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IASB
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29 September 2014

Dear Hans,

Re: IASB's quality control procedures prior to issuance of a final standard or major amendment to a standard

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing this letter to make recommendations for enhancing the IASB quality control procedures prior to final amendments or standards becoming effective.

In EFRAG's view, appropriate IASB quality control is necessary to facilitate and reduce the cost of implementation of new requirements and support our common objective of consistent application of IFRS. There is no doubt that the IASB and its staff are dedicated to delivering the best possible product and already make all possible efforts within the IASB's current due process. Recent experience shows that, despite all these efforts, final requirements – or intended final requirements – can be difficult to understand and implement by the public at large. If we consider recent projects, we note that at the time the IASB and the FASB issued the second exposure draft on Revenue Recognition, they genuinely thought that a final standard was nearly ready for issue. The consultation period showed, however, that constituents had considerable difficulties in understanding some of the proposed requirements. An example of a recent standard that is causing numerous and significant implementation problems is IFRS 11 *Joint Arrangements*.

In EFRAG's view this situation shows that the IASB's standard setting process at the stage of finalising a standard can be improved. The IASB is striving to have its new standards improve financial reporting at as low a cost as feasible. Difficulties in understanding a standard increase the implementation costs, feed the views of those who feel that IFRS are too complex and encourage the questioning of the quality of IFRS. It also creates divergence in practice and tends to transfer to the auditors the responsibility for interpreting IFRS. In several cases in the recent past, narrow-scope amendments to recent standards have been needed, with the supplementary cost to IFRS standard setting, adoption and implementation of the frequent changes in financial reporting.

EFRAG has recommended that the IASB undertakes public fatal flaw reviews prior to finalising any major amendment or new standard. All those who participate in the IASB's private fatal flaw reviews, including ourselves, have had involvement and interaction with the IASB in the development of the standard. As a result, the draft requirements are read with prior understanding of the intended outcomes and the review is likely to miss shortcomings in the drafting. These shortcomings appear only after standards are published and exposed to the fresh eyes of preparers, auditors, and enforcers who have had no direct involvement in setting the standard.

Hence in our response to the revision of the IASB *Due Process Handbook*, we noted that the IASB's due process in relation to review drafts needs to be further developed. More particularly, EFRAG:

- (a) Welcomed and underlined the need for the use of public review drafts for systematic public "fatal flaw" reviews and identification of potential implementation difficulties or undue costs.
- (b) Recommended to the IASB that results of public fatal flaw reviews should be assessed, in a public meeting, before the IASB makes its final decision on a new or amended standard and a summary of the results should be published.
- (c) Recommended to the IASB that final balloting should only take place on the final draft after including the public results of the public 'fatal flaw' review and when appropriate of field tests.

We believe that the experience of the public fatal flaw review of IFRS 9 phase 3 "General Hedge Accounting Model" was successful. In its comments EFRAG did not re-open issues already fully deliberated – we recommended particular care in the final drafting of the basis for conclusions. Comments received were helpful in adjusting the final wording and this supplementary due process step has been helpful in reducing misunderstandings. One of the advantages of this process was that the IASB was encouraged to proceed to some helpful late amendments without undertaking a separate public consultation. Another advantage was that the fatal flaw review could be coupled with a final effect analysis of the upcoming standard. If the fatal flaw draft had not been publicly available an effect analysis and field testing would not have been possible.

Despite this successful experience, we understand that the IASB saw more impediments than benefits in public fatal flaw reviews, and our recommendations have not been reflected in the final version of the IASB *Due Process Handbook*. We understand that major arguments against running fatal flaw reviews are that they would be considered by the public at large as a supplementary round of exposure and that too few participants would bear the cost of participating in the review as the standard remains subject to further changes.

We have just run a public consultation on the basis of a possible alternative to public fatal flaw reviews. We have been encouraged by an important number of our constituents, notably by those that are not included in the IASB's restricted fatal flaw reviews, to renew our recommendation that public fatal flaw reviews take place rather than thinking of another possible post publication light due process stage. The comments we have received do reflect that public fatal flaw reviews would not be regarded as a supplementary opportunity to challenge the IASB's final decisions. EFRAG has therefore decided to reiterate its recommendations that in case of major changes the IASB undertakes public fatal flaw reviews. We do believe indeed that all practitioners should be treated on equal footing when it comes to giving input to the IASB on difficulties in understanding or implementing IFRS requirements.

A major advantage of public fatal flaw reviews is that the IASB can deal with its outcomes within the post ED redeliberation stage, i.e. does not have to run a full due process in order to remedy the weaknesses identified. 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 further note that to date educational material is developed by the IASB long after a new standard is issued and is not available to assist in the implementation phase. It therefore cannot make up for any drafting and other textual shortcomings in the IFRS detailed requirements.

A public fatal flaw review as a standardised procedure would contribute to reaching a higher quality standard and reduces, at least to a large extent, the need for amendments immediately after publication. It allows for the introduction of changes without having to submit those changes to the full due process (be it well understood that those changes are within the confines of not needing to go for re-exposure).

We recognise that the decision of the IASB and the FASB to establish Transition Resource Groups to support the implementation of the Revenue Recognition and for Impairment of Financial Instruments standards provides other ways in which the IASB intends to support the implementation of a new standard. We note that wide support for such efforts has been expressed by the IFRS Advisory Council. Whilst the two Transition Resource Groups have just been established, the IASB has indicated that no change would be made to the standards without the usual due process steps. This supplementary assistance that the IASB is providing to implementation efforts does therefore not eliminate the high hurdle that a full due process represents.

We therefore continue to suggest that a public fatal flaw review be included as a formal step in the IASB due process including discussion of the fatal flaw results in a public meeting of the IASB based on a public summary report of these results before the final text of the standard is approved by the IASB. This procedure and its objective should be described in the Due Process Handbook.

We believe that the above recommendation will enhance the IASB's quality control and result in new IFRS requirements that are of higher quality.

If you would like to discuss our comments further, or if we can assist in any other way, please do not hesitate to contact Françoise Flores or me.

Yours sincerely,



Hans van Damme

Acting Chairman
EFRAG Supervisory Board

Cc: Michel Prada, Chairman, IFRS Foundation
Scott Evans, Chairman, IFRS Foundation DPOC