EUROPEAN ASSOCIATION ELTI LONG-TERM INVESTORS

European Commission
Internal Market and Services DG
Unit F3 – Accounting and Financial Reporting
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The Secretary-General

Brussels, 28 October 2014

Subject: Public consultation – ***Effects of using IFRS in the EU***

Dear Sirs,

We thank you for offering us the opportunity to provide our experience with the use of IFRS in the EU. We have considered the various questions raised in the questionnaire and focus our answers on the topics where we consider that our feedback as long-term investors could benefit the evaluation undertaken by the Commission. For practicability reasons, we submit our contribution in the form of a letter.

The European Long-Term Investors association ('the association' or 'ELTI') was created in 2013 to promote and attract long-term financing of sustainable investment in the real economy. Its Members are long-term investors (or LTIs) sharing a public or promotional development mission in providing long-term funding to sustainable investment projects supporting EU policy.

Most of our members both prepare financial statements and use them for investment/lending purposes. When it comes to preparation of financial statements, most of our members are required to apply IFRS to their consolidated accounts for regulatory purposes (e.g. listing of bonds).

You will find our detailed comments in the annex to this letter.

We remain of course available, should you wish further clarification on our opinion.

Best regards,

Dominique de Crayencour
Secretary General

Relevance of the IAS Regulation

Objective

Overall we think that the Regulation has enhanced the level of transparency but not necessarily the comparability and usefulness of financial statements.

Currently, the information provided to shareholders in the statement of financial position and in the income statement does not always appropriately reflect the business model of the entity's activity. As a consequence, preparers need to create separate documents ("non-GAAP" information) to meet regulatory requirements but also in order to explain to shareholders the company's performance and how the strategy translates into the financial statements. Over time this has led to too much and too complex information as well as, at times, misleading information being provided to shareholders.

Since the introduction of the Regulation by the European Union, the geographic reach of IFRS has continued to widen, though the lack of progress with its application in the US remains a major drawback. While the EU remains a dominant user of IFRS, the increased number of constituents has diluted the relative weight of the EU and renders achieving a consensus at times more difficult.

In the future, priority of the IAS Regulation should be an appropriate recognition of the entity's business model and enhanced comparability of financial statements based on the business model. In addition, more transparent and intelligible financial statements would go with a drastic reduction of the need for notes to the financial statements.

Cost-benefit of the IAS Regulation

Overall, we think that the application of IFRS has improved the quantity and quality of information available to investors through an improved transparency although there is too much and too complex information being provided to the user of the financial statements.

In general, financial statements prepared under IFRS are fairly complex and difficult to understand compared with the situation before mandatory adoption, in particular for financial instruments. Some standards are difficult to comprehend, prepare and audit which translate into higher costs, both from the perspective of the time required and the system requirements. In addition to the data stored in accounting records, the standards require pulling together very detailed data from other sources, creating difficulties for the whole reporting process including harmonisation of data.

Although in our view IFRS does not have a direct effect on the overall cost of capital, the preparation of financial statements under IFRS may provide certain companies with an easier access to international capital markets with favourable terms. On the other hand, some of our members noted that the increased complexity of financial statements was raising questions from rating agencies, which do not always understand the rationale for certain disclosures, and the risk of possible misinterpretation.

Finally, in our experience, the bulk of IFRS implementation costs related mainly to IT development costs associated with the first time application of IAS 39. We expect that the implementation of IFRS 9 requirements will also lead to significant costs.

Endorsement mechanism and criteria

We support the recommendations made by Mr Maystadt in his October 2013 report regarding the current IFRS endorsement process in the EU and see the recommendation as the most pragmatic approach for implementation.

We agree, in particular, that the 'public good' criterion should be clarified. In addition, we support the idea that any IFRS to be adopted in the EU should not be an impediment to the provision of long-term finance and that the concept of prudence should also be adequately considered.

If the EU was to set its own accounting standards, proper consideration should be given to the human and financial resources needed for implementation. In addition, such an approach would require time before it can be actually effective and it would also lead to a loss of comparability with companies outside the EU. For preparers of financial statements under local GAAP and IFRS, an additional 'EU standard' would represent additional burden without clear additional benefits.

If IFRS continues to be applied within the EU, we think that the current limitation of the Commission to modify standards should remain in place, but that the EU should instead have a more prominent role in the IASB decision-making process. This would lead to a more 'straightforward' and faster process at the endorsement level, which is currently too long.

Quality of IFRS financial statements

We want to stress that giving more prominence to the business model criterion is key to provide relevant and useful information to the users of the entity's financial statements.

Providing information reflecting events that are not likely to occur, or using valuations that do not reflect the most likely way an entity will realise its cash flows does not help users - for long-term oriented entities, short-term valuation effects do not provide relevant information. The purpose of financial statements should be to capture the performance of the entity in the context of its business model in sufficient, relevant and reasonable volume of information and to provide investors and stakeholders with a true and fair view of the entity's activities and related performance.

As LTIs, recognition of transitory unrealised results that will never materialise into cash flows does not provide relevant information to the users of financial statements. In our view, too much emphasis is put on the characteristics of the instrument resulting most of the time in the same accounting treatment applied to different transactions but involving the same instrument type (e.g. equity, derivatives). Most of the time, users of the financial statements would exclude unrealised results from their analysis based on the business model provided by the entity's management in supplementary information.

However, we recognise that fair value can be informative even in the context of a LTIs business model. Therefore, we would support an approach whereby assets and liabilities are presented in the primary financial statements at amortised cost where appropriate based on the entity's business model and fair value is provided as additional information in the notes to the financial statements.

In addition to IFRS, most of our members apply for the preparation of their statutory financial statements local GAAPs mostly based on the general principles of the EU accounting directives. The majority of our members agree that local GAAP better reflects their business model as long term investor.

Although our members did not experience numerous instances of departure from IFRS (under 'extremely rare circumstances', as allowed by IFRS), one entity had to use this exception following the take-over of real-estate assets and recognising them as non-current assets held for sale longer than two years because of the drastic deterioration of the local real-estate market and conditions coupled however with official commitments to undertake all actions required to sell those assets.

Consistency of EU law

In our view the combined effects of, and interaction between, different reporting requirements in the EU (e.g. prudential requirements, company law, tax, etc..) is time-consuming, costly and could be confusing for investors and shareholders due to different presentation of items and different terminology used for the same item.

User-friendliness of legislation

Complicated standards are difficult and time consuming to analyse, implement, review and audit. If experts may debate about interpretations of certain standards which are not straight forward, non-experts are often quite at a loss to comprehend various concepts.

Changes in standards can be quite disruptive also as regards the long term comparability of results under IFRS which for preparers with a long term business model and/or long term investors could be of some relevance.