS adequately enforced in your country?*

- Yes
- Yes, to some extent
- No
- Not applicable
- No opinion

32. Does ESMA coordinate enforcers at EU level satisfactorily? *

- Yes
- Yes, to some extent
- No
- Not applicable
- No opinion

33. Has enforcement of accounting standards in your country changed with the introduction of IFRS?*

- Enforcement is now more difficult
- Enforcement has not changed
- Enforcement is now easier
- Not applicable
- No opinion

34. In your experience, have national law requirements influenced the application of IFRS in the EU country or countries in which you are active? *

- Yes, significant influence
- Yes, slight influence
- No
- No opinion
- Not applicable

35. If you are aware of any significant differences in enforcement between EU countries or with other jurisdictions, do they affect your practice in applying IFRS or analysing financial statements? *

- Yes, significantly
- Yes, but the impact is limited
- No
- No opinion
- Not applicable

36. The recitals of the IAS Regulation stress that a system of rigorous enforcement is key to investor confidence in financial markets. However, the Regulation contains no specific rules on penalties or enforcement activities, or their coordination by the EU.

Should the IAS Regulation be clarified as regards penalties and enforcement activities?*

- Yes
- No
- No opinion

37. Should more guidance be provided on how to apply the IFRS? *

- Yes
- No
- No opinion

Consistency of EU law

There are different types of reporting requirements in the EU (e.g. prudential requirements, company law, tax, etc.)

38. How would you assess the combined effects of, and interaction between, different reporting requirements, including prudential ones? *

A question that arises is whether there should or should not, in the case of financial companies, be more than one way of assessing the value of their assets. EU Law requires prudence in valuing assets. Properly applied, and with the ultimate goal being capital protection, these numbers should be aligned with the interests of prudential regulators. Indeed, the fact that regulators have not been able to rely upon the IFRS accounts produced by banks is itself disconcerting for shareholders interested in the underlying capital position, rather than trading.

39. Do you see any tensions in interaction between the IAS Regulation and EU law, in particular:

	No	Yes	To some extent	No opinion
Prudential regulations (banks, insurance companies)	○	●	○	○
Company law	○	●	○	○
Other	○	●	○	○

39.1. Other - please specify.*

The EU's Fair Value Directive has, in our view, created confusion around the over-riding requirement for prudence and thus further undermined understanding of the link between TFV and capital maintenance as required in the 2nd Directive.

39.2. If you answered "yes" or "to some extent", please give details and state what the main effects of these tensions are.*

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Please see previous responses, specifically Q6, which sets out our view
that the IAS Regulation has failed (in implementation) to ensure capital
maintenance as required under the 2nd Directive.
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User-friendliness of legislation

All standards are translated into the official EU languages before they are adopted. The Commission also regularly draws up a consolidated version of the current standards enacted by the EU (
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:02008R1126-20130331:EN:NOT
). The consolidated version does not include any standards that are not yet in force, but can be applied before the date of entry into force.

40. Are you satisfied with the **consolidated version** of *IFRS standards adopted by the EU*, which is not legally binding, or would you like to see improvements?

- ( ) Satisfied
- ( ) Need for improvements
- ( ) I wasn't aware of it
- ( ) I don't use it
- (•) No opinion

41. Are you satisfied with the quality of **translation** of IFRS into your language *provided by the EU* ?*

- (•) Yes
- ( ) Yes, to some extent
- ( ) No
- ( ) No opinion
- ( ) Not applicable

41.1. Please give details.

General

42. Do you have any other comments on or suggestions about the IAS Regulation?

Thank you for your valuable contribution.

Contact

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