



## Overview

1. The objective of this paper is to seek the Advisory Council's advice on how the IASB could improve the way it responds in circumstances when its proposals continue to meet criticism after it has completed its technical discussions.
2. The IASB Due Process Handbook sets out the consultation that the IASB should complete when developing IFRSs. To provide context and a summary of how the IASB currently interacts with constituents, this paper provides two case studies of current projects, in which the Board's proposals have been controversial with respondents. These projects are *IAS 37 Provisions, Contingent Liabilities and Contingent Assets* and *IFRS 9 Financial Instruments*. A short description of the main issues in each of the projects and how the IASB responded to them is included in appendices B and C.

## IASB's due process

3. The foremost objective of the IASB is to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards. The IASB consults interested parties to gain a wide range of views as it develops IFRSs. It does this to gain a better understanding of different accounting alternatives and the potential impact of proposals on affected parties. The IASB Due Process Handbook sets out the consultative arrangements that the IASB follows to ensure that it addresses the following requirements:
  - (a) transparency and accessibility;

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This paper has been prepared for discussion at a public meeting of the IFRS Advisory Council of the IASB.

The views expressed in this paper are those of the authors.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

## IFRS Advisory Council meeting

- (b) extensive consultation and responsiveness; and
  - (c) accountability.
4. Extracts from the IASB Due Process Handbook are included in Appendix A. These extracts provide detailed guidance on what is required of the IASB in terms of the requirements set out in paragraph 3.
  5. The Due Process Handbook also provides detailed guidance on the development and publication of an IFRS. This provides guidance on deliberation of comments received on an exposure draft and the basis on which the decision to re-expose the proposals should be made in circumstances when there have been changes from the exposure draft. The relevant extract from the Due Process Handbook is also included in Appendix A.

***IASB's feedback to respondents***

6. The requirements of the IASB to communicate why it decided to finalise proposals are set out in the IASB Due Process Handbook. This is particularly important when the IASB is finalising proposals that have been criticised by a significant number of respondents. One of the obligations of the IASB is to publish a feedback statement when it publishes a new standard. It is required to explain how it has responded to the most significant matters raised in the comments process. The explanations given in the feedback statement are drawn from those that the IASB gives for its decisions in the basis for conclusions that are published, both with exposure drafts and final standards.
7. The requirement to publish the feedback statement was introduced in 2009 and to date the IASB has published feedback statements for IFRS 3 *Business Combinations* and IFRS 9. Before that time the response of the IASB was communicated only in the basis for conclusions, which accompanies each standard.
8. The IASB is also now required to prepare an analysis of the likely effects of a new IFRS or major amendment. The first of these was published for IFRS 3.

## IFRS Advisory Council meeting

9. The IASB has also, in recent years, increased its outreach activities in number of ways, for example by meeting more with interested parties, conducting webcasts and producing additional material such as snapshots and Q&As which it makes available on its website. These additional activities are intended to enable the IASB to get a better understanding the concerns that its proposals may cause and give the IASB further opportunity to explain its proposals to interested parties.

**Question to Council members**

1. In the light of the experience of recent projects, and considering the current requirements of the IASB Due Process Handbook, what advice do Council members have for how the IASB could improve its consultation procedures when its proposals are controversial?
  - (a) In what circumstances do Council members think that there is insufficient consultation?
  - (b) Are there areas in which Council members think the IASB undertakes more consultation than is necessary and efficient?
  - (c) What advice and support can Council members provide to the IASB on how it might respond when its proposals continue to meet criticism after it has completed its technical discussions?

## Appendix A – Extracts from IASB Due Process Handbook

### Due Process Handbook Guidance on Consultative Arrangements (paragraphs 10-17)

#### *Transparency and accessibility*

10. The IASB considers adding topics to its agenda after consultations with constituents and on the basis of research conducted by or in conjunction with IASB staff. Potential agenda items are discussed in IASB meetings. Those meetings, as well as meetings of the Standards Advisory Council (the SAC), the International Financial Reporting Interpretations Committee (the IFRIC) and the IASB's working groups, are open to the public for observation. IASB meetings are also broadcast and archived on the IASB's website.
11. Comment letters from interested organisations, IASB meeting observer notes and IASB decisions are posted on the IASB's website. Discussion papers and exposure drafts are also posted on the website and published for public comment (see paragraph 111).

#### *Extensive consultation and responsiveness*

12. The IASB solicits views and suggestions through its consultations with a wide range of interested parties and a formal process of inviting public comment on discussion papers and exposure drafts. Organisations that the IASB consults include, among others, the SAC, standard-setting organisations and various regulatory bodies. The IASB may also arrange public hearings and field visits and set up working groups to promote discussions.
13. IASB members hold a large number of meetings with groups of preparers, users, academics and others to test proposals and to understand concerns raised by affected parties. Additionally, IASB members and senior staff appear at many public events to exchange views with constituents.

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## IFRS Advisory Council meeting

14. The IASB listens to, evaluates and, where the IASB considers it appropriate, adopts suggestions received during the consultations. It also debates different views on technical matters in public IASB meetings, conferences and seminars. In response to public comments, the IASB considers alternatives to its proposals.
15. Comments received from interested parties as part of the consultation process are summarised, analysed and considered by the staff, who make recommendations for the IASB to consider in its public meetings. Using its website, project summaries and feedback statements, the IASB informs the public of its position on major points raised in the comment letters received.

*Accountability*

16. Adopting the ‘comply or explain’ approach that is used by various regulatory bodies, the IASB explains its reasons if it decides to omit any non-mandatory step of its consultative process as described in the Constitution (see paragraphs 112–114 below).
17. In addition, the Trustees review and ensure compliance with the IASB’s procedures and mandate, consider the IASB’s agenda, and conduct annual reviews of the IASB’s performance (see paragraphs 115 and 116).

## Development and publication of an IFRS (paragraphs 45-50)

45. The development of an IFRS is carried out during IASB meetings, when the IASB considers the comments received on the exposure draft. Changes from the exposure draft are posted on the website.
46. After resolving issues arising from the exposure draft, the IASB considers whether it should expose its revised proposals for public comment, for example by publishing a second exposure draft.
47. In considering the need for re-exposure, the IASB

## IFRS Advisory Council meeting

- identifies substantial issues that emerged during the comment period on the exposure draft that it had not previously considered
  - assesses the evidence that it has considered
  - evaluates whether it has sufficiently understood the issues and actively sought the views of constituents
  - considers whether the various viewpoints were aired in the exposure draft and adequately discussed and reviewed in the basis for conclusions on the exposure draft.
48. The IASB's decision on whether to publish its revised proposals for another round of comment is made in an IASB meeting. If the IASB decides that re-exposure is necessary, the due process to be followed is the same as for the first exposure draft (see Stage 4 at paragraph 40).
49. As it moves towards completing a new IFRS or major amendment to an IFRS, the IASB prepares a project summary and feedback statement. These :
- give direct feedback to those who submitted comments on the exposure draft.
  - identify the most significant matters raised in the comment process and
  - explain how the IASB responded to those matters.
50. At the same time, the IASB prepares an analysis of the likely effects of the forthcoming IFRS or major amendment. The IASB has undertaken to provide such information to jurisdictions that adopt IFRSs. The IASB is committed to imparting information and sharing knowledge on the likely costs of implementing a new requirement and the ongoing associated costs. The IASB also documents what it learned during the development of the IFRS about the likely costs of implementing a new requirement and the subsequent ongoing costs, and the likely effect of an IFRS on the quality of the information that entities will provide to users. The analysis will therefore attempt to assess the likely effects of the new IFRS on:
- the financial statements of those applying IFRSs
  - the possible compliance costs for preparers

**IFRS Advisory Council meeting**

- the costs of analysis for users (including the costs of extracting data, identifying how the data have been measured and adjusting data for the purposes of including them in, for example, a valuation model)
- the comparability of financial information between reporting periods for an individual entity and between different entities in a particular reporting period and
- the quality of the financial information and its usefulness in assessing the future cash flows of an entity.

## Appendix B – IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

- A1. The IASB has yet to issue a new standard to replace IAS 37. This project has been ongoing since 2002 when it was started as a ‘short-term convergence’ project.
- A2. IAS 37 is the accounting standard for liabilities that are not within the scope of other standards. Typically, these liabilities are non-contractual—they arise from statutory (eg environmental) liabilities, tort or breaches of regulation.
- A3. The purpose of the project is not to develop an entirely new accounting model for liabilities within the scope of IAS 37. Rather, it is to eliminate specific weaknesses in IAS 37. Those weaknesses include inconsistencies with other IFRSs and unclear wording, which has led to divergent practices
- A4. The IASB issued an exposure draft in 2005 and received 123 comment letters. In the comment letters received most respondents disagreed with the proposals that all lawsuits give rise to liabilities, and that defendants in lawsuits should record those liabilities whether or not outflows are probable. Most respondents also disagreed with IASB’s proposed interpretation of the measurement requirements. In particular, they disagreed with the IASB’s proposal that reporting entities should measure liabilities at the average of the possible outcomes and raised concerns that even with the proposed clarifications, the requirements remained unclear. In particular, it remained unclear whether the objective is to measure the costs of fulfilling the liability or the price of transferring it to another party. Most respondents opposed a transfer price objective, because most liabilities in the scope of IAS 37 cannot be transferred to another party.
- A5. In response to the concerns about recording liabilities for lawsuits, the IASB reconsidered its proposal that all lawsuits give rise to liabilities. It decided that this proposal had been wrong. It accepted the respondents’ argument that the existence of a liability depends on the validity of the plaintiff’s case: reporting



entities should consider the available evidence and record a liability to the extent that the evidence suggests that the claim is valid. By reversing its initial proposal in this way, the IASB addressed the concern that reporting entities would have to record liabilities even for lawsuits that they expect to defend successfully.

- A6. The IASB also held public round-table meetings in 2006. The meetings covered all aspects of the proposals. The IASB used the opportunity to:
- (a) confirm that participants agreed with its revised conclusion on lawsuits, ie that whether the defendant has a liability depends on the validity of the plaintiff's case;
  - (b) discuss with participants what further guidance might be given to help defendants judge whether they need to record a liability;
  - (c) seek a better understanding of participants' concerns about the other proposed changes.
- A7. During 2007 and 2008, the IASB re-deliberated the matters raised during the round-table meetings. After extensive discussions, it decided not to make any further major changes to its proposals, but to develop more guidance on measurement. It developed this guidance during 2009.
- A8. The proposed new measurement guidance would not change the original measurement proposals. It largely seeks to respond to the suggestions of respondents to the 2005 exposure draft. However, one aspect of the proposed guidance is controversial. This is the proposal that liabilities to undertake a service (such as environmental restoration) should be measured by estimating the value (rather than the cost) of the services. Six IASB members disagree with this proposal so voted against publication of the exposure draft.
- A9. Having refined and expanded its proposals, the IASB considered at its public meeting in October 2009 the need for re-exposure. The IASB decided:
- (a) to re-expose for further comment the proposed new measurement guidance;
- and

## IFRS Advisory Council meeting

- (b) to make available a working draft of the entire new IFRS so that interested parties could see the proposed new measurement guidance in the context of the latest proposals for the IFRS as a whole.

A10. A minority of IASB members would have preferred to re-expose the whole standard. Two of these IASB members expressed this view when explaining their reasons for voting against the exposure draft of the revised measurement guidance. Their arguments were that:

- (a) the measurement requirements are closely related to other requirements—especially the criteria for recording liabilities;
- (b) respondents had opposed some of the proposed changes to the criteria for recording liabilities when the IASB had previously exposed them in 2005;
- (c) many of those who would now be interested in the proposals would not have commented on them in 2005; and
- (d) re-exposure of the whole exposure draft would not significantly delay the project as a whole.

A11. The counterarguments to these views are that:

- (a) the *new* aspects of the measurement guidance are unlikely to affect constituents' views about the criteria for recording liabilities (or vice versa)—the new aspects of the guidance relate to liabilities to perform services, for which the criteria for recording liabilities are uncontroversial.
- (b) opposition to specific proposals does not compel the IASB to re-expose the proposals. Rather, it compels the IASB to examine carefully whether it has reached conclusions that will improve financial reporting and to justify in a feedback statement its decision to proceed with the proposals.
- (c) although nearly five years have passed since the 2005 exposure draft, the passage of time is not an argument for re-exposing proposals, unless accompanied by changes in circumstances, which might change views or

## IFRS Advisory Council meeting

raise new issues. The IASB is not aware of any significant changes in circumstances.

- (d) a view that the whole standard could have been available for re-exposure relatively quickly is not an argument for re-exposing it. Re-exposing the whole standard would have given the misleading impression that the IASB was inviting further comments on proposals on which it had already received comments.
- (e) many have expressed concerns about the number of exposure drafts the IASB has needed, and still needs, to issue in 2009 and 2010. It would impose unnecessary burdens on respondents to seek further comment on issues for which the IASB has already completed the full due process.

A12. The IASB published the limited-scope exposure draft of the new measurement guidance on 5 January 2010. The exposure draft also noted the IASB's intention to post a working draft of the entire standard on the IASB's web site by February. The IASB posted the working draft to its website on 19 February 2010.

A13. During the comment period for the exposure draft of the measurement proposals (January-May 2010), the IASB staff and IASB members have conducted public webcasts and held dozens of meetings with a range of constituents to help explain and explore views on the proposals.

A14. The comment period has now closed. Some respondents have criticised the IASB for not re-exposing the whole of the proposed IFRS. They appear to have done so because they continue to oppose two aspects of the proposals that the IASB exposed in 2005; namely the removal of one of the criteria for recording a liability and the requirement to measure liabilities at the average of the possible outcomes. In other words, the concern appears to be that the IASB has not amended its original proposals as much as these respondents would have wished.

## Appendix C – IFRS 9 *Financial Instruments*

- C1. The IASB issued IFRS 9 Financial Instruments in November 2009. IFRS 9 prescribes the classification and measurement of financial assets and completed the first phase of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The initial classification requirements in IFRS 9 provide the foundation on which the reporting of financial assets is based, including how they are measured and presented in each reporting period.
- C2. The scope of IFRS 9 was limited to financial assets. The objective of the first part of the project to replace IAS 39 was to make it easier for users of financial statements to assess the amounts, timing and uncertainty of cash flows arising from financial assets. IFRS 9 achieves this objective by aligning the measurement of financial assets with the way the entity manages its financial assets (its ‘business model’) and with their contractual cash flow characteristics.
- C3. The IASB conducted extensive outreach activities as part of the development and follow-up of the exposure draft which was published in March 2009. IASB members and staff conducted more than 100 one-on-one and small group discussions with financial and non-financial entities, auditors, regulators, investors and others. The IASB also held roundtable meetings, jointly with the FASB, in Japan, the UK and the US to discuss the proposals on classification and measurement.
- C4. The IASB also worked together with supervisors in key areas and held several meetings with the Basel Committee on Banking Supervision. In addition, supported by the Financial Stability Board (FSB), it held a meeting with senior officials and technical experts of prudential authorities, market regulators and their international organisations to discuss financial institution reporting issues in August 2009. This meeting included senior representatives from a number of emerging market economies that are FSB members.
- C5. Additionally, the IASB drew on the expertise of, and met with, its Financial Instruments Working Group to discuss the exposure draft. The project team

## IFRS Advisory Council meeting

staff and some Board members also held numerous webcasts about the exposure draft attracting many thousands of participants.

- C6. The IASB received 244 comment letters on the proposals for classification and measurement. These comment letters were analysed and the comments along with the feedback from the outreach activities were used as the basis for reconsidering the exposure draft. The proposals were reconsidered during September and October 2009 at a series of regular and additional public meetings of the Board.
- C7. The most controversial issues in the exposure draft were that it was unclear whether the proposals would lead to more or less financial assets being measured at fair value than under IAS 39 and that no reclassification would be permitted after initial recognition between the amortised cost and fair value categories.
- C8. The IASB responded to the comments on these issues in the feedback statement that was prepared when the final standard was issued.

On more or less fair value:

It was not our objective to increase or decrease the application of fair value measurement, but rather ensure that financial assets are measured in a way that provides useful information to investors to help predict likely actual cash flows.

Whether an entity will have more or fewer financial assets measured at fair value as a result of applying IFRS 9 will depend on the nature of their business and the nature of the instruments they hold. The more risky financial assets an entity holds the more likely it is that those financial assets will be measured at fair value.

However, by removing the available-for-sale and held-to-maturity categories we have also removed the restrictions that exist in IAS 39 that prevent many financial assets being measured at amortised cost.

On reclassification the response was as follows:

We were persuaded by the views expressed by these respondents. The classification model is based on an entity's business model and the contractual terms of the asset. Therefore, IFRS 9 requires an entity to reclassify financial assets between the fair value and

## IFRS Advisory Council meeting

amortised cost categories if there is a change in its business model. In all other circumstances reclassification remains prohibited.

A business model is not the same as management's intentions. We expect changes to a business model to be rare and, accordingly, reclassifications should also be rare.

Financial assets must be reclassified on the first day of the reporting period following the change in business model. This requirement reduces the risk of an entity choosing a particular reclassification date in the reporting period that provides an advantageous accounting outcome. An entity that does reclassify financial assets must provide users of its financial statements with information about the effects of the change. Those disclosure requirements ensure that the changes in the business model and the associated reclassifications are transparent and the comparability of the related information is enhanced.

- C9. In addition to this the IASB decided to exclude financial liabilities from the scope of the projects in response to concern expressed by respondents about reflecting entity's own credit risk in the measurement of financial liabilities.