

# AGENDAPAPER

IFRS Advisory Council Meeting

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TOPIC Summary of the discussions at the June 2012 Council meeting on external involvement in the IASB standard-setting process

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## Overview

1. At the June 2012 meeting of the IFRS Advisory Council it discussed external involvement in the IASB standard-setting process.
2. Michael Stewart, Director of Implementation Activities, started by giving the Council an overview of the outreach and consultation activities that the IASB conducts towards its main stakeholder groups. The groups identified in the presentation are:
  - (a) investors (and other users of financial information);
  - (b) accounting standard-setters;
  - (c) academics;
  - (d) preparers;
  - (e) auditors;
  - (f) securities regulators; and
  - (g) prudential regulators.
3. A representative of each of the groups mentioned above also gave a short presentation on these issues. The presenters were:
  - (a) Vincent Papa (user);
  - (b) Tricia O'Malley (IFASS/standard-setter);
  - (c) Michael Bradbury (academic);
  - (d) Karyn Brooks (preparer);
  - (e) Joel Osnoss (auditor);

- (f) Patrick Parent (securities regulator); and
  - (g) Nic van der Ende (prudential regulator).
4. The objective of the session is to get the Council’s view on the IASB’s stakeholder interaction from a broad perspective. This would include:
- (a) Which different stakeholder groups/networks should the IASB be engaging with and what form should that engagement take?
  - (b) At what stage in the standard-setting process should the IASB engage with the different groups, and are there changes needed to the IASB’s due process to engage with stakeholders more effectively and efficiently?
  - (c) Are there other changes needed to the IASB’s stakeholder engagement, for example to help reduce the risk of non-endorsement of Standards or to safeguard the IASB’s independence?
5. After the presentation the Council was divided into groups to discuss five questions set out in Agenda paper 6 for this meeting. The questions were as follows:

- 1 What are the global or regional networks that we should be engaging with for each stakeholder group to ensure that we are receiving the global input we need in an efficient manner? Do those networks already exist? If not, how should they be established?
- 2 What sort of formats, and frequency of engagement, is likely to be most effective for the different stakeholder groups and networks, taking consideration of time and other resources limitations?
- 3 What changes are needed, if any, to our due process and stakeholder engagement to ensure that the Standards we develop are accepted and endorsed without modification?
- 4 How can we make effective use of stakeholder engagement to reduce the risk of non-endorsement?
- 5 Are there other matters that you think we need to consider as we develop our stakeholder engagement, including any safeguards to protect the IASB’s independence?

## Reports back

- 1. The Council members were split into four groups:
  - (a) Group 1 (users and academics) led by Norbert Barth.
  - (b) Group 2 (preparers) led by Will Widdowson.

- (c) Group 3 (standard-setters and other similar organisations) led by Bruce Mackenzie.
  - (d) Group 4 (auditors and regulators) led by Leo van der Tas.
2. The main feedback from the session was positive and took the nature of suggesting potential enhancements rather than pointing out existing flaws. In particular, the IASB's outreach efforts and transparency were praised. Council members saw little risk that the IASB's processes would impair, or be seen to impair, its independence, but they think that current convergence and other bilateral arrangements between the IASB and individual national standard-setters have outlived their usefulness. Some combination of regional/geographical channels and industry/topic matter expertise is probably needed and more effort should be directed at the emerging markets. To some extent the onus rests with stakeholders to help the IASB to identify the most effective and efficient channels of communications (a bottom-up approach).
3. The following are the reports back from the groups that Council members were split into.
- Group 1*
4. Norbert Barth reported back for the group. The group focused on question 1 and thought that it is quite difficult to engage with the users, especially investors. There is not much interest and sometimes not much knowledge on the part of users in accounting. Users do not see accounting as part of their business. The group also thought that users do not try to influence the standard-setting, it is more that they live with the Standards that are set. One of the reasons for this is that potential changes to Standards are too far ahead in the future and therefore not relevant to users at present.
5. The group thinks that the outreach to investors that is being done in the developed markets is good. There is, however, a need to improve outreach in emerging markets. There especially is a need to improve the outreach to investors in South America and in Asia where the IASB is unknown to some users. There are also regional user forums in Asia that could be used to involve users more. Financial reporting is a part of corporate governance, and meetings and events on corporate governance could be used to approach users with accounting issues.

6. There are different types of users, which have different needs. The group thinks that it is very important that there should be much more contact with advisors (ie sell-side and buy-side analysts) than with deciders (ie asset management companies, portfolio managers). The reason for this is that advisors are much closer to the companies that are producing the numbers than the asset managers are. There also seems to be much less accounting knowledge by the asset managers.
7. On the question of different user needs, the group named as an example the difference between the needs of prudential regulators and those of investors, and that it may not be possible to meet all the needs of all user groups. Trying to do so could result in inconsistent standard-setting. It is also important that the Constitution of the IFRS Foundation should define the primary users of financial reporting. It is also important for future agenda-setting to work on the *Conceptual Framework*.
8. The group also discussed the difference between the information needs of debt investors and equity investors and concluded that there is not much difference.
9. On question 2, the overall conclusion of the group was that current engagement (both formal and informal engagement) with users is good and well balanced. The IASB needs to build up a network of contacts and put the information into a database.
10. The group also thought that it was a good idea to provide specific investor perspectives on the IASB website. It is however also important for users to get reactions to IASB proposals from other groups such as academics.
11. On frequency of contact with investors, the group thought that user groups had different needs in that respect. The group also thought that, on important topics, there was a risk of political involvement.

#### *Group 2*

12. Will Widdowson reported back for the group. On question 1, the group thought that the IASB should set up working groups on a Standard-by-Standard basis. The membership criteria for these groups should be clear and it should also be clear whom the members are representing. There should not be a regional cut of these groups. These working groups should have an advisory mandate and preparers need to be represented in these groups.

13. On questions 2 and 3 the group thought that the working groups should come into the due process.
14. On question 4 the group thought that the biggest blockages to endorsement were the cost-benefit analysis and objections on matters of principle or technical matters.
15. As the group worked through the process of standard development, it looked at it in sequence. At the research stage, it is important to bridge the expectation gap between users and preparers. A clear articulation of user needs and of exactly what problem is being solved is important. Why this work is important needs to be made public. The second stage, the agenda decision, needs to refer to the clear reasoning supported by the user needs, and should also include a cost-benefit analysis. The group however understands that until a Standard is developed, the actual implementation costs may not be fully clear, but at least some analysis of benefit should be feasible. Moving on to the process of developing and endorsing Standards, it is critical to maintain preparer involvement in the dialogue through that whole process. The use of working groups and preparer involvement in them is therefore important. Cost-benefit analysis should be performed at the Exposure Draft stage. At this stage there should be clear proposals for implementation. Opposing views expressed by constituents should be included in the Basis for Conclusions. This should therefore be an open and honest process for decision-making at the IASB level on the technical and principle issues. The strategy should be to get the cost-benefit assessment on the table as early as possible.
16. On question 5 the group thought that there was a low risk of any of the points affecting the independence of the IASB.

*Group 3*

17. Bruce Mackenzie reported on behalf of the group. On question one the group thought that what groups the IASB should engage with should be purpose-driven. What are we looking at and what needs to be done? For example, if we are looking at extractive industries, then we would reach out to countries where extractive industries are a big issue. Starting off on a geographical basis is probably the best way to do things. This is because there may be structures in place, such as regional bodies, who would find it easier

to get people together. After the groups have been formed it is possible to stratify them by industry or function (user, preparer, auditor). With more organisations being formed it might also be sensible to use regional bodies to filter issues. The IASB could then engage with a much smaller group, which would represent the views of a broader group.

18. On question 2 the group thought that this had to be looked at on a case-by-case basis, because all the stakeholders are different. There needs to be a lot more involvement in the research. There could be more frontloading of the work that is done and there needs to be engagement by stakeholders from Day 1. If the engagement is left for the later stages, then that is where the challenges are coming in, because people will be saying at the last minute that the proposals do not work. The frequency of engagement is also important and here the use of the regional bodies is important.
19. On question 3 and 4 the group thought that there is always going to be a risk of non-endorsement. The group also debated the models by which various countries have adopted. There is South Africa on the one hand, which adopted IFRS as is, so when the IASB issues a Standard it immediately becomes law in South-Africa. This is because South Africa made the decision to be a part of the process. Then we have the middle ground, eg Canada, where there is an endorsement mechanism, which functions as a little more than a mere rubberstamping. Then on the other side we have the Europeans, who have a more formal process and we have seen the risk of non-endorsement there.
20. There should be more field testing before publication of the Standards. The field testing could also be more formalised. The IASB could put together a field testing toolkit. This would be something more detailed and more focused, identifying the issues and what we want to know. There is a need to highlight the controversial issues. IFRS 10 and SPE are examples.
21. Once the Standard has been issued it is out there it automatically becomes law in some countries. Consequently, if there is a need to change something, that will cause problems. The group also discussed justifying decisions as they are made. There was a concern that people are giving feedback that is not incorporated into the final Standard, which may

lead to a feeling that the feedback has not been taken into consideration. It should therefore be made clear that the IASB has considered it.

22. The IASB also has to rely heavily on due process. If we have performed due process and if we all buy into it then we have to accept the outcome. One concern about outreach is that it should not be done too late. If the IASB is doing outreach too late to change course, the outreach is a waste of time. The involvement of outside bodies in the process has to be proactive. The IASB cannot itself find every constituent that it should consult. If organisations want to be involved, they need to get the views of their members and communicate them to the IASB. There are always going to be people who are unhappy but as long as their views have been considered there is a lot less risk of non-endorsement.
23. On question 5 the group thought that independence is key and that any risks to independence are more perceived than real. More stakeholder engagement should also decrease the risk. One matter that was raised was the feeling that we need to converge with the US no matter what. The focus on convergence may seem to be a risk to the IASB's independence.
24. On governance issues the group thought that if a Standard is issued and everyone is unhappy with it, maybe that is the point at which you realise that the IASB did not arrive at the right answer. One issue that was raised was that if a Standard has been issued and there is a major implementation problem, then there needs to be a mechanism to deal with that quickly.

*Group 4*

25. Leo van der Tas reported back on behalf of the group. The group started by complimenting the IASB on its outreach and consultation activities over the past few years.
26. With the growing number of constituents over the past few years, it is simply not possible to talk to everyone about everything all the time. This is therefore not about doing more, it is about getting a 'bigger bang for your buck'.
27. When looking at question 1 the group thought of two groups of constituents that should be added to the list. These are other groups of international standard-setters and international

organisations. It is also clear from the presentations that the different groups of constituents have organised themselves differently (at an international or a regional level for example). The question for the IASB is then whether it wants to create its own network or use an existing network. Using an existing network is probably easier but creating your own is probably more functional. One size will not fit all. There needs to be consideration of what stage the project is at, as well as of what the topic is. There was a general consensus that the issues should start with the regional standard-setters. They have already organised something at the regional level between the constituents so that is the easy one to tap into. There is also an existing relationship there with the IASB. The overriding goal should be that everyone should feel connected. Regional standard-setters can then organise groups and meetings.

28. On question 2 the group thought that the format that should be used there is periodic regional networking, which could be done with the regional standard-setters. The IASB will also need targeted outreach depending on the phase of the project or topic. Here you would need to think about sectors that are involved in a particular project. At the beginning of a project you probably need a more conceptual input, but at a later stage you are looking more at the practicalities and economic consequences.
29. On question 4, that is, endorsement and acceptance, the group thought that if we at least involve everyone in the process, and make sure that they feel that they are a part of the process, that offers the best chance of getting the Standards accepted. This probably starts with regional standard-setters but there is also a need to consider others that make those decisions or have significant influence on those decisions.
30. On question 5, on independence, the main message from the group was: be even-handed. Do not raise the suspicion that one group of constituents is getting more favourable treatment than others. The group also discussed national or regional interpretations. Regional standard-setters may play an important role here: first, by challenging these interpretations and then by seeing that these issues are brought to the Interpretations Committee. Experience shows that there are hardly any country-specific issues.



31. Finally, the group wanted to mention that in some regions at least some of the constituents feel left out or have not formed themselves into organisations. Regional standard-setters should therefore be encouraged to be inclusive.

### **General discussions**

32. Charles Macek raised two issues that were discussed in his group (group 1) that had not been mentioned. The first is: what channels of communications could be used in a world where there are multi-channels. The group considered, within that context, the use of social media. The view of the group was that social media could be a useful tool for the IASB to communicate outwards but would not be useful for receiving meaningful feedback, particularly within the context of having some quality control over the feedback and identifying the source.
33. The other issue was how to minimise the risk of carve-outs. Clearly everyone was focused on due process, maintaining the integrity of the due process and keeping it transparent to reassure all users of IFRS that the process is fair. In terms of cost-benefit analysis, the focus seems to be on a Standard-by-Standard basis, but there is also a cost-benefit way of thinking about accepting full compliance with IFRS as opposed to creating a carve-out. In other words, it is logical that any country would only give up sovereignty over its standards and outsource that to a foreign institution in exchange for some perceived benefit. The benefit is wrapped up in the expectation of high quality standards, but high quality standards are a means to an end. The end must be enhanced allocation and efficiency of capital or lower cost of capital.
34. This is a potential source for some interesting research, now that there is a sufficiently long history in a number of jurisdictions that are adopting IFRS to try to do some meaningful research, recognising that it will not be easy to isolate the use of accounting standards from other factors that clearly influence the cost of capital. In the same way, the national jurisdiction can exercise ‘a stick and a carrot’. The ‘stick’ is that you must comply fully with the law and you cannot carve out part of the law that you do not like. Obviously that is not practical within the context of the IASB but there could be a

notional stick if there were a more robust and transparent way of identifying and effectively listing and rating countries according to their compliance, so that full compliance with IFRSs means that you are effectively triple-A rated. And in the same way a credit rating has a direct impact on your cost of capital. A lower cost of capital would be the 'carrot'. That sort of approach to adoption of accounting standards might also be able to demonstrate and become the proof that full compliance may be better than having carve-outs as there is actually a penalty in the cost of capital.

35. Paul Cherry concurred with Charles and said that eventually that hypothesis has to be tested in terms of whether the benefit is there. He said that a wide range of views had been expressed and gave Hans Hoogervorst the opportunity to react.
36. Hans Hoogervorst said that there was indeed a wide range of views, but also a lot of agreement. There seems to be appreciation for the way in which the IASB does outreach and it is recognised that we do a lot of it. There is also a growing realisation that we need to do it better, that we are entering a new era and that we have to streamline both our networks and our procedures.
37. Why is the IASB at the beginning of a new era? There are a couple of factors: the convergence progress with the US is coming to an end and that is going to change the way we are going to work with standard-setters. The fact is that our Standards have spread over the world in the last few years, which has increased our web of relationships without necessarily creating a lot of structure in it. It has also increased the risk of non-endorsement. The greater the use of the Standards, the more likely it is that one jurisdiction will say that it does not particularly like one Standard and would like to do something different.
38. All these risks have to be contained and the organisation must be prepared to better communicate with all the actors, preparers, investors, users and regulators. The IASB talks with everybody but it may not be doing so efficiently.
39. One area that the IASB is looking at very closely now is how to work with the national standard-setters and the regional groups. The situation today is that three groups have privileged access to the IASB: the FASB, EFRAG and twice a year we meet with the

Japanese standard-setter. The IASB has have relations with everyone else through NSS, IFASS and the World Standard-setters group. These three groups have regular, more formal access to the IASB. This is not tenable for the future. There has to be a council or a forum of standard-setters plus regional groups, which the IASB can talk to on a regular basis and from which we can get feedback on our work and get early signals on the work the IASB is doing. This would be an advisory function and should not infringe on the independence of the IASB, but it should be a close relationship with meetings at least four times each year.

40. This group has to be inclusive but nevertheless also compact. If the group is too big, there is a danger that the message will be watered down. The big challenge is of course how we are going to do that. Choices will have to be made and not everyone will be happy. The current IFASS is a very useful organisation, but it is informal and is clearly too big and not inclusive enough, because many standard-setters do not participate in it. It could be the model or basis for the new group. The World Standard-setters group is very inclusive but too big. We need to find a formula by which the major players have access to this group and also set up a rotational system which would give smaller countries access to the group. The Monitoring Board is working on such a formula and the IASB might be able to borrow ideas from there. The regional groups will also have to come aboard because they are very inclusive and work really well and bring a lot of input to the table.
41. That is what the IASB is looking at, but these are only preliminary ideas at this moment. The IASB will consult on this. It is a sensitive problem that needs to be solved, but an acceptable solution should be reached. This group should not be another United Nations. These are however just ideas and the IASB and the Trustees will need to discuss this.
42. Finally, a few words on the other groups. As for users, they are extremely hard to reach, but the IASB must reach out to this group. We have been doing a lot in the last couple of years but we must do more. The IASB would like to develop closer ties to real investors who actually own assets. For preparers, they do not need to be encouraged to reach the IASB. They are highly motivated and have the knowledge and resources.

Communication with preparers might be more efficient and the IASB is working on proposals for that.

43. Many other comments and recommendation were made, especially on how to try to avoid non-endorsement. Working with national standard-setters is really important, so are the ideas about more and better field testing. There were also some comments on cost-benefit analysis being applied both at the beginning of a project and at the end. However, a full-blown economic analysis was not expected. It can however be made transparent, with the assistance of preparers, to estimate how costly the proposals may be to implement. Are the costs one-time costs or are they recurring? And if this is costly, is it clear that there is sufficient reward for that cost? If the IASB can show that it has done this analysis, the risk of non-endorsement will decrease.
44. The relationship with the auditors is also something that the IASB must work at. There is also a need for much stronger and more formal relationships with regulators, not just with the Basel Committee but with the securities regulators. The IASB has no vision of becoming an enforcement agency, but we need the feedback from securities regulators and they probably need our feedback as well.
45. Paul Cherry then commented that there was a lot to be done and the infrastructure both at the IASB and round the world continues to evolve, so the Council will probably have to come back to some of these issues on an ongoing basis. Later today, the Council will discuss what it would like to do in light of this topic and things covered during this meeting. Of course we have a tendency to look at things that need to be improved when we are asked about these issues. There is a lot of support for what the IASB is doing. There are also a lot of similarities between the strategic direction of the agenda consultation and what we have been discussing. There is a message that can be transmitted to stakeholders. That message is that there is a plan and that various actions are being taken that support a cohesive package of proposals.
46. Paul then opened the discussion up for brief comments.
47. Sei-Ichi Kaneko said that he had a slightly different view of a true investor from what had been mentioned in the discussions. That is, someone who owns assets and could be an

asset manager or a portfolio manager. These investors may not really use financial statements much and might therefore not be the best source for input. Buy- and sell-side analysts use financial information more and are therefore better sources to work with.

48. Tricia O'Malley said that it was interesting that people are suggesting a lot of consultation, and it is a question of ordering: whether it is first region and then expertise, or the other way around. Both of those dimensions are clearly very important. The idea that national standard-setters should be facilitating this work and prospecting for the people, both in terms of their expertise and of representing their regions, is something that we need to make sure is appropriately dealt with in the statement of best practice that IFASS and the IASB are currently discussing.
49. Nic van der Ende said that the discussions had been very interesting and useful. He said that the Basel Committee strongly supports of the IASB and its processes.
50. Paul closed the session by thanking the discussion leaders and the presenters for their work.