Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
F +44 (0)20 7600 8288
mail@theqca.com

www.theqca.com

Internal Market and Services DG,
Unit F3 – Accounting and Financial Reporting
European Commission
SPA2 00/089
1049 Brussels
Belgium

MARKT-F3@ec.europa.eu

3 November 2014

Dear Sirs,

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

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

There are approximately 2,000 small and mid-size quoted companies on the Main List of the London Stock Exchange and quoted on AIM and ISDX in the UK, representing 85% of all UK quoted companies. The total market capitalisations of the small and mid-size quoted company sector in the UK is £351bn (as of October 2014). The total turnover of the small and mid-size quoted company sector is £180bn (as of October 2014).

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Our ID number for the European Commission's register of interest representatives is 45766611524-47.

***Response***

**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.

The objective should remain to ensure that the EU capital market and single market operates efficiently. The comments we make later highlight where we believe this could be improved.

**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.

In our opinion the adoption of IFRS by the EU has encouraged wider adoption of IFRS and assisted the move towards establishing a set of globally accepted high-quality standards.

**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)?***

No.

**8.1 How would you propose it be changed?**

**Other, please specify.**

While we support the adoption of full IFRS for larger listed companies, we believe it is appropriate to recognise the difference in scale, and of resources available to small and mid-size listed companies, which may have a capitalisation of just a few million pounds compared to their global listed counterparts capitalised at many tens of billions of pounds.

We, therefore, consider that small companies listed on regulated markets should have the choice to use IFRS for SMEs or full IFRS, rather than having to use full IFRS as at present. We note that the ESMA Markets and Securities Stakeholder Group has recommended that the use of full IFRS should be optional for SMEs (ESMA Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding, page 17: http://www.esma.europa.eu/system/files/2012-smsg-59.pdf).

However, we do not think that it would necessarily be helpful for the EU to adopt its own set of accounting standards for small and mid-size listed companies on regulated markets. We believe that this could be counter-productive by adding complexity and decreasing comparability.

**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** x

**Too wide**

**Too narrow**

**No opinion**

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

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?**

Slightly more transparent.

**11.1. Please elaborate.**

Most our of members - small and mid-size quoted companies - consider that applying IFRS is more transparent.

According to some member companies, in many instances greater clarity has been achieved. However, some of our members have noted that, in some instances, 'transparency' means only more information. Therefore, we believe that are some changes that the IASB should consider to the IFRS to tackle the issue of excessive disclosure and note that it is currently attempting to address this issue through its disclosure initiative.

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

No opinion.

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

No, in general.

**13.2. Please elaborate.**

We are uncertain about whether financial statements have become easier to understand since the introduction of IFRS. Whilst many of members - small and mid-size quoted companies - believe they have not, a similar amount believe they have.

We believe that the understandability of IFRS financial statements is mainly affected by the issue of disclosure overload in financial statements, which we mentioned earlier in our response. We believe that, if this issue is addressed, IFRS financial statements could become even easier to understand and be more clear for both users and preparers.

**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?**

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?**

No opinion.

**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.)**

No effect.

**16.1. Please provide data/ examples if available.**

Our members - small and mid-size quoted companies - do not believe that the adoption of IFRS has had a direct effect on the cost of capital for their companies. We believe that this is supported by academic studies which seem to indicate that the reduction in the cost of capital is limited to the larger companies on the capital markets.

**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 small extent.

**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?**

Yes, to a small extent.

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

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 slightly exceed the costs.

**P7+U4. Has the application of IFRS in the EU influenced the need for other non-IFRS based information ("non-GAAP" information) to explain companies' financial performance, compared with the situation before mandatory adoption?**

No opinion.

**U.5. How have IFRS affected your ability to assess stewardship by management (including understanding companies' current performance, financial position, and generation of cash flows)?**

No opinion.

**U.6. How have IFRS affected your ability to estimate future cash flows for the companies you are covering?**

No opinion.

**U.7. In your experience, does the ongoing application of IFRS (excluding costs relating to the initial transition to IFRS) significantly change recurring costs for the analysis and benchmarking of companies – when compared with other costs that your company would otherwise have incurred if IFRS had not been applied?**

No opinion.

**P.8. In your experience, is the ongoing application of IFRS costing you more than compliance with alternative standards would have done?**

**By this we mean: Does it significantly change any administrative, compliance or other costs incurred by your company (e.g. IT developments, costs for additional staff, training, advisory services, external audit, additional expertise/valuation), when compared with other costs that your company would otherwise have incurred to comply with alternative standards (excluding costs arising from the initial transition to IFRS)?**

Slightly increased.

**P.9. In your experience, have the costs of IFRS preparation changed significantly over time for your company since you adopted IFRS (e.g. IT developments, cost of additional staff, training, advisory services, external audit, additional expertise/valuation) – when compared with other costs that your company would otherwise have incurred to comply with alternative standards?**

**Please take into account any impact that regular amendments may have had on existing standards or the introduction of new standards by the International Accounting Standards Board (IASB).**

Slightly increased.

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

**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 believe that the endorsement process seems to work relatively efficiently and note the important role that the European Commission and European Parliament play in this. However, we believe that the European Commission/European Parliament should only use its ability to carve out IASB standards in extreme circumstances, as this undermines comparability and could create complexity for companies.

**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.

**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.

**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)?**

No opinion.

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

Good.

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

The majority of our members believe that the quality of financial statements prepared by EU companies using IFRS is good and note that the key benefits of using IFRS is the relative wide-use and the comparability which this generates between companies which report in different countries.

However, some of our members also note that their financial statements and annual reports have increased in length following the introduction of IFRS, as a result of increased disclosures. Therefore, as mentioned earlier, we believe the issue of disclosure overload in IFRS should be addressed and note the IASB's disclosure initiative, which is currently ongoing.

**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?**

Fairly complex & difficult to understand.

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

The majority of our members are of the opinion that financial statements are fairly complex and difficult to understand. We believe that this is mainly a result of the increased disclosure resulting from IFRS. For example, key areas which we believe should be reviewed include financial instruments disclosures, financial assets and liabilities, derivatives disclosures, hedging and share-based payments. As mentioned earlier, we believe the issue of disclosure overload in IFRS should be addressed and note the IASB's disclosure initiative, which is currently ongoing.

**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** | | x | | |
| **Information under any other GAAPs** | | | | x |

**27.1. What are your local GAAPs?**

UK GAAP (UK FRS 102)

**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** | | x | | |
| **Any other GAAPs** | | | | x |

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

Most of our member companies consider IFRS to be better or equivalent to UK FRS 102. We note that UK FRS 102 is based on IFRS and so this is not surprising.

**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?**

Hardly ever.

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

Most of our members note that they have never or hardly ever departed from IFRS to reflect the reality of a company's financial performance and position in a fairer way.

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

IFRS are flexible enough.

**30.1. Please explain.**

Most of our member companies believe that IFRS are flexible enough to reflect the company's business model in its financial statements or that this is not an issue.

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

Yes.

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

No opinion.

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

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?**

No opinion.

**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?**

No.

**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?**

No.

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

No.

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

As mentioned earlier, many of our members - small and mid-size quoted companies - are concerned about the increasing length of their annual reports and accounts as a function of increased disclosure both in the narrative and financial statements. We believe that this increasing length as a result of increasing disclosure could result in annual reports and accounts becoming less clear (thus potentially obscuring important information) and more full of standard 'boilerplate' disclosure, which do not tell the users/investors much about the company and its position.

Overall, we believe that both the EU, member states and accounting standard setters need to take into consideration the combined effect of adding more disclosure to companies' annual report and accounts and evaluating whether the cost/benefit of the disclosure is appropriate, considering in particular whether adding disclosure will increase transparency or have the opposite effect of overloading the accounts and thus potentially obscuring important information.

Furthermore, as mentioned earlier, we believe that the EU, member states and accounting standard setters must recognise the difference in scale, and of resources available to small and mid-size quoted companies, which may have a capitalisation of just a few million pounds compared to their global listed counterparts capitalised at many tens of billions of pounds. We would welcome the EU using its power to ensure this issue is addressed appropriately by the IASB and considering whether changes should be made to the IAS Regulation to ease this burden.

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

| | |
|---|---|
| **Prudential regulations (banks, insurance companies):** | to some extent |
| **Company law:** | to some extent |
| **Other:** | no opinion |

**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?**

No opinion.

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

No opinion.

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

We believe that it is important to continue building on IFRS to produce a set of high quality standards for companies. We emphasise that companies consider the key benefit of IFRS to be its relatively wide-use and the comparability which this generates between companies which report in different countries.

For this reason, we believe that carve-outs of IFRS in the European legislation should be limited and only used in extreme circumstances We also strongly oppose the creation of a different, separate EU standard, as this could undermine the comparability element of IFRS that companies consider a key benefit.

While we support the adoption of full IFRS for larger listed companies, we believe it is appropriate to recognise the difference in scale, and of resources available to small and mid-size listed companies, which may have a capitalisation of just a few million pounds compared to their global listed counterparts capitalised at many tens of billions of pounds.

We, therefore, consider that small companies listed on regulated markets should have the choice to use IFRS for SMEs or full IFRS, rather than having to use full IFRS as at present. We note that the ESMA Markets and Securities Stakeholder Group has recommended that the use of full IFRS should be optional for SMEs (ESMA Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding, page 17: http://www.esma.europa.eu/system/files/2012-smsg-59.pdf).

However, we do not think that it would necessarily be helpful for the EU to adopt its own set of accounting standards for small and mid-size listed companies on regulated markets. We believe that this could be counter-productive by adding complexity and decreasing comparability.

While we are supportive of the use of IFRS, our members have voiced concerns, as mentioned above, on the issues of disclosure overload and complexity associated with some IFRS, which could be improved. We note that there is an important role for the European Commission, European Parliament and national standard setters to play in influencing the IASB's standard setting process and ensuring that the IASB continues to address the issue of disclosure overload through its disclosure initiative.

If you would like to discuss any of our responses in more detail, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

**APPENDIX A**

**Quoted Companies Alliance Financial Reporting Expert Group**

| **Matthew Stallabrass (Chairman)** | **Crowe Clark Whitehill LLP** |
|---|---|
| Jonathan Lowe<br>Paul Watts<br>Nick Winters | Baker Tilly |
| Anna Draper | BDO LLP |
| Joseph Archer | Crowe Clark Whitehill LLP |
| Bill Farren<br>Ian Smith | Deloitte LLP |
| David Gray | DHG Management |
| Shalini Kashyap | EY |
| Gary Jones | Grant Thornton UK LLP |
| Anthony Carey | Mazars LLP |
| David Pugh | Nationwide Accident Repair Services plc |
| Nigel Smethers | One Media IP Group plc |
| Niraj Patel | Saffery Champness |
| Matthew Howells | Smith & Williamson LLP |
| Jack Easton | UHY Hacker Young |
| Ian Davies | Vislink PLC |
| Edward Beale | Western Selection Plc |