

AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

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Effects analysis

Introduction

1. The purpose of this paper is to:
 - (a) update the DPOC on the activities of the Effects Analysis Consultative Group and the status of its report; and
 - (b) seek the support of the DPOC for finalising the report.

Approval by the Consultative Group

2. Most members of the Consultative Group have indicated that they support the release of the document in principle, on the basis of the draft they reviewed in July. We have made it clear that the members of the Consultative Group were appointed because of their experience and they contributed as individuals. None of their organisations have been asked to approve the report.

Presentation of the report

3. The revised report now includes a letter from Ian Mackintosh, as Chairman of the Consultative Group, presenting the report to the Trustees. The text includes the following statements:

Part of the responsibility of the IASB in developing high quality, understandable, enforceable and globally accepted financial reporting standards is explaining to those affected by its Standards how it assessed the likely implications of new requirements. This includes explaining how general purpose financial reports are likely to change because of the new requirements and why it considers those changes to be justifiable, demonstrating how it assessed the likely effects on the direct costs to preparers of meeting the new requirements and the related costs to users.

Just as the Standards need to be globally accepted, it is also important that the steps taken and processes applied by the IASB in developing the

Standards should be globally accepted. The purpose of the Effects Analysis Consultative Group has been to provide advice that the IASB can use to improve how it undertakes field testing and reports effects analysis, with this in mind.

We believe that confidence in the standard-setting process can be improved, by improving how the IASB undertakes and assesses fieldwork and how it shares the results of its fieldwork.

We hope that our observations and recommendations will be helpful to the Trustees and to the IASB.

Next steps

4. I have been working through the comments I received on the July draft. A brief overview, and examples, of the type of comment I received is provided in the appendix to this paper. The most recent version of the report is attached as a separate paper (Agenda Paper 3D(i)).
5. If the DPOC supports the finalisation of this report I will work through the final review steps to get clearance from members of the Consultative Group. It is their report and I think it is important that they make the final decision on clearance.
6. The report still needs a final editorial sweep after which we will put the report into our production processes.

Questions for the DPOC and Recommendation

7. Do DPOC members have any comments or questions about the (near) final report?
8. I recommend that the DPOC formally acknowledge the work to date of the Effects Analysis Consultative Group and note that the DPOC looks forward to the finalisation of their report.
9. Further, if the DPOC supports the report I recommend that the Trustees should welcome the final version of the report and commend it to the IASB to implement the conclusions and recommendations to the extent that they have not already been implemented.
10. I also suggest that the staff be asked to report to the DPOC on progress in implementing the recommendations, about six months after the *Report of the Effects Analysis Consultative Group* has been finalised.

Appendix

Review and editing

A1 I received over 1,000 comments and suggested edits to the last version of the report. I categorized these into three groups:

Minor editorial improvements

A2 The vast majority of the comments were relatively minor editing or consistency suggestions, or reflected preferences for how a particular matter could be expressed. None of these comments were fatal or fundamental. However, as is often the case when fresh eyes view a document, most of these suggestions had merit and I have accommodated as many as possible. In some cases the resulting editing will look extensive because a small comment that suggested a sentence or phrase was unclear was addressed by re-writing the sentence or moving it to a different paragraph.

A3 On the face of it, the report could have been issued without making these changes (putting errors aside). However, I have no doubt that the feedback and resulting edits have improved the consistency and clarity of the report.

More substantive drafting comments

A4 About 300 comments were of a more substantive nature. Typical of this were cases where a statement in the report gave the appearance of being an assertion by either the IASB or the Consultative Group. In cases where a statement was made about the current approach of the IASB I have added as far as possible direct references to support those statements, or modified the language. By way of example, the original text in paragraphs 17 and 18 of the report discussed the objectives of the Financial Stability Board and the IASB and asserted that the IASB views these objectives as being complementary. The same message has been conveyed by inserting a direct quote from the 2011 IFRS Foundation that is attributable to the Trustees. This sort of change makes it absolutely clear whether it is the Consultative Group making a statement or that the statement comes from another body.

A5 Another type of change related to some confusion about whether the report was referring to the transparent (open) way in which the IASB operates or the goal of improving the transparency of information in general purpose reports. That has been addressed by defining the purpose of general purpose financial reports

(which includes a reference to transparency) and then referring to improving general purpose financial reports in the rest of the document.

Messaging

- A6 Only a relatively small number of comments were more fundamental in that they related to the main messages being conveyed. Two matters raised by the Trustees in July fit into this category—explicit references to stewardship and a statement that the IASB needs to assess potential changes to financial reporting requirements from a global perspective. (See paragraphs 0 and 0 of this report.)
- A7 Added some recommendations that we implicit and included in the body of the text. For example, the report now includes a recommendation that if the IASB develops a separate summary effects report that the report should be included in the package of documents balloted by the IASB.
- A8 In the paragraphs that follow I have set out the main changes that relate to different messages.

Consequences – stewardship

- A9 The sections on the consequences of financial reporting standards referred to investor’s assessments possibly being affected by the new information required by a new requirement—buy, sell and hold. Paragraph 55 has been amended by replacing a reference to accountability with a reference to stewardship and a reference to voting has been added:

... When investors, existing or potential, receive new information from general purpose financial reports, that information could influence how an investor assesses how the management have discharged their stewardship responsibilities or an investors assessment of the cost of capital of the entity. This, in turn, could influence how the investor votes at a shareholder meeting or influence a decision to buy, sell or hold shares in the entity.

Global assessments

- A10 Feedback from some Trustees suggested that we need to emphasise that the IASB needs to assess the net benefits of a change in financial reporting from a global perspective. Paragraphs 115 and 116 now state:

The IASB has a responsibility to give full and fair consideration to the perspectives of those affected by IFRS globally. This is particularly important

in ensuring that the Standards are able to be implemented across a range of jurisdictions with a variety of different regulatory frameworks.

Having said that, the IASB must make its assessment from a global perspective and not make its decisions because of how the new requirements could affect a particular jurisdiction. There might be circumstances where the net benefits of a new requirement are negligible (or even create a net burden) for entities within in a particular jurisdiction. The IASB's assessment needs to be whether new financial reporting requirements are justifiable on a global basis.

Summary report and basis for conclusions

A11 There was some confusion about whether a summary effects report and the basis for conclusions would, or should, contain the same information on effects. The uncertainty related to the comments about ensuring that the IASB should take ownership, and be seen to take ownership, of the effects analysis. This section (paragraphs 131 to 135) addresses the issue of repeating information in different documents. The most important change is that a new recommendation has been added to the report stating that if a separate report on effects analysis is prepared that this report should be included in the package of documents balloted by the IASB when it finalizes an IFRS.

Economic and other consequences

A12 The language in the section on economic consequences (starting at paragraph 55) has been strengthened. Some Consultative Group members noted that the report said that the IASB considers economic consequences but did not say which ones or how. Paragraph 59 now introduces this concept more clearly and includes an example of economic consequences (relating to job losses in the leasing industry) sent to the IASB as part of leases project. The new text reads:

The IASB's Due Process Handbook requires that the IASB to explain how the improvements to financial reporting will result in better economic decision-making. The IASB's primary concern is to improve general purpose reporting of an entity's activities in a cost beneficial way, rather than to judge the consequences of changes to reporting requirements. In the lease example mentioned in paragraph **Error! Reference source not found.**, the IASB will be assessing whether the proposed financial reporting requirements will provide

better information about leases by making “hidden debt clearly visible”.¹ The IASB is not required by its due process to factor into its assessment the possibility that the leasing industry might employ fewer people because of these changes. The consultative group agrees that assessing these broader consequences is not the responsibility of the IASB.

The objective of general purpose financial reporting relates primarily to improving the quality of financial information for the purposes of making decisions about evaluating the entity’s management or providing resources to the entity. The focus of the IASB’s assessment should be on how a proposed financial reporting change is likely to affect that objective. The IASB is not required to assess possible broader economic consequences because these are beyond its objective.

Prudential supervision

A13 The extent to which the IASB should “consider” financial stability has been a sensitive issue and therefore sensitive part of the report. The wording has been amended slightly, to emphasise that the IASB’s responsibilities relate to communication. The recommendation, at paragraph 69, states:

The mandate of the FSB is to promote the stability of financial markets as a whole. The IASB focuses primarily on ensuring that investors have high quality, transparent and comparable information (general purpose financial reports) about individual entities.

To help the FSB achieve its objectives, the IASB should, without compromising its own objectives, continue to engage with the FSB to ensure that the FSB is aware of proposed changes to financial reporting and has sufficient time to assess and address how changed financial reporting information should be incorporated into their monitoring systems.

Cooperation with other standard-setters

A14 The last version of the draft highlighted the problems of the IASB undertaking its own fieldwork—small and biased samples making it difficult to generalize the results and problems of including participants globally.

A15 The report noted that working with other standard-setters could help alleviate some of those concerns. Feedback during the review suggested that this idea seemed to be presented a little dismissively. There is a strong case for the IASB

¹ Europe and the path towards global accounting standards, Hans Hoogervorst, 2013 Ernst & Young IFRS Congress, Berlin

changing its model for undertaking fieldwork to become more of a facilitator and consumer of fieldwork results. The report has had some paragraphs added to describe this approach. (See paragraphs 117 to 119).

The IASB already works closely with National Standard-setters on the development of IFRS. The Consultative Group considers that there is scope for these other standard-setters undertaking more fieldwork within their jurisdictions and sharing the results with the IASB. These standard-setters could become the primary field-testers and the main role of the IASB would be to receive and assess the fieldwork results.

The Consultative Group thinks that such an approach has the potential to broaden the number of fieldwork participants significantly, improving the generalizability of the results and assessing a broader range of local conditions. Having local standard setters involved in identifying fieldwork participants and administering the work could also increase the confidence of national jurisdictions in the fieldwork process.

This approach is not without risks. The IASB would need to be involved in designing the fieldwork and may need to supervise the fieldwork to ensure that the testing is undertaken in a consistent manner. The National Standard-setters would also need to strive to make the data publicly available. Not all standard-setters have the resources to be able to undertake work for the IASB. Nevertheless, the Consultative Group considers that this is an avenue worth exploring further.