

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Eighth Delegated Legislation Committee

DRAFT INTERNATIONAL ACCOUNTING
STANDARDS AND EUROPEAN PUBLIC LIMITED-
LIABILITY COMPANY (AMENDMENT ETC.)
(EU EXIT) REGULATIONS 2019

Wednesday 20 March 2019

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The Committee consisted of the following Members:

Chair: MARK PRITCHARD

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| † Day, Martyn (<i>Linlithgow and East Falkirk</i>) (SNP) | † Shelbrooke, Alec (<i>Elmet and Rothwell</i>) (Con) |
| † Elliott, Julie (<i>Sunderland Central</i>) (Lab) | † Swire, Sir Hugo (<i>East Devon</i>) (Con) |
| † Esterson, Bill (<i>Sefton Central</i>) (Lab) | † Tolhurst, Kelly (<i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i>) |
| † Foxcroft, Vicky (<i>Lewisham, Deptford</i>) (Lab) | † Twist, Liz (<i>Blaydon</i>) (Lab) |
| † Harris, Rebecca (<i>Lord Commissioner of Her Majesty's Treasury</i>) | † Warburton, David (<i>Somerton and Frome</i>) (Con) |
| † Jones, Susan Elan (<i>Clwyd South</i>) (Lab) | † Whittingdale, Mr John (<i>Maldon</i>) (Con) |
| McKinnell, Catherine (<i>Newcastle upon Tyne North</i>) (Lab) | † Williams, Dr Paul (<i>Stockton South</i>) (Lab) |
| † McLoughlin, Sir Patrick (<i>Derbyshire Dales</i>) (Con) | Kevin Candy, <i>Committee Clerk</i> |
| † Newton, Sarah (<i>Truro and Falmouth</i>) (Con) | |
| † O'Brien, Neil (<i>Harborough</i>) (Con) | † attended the Committee |

Eighth Delegated Legislation Committee

Wednesday 20 March 2019

[MARK PRITCHARD *in the Chair*]

Draft International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019

2.30 pm

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Kelly Tolhurst): I beg to move,

That the Committee has considered the draft International Accounting Standards and European Public Limited-Liability Company (Amendment etc.) (EU Exit) Regulations 2019.

It is a pleasure to serve under your chairmanship, Mr Pritchard. The regulations aim to address failures of retained EU law to operate effectively in the field of accounts and reports of UK corporate bodies. They also address certain other deficiencies arising from the UK's exit from the EU.

The international financial reporting standards are a set of international accountancy standards written for use by multinational companies when producing their annual accounts. The International Accounting Standards Board publishes those standards after consultation with its international stakeholders. The standards are required or permitted for use in more than 125 countries, including in all European economic area countries and in 15 of the G20.

Standardising financial reporting across the globe helps lower costs for businesses and enhances investor confidence in company reporting. For companies, using the IFRS reduces the burden of complying with multiple reporting requirements, if they are listed or have operations in different countries. Investors also find it easier to compare the accounts of companies in different jurisdictions when companies use the same set of standards to prepare their annual accounts.

EU regulation 1606/2002, known as the IAS regulation, requires that all publicly traded companies must use IFRS, as endorsed and adopted by the EU, when preparing consolidated accounts for their groups. In the UK, the Companies Act 2006 also permits other UK companies to produce their accounts in accordance with IFRS. Overall, approximately 15,000 companies in the UK use the standards to prepare their annual accounts.

The IAS regulation also sets out the provision for an endorsement process to adopt international accountancy standards for use in the EU. Once the UK leaves the European Union, the EU framework for adopting the IFRS will no longer apply. The regulations in front of the Committee aim to provide continuity and clarity to business by bringing the European framework for adopting IFRS into UK law. That will ensure that UK-registered companies will not have to change their processes for preparing annual accounts.

The power to endorse and adopt IFRS for use in the UK will be transferred to the Secretary of State. The responsibilities transferred to the Secretary of State will be bound by the process and the required scrutiny set out in the regulations. First, any new or amended international financial reporting standard must be considered against certain assessment criteria before it can be endorsed for use in the UK. Those criteria are consistent with those used by the European regulation and they include that the standards provide a "true and fair" view of an undertaking's financial position; and their adoption is conducive to

"the long-term public good in the United Kingdom".

Secondly, the regulations set out that for all proposed endorsement decisions on new or amended IFRS the Secretary of State must consult stakeholders with an interest in the quality and availability of accounts, and the final decisions must be published. Finally, the Secretary of State will also be required to lay a report before Parliament each year, detailing the carrying out of his or her responsibilities to endorse and adopt the IFRS. That will ensure that Parliament has an opportunity to hold the Secretary of State to account for adoption decisions.

The regulations provide for sub-delegation of endorsement and adoption powers to a designated UK body. A subsequent affirmative SI will transfer the powers to a new UK IFRS endorsement board. We expect that endorsement board to be hosted by a subsidiary of the Financial Reporting Council. As such, it will benefit from the FRC's existing operational processes, such as the human resource function and premises. The FRC's role will be limited to monitoring the governance and due process of the endorsement board. It will have no role in the process of adopting those standards.

As hon. Members will be aware, in December the independent review of the FRC published a comprehensive and detailed report that made 83 recommendations. The Government welcome and share the review's vision for a new regulator, with a new mandate, new leadership and stronger statutory powers, and we will take swift action to deliver that. The role of the FRC in relation to the endorsement board will be transferred to the new regulator once it is operational.

The Government have worked closely with businesses and regulatory bodies while developing the regulations. Informal consultations were carried out with companies, their advisers and investors. In addition, a dedicated stakeholder group helped to inform the decisions about these regulations. Stakeholders were strongly in favour both of establishing a UK framework for the continued use of IFRS, and of consultation before a standard is adopted for use in the UK.

The draft regulations also make amendments relating to the *societas Europaea* or SE, a specific European type of public limited liability company that cannot be registered in the UK after EU exit. Regulations have been made to ensure that any entities registered in the UK on exit day will have a clear legal status by automatically converting those entities to a new corporate form, a UK *societas*.

The amendments relating to those entities do three things. First, they preserve a particular employee involvement provision, ensuring that employment rights have been maintained wherever practical. Secondly, they apply the

Overseas Companies Regulations 2009 to SEs registered in other member states. This will ensure that UK branches of entities registered in other member states are treated in the same way as UK branches of any other overseas company. Finally, they make a number of minor consequential amendments to other legislation, such as replacing references to “SE” with “UK *societas*” where necessary to ensure that the UK has a functioning statute book on and after exit day.

The Government carried out a *de minimis* impact assessment of the regulation, as the overall cost to the businesses was established as being small. The annual net direct cost to business of the IFRS-related changes was estimated to be £2.4 million a year. The estimated impact for the SE-related changes was £10,400 a year. Both figures are below the £5 million threshold necessary for a full impact assessment.

In conclusion, these regulations provide continuity and clarity to business by setting out a framework for continued use of IFRS in the UK. I therefore commend them to the Committee.

2.38 pm

Bill Esterson (Sefton Central) (Lab): It is a pleasure to serve under your chairmanship, Mr Pritchard.

The importance of accounting standards cannot be overstated. I am sure all members of the Committee understand that it is crucial that we get this right, and that the public, stakeholders, investors and the Government can rely on the accuracy of published accounts. Given the recent public concern over audit and the question of the independence or otherwise of the big four, this topic deserves thorough debate and scrutiny. It is essential that accounts give a true and fair view and, therefore, essential that, whether the standards are national or international, they are delivered in the appropriate way and with the right degree of support, scrutiny and accountability.

I believe I am right in saying that we are dealing here with the arrangements that would be in place in the event of no deal. As ever with the regulations brought before us in these Committees, there is the question of the adequacy of scrutiny and our ability to scrutinise properly, given the time available to us, the complexity of what we are being asked to consider and, frankly, the inadequacy of the consultation—in this case, the fact that no public consultation has been carried out.

I will ask the Minister to respond in her reply on the nature of the informal consultation on these regulations, who was consulted and what they said in response. I was informed yesterday, by being copied into a letter to one of her ministerial colleagues, about the nature of a consultation on another set of regulations; I was copied in because I was the shadow Minister on that occasion as well. What concerned me about the letter sent to the Minister’s colleague was that the consultee had been instructed—not asked, instructed—by the Department to comment only on the technical content of the regulations and not to advise on whether the regulations would deliver what the Government needed to be delivered in the event of no deal. That is of great concern. Will the Minister confirm whether that is true here and whether the informal consultees, assuming there have been some, were asked to comment on a similar basis—only on the very narrow technical content of the regulations—or whether they were asked to comment on their adequacy and the wider issues involved.

In this case, I assume—perhaps the Minister can confirm this for the Committee’s benefit—that the big four were consultees. If not them, then who? Perhaps she can also confirm whether there was wider public consultation or consultation with organisations independent of the accountancy profession, which would have been necessary to ensure proper scrutiny of what we are considering—not that we have been given sight of their comments, which is why I have asked her to let us know what they said.

Yet again, we have no business impact assessment. Again, I put on record that it is impossible for members of this Committee to know whether that is an appropriate judgment by the Department, because we do not have enough information before us; we do not have the depth of knowledge, the detail of consultation or comment by expert witnesses to give us the evidence to judge whether there will be a significant impact.

The regulations mention the Financial Reporting Council’s involvement and the fact that it is being asked to set up and oversee an endorsement board to take on the responsibilities currently delivered by the European Commission. That is cause for great concern. The FRC is due to be reconstituted, involving primary legislation, as a result of the Kingman review, which was published in December. I do not know whether the Minister is able to say when that primary legislation will be considered and when that work will be undertaken, but it clearly will not happen in time for these regulations to be enacted and for the FRC to take on the responsibilities set out in these regulations. Perhaps she can tell us when time will be made available for the work that needs primary legislation. Given the volume of legislation—we hear talk of the Easter recess being cancelled so that we can consider further statutory instruments like this one—perhaps she can tell us when that primary legislation is due to be considered by Parliament so that the FRC can be reconstituted.

That is of concern that we are in a position where, as the front page of the *Financial Times* put it, the FRC is “to make way for stronger accounts watchdog after a string of audit failures”.

Given that concern about the FRC, it seems quite odd to ask it to take on this additional responsibility. The FRC is subject to 83 recommendations for change, a third of which require primary legislation. Will the Minister say how the FRC will have the capacity, and how we can be sure it has the competence, to take on this added responsibility as a result of the regulations? It is incredibly important that we get our financial standards right, for the reasons I set out. The concern is that the FRC simply has enough on its plate already, as set out by the Secondary Legislation Scrutiny Committee when it recommended that the draft regulations be subject to the affirmative procedure.

I am also curious to hear the Minister’s view on the Association of British Insurers’ suggestion that the Secretary of State should have active political oversight of the endorsement board. It made that suggestion because of the upheaval at the FRC, and also because of longer-term implications; as the international financial reporting standards evolve, a significant amount of work by the board will be needed. The Minister mentioned the annual report by the Secretary of State to Parliament, but that is very different from active and regular political oversight of the endorsement board.

[Bill Esterson]

I believe that Australia has such a system; I notice that Australia was mentioned a few times in the draft explanatory memorandum. I wonder why the Government have not considered what seems to be an effective system of political oversight and why they have taken this light-touch approach to the day-to-day management of this incredibly important piece of work. I remind the Committee that the independent review of the FRC found that it is not fit for purpose and has serious problems in how it recruits top staff. Those reasons are enough now for having that active political oversight, and they will be cause for great concern until that primary legislation comes forward and a new body is set up.

The Minister's Department told a House of Lords Committee that it was

"currently working with the FRC to build capacity to set up the new Endorsement Board...in time for EU Exit."

The Department also told the Committee that

"stakeholder input helped us define the extent of the FRC's role in relation to the new Endorsement Board".

How is the setting up of the new endorsement board going, who are those stakeholders and what was their input into the creation of the board?

The European Commission currently oversees the application, and influences the development, of IFRS across the EU. What is proposed raises concerns about a lack of political oversight of the board. I will be grateful for the Minister's comments on that point. The United States applies IFRS only piecemeal, which reduces the international effectiveness of IFRS itself. Have the Government lobbied the US to adopt IFRS? Will the Minister tell us about the impact on US-UK trade agreements of a lack of adoption of those standards and of having different regulatory environments? Are these matters being discussed by her colleagues in the Department for International Trade in their preliminary discussions about potential US-UK trade agreements?

On the setting up of the endorsement board, will the Minister tell us who will be represented on it? Will it reflect stakeholders, including those independent of the profession, as well as representatives of the nations of the United Kingdom? Accounting standards are of great importance, and making sure that regulations are in place in the event of no deal is essential.

There are real concerns about the regulations and the ability of the FRC to put in place a system that ensures their robust implementation. Given that this instrument has already been through the House of Lords, I hope the Minister is in a position to give detailed responses to the points I have raised. They were raised in the House of Lords equivalent of this debate and I would like to think that she has come prepared to answer them.

2.50 pm

Kelly Tolhurst: I am grateful to the hon. Gentleman for his contribution. International financial reporting standards are a world-leading set of accounting standards, used by a large number of companies in the UK, the EU and other countries around the world. Their use helps inform decision making, improves transparency and promotes confidence in the business environment. As we leave the EU, it is vital we maintain the integrity of the UK system of accounting and reporting.

I remind the hon. Gentleman that we are talking about a statutory instrument that would transfer the current rules that we already work to within the European Union and how the EU applies those rules across member states. In the event of our exit from the EU, we are bringing together a UK framework. It is important to bear that in mind. This is about how we develop a successful framework that enables us to maintain our position as a great place to do business, and reassures investors and companies of that.

We are the biggest capital market outside the US and, therefore, it is right for us to have the regulations; I am sorry to hear that the hon. Gentleman has concerns about them. Having worked through them as a Minister, I think they are sensible and would enable the UK to carry on securely.

I will answer some of the points raised by the hon. Gentleman. The stakeholder group was established in April 2018 to look at the regulations, and it held six meetings. That group included investors, accountants, advisers and business representatives who took part in the meetings as independent individuals. They were asked to participate because of their knowledge, expertise and potential to help in this area, to work with us to look at the technical information and ensure that any regulations brought forward would be in good order.

As the hon. Gentleman mentioned, there was no public consultation on the regulations, but we held informal stakeholder meetings of those affected and interested parties over a long period, from 2018.

With regard to the hon. Gentleman's comments on the FRC, we welcomed the review undertaken by Sir John Kingman and we will bring forward primary legislation on that point. I must point out that the endorsement board will be a subsidiary of the FRC. It is not currently constituted. The regulations will enable the Secretary of State to have those powers and he will be able to sub-delegate them to an endorsement board.

We are working with FRC officials, and the Secretary of State has full oversight of the development of the EB and its design. He will eventually appoint a chair, shape governance and have full political oversight. The EB will be run separately, as a subsidiary; it will have its own running costs and will be funded through a levy, which organisations that have to comply with FRC rules currently pay to the FRC.

One good thing about the endorsement board and its being structured within the FRC is the future thought leadership that the board will give. It will really be able to influence, on the international stage, any future developments in IFRS standards. That area will be key for the endorsement board going forward.

Bill Esterson: Earlier, I put to the Minister her Department's statement to the House of Lords Committee that it was working with the FRC to have the new endorsement board ready in time for EU exit. I take it, from what she just said, that that will not happen. Will she confirm that? Will she also confirm the arrangements for the work that the new endorsement board will undertake once it is set up?

Kelly Tolhurst: I am sorry; I thought I had already outlined that to the hon. Gentleman. The Secretary of State has those powers, which will he will sub-delegate

to the endorsement board. We are working to develop that board, and our intention is that it will be in place by the end of 2019. I thought I had made that clear.

The Secretary of State will have the power to sub-delegate, but he will also have the power to revoke powers sub-delegated to the endorsement board in the future. To clarify, and to give Members comfort that political oversight will continue, the hon. Gentleman was quite right that the Secretary of State will have to report to Parliament annually, and the endorsement board that carries out these tasks in the future will also report annually to the Secretary of State. Those reports will be placed in the Commons Library. Even when there is an endorsement board, the Secretary of State will still lay an annual report in Parliament, which will give an opportunity for parliamentary scrutiny and for the Secretary of State to be scrutinised and held to account for particular activities of the endorsement board when that sub-delegation has occurred.

On the hon. Gentleman's comments on whether we are lobbying the US to follow IFRS standards more closely, that is not something I am directly involved

with. The draft regulations are very much about making sure that the UK is able to maintain its place in the global market. As an independent nation after EU exit, we will have the opportunity to make sure that we have a wider influence in the world on the adoption and formulation of standards.

As I have outlined, the draft regulations will provide continuity and clarity to business by ensuring that UK companies can continue to use IFRS, as adopted in the EU, when preparing their annual accounts. They also set out a future adoption framework for the UK that is robust and transparent, and that will act in the national interest. This framework has been developed in close consultation with stakeholders, as I have outlined, and represents the best way forward for the UK's continued use of these international standards. I therefore commend the draft regulations to the Committee.

Question put and agreed to.

2.59 pm

Committee rose.

