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Due Process Oversight Committee

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This paper has been prepared by staff of the IFRS Foundation. The views expressed in this paper reflect the individual views of the author[s] and not those of the IASB or the IFRS Foundation. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs.

The attached paper is being discussed by the IFRS Advisory Council on 14 and 15 October 2013.

The paper was written with the DPOC in mind, to assist in the development of appropriate procedures around the development of material accompanying Standards, particularly after a Standard has been issued.

AGENDA PAPER

IFRS Advisory Council Meeting

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TOPIC *Implementation and maintenance activities*

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Background

1. The IASB is charged with developing high quality, understandable, enforceable and globally accepted financial reporting Standards that are based on clearly articulated principles. Those Standards should require high quality, transparent and comparable information.
2. The objective of this paper is to ask the Advisory Council members for their views on how we can enhance our procedures and due process in support of consistent application of IFRS. Specifically, this paper discusses:
 - (a) Standards and supporting material—the role of Application Guidance, Illustrative Examples and education material;
 - (b) Education Initiative update;
 - (c) post-publication support – providing implementation support after a Standard had been issued;
 - (d) maintaining converged Standards; and
 - (e) working with securities regulators.

Standards and supporting material

New Standards

3. When the IASB issues a new Standard, its required content is:
 - (a) the principles and the related Application Guidance;
 - (b) the defined terms; and
 - (c) the effective date and transition paragraphs.¹
4. Typically, a new Standard sets out the principles in the main part of the document. Appendix A presents any defined terms, Appendix B is the Application Guidance and Appendix C has the effective date and transition requirements.
5. The rubric to each Standard states that all paragraphs have equal authority.² Application Guidance (ie Appendix B) is not in any way ancillary to the main principles. Older Standards did not have a separate appendix for Application Guidance. The principles and guidance were presented in one section. The decision by the IASB to create a separate appendix was pragmatic. The IASB thought that the separation would make it easier for readers to gain an overview of the Standard and its principles. Readers could then refer to the supporting Application Guidance when they needed more details.
6. Hence, the separation of the principles and the Application Guidance is no more than one of geography. Sometimes a small amount of what is clearly Application Guidance is included in the front part of a Standard rather than in Appendix B, simply because placing it in a separate part of the Standard makes the content disjointed.
7. Each Standard is also normally accompanied by additional material that is not an integral part of the Standard: a table of contents; an introduction; the Basis for Conclusions (including an *Effect Analysis*) and dissenting opinions. Sometimes the accompanying material will include a table that shows the relationship between paragraphs in the old and the new requirements, a brief history of the Standard and

¹ see paragraph 6.30 of the *Due Process Handbook*.

² The rubric in an IFRS is a set of instructions in a box at the beginning of each Standard that explains how the IFRS is set out and should be read.

Illustrative Examples. In all cases the documents will state clearly whether the material is an integral part of the Standard or whether it accompanies it but is not integral.³

8. The *Due Process Handbook* states:

As a principle, Standards should be able to be applied without the accompanying material.⁴

9. In other words, the requirements—principles and the related Application Guidance—must be able to stand alone, without the Basis for Conclusions or Illustrative Examples.⁵
10. To summarise, Application Guidance is a necessary and integral part of a Standard, whereas Illustrative Examples are not. It is therefore important to have a clear, well defined purpose for both the Application Guidance and the Illustrative Examples. Unfortunately, we do not. In the next sections we outline what we think the purpose of each should be.⁶

Application Guidance

11. We think an appropriate purpose of Application Guidance is to *put into effect* the principles that are set out in the Standard. Application Guidance is normally considered necessary for the Standard to be able to be applied consistently and is therefore an integral part of the Standard. Such guidance would therefore normally take the form of examples and explanations that demonstrate how the principles should be applied and interpreted. The Application Guidance provides more details to the principles, making them more complete.

³ see paragraphs 6.32 and 6.33 of the *Due Process Handbook*.

⁴ see paragraph 6.34 of the *Due Process Handbook*.

⁵ Although the most common term we use for examples that accompany, but are not part of, the Standard is ‘Illustrative Examples’, it is not the only term. However, for the purposes of the next part of this paper that term is used. Later in the paper an explanation is provided about how that term is not applied consistently, which creates some confusion among readers.

⁶ This paper does not consider possible inconsistencies in the types of material referred to as ‘Application Guidance’ in one Standard but referred to as ‘Illustrative Examples’ in another Standard. Those inconsistencies will be addressed in due course.

12. As an example, IFRS 3 *Business Combinations* has a principle that an entity recognises assets acquired in a business combination. The Application Guidance then expands on this principle and explains how it applies to some particular assets, including reacquired rights and an assembled work force. The IASB assessed that without this guidance those applying IFRS 3 might struggle to apply the very general principle consistently to some types of asset. This seems to be an appropriate example of Application Guidance.

Illustrative Examples

13. We think an appropriate purpose of Illustrative Examples is to help those applying a Standard for the first time to become more familiar with the requirements of that Standard. Illustrative Examples can also demonstrate the accounting mechanics or outputs, once the judgements have been applied.
14. For those not yet familiar with the Standard, Illustrative Examples should provide them with an introduction to the requirements. Some would describe this as helping those applying the Standard for the first time to move ‘up the learning curve’. Ideally, once a person is familiar with the Standard they should no longer need to refer to the related Illustrative Examples.
15. We think of Illustrative Examples on the basis of ‘initial application’ because if a particular example is necessary to help people apply the Standard throughout the life of the Standard it would seem to be integral and should therefore be classified as Application Guidance.
16. On this basis, Illustrative Examples should not interpret the principles. It should also not be necessary to refer to Illustrative Examples to be able to apply the Standard on an ongoing basis.
17. Illustrative examples can be relevant and necessary beyond just the initial period after a Standard is issued. A person looking for the first time at a Standard that has been in effect for some time could benefit from Illustrative Examples. In other words, Illustrative Examples are relevant to anyone who is not familiar with a Standard, whether the Standard is new, the person is looking at an older Standard for the first time or the person does not regularly work with that Standard and needs reminding.

18. In IFRS 3 the Illustrative Examples include a section that describes different types of intangible assets, including music rights, software licences, franchise agreements and computer software and mask works. The descriptions are very general and were designed to help those not used to recognising intangible assets in a business combination become more familiar with different types of intangible assets. IFRS 3 also provides the accounting entries and calculations for a reverse acquisition. That section did not help a reader determine if they had a reverse acquisition. It demonstrated the mechanics once that determination had been made.

Risks and opportunities

19. When the IASB considers new requirements, the staff often develops examples that illustrate the consequences of the proposals. Experience has shown that some of those examples are also helpful to parties reading, and responding to, the proposals. By demonstrating the mechanics of an issue or a proposal by using examples, readers are able to focus on the more important technical issues.
20. As mentioned earlier, IFRS 3 includes an illustrative example of the accounting entries and calculations for a reverse acquisition. That example was included in the Exposure Draft because the mechanics are challenging and we wanted readers to focus on whether we had made the best financial reporting decisions, not getting to grips with the accounting entries. It also served to illustrate the consequences of those financial reporting decisions and check that we had explained them clearly enough. Illustrative examples give us the opportunity to help people to make the transition into new requirements more easily.
21. However, there are risks associated with Illustrative Examples. Even a simple example demonstrating how some information could be disclosed could be misinterpreted as specifying how that requirement **must** be met, or misunderstood as providing a template for that disclosure. When we developed the Application Guidance and Illustrative Examples for IFRS 10 *Consolidated Financial Statements* we needed to be careful that we did not put percentages in examples that could be interpreted as establishing 'bright-lines'.
22. The IASB and the Due Process Oversight Committee are aware of the added difficulties of generating helpful education material without undermining our open

and consultative processes. Paragraph 6.43 of the *Due Process Handbook* states that the IASB and the technical staff have a responsibility to ensure that any educational material is not confused with an IFRS or perceived as being mandatory.

Consequently, as stated in paragraph 6.44(c) of the *Due Process Handbook*, educational material accompanying a Standard must be reviewed by at least three IASB members.

23. Early in 2013 additional illustrative examples were developed for IFRS 11 *Joint Arrangements*. Our pre-release consultation led us to conclude that some of the examples were more in the nature of Application Guidance because they were interpretative. The fact that we did not release the material demonstrated that our procedures were effective. It stopped us releasing interpretative material.

Timing

24. The risk that Illustrative Examples will be seen as interpretative probably increases when they are issued after the Standard to which they relate has been released. Our goal should be to develop and issue Illustrative Examples at the same time as the related Standard. If the purpose of the examples is to support initial application and help people step up to the new requirements, any later release is likely to be less effective in meeting that goal.
25. In developing IFRS 11 *Joint Arrangements* the accounting requirements for assets that are jointly controlled by contract (defined as a 'joint operation') were unchanged from the requirements in IAS 31 *Interests in Joint Ventures*. Yet, it has become clear that some examples would be helpful, particularly to highlight any differences in outcome when a joint operation is housed in a separate legal entity.
26. Ideally, the additional Illustrative Examples for IFRS 11 would have been released at the same time as that Standard. However, sometimes the need for education material arises because a new region or jurisdiction adopting IFRS has needs that earlier adopters do not. This can happen well after a Standard has been issued. In other cases some issues arise that were not anticipated by the IASB or respondents to the Exposure Draft at the time that the Standard was being developed.
27. For example, in late 2013 the IASB released educational material on *Fair Value Measurement: Measuring the fair value of unquoted equity instruments within the scope of IFRS 9 Financial Instruments*. This material presented a range of commonly

used valuation techniques for measuring the fair value of unquoted equity instruments. It did not prescribe the use of a specific valuation technique, but instead encouraged the use of judgement and the consideration of all facts and circumstances surrounding the measurement. The material was designed by the IASB technical staff with the support of an expert advisory group to help those less familiar with valuation techniques. We developed the material in response to a perceived need for this type of training.

28. If we are asked to provide additional illustrative examples after a Standard is issued, we need to be very comfortable that they are not interpretative. We address this in the section on post-publication support.

Naming protocol

29. Although we have used the terms ‘Application Guidance’ and ‘Illustrative Examples’ here, the IASB has not always been consistent with terminology. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* has an ‘application supplement’ rather than Application Guidance. With that one exception, over the last five years we have ensured that we only use the term ‘Application Guidance’ within the mandatory parts of a Standard.
30. The older Standards (IASs) generally do not have separate Application Guidance (IAS 39 *Financial instruments: Recognition and Measurement* is the exception).
31. Today you will still find different terms to describe material that is published with a Standard that has the same status as Illustrative Examples. It is variously labelled as guidance on implementing (for example, IFRSs 2, 4 and 5) and Illustrative Examples. IFRS 9 has an Illustrative Example and guidance on implementing, but does not explain why the contents are differentiated in that way.
32. Our goal is to be more consistent with how we label material. Within a Standard we will only use the term ‘application’ to describe the examples and additional explanations that are needed in order to apply the principles. As older Standards are revised we will address the current inconsistencies.
33. Material that supports, but is not an integral part of, a Standard should be clearly differentiated from the mandatory material.

A way forward—education ‘branding’

34. Because the purpose we set out for Illustrative Examples is consistent with the objective of the IFRS Education Initiative (as set out in the next section of this paper), we think that we should consolidate our ‘branding’ by publishing all Illustrative Examples as education material, notwithstanding when the examples are developed. The naming distinction between an Illustrative Example and Application Guidance is too subtle (even putting aside the additional names we use to describe this material).
35. Illustrative examples should continue to be developed and should be included with Exposure Drafts, even more extensively than is done now. However, it should be made clear that these examples are educational in nature and are intended to be published as accompanying educational material when the Standard is issued. When a Standard is issued, the formal release package should contain the Standard and the accompanying Basis for Conclusions. Illustrative Examples should be released at the same time but as separate documents. (We will consider whether such educational material should be published electronically rather than in print.)
36. There are several advantages to this approach. The material accompanying our Standards has evolved over time, and includes ‘equivalence’ tables, which identify equivalent paragraphs in the Standard being replaced, comparisons with US GAAP, the Basis for Conclusions and Illustrative Examples. Having the Standard and Basis for Conclusions published as the two main documents provides a much cleaner focus on the two most important outputs.
37. Publishing Illustrative Examples and similar guidance in a clearly labelled education support pack helps to ensure that those examples and guidance are perceived as supportive, rather than interpretative, material.
38. Some of the material we release with a new Standard is designed to help people become more familiar with the new requirements, and includes webcasts, snapshots and presentation slides. We are not suggesting that all of this material should be included into an ‘education’ package. We might, however, include, for example, an executive summary in the package, similar in nature to those in *IFRS —A Briefing for Chief Executives, Audit Committees & Boards of Directors*.

39. Although how we package or present the material can help to make its purpose much clearer, what will be critical is ensuring that the examples and explanations inside a Standard and the examples and explanations inside the education material, published outside a Standard, are different in terms of their nature and purpose. Ideally, the material we publish to support a new Standard (such as the Illustrative Examples) will not need to be supplemented at a later date. However, it is inevitable that, just as we sometimes need to amend or interpret a Standard, we will sometimes see the need to issue additional education material after a Standard has been issued. Also, as the Education Initiative identifies new needs across a broad range of topics it will continue to develop its own priorities.
40. The next section provides an update on the IFRS Education Initiative and sets out the newly formalised due process for the development of education material.

Education Initiative update

41. The Education Initiative staff last updated the IFRS Advisory Council on its activities in October 2011, when it set out its current and medium-term plan (2012–2016). In October 2012 the plans were expanded to include an Investor Education project and IFRS capacity building workshops for emerging market and developing market IFRS regulators.
42. Consequently, the Education Initiative now focuses on supporting IFRS teachers; IFRS adoption and implementation support (including workshops for IFRS regulators); *IFRS for SMEs* adoption and implementation support; and investor-focused IFRS education.
43. The objective of the Education Initiative is to promote the adoption and consistent application of IFRS, while taking into account the particular needs of emerging economies and SMEs. The Education Initiative does not interpret Standards or respond to specific questions about the application of a Standard. Rather, it focuses on making IFRS material more accessible to particular audiences.
44. For example, the Framework-based teaching project supports Chartered Accountant/Certified Public Accountant/equivalent IFRS teachers by giving them teaching material designed to help their students develop the skills to *apply* principles-based standards—ie to develop their students’ ability to make IFRS judgements and estimates. Since publishing the first batch of its Framework-based teaching material in January 2013, the World Bank and others have funded its translation into all the United Nations’ official languages and they have organised regional workshops at which the Education Initiative staff has trained about 1,500 teachers worldwide in the use of that material.

Due process

45. The IASB and the Due Process Oversight Committee are aware of the added difficulties of generating helpful education material without undermining our open and consultative processes. In February 2013 the *Due Process Handbook* was updated to codify the due process for education material, as follows:

Education Initiative

- 6.42 The IFRS Foundation sometimes produces educational material related to IFRSs, including presentations for conferences, guides for executives, *IFRS for SMEs* training material and

educational material that accompanies, but does not form part of IFRSs. The development of educational material does not take place in public meetings and is not subjected to the public scrutiny that is given to the development of IFRSs.

- 6.43 The staff of the IFRS Foundation Education Initiative are part of the technical staff and report to the Senior Directors of Technical Activities. The IASB and the technical staff have a responsibility to ensure that any educational material is not confused with an IFRS or perceived as being mandatory. Consequently, the IASB has an interest in ensuring that the Education Initiative has quality assurance processes that are appropriate for each of its publications.
- 6.44 In order to meet the assurances above, educational material developed by the Education Initiative is subjected to the following peer reviews:
- (a) high level summaries, such as Executive Briefings and PowerPoint presentations, are reviewed by an appropriate technical staff member and by a member of the Editorial team;
 - (b) teaching materials, such as those used for *Conceptual Framework*-based teaching, are also reviewed by an IASB member or appropriate external expert, such as an academic. More detailed teaching materials, however, such as comprehensive *IFRS for SMEs* training material, is reviewed by at least two IFRS experts, one of which must be an IASB member; and
 - (c) educational material accompanying an IFRS must be reviewed by at least three IASB members.

The due process requirements are designed to make sure that educational material is not interpretative, amongst other things. Consequently, the more detailed the education material is, the more formality we have in terms of due process requirements. On the other hand, some suggest that the more formality we put around education material the more authority people might attach to that material.

46. We think these safeguards work well and reflect a pragmatic approach to protecting the integrity of the educational material.

The Education Initiative and education material

47. In 2012 the Education Initiative became part of Technical Activities. This was in recognition of the importance of education in helping to achieve consistency in the application of IFRS. That initiative has its own mission, which is described above.
48. The proposal to label Illustrative Examples as education material should not be confused with the role of the Education Initiative. One of our quality controls is identifying the right people to prepare and review the material. Accordingly, when we develop supporting material, including Illustrative Examples and conference presentations, many people are involved. For example, the Fair Value Measurement educational material was developed by the technical staff who look after IFRS 13. The IFRS 11 material, that we did not publish, was developed by members of the IFRS implementation team.

Post-publication support

49. Once a Standard is issued it is, for all intents and purposes, a final document. Any change to that Standard would require an amendment that must be developed with full public consultation. In a similar manner, an Interpretation must be developed applying the full due process.
50. Yet, it is often in those early phases when the most uncertainty about the new requirements exists. Only when entities begin to apply a new Standard to their transactions and activities do they identify areas of uncertainty. This is inevitable with any change. Although outreach and field testing is likely to reduce the uncertainty for those who participated in that process, most entities will be applying these requirements for the first time. Even if they are familiar with the requirements, preparing financial statements that are subject to public scrutiny has more finality and brings added pressure.
51. Uncertainty associated with first-time application of a Standard is not necessarily caused by a lack of clarity in the requirements of a Standard. Rather, it is often, in our experience, caused by a lack of familiarity with, and the absence of established precedents for, the new Standard. This unfamiliarity reduces the confidence of those applying the Standard for the first time. We think that this uncertainty is best resolved through mechanisms that allow those applying the Standard for the first time to share their experiences.
52. That is not to say that all uncertainties are caused by a lack of familiarity. There will be cases where a Standard is unclear in some respect in a way that it will be necessary to amend or interpret the Standard to reduce diverse application evolving.
53. The challenge we face is assessing whether the uncertainty is best resolved by developing educational material, through additional educational steps by us, by referring a matter to the IFRS Interpretations Committee (the 'Interpretations Committee') or the IASB, or by doing nothing and letting practice evolve because the matter is one for which the IASB expects the application of judgement.

Post-publication Interpretation and education

54. After the IASB issued IFRS 3 *Business Combinations* we received several requests to 'clarify' that Standard. At the time we allocated a technical manager to review those

requests and to ask members of the Interpretations Committee, national standard-setters and the main accounting firms if they were aware of difficulties arising in the initial application of the Standard. Those enquiries took place after IFRS 3 was issued but before it became mandatory.

55. The staff received requests for approximately 70 amendments to be made to IFRS 3. We documented those requests and, in consultation with the Interpretations Committee, identified about ten that the Interpretations Committee thought warranted further consideration. The sixty or so that we did not take forward were matters that seemed to the staff to be related to fact patterns that were covered by the principles in IFRS 3. The staff did not provide any direction or advice to the people who had raised those issues but we indicated that we did not plan to take the matters any further. The other parties had the option of formally raising those matters with the Interpretations Committee, but they did not do so.
56. Of the ten issues considered by the Interpretations Committee and the IASB, three were finalised. In developing our response to each of those issues we worked with the FASB to ensure that we remained converged.
57. We consider this to be a positive and responsive approach to the initial application of a Standard. However, this approach was informal and not as transparent to outside parties as most of our other processes.

A more general approach

58. The IASB and FASB have decided to set up an implementation group for the new revenue Standard. That group will not interpret the new Standard, but our initial thinking is that it will operate in the same way that we managed the IFRS 3 requests, albeit in a more open way.
59. The revenue group is being set up in anticipation of the Standard. This reflects the importance of revenue as the top line in financial statements and the fact that so much guidance that has built up over a long period of time is being replaced by the new requirements. We are not anticipating problems with the new Standard, but are signalling our readiness to respond if required.
60. We think that there is merit in the IASB developing mechanisms for reviewing requests for clarification of a new Standard in a proportionate and transparent manner.

We say mechanisms, because a one-size-fits-all approach would be ineffective and inefficient. The proposed implementation group for revenue recognition is at the high end of the scale. If we monitor new Standards appropriately we can respond by setting up a full resource group, arranging an ad-hoc public discussion forum or discussing requests in a public IASB or Interpretations Committee meeting. What is important is to give the IFRS community the confidence that we will respond appropriately and in a timely manner. If we are too slow in responding we risk allowing diverse practice to become embedded.

61. Having a public review of early application issues should also assist the IASB to identify the most appropriate tool with which to respond, if a response is deemed necessary—education material, an Interpretation or an amendment.

IASB and the IFRS Interpretations Committee

Responsibilities of the Interpretations Committee

62. The Interpretations Committee has an important role to play in supporting the consistent implementation of a Standard. The objectives of the Interpretations Committee are to⁷:
- (a) interpret the application of a Standard;
 - (b) provide timely guidance on financial reporting issues that are not specifically addressed in the Standards; and
 - (c) undertake other tasks at the request of the IASB.
63. The Trustees completed a review of the efficiency and effectiveness of the Interpretations Committee in May 2012. One of the main recommendations of that review was that a broader range of ‘tools’ should be deployed by the Interpretations Committee, enabling it to be more responsive to requests for assistance.
64. This broader range of tools means that, in addition to developing Interpretations and Annual Improvements, the Interpretations Committee should also, where appropriate, develop proposals for narrow-scope amendments to Standards, develop proposals for additional Illustrative Examples and refer issues to the Education Initiative for the development of other education material.
65. We see the Interpretations Committee as continuing to be the principal forum where implementation issues that require standard-setting action are addressed. We see the general mechanisms described in the previous section as additional ways in which issues are identified for referral to the Interpretations Committee. Where those issues are best addressed through the development of additional education material, this fits well with the broader range of tools available to the Interpretations Committee.

Interactions between the IASB and the Interpretations Committee

66. The IASB and the Interpretations Committee share a common view on the role that the Interpretations Committee should play: both bodies see the Interpretations

⁷ see paragraph 43(a) of the IFRS Foundation Constitution.

Committee as working in partnership with the IASB to give guidance that responds to the implementation needs of those applying IFRS.

67. Since the Trustees' review of the Interpretations Committee, the interaction between the IASB and the Interpretations Committee has been enhanced. Four IASB members regularly attend and speak at the Interpretations Committee meetings. In addition, IASB members are provided with timely briefings of the principal issues discussed by the Interpretations Committee. The Interpretations Committee has also sought the IASB's views on significant issues when it has reached important decision points in its discussions. Those various steps are intended to ensure clear communication between both bodies and thus reduce the risk of an issue being passed back and forth between them.

Maintaining convergence

68. Several Standards are the product of the convergence programme with the FASB. Significant effort has been made over the last ten years or more to reach common conclusions on a number of Standards, or to develop Standards that are largely the same as those already issued by the FASB. Having invested that time and effort in achieving convergence, it is important that convergence is maintained.
69. Whenever the Interpretations Committee or the IASB considers an amendment to a converged Standard, it considers the effect on convergence. When developing our staff analysis of issues relating to a converged Standard, we liaise with FASB staff to understand their views on the issue from a US GAAP point of view. When we think that the issue should lead to an amendment to a converged Standard, we discuss this with FASB staff to explore the opportunity for an equivalent amendment to be made to US GAAP, thus maintaining convergence.

Working with securities regulators

70. In 2013 the IFRS Foundation strengthened its co-operation with IFRS regulators on two fronts:
- (a) the International Organization of Securities Commissions (IOSCO) and the IFRS Foundation agreed on a set of protocols under which the two organisations will deepen their co-operation in support of their shared commitment to the highest standards of financial reporting globally; and
 - (b) the Education Initiative hosted jointly with the World Bank and the Asian Development Bank a series of regional five-day IFRS capacity building workshops for emerging market and developing market IFRS regulators.
(For more information see page 6 of the Appendix to this Agenda Paper.)
71. The protocols agreed between the IFRS Foundation and IOSCO identify the benefit of timely communication between the two organisations in leading to the early detection of implementation issues and the opportunity to prevent or limit the development of diversity in practice. Among the steps that each will take are:
- (a) a regular discussion of the types of IFRS implementation issues that the IOSCO members are observing;
 - (b) communicating the aspects of implementation of new or significantly amended Standards that the IASB staff anticipates are most likely to be of interest to securities regulators; and
 - (c) discussing the issues and Standards that seem to be raised most frequently or most significantly in IFRS enforcement matters.
72. We expect that this enhanced communication, and the capacity building, will contribute further to consistent implementation of IFRS.