

# AGENDA PAPER

IFRS Foundation Trustees meeting—Due Process Oversight Committee

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## Correspondence: update

### Introduction

1. The purpose of this paper is to provide an update to the Due Process Oversight Committee (DPOC) on any correspondence received on due process matters since the DPOC's meeting held on 8 October 2014 in Mexico City.
2. At the last DPOC meeting we brought one potential item to the DPOC's attention (Agenda Paper AP 3F for that meeting refers). We informed the DPOC that we were expecting a letter from the European Financial Reporting Advisory Group (EFRAG). The letter was received in early October 2014 and a copy was made available to the DPOC at its meeting (a copy of the letter is at Agenda Paper 2F(i)). As agreed at that meeting, Scott Evans sent a holding reply to EFRAG, a copy of which is attached at Agenda Paper 2F(ii).
3. On the basis of the feedback received from the DPOC members and discussions with IASB technical staff, a draft response to EFRAG is at Agenda Paper 2F(iii).
4. The letter from EFRAG is the only correspondence received on due process matters.

### Overview of EFRAG's letter

5. Members may recall that EFRAG issued a draft letter on its website *EFRAG Invites comments on proposals to enhance IFRS quality control*. EFRAG received 14 responses to its consultation and the EFRAG Supervisory Board considered the comment letters at its meeting on 19 September 2014.
6. The comment letters did not support all of the improvements suggested in the EFRAG draft letter. The comment letters did, however, reveal support for EFRAG's view that the IASB's standard-setting process at the stage of finalising a Standard can be improved.

7. Respondents expressed a number of reasons for agreeing with EFRAG's view that the IASB's standard-setting process at the stage of finalising a Standard can be improved. These reasons include:
  - (a) in some cases, amendments have been issued shortly after the Standard has been issued; and
  - (b) reduced understandability of recently issued Standards, including a concern that Standards are not written in plain English and that there is a lack of clarity about new and existing terms.
8. The main points raised by EFRAG in its final letter are:
  - (a) Appropriate quality control is necessary to facilitate and reduce the cost of implementation of new requirements and to support a common objective of consistent application of IFRS.
  - (b) There is evidence that the IASB's standard-setting process at the stage of finalising a Standard can be improved.
  - (c) The IASB should undertake public fatal flaw reviews prior to finalising any major amendments or new Standards. Support for a public fatal flaw is based on a public consultation carried out by EFRAG.
  - (d) Past practice has shown that the IASB is (understandably) reluctant to running a full due process for small amendments because minor amendments issued shortly after publication do not reflect positively on the IASB's work/standard-setting process.
  - (e) Educational material is developed long after a new Standard is issued and is not available in the implementation phase.
  - (f) Supplementary assistance that the IASB is providing to implementation efforts by the Transition Resource Groups does not eliminate the high hurdle that a full due process represents.

### **Staff comment**

9. As noted above, a draft response to EFRAG's letter is set out at Agenda Paper 2F(iii). The following sets out how we propose that the DPOC should respond to the comments raised by EFRAG in its letter.

***Appropriate quality control is necessary to facilitate and reduce the cost of implementation of new requirements and to support a common objective of consistent application of IFRS.***

10. The draft response agrees with EFRAG that appropriate quality control is necessary to facilitate and reduce the cost of implementation of new requirements and to support the consistent application of IFRS. We have discussed this concern with IASB technical staff and with other national standard-setters. Following these discussions, the IASB technical

staff have identified improvements to the review process to be used by technical and production staff. The improvements to the processes are designed to ensure that some specific procedures required in completing a final amendment or Standard have been carried out and that that procedure is evidenced.

11. As part of the improvements to the process, the IASB technical staff will focus on improving the quality of pre-ballot drafts. In future, internal, where appropriate, ‘cold reviews’ will be undertaken by senior members of the technical team on all pre-ballot drafts.

***There is evidence that the IASB’s standard-setting process at the stage of finalising a Standard can be improved.***

12. EFRAG raise two instances, the publication of the second exposure draft for *Revenue Recognition* and the issuance of IFRS 11 *Joint Arrangements*, where it considers there is evidence that the standard-setting process at the stage of finalising a Standard could have been improved.
13. In relation to *Revenue Recognition*, we note that EFRAG are referring to the publication of a second Exposure Draft, which was subject to public consultation. The objective of publishing the second Exposure Draft was to seek feedback on the draft Standard and to ensure that the proposed requirements were clear. The technical staff note that if the IASB and FASB had decided not to publish a second Exposure Draft, the finalisation procedures for issuing the Standard would have undergone a different process from the process that was used for the second Exposure Draft. The technical staff do not consider that publishing a second Exposure Draft can be considered as evidence in considering whether the IASB’s procedures for finalising a Standard require improvement.
14. In relation to IFRS 11, the IASB technical staff are aware that there are differing views on the implementation difficulties in Europe and that not everyone would agree with EFRAG’s comment.
15. The EFRAG letter also raises concern regarding the current private editorial reviews. The letter notes that those who participate in the IASB’s current editorial reviews, including EFRAG, have had involvement and interaction with the IASB in the development of the final amendment or Standard. EFRAG argues that this prior understanding leads to shortcomings in the review process.
16. The technical staff do not consider that there is evidence that a mandatory public fatal flaw review would lead to improvements, because it is not clear that a public fatal flaw review would attract many ‘new participants’ to participate in the review process. Indeed, some of those new participants would be more likely to use the review as an opportunity to re-debate the technical decisions of the IASB. The staff have, however, discussed the concerns raised by EFRAG with some of those who participate in the editorial reviews and

they have arranged to increased support for the process. In addition they have also offered to undertake a second review if significant changes have been made following the first editorial review.

17. The IASB has also made arrangements for an external independent review to be made of all pre-ballot drafts. This will further enhance the external review process.

***The IASB should undertake public fatal flaw reviews prior to finalising any major amendments or new Standard. Support for a public fatal flaw is based on a public consultation carried out by EFRAG.***

18. As we discussed with the DPOC at its last meeting we do not support the call for changes to the *Due Process Handbook* to mandatorily require a public fatal flaw review. In our last update to the DPOC we noted:

We note that the DPOC considered EFRAG’s request for a public fatal flaw review in its response to the IFRS Foundation’s 2012 review of the *Due Process Handbook*. The DPOC considered this at its meeting in October 2012, as part of its consideration of the issues raised by responses to the proposals to revise the *Due Process Handbook*. The report of that meeting<sup>1</sup> noted that:

“The DPOC considered the suggestions made by some respondents that review drafts should in effect become a systematic step in the due process and be published on the website for public fatal flaw reviews and field testing. It was noted that the purpose of a review draft was unclear. The IASB saw review drafts as a final ‘housekeeping check’ to ensure that the draft document was clear and reflected accurately the technical decisions made by the Board. It was not a document used to consider the appropriateness of the Board’s decisions. The DPOC accepted that having a review draft for external review should not become a mandatory due process step, but thought that the DPH should clarify the purpose of a review draft and what a review draft was not”.

This view was reflected in the *Due Process Handbook: Feedback Statement* that accompanied the issue of the revised *Due Process Handbook* in February 2013:

“We do not think that a review draft should become a mandatory due process step. The *Due Process Handbook* clarifies what the purpose is of such a draft and what it is not, noting that it does not constitute a formal step in the due process, and it is not a substitution for a formal due process step. It has a limited purpose, representing an editorial ‘fatal flaw’ review in which reviewers are asked whether the draft is clear and reflects the technical decisions made by

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<sup>1</sup> Available at: <http://www.ifrs.org/DPOC/meetings/Documents/DPOCmeetingreportOct12.pdf>.

the IASB. To reflect this, the *Due Process Handbook* uses the term ‘draft for editorial review’<sup>2</sup>.

The Due Process Handbook (paragraph 3.31) does give the IASB flexibility as to whether it makes available on the website a draft for editorial review. The IASB also has discretion as to the nature of the external review. But the *Due Process Handbook* (paragraph 3.32) does go on to specify the limited purpose of the draft for editorial review and the fact that it does not constitute, nor is it a substitute for, a formal step in the due process. EFRAG’s draft proposal would imply the introduction of another formal step.

19. As a consequence, the proposed response to EFRAG does not support the call for a public fatal flaw review. Instead the draft response maintains that it is better to retain the current flexibility provided in the *Due Process Handbook* rather than amend the *Due Process Handbook* to require a mandatory public fatal flaw review.

***Past practice has shown that the IASB is (understandably) reluctant to running a full due process for small amendments because minor amendments issued shortly after publication do not reflect positively on the IASB’s work/standard setting process.***

20. We are proposing that the DPOC should state that it does not agree with EFRAG’s comment that “past practice has shown that the IASB is (understandably) reluctant to running a full due process for small amendments and because minor amendments issued shortly after publication do not reflect positively on their work/standard setting process”. We are not aware that there is any evidence that the IASB has failed to add a potential item to its work programme where an issue warrants addressing. On the contrary, at the last Accounting Standards Advisory Forum members requested that the IASB should resist calls for continual minor amendments to Standards.
21. In addition, the IASB’s decision to add a potential item to its work programme is guided by the *Due Process Handbook*. This requires the IASB to evaluate the needs of users of financial reports, while also taking into account the costs of preparing the information in financial reports.

***Educational material is developed long after a new Standard is issued and is not available in the implementation phase.***

22. We suggest that the DPOC need not respond to comments about the timing of educational material. In the education staff’s view, irrespective of when educational material is issued, it cannot, as suggested by EFRAG, ‘make up for any drafting and other textual shortcomings in the IFRS detailed requirements’. The function of education material is not to interpret IFRS but instead to illustrate the requirements and to support the development

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<sup>2</sup> The Feedback Statement can be accessed at: <http://www.ifrs.org/DPOC/Documents/2013/Feedback-Statement-Due-Process-HB-Ferbruary-2013.pdf>.

of capacity to make the judgements that are necessary to apply IFRS. For example, increasing understanding of the reasons for the decisions within the context of a particular Standard (and why those reasons might differ from those that apply in other Standards) develops a cohesive understanding of IFRS, which informs the judgements necessary when applying the IAS 8 hierarchy to plug a resulting gap in IFRS requirements.

23. Contrary to EFRAG's view, some educational material is in fact issued together with a new IFRS; for example, illustrative examples and other non-mandatory implementation guidance, which accompanies but does not form part of a new IFRS.
24. Some other educational material is necessarily developed after an IFRS is issued. For example, education material that documents the 'lessons learned' by those applying early a new IFRS cannot be developed before the new IFRS is issued.

***Supplementary assistance that the IASB is providing to implementation efforts by the Transition Resource Groups does not eliminate the high hurdle that a full due process represents.***

25. We agree with EFRAG's comments that supplementary assistance to implementation efforts that the IASB is providing by the Transition Resource Groups does not eliminate the need to ensure a high quality final amendment or Standard. The objective of the Transition Resource Groups is to assist in the implementation and consistent application of Standards.

#### **Action**

26. We are seeking the approval of the DPOC to the letter at Agenda Paper 2F(iii).