European review questions approach to IFRS

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Mr. Jon D. Hogan
Director Regulatory Affairs
International Standards Group
KPMG in the UK

As Europe looks at corporate reporting, IFRS is in the spotlight, with global implications

Highlights

- The need for change? Sustainability and greater efficiencies
- IFRS in focus – Impact in Europe and beyond
- New reporting opportunities – Giving investors the bigger picture
- Have your say – Contribute now to the EU consultation

The European Commission has opened a public 'fitness check' consultation on corporate reporting, which could lead to changes to the accounting framework under which all European companies have to report.

The questions raised are also of interest to those outside Europe, because a change in approach by the EU could have implications in other jurisdictions.

Specifically, the EU is questioning endorsing IFRS without modifications, a change that raises doubt over the EU's continuing commitment to global standards. All those with an interest in corporate reporting, including IFRS, have until 21 July to contribute their views.

The need for change?

A key political driver for the questions asked in the fitness check is the EU's sustainable finance agenda. Climate change commitments and international sustainable development goals have raised questions about the information that companies disclose to investors.

In addition, with a new mandate starting in 2019, the Commission is thinking about its future agenda, including developments in corporate reporting and whether further regulatory initiatives are needed.

To help inform its thinking, the European Commission established the **High Level Expert Group on Sustainable Finance** to look at how investment flows could be better directed towards longer-term sustainable development. It published its recommendations earlier in 2018, with much of the focus of recommendations on investors themselves; however, actions were also targeted at companies' corporate reporting.

The fitness check builds on these recommendations, asking questions on current experience and possible future approaches to non-IFRS reporting under national GAAPs, IFRS reporting and non-financial reporting.

Overlaps, inconsistencies and duplications are also on the agenda. The current EU framework was introduced over many years, so inefficiencies and inconsistencies could be causing unnecessary costs for companies without giving investors the clear picture that they need.

Impact in Europe and beyond

The EU currently endorses IFRS without modifying the *content* of standards. The endorsement process includes a rigorous assessment of whether a new standard passes public good tests. Once it is endorsed, the standard is then mandatory for all listed companies and most credit institutions and insurance firms in the EU.

Europe has considerable influence globally on the wider adoption of IFRS because of this mandatory approach. In those countries yet to fully endorse IFRS, this leadership role has significant influence over their own path to full adoption.

The sustainability debate has resurfaced questions over whether the EU should apply IFRS without modification, or whether it should consider making changes (known as 'carve-ins'). Some cite the role that accounting standards might play in investors' long-term decision making, which is a key element of the sustainability agenda. However, accounting standards are unlikely to be the only consideration influencing investor behaviour. A change in approach by the EU to endorsing IFRS without modification would be detrimental to global consistency and diminish the leadership role that the EU has assumed by being one of the first major economic blocs to adopt IFRS as issued by the IASB.

The EU already has the power to reject elements of IFRS (known as 'carve-outs'), but only as a 'nuclear option', and it has been used only once with respect to a narrow technical issue.

In addition to a discussion about possible changes to the endorsement process, the European Commission has also asked EFRAG to examine certain aspects of IFRS 9 *Financial Instruments* accounting for equity instruments and the interaction with long-term investment.

New reporting opportunities

Investors are looking for disclosure beyond the financial reports on strategy, operational management and drivers of future value. Here, international bodies including the IASB and IOSCO are looking at how global approaches could be developed to increase the value to investors of non-financial disclosures.

There is an opportunity for the EU to take the lead in supporting global approaches, and to take a more holistic overall view of corporate reporting.

Have your say

The European Commission fitness check is open for public comment until 21 July 2018 via an **online questionnaire**.

If you have an interest in how the future of corporate reporting is shaped in Europe and beyond, this is your chance to have your say.

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