

AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Washington DC 11 July 2012

Agenda paper 4E

To: Due Process Oversight Committee

From: David Loweth/Alan Teixeira

Date: 29 June 2012

Re: Strategy Review follow-up: Proposals for a consultative group on the methodology for field tests/fieldwork and effect analyses

Overview

1. The purpose of this paper is to seek the Committee's views on proposals for how the organisation should take forward the recommendation by the Trustees in their February 2012 report *Strategy Review 2011*, of the establishment of a working group from the international community, chaired by the IASB, to develop an agreed methodology for field testing and effect analyses.

Background

2. As noted in the *Strategy Review 2011* report, field visits/tests and effect analyses are now considered best practice in the establishment of regulations. They are now regular parts of the IASB's due process:

- field visits and tests (also referred to as fieldwork) are not part of the mandatory due process steps that the IASB has to undertake, but if they are not undertaken, the IASB must explain why on the project page on the website and inform the Trustees' Due Process Oversight Committee (DPOC); and
- effect analysis is a requirement for major projects, and three comprehensive analyses have been prepared since 2008 (Business Combinations, Consolidated Financial Statements and Joint Arrangements).

3. Having said that, the Trustees think that there is a sense among stakeholders that the IASB should further clarify the role of these elements of the IASB's due process. Many jurisdictions have regulatory review processes in place (often called impact assessments, or

cost-benefit analyses). We know that many of these reviews will have common objectives, while other aspects are unique to a particular jurisdiction.

4. There is also an extensive literature on the carrying out of such analyses (also referred to as cost-benefit analyses or impact assessments). In addition, the European Financial Reporting Advisory Group (EFRAG) and the UK Accounting Standards Board (ASB) have been working together to develop proposals calling on standard-setters to consider the effects of accounting standards throughout their due process, from start to finish. The results of that project, expected to be published in July, will serve as a useful input. The US Securities and Exchange Commission (SEC) has also recently issued guidance on economic analysis in its rulemakings, which will also be a useful reference.

5. The IASB could benefit from bringing together a cross-section of regulators who have regulatory impact assessment requirements to help the IASB develop an agreed methodology for field testing and effect analyses. A primary objective of the working group will be to help the IASB identify the extent to which it can, and should, meet the needs of endorsement bodies with respect to effects analysis. Ideally, the effects analysis presented by the IASB will relieve the endorsement bodies from having to perform any additional analysis relying instead on the work of the IASB. Such an outcome would likely speed up the endorsement processes in some jurisdictions. We think it is likely that the working group will identify local requirements which are best left with the local jurisdictions to satisfy.

Terms of reference and composition

6. The group would be advisory body only and any decisions on the methodologies developed would be for the IASB to take, in consultation with the Trustees.

7. We propose that the terms of reference should focus on the following areas:

- a. Members of the group will provide information on, and an assessment of, field testing and effect analyses methodologies that are used currently and whether and, if so, how they might be applied to the IASB's standard-setting activities, together with advice on the most appropriate methodology (or methodologies) that might be used. In terms of:
 - i. field testing/fieldwork – the Trustees' draft *Due Process Handbook*, issued for public comment in May 2012, sets out (in paragraphs 3.67 to 3.69) what such activities may entail; and
 - ii. effects analyses – the draft *Due Process Handbook* includes a discussion of the process of assessing the likely effects of an IFRS and how the IASB forms a judgement on the evaluation of those likely effects (paragraphs 3.72 to 3.75).
- b. The group should be asked for its advice on any field testing and effects analyses on any projects on the current IASB Work Plan and the lessons that might be learned in the development of an appropriate methodology.

- c. The group's advice should also be sought on identifying and managing expectations regarding the scope of effect analyses, given that some parties believe that the scope of effects should go much wider and take into account macro-economic effects such as financial stability impacts. The draft *Due Process Handbook* (paragraph 3.72) makes clear our view that the likely effects of any new or revised IFRSs should be assessed (a) in the light of the IASB's objective of financial reporting transparency; and (b) in comparison to the existing financial reporting requirements.

Candidates for Membership

8. In our view, the consultative group should have at least 12 and not more than 20 members. We recommend that the IASB make an open call for candidates. but supplement this with targeted invitations to ensure involvement of the European Commission (EC) and the SEC, both of which are required to undertake impact assessments (EC)/cost-benefit analyses (SEC) in their own law/rule-making activities. The EC in particular has long emphasised the need for effect analysis to play a more important and formal role in the IASB's due process and the endorsement process for the adoption of IFRSs within the European Union requires an 'effects study' to be carried out, a task undertaken currently by the European Financial Reporting Advisory Group (EFRAG). We plan to target both organisations to encourage them to participate. Other than that, we recommend that the Board should invite nominations, including self-nominations, on the Foundation's website, although the choice of members of the group will rest solely with the Trustees.

9. Candidates for membership should be expected to have a good knowledge of and experience in financial reporting and relevant practical experience in areas within the remit ie in conducting field testing/assessing the effects of financial reporting requirements. The Board should seek candidates from all geographical areas and from a range of backgrounds. Effects analyses have attracted a lot of interest from the academic community, so a number of candidates from that source might be anticipated, although they might be concerned by the Foundation's usual policy that all members of the consultative group shall serve on a voluntary, unpaid basis.

Administrative matters

10. Meetings will be physical meetings to the largest degree possible, but the Board should aim to provide facilities to allow participation by video link or telephone. We anticipate that this would be a consultative group with a limited lifespan (9 months to a year), with a maximum of 4 to 5 meetings, held approximately every 2 months.

Next steps

11. The views and comments of DPOC members are welcome. Subject to these, the plan is for the IASB to issue a call for candidates and then come back to the DPOC with a proposal for the composition of the group.