

STAFF PAPER

27 February – 2 March 2012

February 2012 IASB Meeting

Project	Interpretations Committee		
Paper topic	Agenda Rejection Notices		
CONTACT(S)	Wayne Upton	wupton@ifrs.org	+44 (0)20 7246 6449
	Michael Stewart	mstewart@ifrs.org	+44 (0)20 7246 6922

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. This paper addresses issues surrounding the notices published by the IFRS Interpretations Committee (the Committee) when it decides to not add an issue to its agenda. These are not new issues, but they continue to raise questions in practice. In our view, these are questions that the Board should resolve.
 - a. What is the status of a Committee agenda rejection notice? Does a notice compel a change in accounting policies? Alternatively, is the notice an explanation of the Committee members' views, with the same standing as implementation or educational guidance?
 - b. What is the effective date and transition method for a rejection notice?
 - c. How should the Committee communicate its decisions? In particular should it state a clear preference for one answer over another?
 - d. How much detail should the Committee provide about the basis for its decisions? Rejection notices have been very brief, usually taking less than 300 words to describe both an issue and the Committee's decision.
 - e. What, if any, role should the Board play in Committee rejection notices?
 - f. What, if any, changes should be made in the due process surrounding rejection notices?

2. We should note here that we expect the number of rejection notices to be fewer today than they were in the past. Following on the IFRS Trustees' study of the Committee's effectiveness, the Committee members have accepted a larger array of tools than it once had. Michael Stewart's paper for this meeting outlines those changes. Most important, for our purposes here, is the change in the emphasis of the Committee's agenda criteria. The existing wording focuses on Interpretations as the Committee's primary work product. The new wording acknowledges that the Committee might take a range of steps to improve IFRSs and provide useful guidance. The changes mean that an agenda rejection issued today communicates that the Committee has concluded no action is necessary or appropriate in the circumstances, even with the Committee's expanded tool kit.
3. Our recommendations build on one another, so we ask that the Board approach them in the sequence laid out in paragraph 1. Our recommendations are cited in *italics*.

Background

4. In its early days, issues submitted to the Committee were evaluated by an agenda committee, which did not operate in public. That approach was changed in 2007 in favour of public discussion of all submissions by the full committee. Preliminary agenda rejection notices are published in the Committee's UPDATE and are open for comment for 30 days. They are confirmed, with any revisions needed to reflect comments received, at the next Committee meeting.
5. There are several reasons why the Committee might decide against taking an issue onto its agenda. Some items are rejected because the Committee decides that an issue is too narrow and should be considered in a broader context. The Committee might observe that an issue is already being considered as part of an active Board project. However, a variety of constituents have expressed concerns that in other cases, the Committee expresses an opinion about the accounting described in an issue. When it does so, that opinion becomes what some see as a "mini interpretation" that could impose changes on practice without full due process. Our focus in this paper is on agenda rejections that provide, or could provide, guidance about the application of IFRSs.

6. In January 2007, a meeting of interested European constituents discussed the role and status of agenda rejection notices. The document published following that meeting is attached as Appendix 1. The key conclusion for our purposes in this paper follows:

As IFRIC rejection notes often provide clarification of the standards, there is an expectation on the part of stakeholders in IFRS that IFRIC rejection notes will be carefully considered by preparers in determining their accounting policies. In the case of a change in a previous accounting treatment following the issue of an IFRIC rejection note, a company should apply IAS 8 and provide proper and sufficient disclosure of the reasons for the change, having regard to the particular facts and circumstances of the individual case, including reference to the IFRIC rejection note. While the issue description above distinguishes between a change in accounting policy and the correction of an error, the conclusion at least for a transitional period was that, in most cases and with appropriate note disclosure, it would not be necessary to be explicit in the disclosure and only the facts should be represented.

7. In July 2011, ESMA published a public statement titled, *Retrospective Adjustments to Financial Statements Following Rejection Notes Published by the IFRS Interpretations Committee*, attached as Appendix 2. ESMA's conclusion was:

ESMA believes that, 6 years after the implementation of IFRS, we are no longer in such a transitional period. Rejection notes published by the IFRS Interpretations Committee often provide clarification of the standards. There is an expectation on the part of the stakeholders in IFRS that rejection notes concluding that IFRSs are sufficiently clear will be carefully considered by preparers in determining their accounting policies. In the case of a change in a previous accounting treatment following the issue of a rejection note, an issuer should apply IAS 8 and provide proper and sufficient disclosure on the reasons for

the change, having regard to the particular facts and circumstances of the individual case, including reference to the rejection note.

8. In both cases, the “elephant in the room” was whether a change in accounting policy prompted by the Committee’s decision is a policy change to a better method or a correction of an error in the application of IFRSs. The January 2012 issue of *Company Reporting Review* brings this point home with its characterisation of an entity’s change in accounting policy. The headline says it all, “In our view, this is a correction of an error.”

Correction of an error

9. Correction of an error is the Scarlet Letter of financial reporting.¹ Characterising a change in accounting as a correction of an error usually has significant regulatory implications. At best, financial statement readers and the media wonder how competent managers and auditors can make an error. At worst, the same groups wonder about the integrity of those involved, and may contemplate legal action.
10. We are unaware of any situation in which an accounting standard setter or its interpretive body has ever branded a change in accounting policy arising from its efforts to clarify its own literature as a correction of an error. Some of the concern about the status of rejection notices, though, can be traced to wording that some constituents saw as very close to a branding. Early notices included phrases like “IAS xx is sufficiently clear” coupled with a description of a particular accounting method or citation from the standard. Given the sensitivity of the word “error,” we understand the concerns.
11. Of course, anyone who has been involved in financial reporting, especially in standard setting, has encountered situations that defy description as anything but an error. If a standard says “recognise a loss if condition a or condition b exists” and an entity recognises losses only when a and b exist, the accounting certainly looks like an error. Why not give it the name?

¹ Apologies to the American author Nathaniel Hawthorne.

12. Because doing so puts the standard setter or the interpretive body in the role of enforcer and punisher. The IASB does not have that role, nor does it seek it. Generations of our predecessors have also concluded that standard setters work best when they have a free and open conversation with constituents. Fear of condemnation does not enhance that conversation.
13. Will a non-judgemental attitude lead to submissions from entities or auditors who (a) have been challenged about an accounting practice and (b) hope that a Committee discussion will impart some legitimacy to the practice? Perhaps. Even if the Committee declines to take the question further and states that a different accounting is mandated by the standard, some will see the discussion as demonstration that the issue was, at least, not unreasonable. In our view, that is a price we should be willing to pay, because the alternative is to close off the discussion of practice issues.
14. *We recommend that the Board affirm that the Committee's agenda rejection notices are not intended to characterise the accounting practices in question as errors. Rather, that is a judgement that is left to companies, their auditors, and their regulators.*

What to do?

About Status

15. Paragraph 1 began with four questions about Committee agenda decisions – status, transition, form, and content. The first two questions go together. Agenda decisions today are not part of the corpus of IFRSs. They therefore fall within the class of considerations found in paragraph 12 of IAS 8:

In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11. [Emphasis added.]

16. In effect, this places an agenda rejection notice on the same level as an article in a professional journal or illustrative examples that “accompany, but are not part of, IFRS xx.” We recognise that practitioners probably draw distinctions among the sources of guidance described in paragraph 12. Examples that accompany an IFRS probably receive more weight than those developed and published elsewhere. Agenda rejections probably receive more weight than the position of an individual firm. The key point here is that IAS 8 requires that the *practitioner* make those distinctions in forming a judgement about an accounting policy. It does not make them for him or her.
17. The Board could amend IAS 8 to change the status of an agenda rejection notice. It could, for example, add another level to paragraph 11. This would place agenda rejections above the *Framework* but below IFRSs and Interpretations. Of course, this would require a significant change in the due process required today. Experience suggests that the result, in time and treasure, would likely evolve into a process not far removed from an interpretation.
18. *We do not recommend any change to the status of agenda rejection notices in the hierarchy found in IAS 8. We do recommend that the Board’s view of their status be clearly communicated on the IASB website.*
19. *Because of their status, agenda rejection notices do not require, nor do we recommend that they have, effective dates or transition requirements.*

About form and content

20. As noted earlier, agenda rejection notices have been brief. In some cases, this brevity impairs their usefulness, especially as time passes. However, some comments that the Committee has received on tentative decisions suggest that they should say even less, to avoid the appearance of a mini interpretation. We see several alternatives.
21. Alternative one – say nothing. The committee could simply announce that it declined to take any action on a submission. It would not provide any rationale for that decision. We do not recommend this alternative. The prime mission of the Committee is to assist the Board in providing guidance. It is important that the results of the Committee’s discussion reach the broad constituency of IFRS

- users. Failing to provide a rationale would not serve that purpose and would concentrate knowledge about the Committee's activities in the small group that has the resources to monitor and document its activities.
22. Alternative two – limit the response to citations. This seems to be the approach favoured by some standard setters in their comment letters. A response might say, “In reaching its decision, the Committee noted paragraphs x, y, and z of IAS xx.” This alternative is somewhat more useful than the first, but not much. People who submit issues to the Committee have read the standards, and they remain uncertain about the answer. Telling them to go back and read again is not useful. We do not recommend this alternative for the same reasons given for alternative one.
23. Alternative three – give a view. If the Committee has reached a view about the accounting in a situation, it would state that view. *We recommend this alternative. It provides guidance to the IFRS constituency efficiently and in a manner that is accessible.*
24. But if there is a clear view among the Committee members, why not simply prepare an interpretation? That is always an alternative. The decision is one based on cost and timeliness. If a statement of the Committee's view meets the needs of the practice community, then a rejection notice is an efficient and accessible means for doing so. There is a risk that constituents will insist that an unpopular view demands the more extensive due process afforded to an interpretation. Our FASB colleagues have some experience with this phenomenon, when constituents insisted that one or another FASB Staff Technical Bulletin be elevated to a Board interpretation. The answer rarely changed, but the time involved did.
25. Would alternative three lead to a proliferation of rules-based guidance? The answer depends a lot on perspective. If a preparer, auditor, or regulator has a question and does not find a ready answer in IFRSs, the answer is rarely considered an unnecessary rule by the submitter. Submissions usually involve unclear passages in an IFRS or choices between principles. For example, the Committee recently considered a submission about an employee bonus based on taxable income. The question was not about the application of the principle, but

instead which principle – income tax accounting or employee benefit accounting – applied in the situation.

26. There remains the question of content. In looking back over agenda rejection notices, we have found that some do not stand on their own. One must read the submission, the staff papers, and perhaps the accounting firms' IFRS books to fully appreciate the issue and the implications of the Committee's view. That, in our view, is not an optimum situation.
27. The IFRS Foundation's education department has already taken some steps to improve this situation. The "green book" includes cross references to Committee agenda decisions. More could be done to make older decisions stand alone, but the time and cost might be significant. *We do not recommend any changes now in the level of detail and background provided by agenda rejection notices. However, we suggest that the Committee staff and Education staff pursue tools that might improve the communication.*

About Board involvement and due process

28. Some have suggested that the Committee's agenda process might be improved by more active Board involvement, probably through some form of Board ratification of the Committee's decisions.
29. We find this a difficult issue. On one hand, the Committee is a body created and directed by the Board. On the other hand, the Committee's decisions are part of its work product. They result from work, study, and deliberation that cannot be efficiently replicated by the Board. The Board already has the authority to ask the Committee to reconsider a decision, or to take on a project of its own to consider an issue. The Board can provide guidance to the Committee, as we will see in the discussion of Interpretation 15 at this month's Board meeting. It is not clear what additional benefit might be gained by adding an explicit ratification step. Indeed, adding a step might further confuse the status of agenda decisions in the hierarchy of IFRS guidance.
30. *On balance, we do not recommend adding Board approval or ratification to the existing process of handling Committee agenda decisions.*

31. Finally, there is the question of due process. The short comment period afforded to agenda decisions is designed to allow the Committee to publish a tentative decision at one meeting and finalise it at the next. Some have observed that only the cognoscenti know that this process exists and that the short exposure period limits the ability of constituents to participate.
32. *We recommend that tentative agenda decisions be open for comment for 60 days after publication. This will delay finalisation by one Committee meeting, but will allow time for broader participation in the process.*