Dear Sir/Madam


The International Corporate Governance Network (ICGN) is pleased to respond to your consultation on this topic. A response to your questionnaire is attached. We also thought it might be helpful to raise with you some of the larger contextual issues which surround the work of the IASB and the implementation of IFRS which we have outlined in this letter.

The original purpose of the corporate audit, and the accountancy standards which support it, was to improve governance. The ICGN therefore believes it has a particular standing in commenting on IFRS. We are the worlds leading investor-led organisation of governance professionals with members including institutional investors based in over 50 countries and collectively responsible for assets under management in excess of US$18 trillion. Our membership also includes other stakeholders in the field of corporate governance including company directors, professional advisors and academics. Our mission is to inspire and promote effective standards of corporate governance to advance efficient markets and economies worldwide. (For more information about ICGN please visit www.icgn.org.)

Audit and accountancy are critical elements of that governance framework. To use a metaphor, the auditor is the “referee” of corporate performance; if you change the way the referee keeps
the score, you will also change the way the players play the game. We therefore welcome the opportunity to comment on the public consultation on the effects of using IFRS. In addition to this letter and the questionnaire, we would refer you to the ICGN Global Governance Principles published in June 2014 and also the ICGN Position Paper ‘What Investors Want from Financial Reporting’ published in 2010, both which reflect the importance of stewardship, and the role of the regulator to determine capital adequacy requirements.¹

ICGN Members value accounts that are transparent and comparable, and prepared under high quality accounting standards which are applied consistently internationally. Thus we support the objectives of the IAS Regulation in requiring the consolidated accounts of EU listed companies to be prepared under a single and robust set of international financial reporting standards in order to ensure the transparency and comparability of financial statements across the EU. This is important not only in ensuring that the EU capital markets operate efficiently and effectively internationally and, in addition, adequately attract international investment.

However, all these comments are made in the context of the ability of corporate reporting to support better governance by companies. Transparency and comparability are not ends in themselves, but means to ensure good stewardship and that investors have confidence in the information reported. This in turn has corollaries; accounts should present a true and fair view of the company’s position and prospects; assets should be valued prudently, issues material to shareholders should be set out succinctly in the annual report, or equivalent disclosures, which should be approved by the board itself etc. In an Appendix to this letter we have set out the ICGN position on these matters, and we would encourage you, in evaluating the present and future development of IFRS to have the consequences accounting standards can have on a corporate’s governance, foremost in your considerations. The ICGN will be delighted to discuss these matters further with you should you wish to do so.

The second point we would like to draw to your attention is about the priorities for developing accounting standards. We know there are many demands on the IASB. However we would note that there are certain pressing issues, (including those termed “non-financial issues”), where there are no agreed standards, yet they are of concern to investors, to policy makers and indeed to the millions of people whose savings we manage. Perhaps the most important of these is in the area of environmental reporting, where current accounting standards do not recognise a liability for assets which may be unsustainable long term, nor do they require the disclosure of the likely scale of damage being done, or contingent liability which might exist.

The effect on corporates of ignoring these issues is to encourage short-term behavior, and result in investors being unable to perform their oversight duties. Might we suggest that this becomes a priority for the IASB and is not left to the many other groups, (such as GRI, SASB etc), who are trying to fill the gap but lack the formal status of IFRS.

We are grateful for the opportunity to comment on the consultation on the effects of using IFRS in the EU. Should you wish to discuss any of the points that we have raised, please contact Kerrie Waring, ICGN’s Managing Director, by email at kerrie.waring@icgn.org or by telephone on +44 (0) 207 612 7079.

Yours faithfully,

Erik Breen
Chair, ICGN Board of Governors

Elizabeth Murrall
Chair, ICGN Accounting and Auditing Practices Committee

Frank Curtiss
Chair, ICGN Integrated Business Reporting Committee

Cc: ICGN Board Members
ICGN Accounting and Auditing Practices Committee

Annex: Enclosed ICGN Global Governance Principles, Principle 7: Reporting and audit
Annex
ICGN Global Governance Principles
Principle 7: Reporting and audit

7.0 Reporting and audit

7.1 Comprehensive disclosure

The board should present a balanced and understandable assessment of the company’s position and prospects in the annual report and accounts in order for shareholders to be able to assess the company’s performance, business model, strategy and long-term prospects.

7.2 Materiality

The board should disclose relevant and material information on a timely basis so as to allow shareholders to take into account information which assists in identifying risks and sources of wealth creation. Issues material to shareholders should be set out succinctly in the annual report, or equivalent disclosures, and approved by the board itself.

7.3 Affirmation

The board should affirm that the company’s annual report and accounts present a true and fair view of the company’s position and prospects. As appropriate, taking into account statutory and regulatory obligations in each jurisdiction, the information provided in the annual report and accounts should:

a) be relevant to investment decisions, enabling shareholders to evaluate risks, past and present performance, and to draw inferences regarding future performance;
b) enable shareholders, who put up the risk capital, to fulfil their responsibilities as owners to assess company management and the strategies adopted;
c) be a faithful representation of the events it purports to represent;
d) generally be neutral and report activity in a fair and unbiased way except where there is uncertainty. Prudence should prevail such that assets and income are not overstated and liabilities and expenses are not understated. There should be substance over form. Any off-balance sheet items should be appropriately disclosed;
e) be verifiable so that when a systematic approach and methodology is used the same conclusion is reached;
f) be presented in a way that enables comparisons to be drawn of both the entity’s performance over time and against other entities; and
g) recognise the ‘matching principle’ which requires that expenses are matched with revenues.
7.4 Solvency risk

The board should confirm in the annual report that it has carried out a robust assessment of the state of affairs of the company and any material risks, including to its solvency and liquidity that would threaten its viability. The board should state whether, in its opinion, the company will be able to meet its liabilities as they fall due and continue in operation for the foreseeable future, explaining any supporting assumptions and risks or uncertainties relevant to that and how they are being managed. In particular, disclosure on risk should include a description of:

a) risk in the context of the company’s strategy;

b) risk to returns expected by shareholders with a focus on key consequences;

c) risk oversight approach and processes;

d) how lessons learnt have been applied to improve future outcomes; and

e) the principal risks to the company’s business model and the achievement of its strategic objectives, including risks that could threaten its viability.

7.5 Non-financial information

The board should provide an integrated report that puts historical performance into context, and portrays the risks, opportunities and prospects for the company in the future, helping shareholders understand a company’s strategic objectives and its progress towards meeting them. Such disclosures should:

a) be linked to the company’s business model;

b) be genuinely informative and include forward-looking elements where this will enhance understanding;

c) describe the company’s strategy, and associated risks and opportunities, and explain the board’s role in assessing and overseeing strategy and the management of risks and opportunities;

d) be accessible and appropriately integrated with other information that enables shareholders to obtain a picture of the whole company;

e) use key performance indicators that are linked to strategy and facilitate comparisons;

f) use objective metrics where they apply and evidence-based estimates where they do not; and

g) be strengthened where possible by independent assurance that is carried out annually having regard to established disclosure standards.

7.6 Internal controls

The board should oversee the establishment and maintenance of an effective system of internal control which should be measured against internationally accepted standards of internal audit and tested periodically for its adequacy. Where an internal audit function has not been established, full
reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained.

7.7 Independent external audit

The board should publish the report from the external auditor which should provide an independent and objective opinion whether the accounts give a true and fair view of the financial position and performance of the company. The engagement partner should be named in the audit report and the company should publish its policy on audit firm rotation. If the auditor resigns then the reasons for the resignation should be publicly disclosed by the resigning auditor.

7.8 Non-audit fees

The audit committee should, as far as practicable, approve any non-audit services provided by the external auditor and related fees to ensure that they do not compromise auditor independence. The non-audit fees should be disclosed in the annual report with explanations where appropriate. Non-audit fees should normally be less than the audit fee and, if not, there should be a clear explanation as to why it was necessary for the auditor to provide these services and how the independence and objectivity of the audit was assured.

7.9 Audit committee

The board should establish an audit committee comprised of non-executive directors, the majority of whom are independent. At least one member of the audit committee should have recent and relevant financial experience. The chair of the board should not be the chair of the audit committee, other than in exceptional circumstances which should be explained in the annual report. The main role and responsibilities of the audit committee should be described in the committee’s terms of reference. This includes:

a) monitoring the integrity of the accounts and any formal announcements relating to the company’s financial performance, and reviewing significant financial reporting judgements contained in them;

b) maintaining oversight of key accounting policies and accounting judgements which should be in accordance with generally accepted international accounting standards, and disclosing such policies in the notes to the company’s accounts;

c) agreeing the minimum scope of the audit as prescribed by applicable law and any further assurance that the company needs. Shareholders (who satisfy a reasonable threshold shareholding) should have the opportunity to expand the scope of the forthcoming audit or discuss the results of the completed audit should they wish to;
d) assuring itself of the quality of the audit carried out by the external auditors and assessing the effectiveness and independence of the auditor each year. This includes overseeing the appointment, reappointment and, if necessary, the removal of the external auditor and the remuneration of the auditor. There should be transparency in advance when the audit is to be tendered so that shareholders can engage with the company in relation to the process should they so wish;

e) having appropriate dialogue with the external auditor without management present and overseeing the interaction between management and the external auditor, including reviewing the management letter provided by the external auditors and overseeing management’s response; and

f) reporting on its work and conclusions in the annual report.