AGENDA

IFRS Foundation Trustees meeting – Due Process Oversight Committee

Kuala Lumpur	January 2019	**Agenda Ref 1G**
Contacts	Samuel Prestidge Richard Thorpe Henry Rees	

Due Process Handbook Review—Effects Analysis

Purpose

1. The purpose of this paper is to explain the proposed amendments to the Due Process Handbook (Handbook) relating to the Board's work assessing the likely effects of new financial reporting requirements. These amendments reflect the DPOC's discussion at its October 2018 meeting.

2. Further background information to assist the DPOC is available in Appendices:

   (a) Appendix A—recommendations from the Effects Analysis Consultative Group (EACG) report of November 2014;

   (b) Appendix B—feedback and recommendations from the Advisory Council in 2018;

   (c) Appendix C—extract from the report of the DPOC's October 2018 meeting summarising the DPOC's discussions on effects analysis at that meeting;

   (d) Appendix D—background on financial stability; and

   (e) Appendix E—draft proposed amendments to the Handbook.

3. This paper asks the DPOC one question:

Question for the DPOC
Do members of the DPOC agree with the proposed amendments to the *Due Process Handbook* relating to effects analysis (subject to editorial drafting amendments)?

Background

4. At its October 2018 meeting, the DPOC discussed proposals for amending the requirements in the Handbook relating to effects analysis. The DPOC agreed with the need to amend the Handbook to reflect the:

   (a) recommendations of the Effects Analysis Consultative Group (EACG);

   (b) feedback received from the Advisory Council in February 2018; and

   (c) developments to the Board's process on effects analysis.

5. The DPOC asked the staff to develop draft text to amend the Handbook for discussion at the January 2019 DPOC meeting. Following the October 2018 DPOC meeting the staff discussed the agreed approach to updating the Handbook relating to effects analysis with the Monitoring Board Deputies at their meeting in December 2018.

6. This paper explains the staff rationale for the draft proposed amendments to the Handbook and, for reference, the draft amendments are available for reference in Appendix E to the paper.

Scope and consideration of wider financial stability

7. To reflect the DPOC's discussion in October 2018, the staff propose amending the Effects Analysis Section of the Handbook to better explain the scope of the Board's analysis of the likely effects of new financial reporting requirements as follows:

   (a) the Board focuses on assessing how financial statements are likely to change because of new financial reporting requirements, whether those changes will improve the quality of financial statements and whether those changes are justifiable.

   (b) as part of the IFRS Foundation's mission, IFRS Standards bring transparency, accountability and efficiency to financial markets around the world. As noted in Section 1.1 of the Handbook, the confidence of users of financial statements in the transparency and integrity of those statements is critically important for the effective functioning of capital markets, efficient capital allocation, global financial stability and sound economic growth.

Therefore, the Board also considers any likely effects on financial stability when undertaking an analysis of the effects of standard-setting.

8. The staff also propose amending the Handbook to explain what is not in the scope of the Board's analysis of the effects. Draft wording has been added to explain that the Board is not required to assess the possible broader economic consequences of a change in financial reporting. Nonetheless, in response to concerns raised by stakeholders during the developing of new requirements, the Board may consider specific matters that go beyond assessing how the financial statements are likely to change (for example, assessing the likely effect of new requirements on the cost of borrowing).

9. In addition, the staff propose amending the definition of effects analysis in the Glossary of Terms in the Handbook to clarify the scope and to differentiate the term effects analysis and the Board's methodology from other terminology and methodologies used by some other organisations, for example Impact Assessment.

Effects analysis throughout the standard-setting process

10. The EACG and the Advisory Council recommended clarifying that the analysis of the effects is ongoing throughout the development of a Standard. The Board's ongoing process is that effects analysis methodology is intrinsic to its standard-setting process, but the Handbook is not currently explicit on this point.

11. To reflect this, the staff have sought to better differentiate between two related but different concepts: the process of analysing effects (the methodology of considering the likely effects of a Standard throughout the standard-setting process) and the 'Effects Analysis' document that is prepared and published upon the issuance of a major Standard. This is, first, to avoid giving an impression that the Board's analysis of the effects takes place only at the end of the standard-setting process, when the separate 'Effects Analysis' report is published, as opposed to being an ongoing process throughout standard-setting. It also emphasises that the Effects Analysis report centres on the likely effects of the final Standard and the steps that the Board went through in carrying out its assessment, and therefore does not necessarily reflect all the matters considered and steps taken through the entire effects analysis process.

12. Therefore, the staff propose amendments to the Handbook to better reflect how the Board considers the likely effects of standard-setting throughout the development of a Standard as follows:

   (a) the initial focus of a project is to define if a financial reporting deficiency exists. Following this, potential solutions to the problem will be sought and consideration of the likely effect of these solutions will be given.

   (b) stakeholder input on the defined problem, potential solutions and likely effects of those solutions is sought through a Discussion Paper and/or an Exposure Draft and the Board’s other processes for receiving input.

   (c) alongside the issuance of a major Standard, the Board publishes a separate ‘Effects Analysis’ report summarising the likely effects and how the Board made its assessments. For less substantial and pervasive changes to IFRS Standards an analysis of the effects is included as part of the Basis for Conclusions.

   (d) a Post-Implementation Review, if the change to financial reporting is substantial, provides the Board with the opportunity to understand the effects of the change by comparison to those identified by the Board at the time of issuing the new financial reporting requirements.

   (e) the Board and the Interpretations Committee consider the effects analysis previously undertaken in respect of a Standard when considering an amendment to an existing IFRS Standard.

13. Each section in the Handbook corresponding to the stages explained above includes a cross-reference to the Effects Analysis section to reiterate that the process for analysing the effects is intrinsic to the standard-setting process.

14. The staff propose amendments to the Handbook to acknowledge how the effects are reported at each stage of the standard-setting process and that more general consideration across a broader potential range of likely effects is given in the initial stages of a project. Consideration becomes more specific in-line with the greater specificity of the proposals as work progresses on the project. In the standard-setting phase, the Board explains why it is proposing a particular change to financial reporting requirements, including referring to the evidence it has collected and any outreach it has undertaken, in the Basis for Conclusions to the Exposure Draft. When

a major new Standard is issued, the Board issues a separate Effects Analysis report that summarises the likely effects and how the Board made its assessments.

15. This amendment to the Handbook can assist the Board to incorporate a proportionate effects analysis at each point of the standard-setting process and encourage consideration of what the outcome(s) of that analysis should be.

16. In being more explicit that the analysis of the likely effects is embedded throughout the standard-setting process, the Handbook also needs to acknowledge that the level and format of the analysis is tailored to the stage of the project. Previously, the Handbook acknowledged that the analysis is proportionate to the size and pervasiveness of the change in financial reporting, but not explicitly that it is tailored to the stage of the project. Staff have also addressed this in the draft amendments.

Question for the DPOC
Do members of the DPOC agree with the proposed amendments to the *Due Process Handbook* relating to effects analysis (subject to editorial drafting amendments)?

Appendix A—Recommendations from the Effects Analysis Consultative Group (EACG)

A1. The EACG confirmed that assessing and explaining the likely effects of new accounting requirements is part of a good standard-setting process. Explaining in an open and transparent manner how those requirements are expected to improve financial information, and why changes in financial reporting are justifiable, increase confidence in the standard-setting process.

A2. The EACG acknowledged that the incorporation of the Effects Analysis in the Board's work processes has evolved over time.

A3. The EAGC issued recommendations primarily related to new projects being developed by the Board and to new stages of projects existing in 2014.

Focus of effects analysis

A4. The EAGC recommended that the focus of the Board's assessment should continue to be on:

(a) how proposed accounting changes are likely to affect the quality of financial information for the purposes of making decisions about evaluating an entity's management or about providing resources to the entity;

(b) how those changes are likely to affect general purpose financial reports; and

(c) why those changes:

(i) will improve the quality of general purpose financial reports; and

(ii) are justifiable for the Board that should assess the likely effects on the direct costs to preparers and users of financial statements.

A5. The EAGC concluded that the Board is not required to assess any broader economic consequences, because these are beyond its objective.

Financial stability

A6. As a member of the Financial Stability Board (FSB), the Board is committed to pursue the maintenance of financial stability and of the openness and transparency of the financial sector.

A7. The EACG:

(a) noted that the Board's responsibility is to focus on ensuring that investors have high quality, transparent and comparable information; and

(b) recommended that the Board should not tailor financial reporting to meet the needs of other parties that use general purpose financial statements for their own objectives—including determining taxable income and distributable reserves, statistical purposes and regulation.

A8. In addition, the EACG:

(c) recognised that the Board has an obligation to allow these other parties to observe changes to financial reporting that could have implications for their activities; and

(d) recommended that the Board continue to engage with the FSB to ensure that the FSB is aware of proposed changes to financial reporting and that the FSB has sufficient time to assess and address how changed financial reporting information should be incorporated into the FSB's own monitoring systems.

Global assessment

A9. The EACG recommended that the Board continue to:

(e) aim to undertake consultation that is geographically broad-based so that IFRS Standards are written with principles that can be applied globally; and

(f) make its assessment from a global perspective to determine whether new financial reporting requirements are justifiable on a global basis, rather than from the perspective of any individual jurisdiction.

Assessing and reporting the likely effects

A10. The EACG recommended that the format of the analysis of the likely effects of proposed changes in financial reporting reflects the stage of the proposals:

(g) in the research stage, an analysis of the perceived deficiencies and the possible solutions should be an integral part of the discussion or research paper;

(h) at the Exposure Draft stage, the Basis for Conclusions should set out why the Board is proposing a particular change to accounting requirements, including referring to the evidence it has collected or the outreach it has undertaken; and

(i) when a new IFRS Standard is issued, the Board should generally prepare a separate Effects Analysis report—a well-focused document that:

  (i) summarises the likely effects and how the Board made the assessments; and

  (ii) is included within the package of documents balloted by the Board.

Appendix B—Advisory Council Feedback and initial recommendations

Feedback from the IFRS Advisory Council

B1 As reported to the DPOC (see Agenda Paper 1D June 2018), the IFRS Advisory Council considered whether and how the Effects Analysis work could be improved at its February 2018 meeting. The table below summarises the feedback from the IFRS Advisory Council and the staff's initial thoughts on how to the address that feedback in the *Due Process Handbook* 2018 Review:

	IFRS Advisory Council feedback	**Staff's initial proposals**[1]
Scope	• Maintenance of flexibility of approach is important; being proportionate and scalable depending on the project • The approach adopted is actively determined at the beginning of the project	• Explain, in paragraphs 3.73–3.76 of the *Due Process Handbook*, how the assessment of the effects is proportionate to the type of standard-setting undertaken. For example, the assessment of the effects of a Standard would be expected to be more comprehensive if that Standard is cross-cutting and affects a wide range of stakeholders across sectors, than if it is narrow in scope

[1] See Agenda Paper 1D June 2018 DPOC meeting.

	IFRS Advisory Council feedback	Staff's initial proposals[1]
Timing	• Analysis of effects is explicitly embedded throughout a project	• Specify the use of effects analysis methodology earlier in the standard-setting process. For example, paragraphs 4.12–4.15 of the *Due Process Handbook* could articulate how an ex-ante assessment of the potential effects of standard-setting is used in the research phase of a project
Content and methodology	• Effects Analysis should continue to focus primarily on the effects on the financial statements, while including acknowledgment and consideration of wider implications • Quantitative numbers are often very hard to determine; ensure assumptions are disclosed	• The *Due Process Handbook* already reflects this. No amendment needed
Format	• Clarify that the scope of Post-implementation Reviews includes an ex-post Effects Analysis • Clearly articulate differences between the Basis for Conclusions, the Effects Analysis and the Post-implementation Review	• Clarify, in paragraphs 6.52–6.63 of the *Due Process Handbook*, the scope and timing of the Post-implementation Review and how it includes an ex-post Effects Analysis

Appendix C—Report and background to the October 2018 DPOC Meeting

October 2018 Report

C1. The DPOC discussed a proposal for amendments to the Handbook to reflect developments to the Board's process on effects analysis, the recommendations of the Effects Analysis Consultative Group (EACG) and the feedback received from the Advisory Council in February 2018. DPOC members discussed the focus of effects analysis as set out by the EACG and were reassured that the Board's practice is to have regard to wider issues than the effect on general purpose financial statements (e.g. including the effect on financial stability and long-term investment). They also noted that the Advisory Council had recommended that the Handbook should be more explicit about the use of effects analysis throughout the standard-setting process, including the ex-post analysis through the PIR process. The proposal also reflects the importance of proportionality in the effects analysis process. The DPOC discussed the risk that the Board's approach to effects analysis could be confused with the impact assessment methodology that is used by many regulators and emphasised the importance of clearly articulating the scope and purpose of effects analysis in the Handbook.

C2. The DPOC agreed with the need to amend the Handbook in this area and the direction of travel set out in the paper, and asked staff to develop a more detailed proposal for the next meeting, including text to amend the Handbook.

Appendix D—Background on financial stability

Scope and consideration of wider financial stability

D1. The EACG and the Advisory Council recommended that the scope of effects analysis should focus on the effect of a change in financial reporting requirements on general purpose financial reports. Specifically, this focus would be on, the likely effects on the direct costs to preparers and users of financial statements of the change in financial reporting requirements on general purpose financial reports. These changes should be assessed to ensure that the changes are justifiable.

D2. The EACG recommendations acknowledged the Board's objective is to focus on "ensuring that investors have high quality, transparent and comparable information" (EACG Report to the Trustees 2014). The Report from the EACG also draws the connection between the Board's objective in providing investors with high quality, transparent and comparable information and improved financial stability. The IFRS Foundation's Mission Statement, also draws this connection, particularly that "IFRS Standards […] bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy".

D3. The Board's process of analysing the effects, for recently issued Standards[2], has also highlighted how improved transparency resulting from changes in financial reporting contribute to long-term financial stability. The Effects Analysis accompanying IFRS 17 *Insurance Contracts* explained that improved transparency in insurance accounting as a result of IFRS 17 contributes to long-term financial stability by revealing useful information that will enable actions from users of financial statements to be taken in a timely way.

D4. The Board's process has also developed to utilise effects analysis (particularly an Effects Analysis published alongside an issued Standard) to respond to project specific concerns about the change to financial reporting. An example of this is the Effects Analysis that accompanied the issuance of IFRS 16 *Leases*[3]. This addressed

[2] IFRS 17 *Insurance Contracts*— Effects Analysis

[3] IFRS 16 *Leases*—Effects Analysis

specific concerns raised by stakeholders relating the effects of the change in requirements from the former Standard IAS 17 *Leases* to the new requirements in IFRS 16:

a. on the cost of borrowing;

b. on debt covenants;

c. on regulatory capital requirements; and

d. on the leasing market and access to finance for smaller companies.

D5. This demonstrates how the Board's process has developed and how the effects analysis process is intrinsic to the standard-setting process. Considering the effects of a change in financial reporting requirements can be specifically in response to specific stakeholder concerns.

Accountability

Effect Analysis

3.74~~3~~ The ~~IAS~~Board is committed to assessing and ~~sharing knowledge~~explaining its views about the likely costs of implementing proposed new requirements and the likely ongoing associated costs and benefits of each new IFRS Standard—the costs and benefits are collectively referred to as *effects*. The ~~IAS~~Board gains insight on the likely effects of the proposals for new or ~~revised~~ amended IFRS Standards through its formal exposure of proposals and through its fieldwork, analysis and consultations with relevant parties through outreach activities. The likely effects are assessed:

(a) in the light of the ~~IAS~~Board's objective of financial reporting transparency; and

(b) in comparison to the existing financial reporting requirements.

3.75~~4~~ The process of assessing the likely effects is intrinsic to the development of financial reporting requirements. Therefore ~~T~~the ~~IAS~~Board assess the likely effects throughout the development of a new or amended IFRS Standard~~.~~, tailoring its assessment to the stage of the process of developing the new or amended IFRS Standard. For example, at the research phase, the Board focusses on assessing the nature of the financial reporting deficiency being addressed, seeks to define the problem and proposes possible solutions, focusing particularly on the likely benefits of developing new financial reporting requirements. At the standard-setting phase, the Board is developing a specific proposal for a new or amended IFRS Standard. Accordingly, it focuses on assessing the potential costs and benefits of implementing that proposal, and on assessing any alternatives that are being considered. The Board tailors the level of analysis to the nature of the proposed change to financial reporting ~~In particular, the IASB's views on the likely effects are approved by the IASB and presented as part of, or with, the Basis for Conclusions that is published with each Exposure Draft and Standard.~~

3.77 When the Board undertakes a PIR it has an opportunity to understand the effects of the change in financial reporting by comparison to those identified by the Board at the time of issuance of the new financial reporting requirements.

3.78~~5~~ In assessing the likely effects the Board focuses on assessing how financial statements are likely to change because of the financial reporting requirements, whether those changes will improve the quality of financial statements and whether those changes are justifiable. ~~In forming its judgement on the evaluation of the likely effects, t~~The ~~IAS~~Board considers ~~issues~~ matters such as:

(a) how the proposed changes are likely to affect the ~~how activities are~~ reporting~~ed~~ of activities in the financial statements of those applying IFRS Standards;

(b) how those proposed changes are likely to affect~~improve~~ the comparability of financial information between different reporting periods for an individual entity and between different entities in a particular reporting period;

(c) how the proposed changes ~~will~~are likely to ~~improve~~ affect the ability of a ~~user's~~ user of financial statements ~~ability~~ to assess the future cash flows of an entity;

(d) how the proposed changes ~~improvements~~ to financial reporting ~~will~~are likely to ~~result in better~~affect economic decision-making;

(e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis; and

(f) ~~how~~ the likely effects on the costs of analysis for users of financial statements (including the costs of extracting data, identifying how the data has been measured and adjusting data for the purposes of including them in, for example, a valuation model)~~ are affected~~. The ~~IAS~~Board should take into account the costs incurred by users of financial statements when information is not available and the comparative advantage that preparers have in developing information, when compared with the costs that users would incur to develop surrogate information.

3.79 IFRS Standards bring transparency, accountability and efficiency to financial markets around the world. As noted in paragraph 1.1 of the Handbook, the confidence users of financial statements in the transparency and integrity of those statements is critically important for the effective functioning of capital markets, efficient capital allocation, global financial stability and sound economic growth. Therefore, the Board also considers any likely effects on financial stability when undertaking an analysis of the effects of standard-setting.

3.80 The Board is not required to assess the possible broader economic consequences of new financial reporting requirements because these are beyond its objective. Nonetheless, in response to concerns raised by stakeholders during the development of new requirements, the Board may consider specific matters that go beyond assessing how the financial statements are likely to change (for example the on likely effect of new requirements on the cost of borrowing).

3.~~76~~81 In addition, ~~T~~the Board is not required to ~~analysis is not expected to include~~ make a formal quantitative assessment of the overall effect of a new or amended IFRS Standard. Initial and ongoing costs and benefits are likely to affect different parties in different ways. ~~The level of analysis is tailored to the type of changes proposed, with more analysis undertaken for new IFRS Standards and major amendments.~~

Reporting the effects

3.82 The Board explains its views on the likely effects at each stage of the development of a new or amended IFRS Standard. The level and format of the analysis is tailored and reflects the nature of the change to financial reporting and the stage of development. For instance, in the research phase, an analysis of the perceived financial reporting deficiency being addressed and the possible solutions are an integral part of the Discussion Paper. In the standard-setting phase, the Board explains why it is proposing a particular change to financial reporting requirements, including referring to the evidence it has collected and any outreach it has undertaken, in the Basis for Conclusions to the Exposure Draft. When a major new Standard is issued, the Board issues a separate Effects Analysis report that summarises the likely effects and how the Board made its assessments. This report is included as part of the documents accompanying the IFRS Standard balloted by the Board. For other new requirements, the Board presents its views as part of the Basis for Conclusions accompanying the new requirements.

Glossary of terms

Effect Analysis: a process for assessing the likely effects of a proposed Standard, which is undertaken as the new requirements are developed.~~, culminating in A ananalysis presented as part of, or with, the Basis for Conclusions published with a new Standard that summarises the IASBoard's assessment of the likely effects of the new requirements~~. The term effects analysis is used as this analysis has a narrower scope than similar analyses undertaken by some other organisations, such as Impact Assessment.

