

AGENDA PAPER

IFRS Foundation Trustees' meeting—Due Process Oversight Committee

Brussels

10 October 2012

Agenda paper 3A

To: Due Process Oversight Committee

From: David Loweth/Tamara Feldman

Date: 2 October 2012

Re: **Draft Due Process Handbook: comment letter summary and issues arising**

Overview

1. The purpose of this paper is to highlight some of the main issues arising from the responses to the recent consultation on the draft Due Process Handbook (DPH), together with some initial Foundation staff views, following an initial analysis of the comment letters. The views of Committee members on all issues are welcome and we can discuss with IASB representatives at the meeting how to take them forward in developing a final version of the revised DPH.

Background

2. The draft DPH was issued for comment on 8 May 2012, with a comment period of 120 days running through to 5 September. The draft DPH represents a substantial review, update and amalgamation of the existing due process handbooks for the IASB and the Interpretations Committee (but not XBRL, which it was agreed would be tackled separately in the light of determining what should be the strategy for XBRL going forward). The draft DPH also fully incorporates the necessary due process enhancements recommended by the February 2012 reports, the Trustees' *Strategy Review 2011* and Monitoring Board *Review of Governance of the IFRS Foundation*, as well as recommendations from the Trustees' *Review of the Efficiency and Effectiveness of the IFRS Interpretations Committee* (published in May 2012).

Comment letter summary

3. A comment letter summary is attached at Agenda paper 3Ai. It shows that 50 comment letters have been received. The overview of the summary (section 4 of Agenda

paper 3Ai) shows that respondents were supportive of the main thrust of the proposed changes to the draft DPH, although they raised a large number of issues, not only on the questions asked in the Invitation to Comment, but also on a wide range of other matters.

Oversight

4. The draft DPH proposed the inclusion of a section (Section 2) on oversight of the due process. Most respondents supported the inclusion of this section and its content, but the main issues raised include:

- transparency, including whether Due Process Oversight Committee (DPOC) meetings should be held in public;
- concerns that the due process as described might be too bureaucratic, especially in relation to the Due Process Protocol (DPP) (see separate section on the DPP below);
- some concerns that the due process might be too passive and not independent enough;
- whether the description of the role and objectives of the DPOC should be in the IFRS Foundation *Constitution* rather than the DPH;
- the handling of perceived breaches of due process (included in Section 8 of the DPH).

Should DPOC meetings be held in public?

5. One of the DPOC’s priorities for the year, as outlined in David Sidwell’s Chairman’s report in the Foundation’s *Annual Report 2011*, is for the Committee to consider holding parts of its meetings in public session. The DPOC held a short, initial discussion on this issue at its July meeting in Washington, in the context of correspondence received from Business Europe (Agenda Paper 4Gii at that meeting). The final draft minutes for that meeting (circulated under cover of Tamara’s e-mail of 20 August) record that the views among Committee members vary, with some preferring the meetings to be in private, in order that frank and candid views can be expressed. Another concern is that holding meetings in public could change the tone of the questions asked by the Committee. Others, however, support public meetings, as it raises issues of credibility and would show that the DPOC is taking transparency seriously. One action point from that meeting is that, in the interim and in advance of any further discussion, a fuller report of DPOC meetings is now being made available on the website.

6. While the draft DPH did not specifically raise the issue of public comments, paragraph 2.15 of the document states that the DPOC “must operate transparently”. In the comment letters, four respondents called for DPOC meetings to be held in public¹, while a number of others called for transparency to be “maximized”² and for “greater visibility”³.

¹ DASB (CL15), EFRAG (CL43), BusinessEurope (CL44), ANC (CL47).

² AcSB (CL6), although more in terms of what and how the DPOC reports, including clear statements about its procedures and conclusions.

³ ASC (CL9).

7. In terms of transparency at present:

- most of the papers for the DPOC meeting are made available on the website;
- the DPOC Chairman provides a report on the Committee's meeting to the full Trustees, as part of their public meeting;
- in line with Scott Evans' suggestion in July, fuller reports of the Committee's meetings are now being made available on the website;
- the Committee prepares an annual report of its activities for inclusion in the *Annual Report*; and
- DPOC governance documents (including the Protocol) are publicly available.

8. It would, therefore, be a relatively small step to making the meetings public. On the plus side, it would 'maximise' transparency and demonstrate how due process oversight is exercised and show that the DPOC has 'nothing to hide'. It would help to allay the concerns expressed by a number of commentators that the due process oversight is too "passive"/not proactive enough⁴ and reinforce paragraph 2.14 in the draft DPH that an "audit" of information is unnecessary because of the "transparent manner in which the IASB and DPOC operate", which some comment letters questioned⁵.

9. On the down side, I can understand the concerns that meeting in public might affect the frankness, candour and tone of the discussion, although a number of bodies that operate 'in sunshine' have not found this to be the case. However, in my view, it would still not be appropriate to hold all of the meetings in public sessions. In particular, discussions on proposals for membership of consultative groups and considering the Work Plan risks on technical activities should continue to be held in closed sessions. Having a meeting with both open and closed sessions would add to the administrative challenge and could make the discussions on technical activities less cohesive (discussing the general due process issues in open session, and the plan risks in a closed session), but that might be a price worth paying for transparency.

10. In my view, I think that the DPOC already demonstrates a good level of transparency, and we can make the public reports of meetings even fuller, especially when the Committee starts to conduct complete reviews of due process throughout the life cycle of a project. Whether parts of meetings should be held in public is dependent on whether Committee members feel comfortable with that and I would welcome views.

Is the due process described too passive and not independent enough?

11. As noted above, a small number of respondents took the view that the due process as described is passive and one respondent⁶ questions the whole legitimacy of the IASB because of a basic flaw in the organisation's governance. In my view, the latter point was addressed as

⁴ DASB (CL15), HKICPA (CL34), EFRAG (CL43).

⁵ ACCA (CL2), DASB (CL15), Deloitte (CL27), Mazars (CL38).

⁶ DASB (CL15).

part of the Trustee's *Strategy Review 2011* and the Monitoring Board's review of governance. On the question of passivity, I think that the DPH (paragraph 2.5) is clear that the DPOC provides "continuous oversight over the IASB and the Interpretations Committee throughout all development stages".

12. On independence, a number of respondents⁷ want to see the DPOC have its own information gathering role (including the possibility of attending IASB meetings, which they can do anyway – as the meetings are in public), having different staff writing due process reports than those involved on the project (I am not sure that is practicable and, in any event, reports are reviewed by Alan Teixeira), and express concerns about the role of the staff as related to that of the Board (this was an issue raised previously by Business Europe and has been picked up by EFRAG as well). In correspondence with Business Europe, we have made clear that responsibility for due process is that of the Board itself, or the Interpretations Committee, and that can be clarified in the drafting of the final DPH. I think that there is also a 'to do' for me, in my (David's) role as Director for Trustee Activities, to enhance my own review of the due process reports that are prepared. A number of those respondents also thought that the DPOC should formally 'sign-off' on due process before any final pronouncement is issued. I prefer the suggestion made by AcSB (CL6) that the DPOC should at the least provide a clear statement on its assessments and the results of its reviews, which is something that can be achieved easily.

Role and objectives of the DPOC

13. A number of respondents⁸ are of the view that the description of the role and responsibilities of the DPOC should be included in the *Constitution* rather than the DPH. The *Constitution* (paragraphs 15f and g) refer in high level terms to the Trustees being responsible for establishing due process and reviewing compliance with it, but I think that how the Trustees fulfil those duties (including having a DPOC) fits better in the DPH. It is also the case that the Foundation only has an undertaking to review the *Constitution* every five years whereas a review of the DPH, if thought appropriate, could take place in a shorter timeframe.

Breaches of due process

14. In answering this question, a number of respondents⁹ also addressed the section in the DPH (Section 8) on breaches of due process, with some wanting a requirement for the reasons for which a breach would not question the decisions already made by the IASB to be made public. Two respondents¹⁰ felt that there should be a time limit in which complaints about due process can be made, to within 120 days of the perceived breach occurring, reflecting a comment made by the Advisory Council in June. This is to avoid any due process

⁷ DASB (CL15), ASCG (CL28), ACTEO-MEDEF (CL30), Mazars (CL38), EFRAG (CL43), Business Europe (CL44), ANC (CL47), FRC (CL48)..

⁸ ASCG (CL28), EFRAG (CL43).

⁹ AcSB (CL6), SEAG (CL7), HKICPA (CL34), Mazars (CL38), IOSCO (CL39), EFRAG (CL43), Credit Suisse (CL46), ANC (CL47).

¹⁰ G100 (CL1) and BDO (CL37).

challenge being lodged after the issue of an IFRS and any legal challenges coming in particular for those jurisdictions where IFRSs became law. I can understand the concern, but I do not think a 120-day limit would stop complaints.

Due Process Protocol

15. Appendix 4 to the draft DPH sets out a Due Process Protocol (DPP), a reporting template for demonstrating to the DPOC how the IASB and the Interpretations Committee have met their due process requirements. The draft document makes clear that this is not an integral part of the DPH. Most respondents agreed with that view, or did not comment on the issue, although a minority of commentators¹¹ felt that it should formally be part of the DPH.

16. A larger number of respondents have raised concerns that the DPP tables are very detailed and that such a checklist could lead to a time-consuming bureaucratic box-ticking approach¹². Some have also suggested that the DPP should focus only on mandatory due process steps¹³. A number expressed concerns that the whole process is excessive and, if the DPP is used at all, it should be for internal purposes only and not made available on the website¹⁴.

17. The staff has been using the DPP tables and attached them as appendices to the reports on due process issues that have been submitted to the Board and the DPOC. In my view, the staff has found the tables useful as a check to see whether and how the due process steps (both required and optional) have been followed as the basis for the discussion in the body of the reports: the tables have not become an end in themselves. Feedback from Alan Teixeira is that the tables are not overly burdensome to complete. We have learned lessons in completing the tables and made changes, which reinforces the fact the DPP is a living document. The tables are made available on the website, but the focus is on the narrative contained in the due process reports.

18. Subject to the views of the Committee, I would recommend that:

- the DPP is maintained as a reporting tool, but not as an integral part of the DPH. The DPH is, first and foremost, a tool to ensure that staff is completing all the necessary due process steps and it documents compliance with those steps. It is, however, important that the DPP and the DPH are consistent, as some respondents have noted¹⁵ and staff plan to do a consistency check with the final version of DPH;
- the full DPP template should be made available on the website, for transparency purposes;

¹¹ ASCG (CL28), FAR (CL35), Mazars (CL38).

¹² AASB (CL3), EEA (CL4), XRB (CL5), JICPA (CL12), PwC (CL14), E&Y (CL18), HoTARAC (CL24), Deloitte (CL27), Credit Suisse (CL46), ANC (CL47) .

¹³ PwC (CL14), ASCG (CL28), Denise Juvenal (CL42)

¹⁴ IFAC (CL10), E&Y (CL18), ICAEW (CL31).

¹⁵ KASB (CL13), PwC (CL14), ASBJ (CL26), Deloitte (CL27), ASCG (CL28), HKICPA (CL34), FAR (CL35), EFRAG (CL43), IMA (CL49).

- the DPP should continue to cover both the mandatory and optional due process steps; and
- staff continue to use the relevant table as an appendix to due process reports, which will be available on the website.

Research programme

19. The proposal in the draft DPH (Section 4) to have a research programme and to build a better evidence base was well supported by respondents. A number of respondents¹⁶ reflected comments made by the Advisory Council in June that there needs to be clarity on why research is being done, criteria for prioritising research projects and adding them to the research agenda, the potential outcomes (together with milestones) for it being carried out, clear criteria for what happens when research ends (including moving items from research to standards-level projects), and for determining when research to end, to avoid leaving research projects ‘hanging’ for a long time.

20. A number of respondents¹⁷ think that the DPH should include guidance on managing a research project, including clearly stated and realistic project objectives, work plan and methodology, and for the project to be realisable in an appropriate length of time. I think that the DPH could refer to the need for these things, but not get into more detailed operational guidance on the management of research projects.

21. Paragraph 4.15 of the draft DPH states that the main output of the research programme “is expected” to be discussion papers and research papers. Some respondents¹⁸ feel that the research phase should always be finalised by a public consultation. I can agree in principle, but there needs to be the ability to cater for exceptions.

Implementation and maintenance: distinguishing between narrow-scope and comprehensive projects

22. The draft DPH (Section 5) included a new section on implementation and maintenance. This issue was generally supported, but provoked a good deal of response and comment.

23. A number of respondents¹⁹ feel that there need to be clear criteria to determine what is a minor or narrow-scope amendment, especially as the section on implementation and maintenance in the draft DPH (paragraphs 5.11 to 5.20) focuses almost exclusively on interpretations. At least one respondent²⁰ finds this section “disjointed”. I think that the staff

¹⁶ AcSB (CL6), ASC (CL9), Deloitte (CL27), ASCG (CL28), FAR (CL35), Mazars (CL38), EFRAG (CL43).

¹⁷ ASCG (CL28), EFRAG (CL43).

¹⁸ ASCG (CL28), EFRAG (CL43), CBI (CL50).

¹⁹ EEA (CL4), SAICA (CL11), Deloitte (CL27), ASCG (CL28), HKICPA (CL34), Mazars (CL38), EFRAG (CL43), Credit Suisse (CL46), CBI (CL50).

²⁰ Deloitte (CL27).

(both Foundation and technical) will need to work together on this issue to see if we can clarify the drafting, in particular on how the criteria for deciding whether the IASB should take an item onto its agenda (outlined in paragraph 5.1 of the draft DPH) can assist in the distinction between narrow-scope and comprehensive projects. At least one respondent²¹ believes that the DPOC should be able to challenge the IASB's decision as to whether a project is narrow-scope or comprehensive, although another respondent²² cautions that this might be difficult, given that "one person's routine maintenance is another person's substantive change".

24. We and the technical staff need to work further on this issue and we will come back to the Committee with proposals.

Comment periods

25. The draft DPH proposes two changes to comment periods:

- an increase in the minimum comment period for the Interpretations Committee exposing the draft of a rejection notice from 30 days to 60 days; and
- the ability for the IASB to have a reduced comment period of a minimum of 60 days for documents it plans to re-expose, if the re-exposure is narrow in focus.

26. The first proposed change attracted wide support, and I think we can reflect this in the proposed final DPH. At least four respondents²³ took the opportunity to stress that the DPH should clearly indicate that rejection notices should not be akin to interpretations and that quality control by the IASB should be reinforced before final issuance.

27. Responses on the second proposed were much more mixed. In terms of those opposing the reduction in the comment period, the response from the AcSB (CL6) captures most of arguments for retaining a longer period, in that it would (i) allow respondents to understand the whole proposals in order to assess the implications of the revisions; (ii) allow NSS and others time to discuss and evaluate proposals with stakeholders and committees to allow for an informed response; (iii) allow more respondents time to develop a response when they are balancing multiple priorities; and (iv) provide time for the revised proposals to be translated and enable stakeholders time to understand them in their native language. Some respondents also noted that 60 days was too short over major holiday/busy periods. A number²⁴ propose a 90-day minimum, which might be an acceptable compromise.

28. A number of respondents²⁵ took the opportunity to express their disagreement with the "exceptional circumstances" provisions in paragraphs 6.7 and 6.8 of the draft DPH to have, with Trustee approval, a minimum comment period of 30 days or even less. I

²¹ Mazars (CL38).

²² EEA (CL4).

²³ DASB (CL15), EFRAG (CL43), Business Europe (CL44), FRC (CL48).

²⁴ ASC (CL9), SAICA (CL11), Deloitte (CL27), IPAS (CL36).

²⁵ DASB (CL15), IDW (CL16), E&Y (CL18), CPA (CL19), LIAJ (CL23), HoTARAC (CL24), HKICPA (CL34), EFRAG (CL43), IMA (CL49).

understand the concern, but the experience of the reclassification of financial instruments episode in 2008²⁶ highlights to me the need to maintain such a provision.

Other matters

29. As section 5 of the comment letter summary of Agenda Paper 3Ai shows, respondents raised a large number of other matters, some to do with clarity and drafting, others more substantive. In this paper, I set out some initial thoughts on the issues raised on some of the more substantive matters:

- should the DPH specify the objectives of due process;
- status of review drafts;
- outreach and co-operation with National Standard-Setters (NSS) and regional bodies;
- effect analysis;
- issues referred by the Monitoring Board;
- comments relating to the Interpretations Committee;
- quorums and voting procedures.

Should the DPH specify the objectives of due process?

30. A number of respondents²⁷, while supporting the principles of due process outlined in the draft DPH, recommend that the objectives of due process should also be specified. As highlighted in section 5.5.4 of the comment letter summary, EFRAG suggests that the following objectives should be set:

- i. Ensuring a shared identification with constituents of well-defined needs for improvement of financial reporting, in a way that allows clarity in how objectives assigned to a project are set;
- ii. Allowing for proper consultation and discussion, prior to, and after, the publication of proposals;
- iii. Setting the legitimacy of the resultant standards or interpretations by gathering arguments and reference to evidence in a basis for conclusions that:
 - o justify (and not assert) how the new requirements do indeed fulfil the original objectives and serve user needs;
 - o explain how specific issues raised by various jurisdictions/constituents have been addressed;
 - o argue why alternatives supported by constituents would not achieve the same outcome or why the final requirements should be preferred;

²⁶ October 2008 Amendments to IAS 39 and IFRS 7 Reclassification of Financial Assets.
²⁷ ASCG (CL28), EFRAG (CL43), FRC (CL48).

- o properly assess the results of effect studies and other field work including field tests, so that there is reasonable assurance that implementation of the final requirements will not cause uncertainty or inconsistency in practice, and that the costs involved are justified by the improvements brought in financial reporting.

31. I have to admit I had taken the objectives of having due process as a given. In principle, I think the DPH could include the objectives of due process, if Committee members think that would be helpful.

Status of review drafts

32. The draft DPH (paragraphs 3.29 to 3.32) notes that, while not a mandatory due process step, the IASB “normally” seeks input on its drafting from external reviewers before finalising any new IFRS or major amendment. A review draft might be distributed to a selected group of reviewers²⁸ or made available on the website.

33. A number of respondents²⁹ took issue with this and felt that the provisions need to be more robust and transparent (see section 5.5.24 of the comment letter summary):

- review drafts should be published on the website for systematic public ‘fatal flaw’ reviews to help identify potential implementation difficulties or undue costs; and
- the IASB should consider the findings and outcomes in a public meeting and that final balloting should only place after this consideration;
- their purpose should be made clear (to ensure that they are not used to replace re-exposure where that might be appropriate).

34. In effect, some of those respondents want to make this another systematic step in the due process, which could run the risk of adding to the concerns about bureaucracy as noted above. To date, the IASB has used external reviewers to give their personal, private (and hopefully candid) views on whether the review draft is clear and reflects the technical decisions made by the Board. It is clear that some respondents see review drafts as much more, using them as “a basis for ultimate field tests” (EFRAG, CL43) or even for a formal pre-implementation review (CCMC, CL22). My initial view is that the IASB should be able to retain some flexibility in using review drafts, but this is a particular issue that the Committee should raise with the IASB representatives at the meeting.

Outreach and co-operation with NSS and regional bodies

35. The draft DPH (especially paragraphs 3.45 to 3.71) outlines the engagement and the outreach (including fieldwork) that the IASB undertakes with a range of parties.

36. Section 5.5.7 of the comment letter summary refers to suggestions that have been made with regard to the IASB enhancing its outreach activities. The main issue relates to

²⁸ AASB (CL3) noted that using this term raises the question of which criteria should be used to make the selection.

²⁹ EEA (CL4), EFRAG (CL43), Business Europe (CL44), ANC (CL47), FRC (CL48).

transparency, and follows a point made by Business Europe in the correspondence discussed by the DPOC at its July meeting. The issue is to find a way in which the substance and conclusions drawn from outreach can be explained and made publicly available without endangering participants' (especially investors) legitimate concerns about confidentiality. The sections in the draft DPH on fieldwork, public hearings and other meetings are silent on how the results of such activities are reported to, and assessed by, the Board. I think we should look to include something on this in the proposed final DPH.

37. EFRAG (CL43) has taken the opportunity of this consultation to promote a shared due process between the IASB and NSS and regional bodies, which would mean that in each jurisdiction the stakeholder consultation would be coordinated and shared between the IASB and the regional and national accounting standard-setting bodies in order to obtain the views from stakeholders on a particular subject. EFRAG is also recommending greater co-operation on outreach initiatives (Section 5.5.8 of the comment letter summary). While greater co-ordination and co-operation is clearly desirable, I think that it cannot be exclusive. The IASB and any NSS and/or regional body has to retain the right to undertake its own due process and outreach where it believes it appropriate to do so.

38. Respondents from Japan³⁰ all referred to the role that the Asia-Oceania office in Tokyo can play in co-ordination and outreach (Section 5.5.7 of the comment letter summary) and a number requested that the DPH refer specifically to it.

39. A number of respondents³¹ expressed concerns (in one case expressed as a strong objection) that the section in the draft DPH on engagement with investors and other users (paragraphs 3.45-3.47) implied giving them preferential treatment and allowing them to bypass arrangements that other constituents have to follow to put across their views. I understand the concerns, but getting input from users has always been a challenge and I think it is important that their views are sought, as outlined in the draft DPH. It is important that the outcome of any such outreach is reported as fully and transparently as possible, mindful of the need to protect confidentiality.

Effect analysis

40. The draft DPH (paragraphs 3.72 to 3.75) set out the IASB's commitment to undertake effects analysis. As highlighted in Section 5.5.20 of the comment letter summary, respondents generally welcome the commitment to carry out effect analyses, but a number of them suggested enhancements. As the DPOC is aware (Agenda Paper 3C), we are in the process of establishing a consultative group to help the IASB develop a robust process for fieldwork and effects analysis. Many of the suggestions made will help inform the work of the group. In this paper, I want to highlight one issue, which again relates to the earlier correspondence from Business Europe, namely that effects analyses should be owned and

³⁰ JICPA (CL12), JBF (CL22), LIAJ (CL23), ASBJ (CL26).

³¹ HoTARAC (CL24), JBF (CL25), Business Europe (CL44).

signed off by the Board. Following the discussion by the DPOC at its July meeting, we have agreed that this will be the case and this should be clarified in the proposed final DPH.

Issues referred by the Monitoring Board

41. The draft DPH (paragraphs 5.6 to 5.10) notes that the Monitoring Board may refer technical financial reporting matters to the Trustees and the IASB Chair. This reflects a conclusion of the Monitoring Board's review of governance in February 2012.

42. A number of respondents³² have questioned this as potentially impinging on the IASB's independence, especially given the reference in paragraph 5.9 that if the IASB does not take up a referral it must "demonstrate" to the Trustees why it would be inconsistent with its standard-setting responsibilities. AcSB (CL6) believes that the DPH should require only that the IASB explains its rationale. In any case, paragraph 5.10 of the draft DPH already makes clear that the Monitoring Board will neither influence nor challenge the IASB's decision.

Interpretations Committee

43. As set out in paragraph 5.5.18 of the comment letter summary at Agenda Paper 3Ai, a good number of comments relate to the working of the Interpretations Committee and its relationship and interaction with the IASB. We have yet to work through them and we plan to work with Alan Teixeira, Michael Stewart and other technical staff to see how the issues raised can be addressed and the drafting clarified for the proposed final DPH.

Quorums and voting procedures

44. The draft DPH (paragraphs 3.13 to 3.20) sets out voting requirements for the IASB and the Interpretations Committee, and refers to the quorum requirement for the latter but not the IASB (on the grounds that as largely a Board of full-time members, with all the current members being full-time, members are expected to attend meetings in person).

45. EFRAG (CL43)³³ believes that there should be a quorum in IASB meetings and that a 'supermajority' as required for an IFRS (9 members with a Board 15) should be required for "every decision made in the standard setting process", including tentative decisions. I am not sure this is necessary, but would welcome the views of Committee members. A number of respondents³⁴ take the view the approval of a final standard should require an even higher majority threshold. The voting requirements are clear, but there are concerns that a final standard can be issued with up to 6 IASB members not voting in favour. Again, I think this is something the Committee should discuss with the IASB representatives at the meeting.

³² AcSB (CL6), JICPA (CL12), ASCG (CL28), HKICPA (CL34), IMA (CL49).

³³ This view is shared by others: IFAC (CL10), Mazars (CL38), Business Europe (CL44), FRC (CL48).

³⁴ ACTEO-MEDEF (CL29), HKICPA (CL34).

Next steps

46. This paper sets out the issues that have struck us most immediately in a first read-through of the comment letters. We will continue to consider them and any other issues arising and discuss them with IASB colleagues, together with work on drafting the proposed final DPH. DPOC conference calls have been scheduled for 6 November and 11 December and we will prepare papers for them. Subject to the issues raised and the views of the Committee, the plan is finalise the DPH around the end of 2012.