2 Wester Balrymonth Steadings
St Andrews
Fife
KY16 8NN
UK
trueandfair@mac.com

30 August 2021

By e-mail to agendaconsultation@endorsement-board.uk

Dear UKEB

UKEB's Draft Comment Letter—Third Agenda Consultation

The UKEB's draft comment letter on the IASB's Agenda Consultation is, in many respects, admirable. It is cogent and addresses all the relevant issues. But there are some respects in which it should be improved, as outlined below.

Lack of ambition

It was understandable, and probably wise, for the IASB to eschew development of major new standards in the period after the issue of IFRS 15, 16 and 17. But this should not instil a complacent belief that all is well with older IFRSs and that nothing beyond tinkering needs to be done.

Accounting standard-setting is different from some other fields in which 'standards' are established. It is a problem if you can place a call to a friend only is she is on the same network as you, so it is important that all networks adhere to the same 'standards': in such a case the technical superiority of one standard over another is of minor importance, compared to that of achieving compatibility. But the delegation of accounting standard-setting to independent (though, of course, accountable) bodies implies an objective that they would not only promote conformity but seek to improve financial reporting. This delegation follows the United States' experience and has been replicated in the EU and elsewhere. It stemmed, at least in part, from recognising that neither professional bodies, who represented accountants, nor governments, open to political pressures, could satisfactorily resolve the issues. The strategy of delegating the development of accounting standards to an independent body has worked well in the jurisdictions in which it has been used and with which I am most familiar. But it imposes an obligation to the designated body to improve the standard of financial reporting rather than merely secure uniformity.

Some current IFRSs defy conceptual justification. Examples include:

- Equity accounting.
- The requirement to recognise a liability for 'deferred tax' if one number that has little or no economic significance (the book value of an asset) exceeds that of another (the tax basis) that is economically relevant. But this is required even if the asset will make an excellent return on its book value.
- Pension liabilities, especially for 'hybrid' schemes which may fall on wrong side of the bright line between defined obligation and defined contribution schemes and so are accorded inappropriate reporting.

In each of these cases (and there are others) the Agenda Consultation suggests 'clarification' or minor amendments to accounting standards would solve the issues. Appendix A to the Consultation suggests 'targeted amendments' to IAS 12, IAS 19 and IAS 37. But this is complacent and is not challenged by UKEB's draft response.

Past experiences of tinkering have not always been encouraging. A recent example is provided by the IASB's Discussion Paper on 'Financial Instruments with Characteristics of Equity', which essentially proposed a sticking plaster for IAS 32 and was not supported by the FRC and nor, I believe, by many other respondents.

Minor amendments often have unintended consequences—imposing cost on preparers who have to check that their previous accounting need not change and agreeing the conclusions of that review with their auditors. They also obscure the underlying principles of accounting standards, resulting in a complex set of requirements that are difficult to understand, perhaps with severe consequences for the education of aspiring accountants.

The Agenda Consultation takes as axiomatic two points which are implicitly accepted by the UKEB's draft response.

- The IASB's resources are limited to their current level. (See paragraphs 17-18 of the Agenda Consultation).
- The opinions of IASB's stakeholders, especially investors, are paramount in considering its priorities.

The following sections of this response question these assumptions.

Resources

Raising resources is, rightly, the responsibility of the IFRS Foundation rather than the IASB. However, if the IASB can demonstrate to the Foundation that it needs more resources to discharge its mandate it should be encouraged to do so. Given its acceptance of existing resources, responses to the Agenda Consultation seem unlikely to achieve this.

There is circularity in the Agenda Consultation. It starts off by assuming that current resource levels are adequate, and then dismisses large projects on the grounds that they would require resources that they do not have. The Agenda Consultation might have provided an opportunity for views advocating more funding could have been expressed, but it is not clear what alternative avenues exist for such opinions. This is disappointing and should be challenged in the UKEB response.

Users and other stakeholders

No standard-setter seeks to provide a product that does not provides useful information to users. While there are a few users—which, in this context, are principally investors—that can provide thoughtful input, in general the views of users should be treated with a reasonable degree of scepticism.

Henry Ford is reputed to have said 'If I ask what my customers want' they would say "A faster horse" (or depending on the version of the anecdote you read "A faster horse and cart"). More recently, Apple has become one of the most valuable companies in the world by producing products that were never demanded, or indeed imagined, by its customers.

A standard-setter can improve financial reporting only by making changes. Change is always unwelcome to those affected, especially as it imposes costs. The challenge for IASB is to develop proposals and then build consensus to support their implementation. It should not be assumed that the lack of a demand for change implies that all is well with current standards or that useful changes should not be considered. Building consensus requires leadership. While it means careful listening to stakeholders, it should not imply simply writing down in the form of a standard what has been heard from them. In some instances a standard-setter should issue a standard even where it is opposed by a large number of its stakeholders.

Priority issues

UKEB's draft response identifies as priority projects: climate-related risk; intangibles; and the statement of cash flows. The last two of these are highly appropriate. On both these subjects the FRC has produced papers that may be useful in raising appropriate questions. The first two of these, however, raise issues that go beyond the primary financial statements, and into that of the possible future sustainability reporting standards board:

the relationship between such a board and IASB's work on Management Commentary needs to be clarified.

There seems to be risk of neglecting the improvement of existing standards because of a focus on topics that are currently fashionable, for example, cryptocurrencies. It may well be preferable to devote more effort to a review of existing accounting standards.

Old standards should be reviewed, even in the absence of obvious issues, because:

(i) They reflect the concerns that were prevalent at the time of their development. For example, IAS 37 sought to require that provisions should be recognised only in restricted circumstances rather than, as then existing practice allowed, the anticipation of future losses. It would be unsurprising if, in pursuing that motive, it went too far and that a more accommodating set of requirements would be more appropriate.[1]

IFRS 2 provides another example. It is arguable that, in the highly charged atmosphere in which it was developed, the (then relatively new) IASB was more concerned to secure that an expense should be reported rather than whether that expense (and related assets/liabilities) were fairly reported.

(ii) Prior to the reform of the IASC into the IASB, standards were drafted in a loose, permissive style that neither the IASB nor its constituents would consider acceptable now. IAS 7, for example, contains a definition of 'cash and cash equivalents' which is, by today's standards, risible.

Concepts and UKEB's proposed thematic approach

One of the IASB's most notable recent achievements has been the publication of its new Conceptual Framework. While it makes many valuable improvements on the previous Framework it (rightly) does not pretend to be a comprehensive statement but leaves gaps. The IASB should therefore be encouraged to devote resource to further work on concepts.

An example is the concept of 'cost'—on which there is a considerable literature. But there is no agreed concept of cost and why information on cost[*2] should be informative. Should consensus be agreed this would underpin work on, for example:

- borrowing costs;
- government grants;

[1] This is not to suggest that a provision should be recognised if it does not represent a liability.
[2] For brevity, I omit here a discussion of whether 'cost' should be historical cost or current replacement cost and, if the latter, how changes in replacement cost should be reported.

- variable consideration;
- discounting;
- inventory and cost of sales.

The difference between the conceptual approach and the thematic approach proposed in UKEB's draft response is not entirely clear. But there seems to be more than labels to consider. Appendix 2 to the UKEB's draft response indicates that nine standards would be tinkered with by a project on climate-related risk, and four (not including Management Commentary) by a project on intangibles, all of which would also be modified by that on climate-related risk. Furthermore, the project on intangibles is indicated as requiring a new standard. It therefore seems to lead numerous piecemeal amendments to standards.

A conceptual approach reduces this risk, because it would allow the IASB and its stakeholders to consider, once new concepts have been agreed, whether changes to standards to bring them into line should be implemented.

Conclusion

I hope the above comments are of assistance to the UKEB. I should be pleased to amplify them if that would be helpful. I look forward to listening to UKEB's discussion of the feedback on its Discussion Paper.

Yours sincerely