**IFRS ten years on: Has the IASB imposed extensive use of fair value? Has the EU learnt to love IFRS? And does the use of fair value make IFRS illegal in the EU?**a

**Christopher Nobesb**

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b Royal Holloway (University of London) and University of Sydney.

**Abstract**

This paper is a commentary on issues related to the first decade’s mandatory use of International Financial Reporting Standards (IFRSs) in the EU. Three specific but related questions are addressed, as in the paper’s title. On the first (imposition and use of fair value), I conclude that the International Accounting Standards Board (IASB) has not substantially extended the use of fair value in its 15 years of work and that most companies hold few assets or liabilities on the fair value basis. On the second question (adoption in the EU), I analyse a consultation exercise which strongly suggests that the EU’s imposition of IFRSs will continue. On the third question (legality of IFRSs), I explain why recent UK legal opinions that question the legality of reporting under IFRSs are not persuasive.

**1. Introduction**

The ‘ten years on’ in the title of this paper refers to the major wave of mandatory adoptions of International Financial Reporting Standards (IFRSs) that occurred in 2005 in the European Union and Australia. We are also about ten years on from the publication of this journal’s ‘most read’ paper,[[1]](#endnote-1) Cairns (2006), which sought to counter widespread claims of extensive mandatory use of fair value (FV) under IFRSs. These are the starting points for this paper.

 The academic literature on IFRSs could be put into six broad subject categories, which inevitably overlap:

 1. The standard setting bodies: their histories, members, legitimacy, institutional structure, political explanations for changing standards, lobbying by stakeholders (e.g. Martinez-Diaz, 2005; Camfferman and Zeff, 2007 and 2015; Zeff, 2012). Papers of this category specifically on FV include Power (2010) and Durocher and Gendron (2014).

 2. The content of the standards: the facts, the antecedents, theoretical aspects, (e.g. Hellman, 2008; Barker, 2010). Papers on FV include Cairns (2006), Hitz (2007) and Penman (2007).

 3. Adoption of IFRSs: voluntary adoption and its causes, mandatory adoptions around the world, explanations for different approaches (e.g. Zeff and Nobes, 2010; Hassan et al., 2014; Ramanna and Sletten, 2014).

 4. Practice under IFRSs, including international differences: choice of options, translation problems, interpretation differences (e.g. Morais, 2008; Kvaal and Nobes, 2010; Evans et al., 2015). Papers on FV include Gebhardt (2012).

 5. The effect of adoption on accounting numbers: effects on profits and net assets, improvements in comparability and cost of capital (e.g. Li, 2010; Ahmed et al., 2013). Papers on FV include André et al. (2009), Cairns et al. (2011) and Amel-Zadeh and Meeks (2013).

 6. Market reactions to adoption of IFRSs: value relevance, bid/ask spreads, analyst forecasts and analyst following (e.g. Choi et al., 2013; Glaum et al., 2014; ICAEW, 2015). Papers on FV include Landsman (2007).

 This present paper aims to contribute to categories 2, 3 and 4. In particular, I first examine whether the position set out by Cairns (2006) has changed: is there still a perception of extensive FV requirements under IFRSs, and is such a perception still wrong? Secondly, I examine the reaction in the EU to a decade’s experience of implementing IFRSs. This examination is made easier because of a major EU consultation exercise whose results were announced in 2015. Thirdly, I analyse a series of recent legal opinions in the UK, some suggesting and some rebutting the idea that IFRSs are illegal, partly because of the imposition of FV.

 My three topics are connected because the supposed extensive imposition of FV in IFRSs was one of the major controversies surrounding adoption in the EU, was the greatest cause of negative comment in the EU’s consultation exercise, and has now been alleged to make IFRSs illegal.

**2. Has the IASB extended FV accounting?**

*2.1 Context*

Cairns (2006) referred to several non-academic sources which had exaggerated the importance of FV under IFRSs. The exaggeration has continued. For example, Rérolle (2008, p. 1) reports that:

In the two key bodies of accounting standards (US GAAP and IFRS), the concept of fair value has become more and more predominant.

Academic papers can give the same impression. For example, Durocher and Gendron (2014, p. 631), in the context of Canadian adoption of IFRSs, refer to:

a context of shifting accounting standards that increasingly gives preference to fair-value measurements…..

Those authors seek to:

… capture a range of different reactions to the relative standardization movement toward fair value …

The matters in this paragraph provide the context for the two questions in this section, as follows. Since Cairns’ study, has the International Accounting Standards Board (IASB) extended the mandatory or permitted use of FV? Secondly, in practice how much FV is applied in financial statements prepared under IFRSs?

*2.2 The IASB’s work*

A recent standard (IFRS 13; see Table 2 for the titles of the standards) defines FV in considerable detail for the purposes of most standards.[[2]](#endnote-2) In summary, FV is a current exit value (for an asset, it is the market selling price), though not a pure form of exit value because it does not take account of selling costs. For this section, we need also to define ‘fair value accounting’. Let us begin with the most obvious meaning: measuring assets or liabilities on a continuing FV basis, i.e. using current FV for ‘subsequent measurement’ at each balance sheet date. The IASB is now in its fifteenth year and, at the time of writing,[[3]](#endnote-3) has issued 15 new standards. How many of these introduce or even significantly extend this ‘FV basis’? In Section 2.3, I ask a similar question about the IASB’s amendments to old International Accounting Standards (IASs).

 The position for the new standards is summarised in Table 1. Five of them have no requirements about measuring assets or liabilities (IFRSs 7, 8, 11 and 12, and IFRS 13 which is definitional). Two standards deal with measurement but do not mention FV (IFRSs 4 and 14). IFRS 1 allows the one-off use of FV for some assets as a simplification in the context of first-time adoption of IFRS. Under IFRS 2, one-off FV is used to establish the initial ‘cost’ of equity-settled share-based payments. However, IFRS 2 does require ‘the FV basis’ for measuring any liabilities for cash-settled payments. In a business combination (under IFRS 3), FV is used for measuring the consideration (which might be only cash) and for measuring assets and liabilities when they are first recognised by the entity, in effect as a way of establishing or allocating ‘cost’. This is similar to the previous standard, IAS 22. IFRS 15 requires the one-off use of FV to measure non-cash revenue,[[4]](#endnote-4) but this replaces much more pervasive references to FV in IASs 11 and 18, as will be explained in Section 2.5. IFRS 5 sometimes requires a version of FV in order to measure for-sale assets but only when it is *lower* than the cost basis, like inventory valuation. IFRS 6 allows exploration and development assets to be held on the FV basis, as though[[5]](#endnote-5) they were under IASs 16 or 38. IFRS 10 requires the FV basis for measurement of those unusual subsidiaries which are not consolidated because they are held by investment companies.

That leaves IFRS 9 which certainly requires FV to be used for initial measurement and requires ‘the FV basis’ under some circumstances and allows it in others. However, IFRS 9 replaces IAS 39 which has a broadly similar[[6]](#endnote-6) mixed measurement model. Controversy has particularly surrounded the presentation of the gains and losses (whether or not they should be in profit or loss) rather than the use of the FV basis.

 In conclusion, most of the new standards (11 of the 15) written by the IASB contain no requirement or permission to use ‘the FV basis’. The remaining four standards do contain the FV basis, but one of them merely clarifies that the permission to use it that already existed in old standards covers particular assets (IFRS 6), one applies to assets of unusual entities (IFRS 10), one applies to unusual liabilities (IFRS 2), and one replaces an old standard which entails similar amounts of FV (IFRS 9). In addition, some IFRSs use FV in the context of one-off initial measurement, and one for writing down an asset. In some of these cases, the content of the IFRS is close to that in an IAS which it replaced.

*2.3 Is the FV basis required or allowed under IASs, and was that introduced by the IASB?*

It was not the IASB that extensively introduced ‘the FV basis’ but its predecessor, the International Accounting Standards Committee (IASC), particularly in the last three of its standards, IASs 39 to 41. Leaving IAS 39 aside for the moment but looking at all other extant IASs, the FV basis is *required* for some purposes by IASs 19, 26 and 41. It is *allowed* for some assets by IASs 2, 16, 38 and 40. It is also *allowed* by IAS 27 in unconsolidated statements as the basis for measuring investments in subsidiaries, joint ventures and associates. It is *allowed* by IAS 28 for holdings in joint ventures or associates in the consolidated statements of venture capitalists, unit trusts or similar investors. This information is summarised in the third and fourth columns of Table 2. Of all the cases in this paragraph, only the last (IAS 28’s option for unusual entities) results from an amendment made by the IASB.[[7]](#endnote-7) Furthermore, the IASB *reduced* the scope of the mandatory FV basis in IAS 41 by requiring bearer plants to be treated as property, plant and equipment (PPE).[[8]](#endnote-8)

The conclusion from this sub-section and that above is that the IASB has not been responsible for any wholesale introduction or expansion of the FV basis. The IASB’s *Discussion Paper* of 2013 on the conceptual framework made it clear[[9]](#endnote-9) that the IASB has no intention of abandoning the present mixed measurement model, which uses mainly a cost-or-lower basis for assets and mainly expected outflows (sometimes discounted) for liabilities. There is also no suggestion of extending FV in the subsequent *Exposure Draft* of 2015.[[10]](#endnote-10)

*2.4 Is the FV basis common in practice?*

How are the standards applied in practice by listed companies? Let us go through the ten IASs of Section 2.3 in more detail. For companies which have defined benefit post-employment plans, IAS 19 requires the FV basis for plan assets. However, they are not shown in a balance sheet (because they are not controlled and therefore not assets of the entity), but are deducted from plan obligations. Of course, many of these assets are fairly easy to value: cash deposits, listed investments and investment properties. The number of listed companies applying IASs 26 or 41 is small.[[11]](#endnote-11)

Turning to *optional* use of the FV basis, IAS 2 does not specifically allow inventories to be so held, but it exempts certain types of industries from the cost basis if they use a FV basis (para. 3).[[12]](#endnote-12) IAS 38 restricts the scope of the optional FV basis to very unusual intangibles which have an active market (para. 75). I have looked at many hundreds of IFRS reports and *never* seen the FV basis for intangibles. Of course, under IFRS 3, intangibles acquired in a business combination are initially measured using FV but that is a one-off estimate of ‘cost’ (see below).

What about the optional FV basis for *tangible* assets in IASs 16 and 40? Surveys of practice show little use of FV for PPE falling under IAS 16. Nobes and Stadler (2013), surveying the 2011 annual reports of 514 large companies of 12 countries, report no use in most countries but a small use in ‘Anglo’ countries, i.e. Australia (10% of companies), Canada (2%), Hong Kong (5%) and the UK (10%). Closer inspection reveals that the FV basis is confined to the financial sector and to property rather than all PPE. Cairns et al. (2011) study the use of FV in the context of adoption of IFRSs in Australia and the UK in 2005/6, also finding limited use under IAS 16. By contrast, the use of FV under IAS 40 for investment property is common, e.g. 93% of Australian companies with investment properties, 80% of Swiss companies, 68% of UK companies, but still only 5% of German companies and no Italian companies in the survey (Nobes and Stadler, 2013). Again, the FV basis is largely confined to the financial sector because that is where most investment properties are.

 I have seen no data on the optional use of the FV basis under IAS 27 but it seems unlikely that, in those countries which allow IFRS for unconsolidated statements,[[13]](#endnote-13) companies volunteer to use the FV basis for investments rather than the simpler cost basis.[[14]](#endnote-14) As noted above, the optional FV basis in IAS 28 is confined to unusual entities.

That leaves IAS 39. Here, of course, the use of FV is extensive. Nevertheless, if we look at non-financial companies (i.e. the large majority of companies), the use of FV is small even for financial instruments. Gebhardt (2012, Table 3) shows that, in 2009/10, only 24% of the financial assets[[15]](#endnote-15) of non-financial companies were held at FV, which amounted to 6% of the companies’ total assets. Further, about half of this is cash, for which the FV is the face value.[[16]](#endnote-16) Of the minority of liabilities within the scope of IAS 39, only 6% were held at FV.

In conclusion, as recorded in Table 2, the FV basis is confined to unusual items or unusual entities under new IFRSs, except for IFRS 9 which at least in the EU is not yet legal. Thus, most companies do not use ‘the FV basis’ for assets or liabilities shown in their balance sheets, except for financial instruments and then for only for a small proportion of them.

*2.5 FV in IASs for purposes other than the FV basis*

 As noted earlier, where ‘the FV basis’ is not applied, FV is sometimes used for one-off initial measurement for various reasons, including when cost is difficult to determine in other ways. FV is also sometimes used to measure impaired assets. Examples of these uses in IFRSs were mentioned in Section 2.2, and they are recorded in the fifth column of Table 2.

In IASs, FV is used for initially measuring the following: some finance leases (under IAS 17, when FV of the leased asset is lower than a measurement of the lease liability, but this will be removed under the new leasing standard, IFRS 16),[[17]](#endnote-17) assets acquired by exchange (IASs 16, 38 and 40), financial instruments (IAS 39), agricultural produce (i.e. dead formerly biological assets as they leave IAS 41 to become inventories for the first time), revenue (IASs 11 and 18), non-monetary grants (IAS 20), and the elements of a compound instrument (IAS 32).

 Some version of FV is also used as one of the ways of measuring impairment or other loss of value of assets. As mentioned above, this is the case under IFRS 5. In old IASs, it applies under IAS 2 and IAS 36 (to which several other standards refer). However, of course, this is only for writing assets *down*. This type of use is recorded in the last column of Table 2.

 Has the IASB extended these uses of FV? As may be seen in Table 2, the IASB’s new standards do require the use of FV for some initial measurements and one type of impairment, though it is not clear what sensible alternative there could be. In old IASs, none of the uses of FV for these purposes results from an amendment made by the IASB. By contrast, at first sight, the IASB has *retreated* from the principle of FV for the initial measurement of the largest figure in most companies’ financial statements: revenue. Under IAS 18 (para. 9), ‘Revenue shall be measured at the fair value of the consideration received or receivable’, whereas under IFRS 15 (para. 46) revenue is measured at transaction price except in the unusual case of non-cash consideration (para. 66). Of course, this is not in practice such as large change; for example, the fair value of €100 cash received at the time of a transaction is €100.

1. **Has the EU learnt to love IFRS?**

*3.1 The EU and international standards*

The IASC began work in 1973, which was when the UK joined what has become the European Union. These events were connected, and the IASC can be seen as an attempt by Anglo-Saxon accountants to avoid control of accounting by political and legal forces based in Brussels (Olson, 1982, p. 226; Hopwood, 1994; Camfferman and Zeff, 2007, pp. 40, 45). This has been understood in Brussels and Paris, where the IASC was viewed negatively (Hoarau, 1995: Flower, 1997; Kleekämper, 2000) for obvious reasons: it speaks English only, it a non-governmental body, and its standards are outside the legal system, beyond political control and separate from tax.

 In its first 20 years, the IASC had little effect in Europe, except probably on the content of the Seventh Directive (Diggle and Nobes, 1994) concerning consolidated statements, which were regarded as supplementary statements in most[[18]](#endnote-18) of those few continental countries in which they were prepared in the 1980s. The turning point came in the middle of the 1990s when German companies started to volunteer to use IASs for consolidated statements (Cuijpers and Buijink, 2005; Tarca et al., 2013). This was connected to the expansion of German companies after the fall of the Berlin Wall. Permission to use IASs was formalised in a German law of 1998 (Haller and Eierle, 2004).

 By 2000, the EU had admitted that its programme of political/legal harmonisation had not worked well (Whittington, 2005). International standards were proposed as the only feasible way of achieving harmonised reporting by EU listed companies in order to compete with US capital markets. Like the German law of 1998, the IAS Regulation of 2002, which came into force in 2005, focussed on the consolidated statements of listed companies.

 This dramatic move by the EU did not imply a warmth of feeling towards the IASB in Brussels or Paris (Standish, 2003; Burlaud and Colasse, 2011), rather a reluctant acceptance that international standards were the only practical way to advance EU harmonisation. Examples follow. First, the EU does not require companies to comply with “IFRSs as issued by the IASB”, unlike over 50 countries such as Azerbaijan, Israel, Nigeria and South Africa (IFRS Foundation, 2015). Instead, in common with some other developed countries, the EU believes that standard-by-standard endorsement is necessary. However, the EU’s interventions are more problematic than those made elsewhere, such as in Australia or Canada (see Zeff and Nobes, 2010). The EU delays in endorsement are longer (especially for IFRS 9)[[19]](#endnote-19) and there is the IAS 39 ‘carve out’ (Whittington, 2005).[[20]](#endnote-20) These create potential[[21]](#endnote-21) problems for EU companies listed on US exchanges because the Securities and Exchange Commission only waives the requirement to reconcile to US reporting for statements prepared under IFRSs not for those prepared under EU-endorsed IFRSs.

There have been many other battles, including that of October 2008, when the EU forced the IASB to amend IAS 39’s reclassification rules without due process (Camfferman and Zeff, 2015, p. 404-415). It is notable that all the problems related to particular standards concern those standards in which FV features heavily.

Later, the IFRS for SMEs was declared illegal in the EU.[[22]](#endnote-22) Then, in 2013, members of the European Parliament proposed removing funding from the IASB unless it changed its conceptual framework by restoring prudence (Crump, 2013; Maystadt, 2014). Members of the Parliament launched further attacks on the IFRS Foundation in 2015 (Crump, 2015).

*3.2 The EU Consultation of 2014*

 After nearly a decade of operating the IAS Regulation, the Commission carried out an extensive consultation exercise in late 2014 to assess the Regulation’s success. There were 200 replies[[23]](#endnote-23) from governments, accountancy bodies, companies and so on. The categories of respondent are summarised in Table 3. Of the replies, 22% were anonymous, mostly from listed companies rather than from individuals. Some respondents were from EU-wide or global organisations (16%). The largest groups of single-country respondents were German (17%), UK (16%) and French (12%). There were only three or fewer replies from most EU countries (Austria, Bulgaria, Cyprus, Estonia, Finland, Greece, Hungary, Ireland, Luxembourg, Malta, Poland, Romania, Sweden; with none from Croatia, Latvia, Portugal, Slovakia or Slovenia). In some cases, the only reply from a country was anonymous. In total, 4% of replies were anonymous as to country. The replies were all in English, except for one from an Austrian trade union body and seven from French respondents.

 The survey instrument could be divided into seven parts: (i) Questions 1 to 5 about the respondent, (ii) Questions 6 to 9 about the Regulation, (iii) Questions 10 to 20 about the benefits and costs of IFRSs, (iv) Questions 21 – 24 about endorsement, (v) Questions 25 – 30 about the quality of reporting under IFRSs, (vi) Questions 31 – 37 about enforcement, and (vii) Questions 38 – 42 about “other” issues. The difference between parts (iii) and (v) is subtle; perhaps (iii) relates to the change to IFRSs and (v) relates to the steady state under IFRSs. However, both parts are about assessing the qualities of IFRSs; and I discuss them together below.

 Virtually all respondents considered that the rationale for the Regulation remains in place and that the Regulation has furthered harmonisation. As to the Regulation’s scope, there was extensive support for *extending* it in various ways:

 (i) Many respondents (especially accountancy bodies and auditors) suggested extending compulsory IFRSs to the unconsolidated statements of those listed companies which do not prepare consolidated statements.

 (ii) Some respondents (especially from Spain) recommended that the Regulation should directly offer companies permission to use IFRSs in unconsolidated statements (i.e. that this possibility should not depend on a member state allowing it).

 (iii) Some Spanish companies also complained that the government should not be allowed to add national guidelines to the content of IFRSs.

 (iv) Some (e.g. from Czech Republic and Italy) recommended compulsory use of IFRSs for the separate statements of listed companies.

 (v) Apart from the very few negative responses, only one respondent suggested a narrower scope: the UK ‘Quoted Companies Alliance’ (which represents smaller listed companies) recommended that smaller listed companies should be exempted.

Many of the consultation’s questions (called parts iii and v above) related to whether the move from national accounting to IFRSs has improved financial reporting. My own analysis of the overall stances of these replies suggests remarkable support for IFRSs, as in Table 4. That is, of the respondents giving a clear answer, 93% were positive[[24]](#endnote-24) and only 6% were negative. There were only nine clearly negative responses: five UK, three German and one French (which really seemed to be about opposition to the IASB’s plans for insurance contracts). None of these negative responses came from standard-setters, accountancy bodies, governments or audit firms. Three of the UK negative responses[[25]](#endnote-25) refer to a UK legal opinion (see Section 4), accusing IFRSs of lacking prudence and of being poor for investor protection.

In May 2015, the Commission issued a report which analysed the responses by question.[[26]](#endnote-26) Table 5 shows the highly positive answers to some of the questions on accounting quality. The responses were not based on scientific empirical evidence but on impressions, but impressions are important for political decisions. Some responses were especially startling: 70% of respondents thought that comparability of reporting had been improved *within their own country* by abandoning national rules in favour of IFRSs.

There was widespread support for the existing EU endorsement process, although some respondents complained about slow endorsement of some standards, a few recommended removing the “European public good” criterion on grounds of vagueness, and several warned against adding to the criteria because that might risk lack of endorsement. Nearly all respondents considered that national enforcement is adequate.

 The Commission’s report and an EU conference of June 2015 concluded that little needs to be changed in the EU’s approach to imposing IFRSs for the consolidated reporting of listed companies. The US regulators were encouraged to accept IFRSs; the IASB was encouraged to improve its impact analyses; but the Commission gave IFRSs (and, incidentally, therefore itself) a glowing endorsement.

* 1. *Research on the effects of EU adoption of IFRSs*

As mentioned above, the overwhelmingly positive responses to the EU consultation were probably largely based on impressions rather than on scientific measurements. However, there has also been extensive empirical research. ICAEW (2015) synthesises about 200 papers set in the context of the EU. Although this research also comes to a positive conclusion overall, there are many contradictory findings and far more nuance, qualification and caveat than expressed in the EU consultation (see Singleton-Green, 2015, in this issue, for a discussion). Naturally, the EU consultation does not cover exactly the same ground as the academic research. Nevertheless, on several issues, they overlap, such as on the questions: did the adoption of IFRSs in Europe increase comparability and did it ease the raising of capital? Where they overlap, the EU responses are much more enthusiastic than would be supported by research findings. One would expect research to be the more equivocal, but the differences are stark. It is possible, therefore, that either (i) the respondents to the consultation were unrepresentative, poorly informed, deluded or dishonest, or (ii) the researchers have not been picking up what preparers, auditors, regulators and users are experiencing. There is a research project here.

1. **Does the use of fair value make IFRS illegal?**

In 2013, some UK investor groups (e.g. the Local Authority Pension Fund Forum) obtained a legal opinion from George Bompas QC suggesting that IFRSs might be illegal, partly on the grounds of IFRSs being imprudent because they require the use of FV. As mentioned in Section 3, this opinion (Bompas, 2013) has been used as part of negative responses to the EU’s recent consultation. The opinion is part of a series of competing legal opinions relating to IFRSs. In this section, I analyse these.

 Readers from continental Europe might welcome a brief note on the status of legal opinions. Such opinions are commissioned from senior barristers (advocates), who have been appointed Queen’s counsels (QCs), as assessments of what would result if the issue came before a court of law. In the UK, the standard-setters had earlier commissioned several opinions because the use of UK standards has never been specifically required by law. In the pre-IFRS period, the most renowned opinions were provided by Hoffmann and Arden (1983) and Arden (1993). Among other things, these opinions suggested that a court would normally hold that compliance with a standard is necessary in order to give a true and fair view.

 As is well known, the EU requirements (in Article 2 (5) of the EU’s Fourth Directive on company law) for financial statements to give a true and fair view and for this to override the detailed provisions of law have UK origins; and some other European countries had looked to the UK when implementing these requirements (Nobes, 1993; Aisbitt and Nobes, 2001). Consequently, the ‘fair presentation override’ in paragraph 19 of IAS 1 also has a UK origin. This provision was supported by many EU countries but opposed by Australia, Canada and the United States (Van Hulle, 1997). These requirements still generate much more official commentary in the UK than elsewhere, but the commentary is potentially of general relevance throughout the EU.

 In 2008, the Financial Reporting Council (FRC) obtained an opinion from Martin Moore QC. This stressed the continuing primacy of the true and fair view under either UK standards or IFRSs. Moore (2008) notes that, under IFRSs, UK auditors are still required by the law to assess whether financial statements give a true and fair view, whereas UK directors are instead required by IAS 1 to ensure that the statements give a fair presentation.[[27]](#endnote-27) Moore argues that the two objectives can be seen as the same. Nobes (2009, p. 418), commenting on the Moore opinion, investigates this issue in other EU countries, finding that in some (e.g. Germany) the two terms have been translated identically.

 Nobes (2009, p. 420) also investigates a curiosity in IAS 1: the ‘override’ in paragraph 19 is not to be invoked when that would be necessary in order to give a fair presentation but when necessary to remove any ‘conflict with the objective of financial statements as set out in the *Framework*’. That objective was to provide useful financial information (IASC, 1989, para. 12). Bompas (2013, para. 50) takes this point up, suggesting that there is therefore no ‘true and fair override’ in IFRSs, which are therefore perhaps illegal in the EU. This ignores the conclusion in Nobes (2009) that, although IAS 1 is elliptical, the requirement of its paragraph 20 (b), that an entity should disclose ‘that it has departed from a particular requirement to achieve a fair presentation’, probably solves the problem.

 Bompas (2013, para.28) also takes aim at IFRSs because prudence was removed from the conceptual framework when it was revised (IASB, 2010). This, Bompas suggests, also casts doubt on the legality of IFRSs. There are several technical problems[[28]](#endnote-28) with this, but the main one is that the revision to the framework has had no effect. That is, there is no evidence that the IASB has written less prudent standards since 2010; and in the unusual circumstances in which entities should directly apply the framework (e.g. when performing an ‘override’ or when changing an accounting policy), it appears[[29]](#endnote-29) that IAS 1 and IAS 8 still refer to the *old* framework (which *does* include prudence). These standards will not be amended until the framework exposure draft of 2015 is implemented, and it proposes to re-introduce prudence (para. 2.18). So, for preparers or auditors, prudence will never have been deleted.

Bompas (2013, para. 69) also targets IAS 39, alleging that marking to market is incompatible with the Directive’s requirement to give a true and fair view. However, IAS 39 was endorsed by the EU after positive advice from the EU’s Accounting Regulatory Committee and the European Financial Reporting Advisory Group (EFRAG), who were required to consider the Directives when giving their advice. Further, marking to market was specifically allowed by revisions to the Fourth Directive in 2001 onwards (e.g. put into UK law as para. 40 (2) of SI 2008/410). Inexplicably, Bompas does not mention any of that. It is therefore unsupportable to imply that a true and fair view cannot be given when complying with IAS 39.

 Finally, Bompas (2013, para.s 29 to 35) suggests that there is another legal problem because accounting under IFRSs was not designed for, and does not disclose, distributable profit. Bompas argues that the Second Directive foresees the calculation of distributable profit from the financial statements. It is true that the purpose of IFRS statements is not to calculate distributable profit, and that many adjustments would be necessary to do the calculation. For example, for the UK, this is explained in 168 pages in ICAEW (2010). However, a key point here is that the Second Directive and the resulting laws relate to *unconsolidated* financial statements, on which dividend decisions are based. There is no such thing as the distributable profit of a group. Since the EU Regulation only imposes IFRSs for *consolidated* statements, there can be no general legal problem. Nevertheless, it would be worth investigating whether the Directives imply that unconsolidated statements should contain a note[[30]](#endnote-30) disclosing distributable profit where this is different from amounts shown on the face of the income statement.

 If Bompas’ opinion were right, chaos would result. For example, dividends paid by any listed company since 2005 would be legally suspect. The FRC therefore rapidly countered the opinion with another from Moore in 2013,[[31]](#endnote-31) but Bompas countered that in 2015.[[32]](#endnote-32) However, Bompas still does not take account of the above points (e.g. para 20 of IAS 1, and the consolidated/unconsolidated dichotomy), therefore his opinions are unlikely to hold sway.

1. **Conclusion**

A decade after the beginning of extensive mandatory adoption of IFRSs, this paper examines three connected issues: the prevalence of FV in the requirements of IFRSs and in practices under them, whether the EU’s imposition of IFRSs has been perceived as a success and will continue, and whether FV requirements render IFRSs illegal in the EU.

 I conclude that, in 15 years, the IASB has not introduced ’the FV basis’ for any major types of assets or liabilities. In old standards, there have been a few extensions of the FV basis, some optional, but only to unusual items or unusual entities. In one old standard, the scope of the FV basis has been reduced. In practice, for a large proportion of IFRS-using companies, the FV basis is confined to a very small minority of their assets and liabilities: a small proportion of their financial items. Thus, extensive use of the FV basis under IFRSs is a myth, albeit one that is well-established in both academic and non-academic writings. FV is also used in a number of circumstances as a way of helping with the initial determination of cost, but there is no sensible alternative in such cases. FV is sometimes used when writing down impaired assets, but prudent accountants could not object to that.

 Apart from a few responses linked to perceived excessive use of FV, the EU’s consultation exercise gave powerful backing to the use of IFRSs. This included all types of respondent from all countries, including famously sceptical countries such as France. I conclude that there will be little change to the EU’s approach to imposing IFRSs. The extensive academic research on the effects of adopting IFRSs in the EU is also positive but much less clear cut.

The FV myth forms part of the background to a campaign by a small number of investor groups, particularly in the UK, to oppose IFRSs on the grounds of imprudence in general and FV accounting in particular. This opposition has included obtaining two legal opinions which suggest that reporting under IFRSs might be illegal. I conclude that the arguments used are not persuasive.

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**Table 1.** Fair value in IFRS 1 to IFRS 15

|  |  |
| --- | --- |
|  | *Number of standards* |
| No requirements about measuring assets or liabilities(IFRSs 7, 8, 11, 12) |  4 |
| Definitional only (IFRS 13) |  1 |
| Containing measurement issues but not FV (IFRSs 4, 14)  |  2  |
| One-off use of FV to establish a version of ‘cost’ (IFRSs 1, 3)One-off use of FV as ‘cost’ for some share-based payments, but FV basis for others (IFRS 2) |  2 1 |
| One-off use of FV to measure non-cash revenue (IFRS 15)FV sometimes, when *lower* than cost basis (IFRS 5) |  1 1 |
| FV basis allowed by analogy to IASs 16 or 38 (IFRS 6)  |  1 |
| FV basis for unusual subsidiaries (IFRS 10) |  1 |
| Extensive use of FV, but broadly similar scope to former standard (IFRS 9) |  1 |
|  |  15 |

**Table 2.** Fair value measurement in IFRSs

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Standard** **and paragraph** | **Title of standard** | **‘FV basis’ required** | **‘FV basis’ or similar allowed** | **FV for initial measurement** | **FV (or similar) when lower than cost basis** |
| IFRS | 1 (App. D) | First-time adoption of IFRSs | - | - | Option to use FV as deemed cost | - |
|  | 2 (paras. 10, 30) | Share-based payment | For cash-settled payments, FV of liability | - | For equity-settled, FV of goods received or instruments granted | - |
|  | 3(paras. 18, 37) | Business combinations | - | - | Assets and liabilities in business combinations, and the consideration | - |
|  | 4 | Insurance contracts | - | - | - | - |
|  | 5(para. 15) | Non-current assets held for sale and discontinued operations | - | - | - | Lower of cost or FV less costs to sell |
|  | 6(para. 12) | Exploration for and evaluation of mineral resources | - | Exploration and evaluation assets | - | See IAS 36 |
|  | 7 | Financial instruments: disclosures | - | - | - | - |
|  | 8 | Operating segments | - | - | - | - |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | 9 (paras. 5.1.1, 5.2.1) | Financial instruments | Instruments except those with certain business models and cash flows  | Designated instruments | All instruments except trade receivables | - |
|  | 10(para. 31) | Consolidated financial statements | Subsidiaries of investment entities | - | - | - |
|  | 11 | Joint arrangements | - | - | - | - |
|  | 12 | Disclosure of interests in other entities | - | - | - | - |
|  | 13 | Fair value measurement | - | - | - | - |
|  | 14 | Regulatory deferral accounts | - | - | - | - |
|  | 15 (para. 66) | Revenue from contracts with customers | - | - | Non-cash revenue  | - |
| IAS | 1 | Presentation of financial statements | - | - | - | - |
|  | 2(para. 3) | Inventories | - | Inventories of mineral producers and commodity traders | - | Inventory at lower of cost or net realisable value |
|  | 7 | Statement of cash flows | - | - | - | - |
|  | 8 | Accounting policies, changes in accounting estimates and errors | - | - | - | - |
|  | 10 | Events after the reporting period | - | - | - | - |
|  | 11(para. 12) | Construction contracts (being replaced by IFRS 15) | - | - | Revenue  | - |
|  | 12 | Income taxes | - | - | - | - |
|  | 16(paras. 24, 29) | Property, plant and equipment | - | PPE | Assets acquired by exchange | See IAS 36 |
|  | 17(para. 20) | Leases | - | - | FV of finance lease asset if lower than DCF of lease liability | See IAS 36 |
|  | 18(para. 9) | Revenue (being replaced by IFRS 15) | - | - | Revenue  | - |
|  | 19(para. 57) | Employee benefits | Plan assets | - | - | - |
|  | 20(para. 23) | Accounting for government grants and disclosure of government assistance | - | - | Non-monetary grant | - |
|  | 21 | The effects of changes in foreign exchange rates | - | - | - | - |
|  | 23 | Borrowing costs | - | - | - | - |
|  | 24 | Related party disclosures | - | - | - | - |
|  | 26(para. 32) | Accounting and reporting by retirement benefit plans | Plan assets | - | - | - |
|  | 27(para. 10) | Separate financial statements | - | Investments treated under IAS 39 or IFRS 9 | - | - |
|  | 28(para. 18) | Investments in associates and joint ventures | - | Associates or joint ventures held by venture capitalists etc | - | - |
|  | 29 | Financial reporting in hyperinflationary economies | - | - | - | - |
|  | 32(para. 31) | Financial instruments: presentation | - | - | Liability component of compound instrument | - |
|  | 33 | Earnings per share | - | - | - | - |
|  | 34 | Interim financial reporting | - | - | - | - |
|  | 36(paras. 6, 59) | Impairment of assets | - | - | - | FV less selling costs is one basis for impaired assets |
|  | 37 | Provisions, contingent liabilities and contingent assets | - | - | - | - |
|  | 38(paras. 45, 72) | Intangible assets | - | Unusual intangibles with an active market | Assets acquired by exchange | See IAS 36 |
|  | 39(paras. 9, 43, 47) | Financial instruments: recognition and measurement (being replaced by IFRS 9) | Trading, derivative and available for sale instruments | Designated instruments | All instruments | - |
|  | 40(paras. 27, 30) | Investment property | - | Investment property | Assets acquired by exchange | If using cost basis, see IAS 36 |
|  | 41(paras. 2, 12, 13) | Agriculture | Biological assets (except bearer plants) at FV less costs to sell | - | Agricultural produce | - |

**Table 3** Types of respondent (percentages) to the 2014 EU consultation on IFRSs

|  |  |
| --- | --- |
| Standard setters |  7 |
| Accountancy bodies |  5 |
| Governments, regulators |  9 |
| Audit firms |  5 |
| Associations of companies, CFOs |  18 |
| Associations of investors |  9 |
| Companies |  25 |
| Individuals |  22 |
|  |  100 |

Respondent letters can be found at <http://ec.europa.eu/internal_market/consultations/2014/ifrs/contributions_en.htm> (accessed on 20.9.2015).

**Table 4.** Author’s assessment of respondents’ reactions to IFRSs in the 2014 EU consultation on IFRSs

|  |  |
| --- | --- |
|  |  *% of responses* |
| Enthusiasm |  41 |
| Good on balance |  43 |
| Ambivalent |  1 |
| Poor |  2 |
| Dreadful |  3 |
| Not enough detail to tell |  10 |
|  |  100 |
|  |  |

Respondent letters can be found at <http://ec.europa.eu/internal_market/consultations/2014/ifrs/contributions_en.htm> (accessed on 20.9.2015).

**Table 5.** Perceived effects of moving from local GAAP to IFRSs by respondents to 2014 EU consultation on IFRSs

|  |  |
| --- | --- |
|  |  % of responses |
| More transparency |  86 |
| More EU comparability |  92 |
| More national comparability |  70 |
| More ‘true and fair’ than local GAAP |  87 |
| More understandable |  68 |
| Easier access to capital |  63 |
| Better investor protection |  71 |
| Improved internal group accounting |  86 |
| Benefits exceed costs |  60 |

Source: <http://ec.europa.eu/internal_market/consultations/2014/ifrs/docs/summary-of-responses_en.pdf> (accessed on 20.9.2015).

1. **Notes**

 As recorded on the journal’s website: http://www.tandfonline.com/toc/raie20/current (accessed 20.9.2015). [↑](#endnote-ref-1)
2. It excludes IFRS 2 and IAS 17. [↑](#endnote-ref-2)
3. October 2015. [↑](#endnote-ref-3)
4. There are sometimes effects on assets and liabilities because of other parts of the double entries for revenue recognition (e.g. IFRS 15, paras. 55 and 91). [↑](#endnote-ref-4)
5. Some exploration and evaluation assets might fall under the general definitions of IASs 16 and 38 but are specifically excluded by those standards (IAS 16, para. 3, and IAS 38, para. 2). In the absence of IFRS 6, the assets might be treated as though they were under IASs 16 and 38 by applying IAS 8, para. 10. [↑](#endnote-ref-5)
6. This is complicated, but amortised cost is required by para. 4.1.2 of IFRS 9 in circumstances that overlap with the definition of held to maturity in IAS 39, para.9. Both standards also contain options to designate assets to FV. A detailed assessment of IFRS 9 is contained in <http://www.efrag.org/files/IFRS%209%20endorsement/IFRS_9_Final_endorsement_advice.pdf> (accessed 26.10.2015). [↑](#endnote-ref-6)
7. Amendment of 2014. [↑](#endnote-ref-7)
8. Amendment of 2014. [↑](#endnote-ref-8)
9. Paragraph 6.14 makes this clear, and there are many references to the advantages of historical cost. [↑](#endnote-ref-9)
10. Again, it is quite clear from Chapter 6 that a mixed model is intended. [↑](#endnote-ref-10)
11. I have not seen any data on this, but my own casual observation of studying hundreds of listed companies is that one never comes across these standards. Of course, unlisted companies and developing countries are not studied in the detail needed to comment on this. The impetus for changing IAS 41 (see above) came particularly from the Malaysian Accounting Standards Board which used evidence from seven companies. See, <http://www.ifrs.org/Meetings/MeetingDocs/IASB/Archive/Agriculture/AGRI-0912-13B.pdf> (accessed 26.10.2015). [↑](#endnote-ref-11)
12. These include mineral producers if they use net realisable value and commodity brokers if they use FV. [↑](#endnote-ref-12)
13. For the EU, see: <http://ec.europa.eu/finance/accounting/docs/legal_framework/20140718-ias-use-of-options_en.pdf> (accessed 20.9.2015). [↑](#endnote-ref-13)
14. The equity method was introduced as a further option in an amendment to IAS 27 of 2014. [↑](#endnote-ref-14)
15. Those within the scope of IAS 39. [↑](#endnote-ref-15)
16. The ‘about half’ comes from Table 2 of Gebhardt (2012) but this uses data of a different date from Table 3. [↑](#endnote-ref-16)
17. See the IASB’s ‘Project Update’ on Leases (p.13), issued in August 2014. [↑](#endnote-ref-17)
18. An exception is the Netherlands (Zeff et al., 1992). [↑](#endnote-ref-18)
19. IFRS 9 was first issued in 2009 and is not EU-endorsed as I write (October 2015). IFRSs 10 and 11 were mandatory for 2013 onwards according to the IASB, but only endorsed in the EU for 2014 onwards. [↑](#endnote-ref-19)
20. Apart from any temporary differences caused by delays in endorsement, the IAS 39 carve-out is the only difference between IFRS and EU-endorsed IFRS. The carve out is only used by a few financial institutions; about 20 of them according to page 4 of: http://www.ifrs.org/Use-around-the-world/Documents/Financial-Reporting-Standards-World-Economy-June-2015.pdf [↑](#endnote-ref-20)
21. Up to now, this has generally been solved by: (i) ignoring the extra latitude for hedge accounting in the EU’s version of IAS 39, (ii) ignoring opportunities for early adoption of standards until they are EU-endorsed, and (iii) obtaining an extra audit report which refers to IFRSs. [↑](#endnote-ref-21)
22. See: <http://www.efrag.org/Front/p172-4-272/Compatibility-Analysis-IFRS-for-SMEs-and-the-Council-Directives.aspx> (accessed on 20.9.2015). [↑](#endnote-ref-22)
23. See: <http://ec.europa.eu/internal_market/consultations/2014/ifrs/contributions_en.htm> (accessed on 20.9.2015). [↑](#endnote-ref-23)
24. That is, 90% of answers were clear, and 84% of the answers were clearly positive. [↑](#endnote-ref-24)
25. Two of these are anonymous. Some others relate to Royal London Asset Management and the Local Authority Pension Fund Forum. [↑](#endnote-ref-25)
26. The responses are summarised in: <http://ec.europa.eu/internal_market/consultations/2014/ifrs/docs/summary-of-responses_en.pdf> (accessed on 20.9.2015). The report can be found at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015DC0301&from=EN> (accessed on 20.9.2015). [↑](#endnote-ref-26)
27. The US origins of this term are investigated by Zeff (2007). [↑](#endnote-ref-27)
28. For example, in Bompas’ para. 26, it is not clear why reference is made to SSAP 2 rather than to FRS 18, which replaced it in 2000. FRS 18 (para. 35 (c)) has the rather restricted meaning (“under conditions of uncertainty”) as in the pre-2010 IASB Framework. Similarly, Bompas’ reference to “all foreseeable liabilities and likely losses” (para. 10.1.3 (ii)) has been removed from the law, as Bompas later explains (para. 26). In para. 11.1, Bompas apparently agrees with the complaint against IAS 39, but this relies on the old legal wording, so the complaint is wrong. On the specific point of bad debt impairment (para. 70), it is not clear that UK GAAP was more prudent than IFRS. The other vague remark about “provisions” (also in para. 70) is inexplicable, given that FRS 12 was identical to IAS 37. [↑](#endnote-ref-28)
29. Although there are footnotes in IASs 1 and 8 which refer to the 2010 framework, these are editorial insertions made without IASB due process and without EU endorsement. [↑](#endnote-ref-29)
30. This would be sufficient because the Fourth Directive and the 2013 Directive which replaces it (Article 4 (1)) consider the notes to be part of the ‘accounts’. [↑](#endnote-ref-30)
31. <https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Martin-Moore-QC-Opinion-3-October-2013.pdf> (accessed on 21.9.2015). [↑](#endnote-ref-31)
32. See: <http://www.lapfforum.org/news/files/BompasFurtherOpinionSignedCopy.pdf> (accessed 25.9.2015). [↑](#endnote-ref-32)