

AGENDA

IFRS Foundation Trustees meeting – Due Process Oversight Committee

Johannesburg October 2018

Agenda Ref 1G(iii)

Contacts Richard Thorpe
 Roberta Ravelli
 Samuel Prestidge

Due Process Handbook Review—Effects Analysis

Purpose

1. The purpose of this paper is to propose that the Due Process Oversight Committee (DPOC) update the *Due Process Handbook* to reflect developments in the effects analysis process.

2. Further background to assist the DPOC to determine if they agree with the staff recommendations is available in the following Appendices which outline:
 - (a) Appendix A— Recommendations from the Effects Analysis Consultative Group (EACG);
 - (b) Appendix B— Advisory Council Feedback and initial recommendations; and
 - (c) Appendix C— Existing *Due Process Handbook* Requirements (Paragraphs 3.73, 3.74 and 3.76 of the *Due Process Handbook* set out the due process requirements that apply to the Board’s Effects Analysis).

Questions for the DPOC

Do members of the DPOC agree to propose amendments to the *Due Process Handbook* to reflect:

- (a) developments to the effects analysis process;
- (b) the recommendations of the Effects Analysis Consultative Group; and
- (c) the feedback received from the Advisory Council?

If the DPOC agree, the staff will develop specific drafting updates to the *Due Process Handbook* to reflect the above. The staff will discuss these specific recommendations with the DPOC in January 2019.

Background

3. Effects analysis is a process for assessing the likely effects of a new or amended IFRS Standard, which is undertaken as the new or amended Standard is developed. For a major Standard, this leads to the publication of a separate *Effects Analysis* alongside the issued Standard. The effects analysis process is defined in the glossary of terms in the *Due Process Handbook*.
4. The first published *Due Process Handbook* in 2006 contained a section on how the Board considers the potential costs and benefits of its Standards as part of its deliberations and throughout the development of a Standard. In 2008 the *Due Process Handbook* was amended further to include an explanation of what effects a separate Effects Analysis document seeks to analyse. These were:
 - (a) the financial statements of those applying IFRSs;
 - (b) the possible compliance costs for preparers;
 - (c) the costs of analysis for users (including the costs of extracting data, identifying how the data have been measured and adjusting data for the purposes of including them in, for example, a valuation model);
 - (d) the comparability of financial information between reporting periods for an individual entity and between different entities in a particular reporting period; and
 - (e) the quality of the financial information and its usefulness in assessing the future cash flows of an entity.
5. In 2008 the Board published its first separate Effects Analysis to accompany IFRS 3 *Business Combinations*. This was followed in 2011 by the Effects Analyses accompanying IFRS 10 *Consolidated Financial Statements* and IFRS 11 *Joint Arrangements*. The current requirements relating to effects analysis in the *Due Process Handbook* were most recently amended in 2012 to “include a more extensive discussion of the process of assessing the likely effects of a Standard” (*Due Process Handbook* Appendix—History and approval) and are included in Appendix C of this paper.

6. In 2013 a working group composed of international stakeholders—the Effects Analysis Consultative Group (EACG)—was formed with the goal of further developing a methodology for field testing and developing Effects Analyses.
7. In November 2014 the EACG completed its work by issuing a report¹ with recommendations to the Board. The Board adopted the EACG recommendations and published separate Effects Analyses to accompany IFRS 16 *Leases* in 2016 and IFRS 17 *Insurance Contracts* in 2017.

Recent experience

8. At previous DPOC meetings, the staff has provided the DPOC with an overview of how the published Effects Analyses for IFRS 16 and IFRS 17 reflect the EACG recommendations.²
9. In line with the proportionality principle outlined in paragraph 3.76 of the *Due Process Handbook*, for those new Standards more analysis has been undertaken compared to minor amendments to IFRS Standards.
10. In line with the principle in paragraph 3.74 of the *Due Process Handbook*, an assessment of the likely effects of new accounting requirements has been carried out throughout a project, although sometimes that assessment has not been clearly labelled as an *Effects Analysis*. Examples of documents including that assessment include:
 - (a) staff papers discussed by the Board in public meetings including an analysis of the possible implications of alternative Board decisions;
 - (b) Discussion Papers;
 - (c) Project Summaries;
 - (d) Basis for Conclusions accompanying an Exposure Draft or a final amendment to an IFRS Standard;

¹ [Effects Analysis Consultative Group Report to the Trustees of the IFRS Foundation](#), November 2014.

² For IFRS 16, refer to Appendix A to [Agenda Paper 3D](#) of the January 2016 DPOC meeting. For IFRS 17, refer to Appendix to [Agenda Paper 1C](#) of the January 2017 DPOC meeting.

- (e) Reports and Feedback Statements describing the findings of Post-implementation reviews.

Feedback from the Advisory Council

- 11. In February 2018 the staff consulted the Advisory Council on the Board's use of effects analysis. The feedback received from the Advisory Council focused on:
 - (a) ensuring that the effects analysis is proportionate and scalable dependent on the project;
 - (b) that effects analysis methodology is embedded throughout the project;
 - (c) effects analysis should continue to focus primarily on the effects on the financial statements; and
 - (d) that a Post-Implementation Review may include an Ex-post analysis of the effects.
- 12. The Advisory Council advised the Board to be more explicit about how it analyses the potential effects even in the early stages of developing an IFRS Standard. For more information see Appendix B.

Staff recommendations

- 13. For this meeting the staff recommend the DPOC provide their agreement in principle that the *Due Process Handbook* be amended to reflect:
 - (a) the developments in the Board's use of effects analysis;
 - (b) the recommendations of the EACG; and
 - (c) the feedback received from the IFRS Advisory Council.
- 14. The staff view is that the current requirements relating to effects analysis in the *Due Process Handbook* will not have to be fundamentally changed to reflect the above. However, the requirements throughout the *Due Process Handbook* could be reviewed and updated to ensure that effects analysis methodology is embedded throughout the standard-setting process.

15. If the DPOC agree, the staff will develop specific drafting updates to the *Due Process Handbook* to reflect the above. The staff will discuss these specific recommendations with the DPOC in January 2019.

Questions for the DPOC

Do members of the DPOC agree to propose amendments to the *Due Process Handbook* to reflect:

- (a) developments to the effects analysis process;
- (b) the recommendations of the Effects Analysis Consultative Group; and
- (c) the feedback received from the Advisory Council?

If the DPOC agree, the staff will develop specific drafting updates to the *Due Process Handbook* to reflect the above. The staff will discuss these specific recommendations with the DPOC in January 2019.

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 EACG 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 EACG 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 EACG 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 address that feedback in the *Due Process Handbook 2018 Review*:

| | IFRS Advisory Council feedback | Staff's initial proposals³ |
|--------------|---|--|
| Scope | <ul style="list-style-type: none"> • 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 | <ul style="list-style-type: none"> • Explain, in paragraphs 3.73–3.76 of the <i>Due Process Handbook</i>, 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 |

³ See [Agenda Paper 1D](#) June 2018 DPOC meeting.

| | IFRS Advisory Council feedback | Staff’s initial proposals³ |
|--------------------------------|---|--|
| Timing | <ul style="list-style-type: none"> • Analysis of effects is explicitly embedded throughout a project | <ul style="list-style-type: none"> • Specify the use of effects analysis methodology earlier in the standard-setting process. For example, paragraphs 4.12–4.15 of the <i>Due Process Handbook</i> 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 | <ul style="list-style-type: none"> • 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 | <ul style="list-style-type: none"> • The <i>Due Process Handbook</i> already reflects this. No amendment needed |
| Format | <ul style="list-style-type: none"> • 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 | <ul style="list-style-type: none"> • Clarify, in paragraphs 6.52–6.63 of the <i>Due Process Handbook</i>, the scope and timing of the Post-implementation Review and how it includes an ex-post Effects Analysis |

Appendix C — Existing Due Process Handbook Requirements

Existing Due Process Handbook Requirements

C1 The Glossary of terms used in the *Due Process Handbook* includes the following definition of Effects Analysis:

Effect Analysis: a process for assessing the likely effects of a proposed Standard, which is undertaken as the new requirements are developed, culminating in an analysis presented as part of, or with, the Basis for Conclusions published with a new Standard that summarises the IASB's assessment of the likely effects of the new requirements.

C2 Paragraphs 3.73, 3.74 and 3.76 of the *Due Process Handbook* set out the due process principles that apply to the Board's Effects Analysis:

3.73 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing associated costs and benefits of each new Standard—the costs and benefits are collectively referred to as effects. The IASB gains insight on the likely effects of the proposals for new or revised 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 IASB's objective of financial reporting transparency; and
- (b) in comparison to the existing financial reporting requirements.

3.74 The IASB will assess the likely effects throughout the development of a new or amended Standard. 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.

3.76 The analysis is not expected to include a formal quantitative assessment of the overall effect of a 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 Standards and major amendments.

C3 Paragraphs 3.75 of the *Due Process Handbook* provides examples of issues for the Board to consider in an Effects Analysis:

3.75 In forming its judgement on the evaluation of the likely effects, the IASB considers issues such as:

- (a) how the proposed changes are likely to affect how activities are reported in the financial statements of those applying IFRS;
- (b) how those changes 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 changes will improve the user's ability to assess the future cash flows of an entity;
- (d) how the improvements to financial reporting will result in better 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 costs of analysis for users (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 IASB 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.