asian-oceanian standard-setters group

31 August 2011

Ms. Françoise Flores
Chairman of European Financial Reporting Advisory Group
35 Square de Meeûs
1000 Brussels
Belgium

Dear Françoise

Re: Considering the Effect of Accounting Standards

The Asian Oceanian Standard-Setters Group (AOSSG) is pleased to respond to the Discussion Paper (DP) "*Considering the Effects of Accounting Standards*" of the European Financial Reporting Advisory Group (EFRAG).

The AOSSG currently has 25 member standard-setters from the Asian-Oceanian region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand, Uzbekistan, and Vietnam.

The AOSSG sets out to promote the development, convergence with, and adoption of IFRS as well as fostering the capacity of domestic standard-setting in the region to contribute to the work of the IASB.

This submission has been prepared by the AOSSG Chairman's Advisory Committee and reviewed by the wider membership. Individual members of the AOSSG may also choose to make their own submissions that are consistent or otherwise with the aspects of this submission. It is a policy of the AOSSG that submissions reflect any diversity of views within the membership of which we become aware.

Although it has not been customary for the AOSSG to respond to consultative documents from those organisations other than the IASB or the IFRS Foundation, we decided to share our views since this issue is particularly important for the IFRS Foundation and IASB to consider when designing future standard setting schemes. The AOSSG hopes that our comments would be conducive to advancing things forward. Accordingly, we are copying this submission to the leadership of the respective bodies of the IFRS Foundation.

The AOSSG strongly believes that the maintenance of independence is critical for accounting standard setters to deliver high quality outputs, whereas fulfilling accountability is equally important. In this respect, we believe that 'effect analysis' is an essential element for a standard setter to fulfil its accountability. Moreover, we are pleased to see that the IASB published a comprehensive effect analysis document regarding IFRS 11, *Joint Arrangements* and disclosure for joint arrangements included in IFRS 12, *Disclosure of Interests in Other Entities* in July 2011, and believe that it constitutes a good starting point for undertaking the initiative.

Yet although 'effects analysis' is defined as a part of the IASB's standard setting process in its Due Process Handbook[1], the process is yet to be further substantiated in it. Clarification of terminologies and steps to take as set out in the DP will ensure the consistency of approaches and help address an expectation gap among stakeholders regarding the steps of effects analysis. Therefore, while there are several instances where further considerations would be warranted (for example, we are not convinced that it is realistic or appropriate to 'consider' macro-economic effects. See our response to Q8.), the AOSSG generally supports the proposed steps presented in the paper.

In addition, taking into account the accelerated trend towards the global convergence of accounting standards, the AOSSG believes that it is not efficient for each national standard setter to replicate the steps that the IASB takes. We believe that the process would be more effective and efficient, if the IASB takes the leadership of the initiative, and national standard setters or regional groups partner with the IASB in proceeding with the steps.

In some jurisdictions in the Asia-Oceania region, due diligence work including effects analysis (or impact assessment) constitutes as a facet of statutory requirements when incorporating each IFRS into their own national context. In the globally integrated standard setting environment, some national standard setters would find it an invaluable aid, if the IFRS Foundation acknowledges such collaborative work as a norm in the due-process document. Such a partnership will be particularly helpful, when liaising with stakeholders on a national level (including regulators, user groups, and industry groups). The AOSSG is pleased to provide the IASB with relevant assistance when undertaking the initiative.

Please see the Appendix for our comments to specific questions in the DP. If you have any questions, please feel free to contact us.

Yours faithfully,

Ikuo Nishikawa
Chairman, AOSSG

CC: Mr. Aki Fujinuma, Vice-Chair of the IFRS Foundation Trustees
Mr. Robert Glauber, Vice-Chair of the IFRS Foundation Trustees
Mr. Hans Hoogervorst, Chairman of the IASB
Mr. Masamichi Kono, Acting Chairman of the IFRS Foundation Monitoring Board

1 IASB Due Process Handbook, *paragraph 109-110.*

asian-oceanian standard-setters group

Appendix

Section 2: The process of '*effects analysis*'

Q1) Do you agree that 'effect analysis' should be defined, for the purposes of accounting standard setting, as a systematic process for considering the effects of accounting standards as those standards are developed and implemented (paragraph 2.2)? If you disagree with the proposed definition, or would like it to be amended, please provide an alternative definition, and please explain why you favour that alternative definition.

The AOSSG wonders if it would be possible to define 'effects analysis' more appropriately than a dictionary does. Rather, a focus should be given more on what is meant by 'effects analysis on developments of or revisions to financial reporting standards.'

We also share the following observations on the proposed definition of 'effects analysis' (i.e., 'a systematic process for considering the effects of accounting standards as those standards are developed and implemented'):

- 'Effects analysis' can be performed either in a systematic or ad-hoc manner, depending upon the surroundings;
- The word 'consider' may be ambiguous; thus clarification should be sought;
- 'Effects' would be difficult to measure, and it may be very difficult, if not impossible, to capture actual effects before standards are implemented; and
- 'Effects' arise not only from the development of standards, but from the revisions to them.

Accordingly, the AOSSG suggests that 'effects analysis on developments of or revisions to financial reporting standards' should be defined as follows (proposed additions are underlined, and proposed deletions are struck-out):

'a ~~systematic~~ process <u>to identify and evaluate</u> ~~for considering~~ the <u>anticipated or actual</u> effects <u>from the development of or revisions to financial reporting</u> ~~of accounting~~ standards as those standards are developed and implemented'

Q2) Do you agree that effects analysis should be integrated (or further embedded) into the standard setting due process (paragraph 2.7)? If not, why not? Please explain the reasons for your answer.

Yes, the AOSSG agrees that effects analysis should be integrated into the standard setting due process. However, we strongly believe that effect analysis is not meant to override the right answer that is underpinned to the conceptual reasoning and full pragmatic consideration.

In addition, as stated earlier, we believe that the IASB and national standard setters can effectively share the responsibility in the global standard setting environment.

Q3) Do you agree that the standard setter should be responsible for performing effects analysis, and that the performance of effects analysis by any other body is not a sufficient or satisfactory substitute (paragraph 2.11)? If not, why not? Please explain the reasons for your answer.

Yes, the AOSSG generally agrees that the standard setters should be responsible for performing effects analysis, since they should have the best knowledge about the proposed standards. Thus, they should be best positioned to identify areas that are likely to be affected.

However, a minority of the AOSSG members suggested that the process could become more objective if the third party committee takes charge of conducting effects analysis. Such a committee may consist of senior individuals who have profound knowledge and experience in financial markets (such as macro-economists, retired regulators, and academia). This does not mean that effects analysis should be undertaken in such a way that inexpert in financial reporting rule on whether a standard should be issued on grounds unconnected with the conceptual framework of financial reporting.

Q4) Do you agree that effects should be considered throughout the life-cycle of a project to introduce a new accounting standard or amendment, but that publication of a document setting out the key elements of the effects analysis should be specifically required, as a minimum, at the following points in time in that life-cycle (paragraph 2.15)?:

A. When an agenda proposal on the project is considered by the standard setter;
B. When a discussion paper is issued for public consultation (this effects analysis is an update to 'A', to reflect the latest information available;
C. When an exposure draft is issued for public consultation (this effects analysis is an update to 'B', to reflect the latest information available);
D. When a final standard or amendment is issued (this effects analysis is an update to 'C', to reflect the latest information available); and
E. For new accounting standards and major amendments, a 'post-implementation review' is required, which is an analysis of 'actual effects' that should be performed and published when the pronouncement has been applied for at least 2 years, together with the publication of an associated document setting out the key elements of the review; a post-implementation review is not required for minor amendments.

If you do not agree, why is this? Please explain the reasons for your answer.

Yes, the AOSSG agrees with the proposal. As stated in the cover letter, the AOSSG is pleased to see the IASB's recent publication of effect analysis; however, we think that it would be more useful if such analysis is provided at respective standard-development stages (rather than only at ex-post standard publication).

In some jurisdictions in the Asia-Oceania region, an impact assessment is required even when making a tentative decision in the national context. However, the AOSSG suggests that the proposal be further clarified by stipulating that there is no need to mention effects in each and every agenda paper for board meetings, since such practice may hinder staff work before undertaking theoretical considerations.

Q5) Do you agree that effects analysis should be undertaken for all new accounting standards or amendments, but that the depth of the analysis work should be proportionate to the scale of the effects (in terms of their 'likelihood of occurring and magnitude of the consequences' if they do occur), the sensitivity of the proposals and the time available (paragraph 2.19)? If not, why not? Please explain the reasons for your answer.

Yes, the AOSSG generally agrees with the proposal. As effects are inherently difficult to measure (thus, identifying immaterial projects to be scoped out is difficult), it is reasonable to presume that all new or revised standards should be scrutinised; while, the depth of the exercise should differ depending upon the nature of the projects.

For the purpose of determining the depth of the exercise, a judgmental framework should not be too definitive or structured so as to ensure practicality of the exercise. We suggest that standard setters should determine the extent of work to be performed, taking into account the relevant qualitative factors.

The AOSSG believes that the 'likelihood of occurrence' and 'magnitude of consequences' are good qualitative indictors in evaluating the scale of the effects, but other factors should not be dismissed. For example, even if the development of or revision to a particular standard has a smaller magnitude of consequences, it may have a significant effect when considered in aggregate with other regulatory or standard-setting developments. Therefore, other elements such as the impact on other standards or regulatory requirements should be factored into when determining the necessary level of analysis.

Section 3: The concept of '*effects*'

Q6) Do you agree that 'effect' should be defined, for the purposes of accounting standard setting, as consequences that flow, or are likely to flow, from an accounting standard, referenced against the objective of serving the public interest by contributing positively to delivering improved financial reporting (paragraph 3.2)? If you disagree with the proposed definition, or would like it to be amended, please provide an alternative definition and please explain why you favour that alternative definition.

As stated in our response to Q1, the AOSSG believes that 'effects analysis' should be defined in the context of developments of or revisions to financial reporting standards. In the same vein, the AOSSG believes that 'effect' should also be defined in the context of developments of or revisions to financial reporting standards.

In regard to whether 'effect' should be defined as referenced against the objective of serving the public interest by contributing positively to delivering improved financial reporting, it is not at least clear about what it ought to mean; thus, the AOSSG members have mixed views. Some members believe that such a reference is necessary, since effects may be unlimited unless analysis is performed referenced against a specific objective. Others find that it is not necessary or appropriate to try to define the term into a narrower scope, on the ground that effects may be perceived differently among stakeholders and standard setters will be asked to be sufficiently responsive when they receive inputs from stakeholders.

Accordingly, the AOSSG suggests that 'effects on developments of or revisions to financial reporting standards' be defined as follows (proposed additions are underlined, and proposed deletions are struck-out):
'*consequences that flow, or are likely to flow, from <u>developments or revisions to financial reporting</u> ~~an accounting~~ standards, referenced against the objective of serving the public interest by contributing positively to delivering improved financial reporting*'

Q7) Do you agree that the term 'effects', rather than term 'costs and benefits' should be used

to refer to consequences of standards, in order to distinguish effects analysis from a CBA, on the grounds that it would not be appropriate to require a CBA to be applied to standard setting (paragraph 3.7)? If not, why not? Please explain the reasons for your answer.

Yes, the AOSSG agrees with the use of the term 'effect' rather than 'costs and benefits', since the term 'cost and benefits' may predicate quantitative measurements of benefits and drawbacks. It is not usually possible or desirable to measure effects quantitatively, in the context of financial reporting standard setting.

Q8) Do you agree that the scope of the 'effect' to be considered, for the purposes of performing effects analysis, should include all effects, both 'micro-economic effects' and 'macro-economic effects' (paragraph 3.12)?

If you disagree, please provide an alternative way of specifying what the scope of 'effects' to be considered to be, and please explain why you favour that alternative.

The AOSSG agrees that clarification of the scope is necessary, but members have mixed views in this regard. Most of the AOSSG members agree that the scope should include all effects, both 'micro-economic' and 'macro-economic effects', while others strongly believe that effects should be considered solely against the purpose of financial reporting. Nevertheless, we believe that the proposal should clarify that it is possible to *identify* whether significant macro-economic effects are likely to exist, but it would be significantly difficult to *consider* effects as proposed[2].

For instance, it might be predictable whether a proposed standard may give rise to some effects (whether they are positive, negative or even encompass pro-cyclical effects on macro economy), but usually it is impracticable to consider or evaluate how their scale would be.

Q9) Do you agree that a standard setter can only be expected to respond to an effect which is outside of its remit (or for which an accounting standard is not the most effective means of addressing the particular effect) by communicating with the relevant regulator or government body to notify them of the relevant issue and to obtain confirmation from them that they will respond appropriately to it (paragraph 3.17)? If not, why not? Please explain the reasons for your answer.

Yes, the AOSSG generally agrees with the proposal. However, the AOSSG believes that it is highly unlikely to be able to obtain confirmation from a relevant regulator or government body that they will respond appropriately to the effect, while it is possible for standard setters to notify them of the relevant issues.

In addition, there may be instances where standard setters may find it difficult to handle the information obtained. If standard setters come across the information that may be relevant to other regulators, they may need to consider passing it to others. There may also be challenges in obtaining information that should be confidential.

[2] The IASB's effect analysis document regarding IFRS 11 and IFRS 12 does not include a discussion about macro-economic implications.

The AOSSG recommends that the proposal acknowledge this regard explicitly.

Q10) Do you agree that 'effects' should be defined by reference to an objective, and that the objective should be that of serving the public interest by contributing positively to delivering improved financial reporting', where 'serving to the public interest' means 'taking into account the interests of investors, other participants in the world's capital markets and other users of financial information' (paragraph 3.19)?

If you disagree because you consider that 'effects' should not be defined by reference to an objective, please explain the reasons for your answer.

If you disagree because you consider that 'effects' should be defined by reference to an objective other than that specified above, please provide an alternative objective and please explain why you favour that alternative objective.

The AOSSG agrees that a common understanding of the key terminology is essential before launching the procedures, but members have mixed views in this regard. Most AOSSG members do not think it necessary to define the 'effects' by reference against the objective as stated, while others strongly believe clarification is necessary so that the effect should be considered only to the purpose of financial reporting.

In general, the AOSSG thinks that effect analysis involves communication with a wide range of stakeholders, and standard setters will not be able to control what should be communicated. In practice, stakeholders may communicate what they perceive as 'effect,' and standard setters would be requested to take a note of it. While standard setters may try to ask specific questions or collate inputs in accordance with the proposed objective, it is unlikely that they can control everything.

If the proposal (i.e., to define effects by reference to an objective) remains intact, the AOSSG recommends that the term 'public interest' be articulated in greater detail. As a notion of public interest may be understood differently among stakeholders, we are concerned that the proposed definition may confuse stakeholders unless it is clearly articulated.

Q11) Do you agree with the following clarifications of the term 'effects'?

a) Effects can be 'positive', 'negative' or 'neutral', as determined by whether they support, frustrate or have no impact on the achievement of the objective of serving the public interest by contributing positively to delivering improved financial reporting (paragraph 3.23);

b) Effects analysis will usually involve assessing the 'marginal effects' of an accounting standard or amendment, relative to the status quo that existed before its introduction, so the term 'effects' should, in general, be interpreted to refer to 'marginal effects' (paragraph 3.24);

c) The term 'effects' can be used to refer to both 'one-off effects' and 'ongoing effects' (paragraph 3.26); and

d) The term 'effects' can be used to refer to both 'anticipated effects' and 'actual effects', depending on what stage the effects analysis is at - before, during or after implementation of the new accounting standard or amendment (paragraph 3.28).

If you do not agree with any of the above clarifications of the term 'effects', which one(s) do you disagree with and why? Please explain the reasons for your answer.

The AOSSG generally agrees with the proposal. However, in relation to the categorisation of effects as stated in a), we believe that effects can be classified in five categories: 'very positive,' 'positive,' 'neutral,' 'negative,' and 'very negative.' Three levels of categorisation may seem too simple, which would not be relevant to achieving the objective of benchmarking exercise.

Q12) Do you agree with the following further considerations concerning effects:

a) Effects analysis should involve considering effects in terms of both their 'incidence' (who is affected) and their 'nature' (how they are affected), and that the standard setter should be transparent about whether and why they consider that the effects on one group should receive greater weight, less weight or equal weight to the effects on any other group (paragraph 3.30); and

b) Effects analysis should involve prioritising effects, possibly by 'ranking' them in terms of their 'likelihood' of occurring and the magnitude of the 'consequences' if they do occur (paragraph 3.32).

If you do not agree with any of the above further considerations concerning effects, which one(s) do you disagree with and why? Please explain the reasons for your answer.

The AOSSG agrees with the proposal set out in paragraph a), but regards that 'ranking' effects as suggested in paragraph b) may be over-engineered. As the extent of effects is largely subject to judgment, and 'likelihood' and 'magnitude' can only work as factors for consideration, the AOSSG proposes not to proceed with 'ranking.'

Section 4: The key principles underpinning effects analysis

Q13) Do you agree that there should be a set of key principles underpinning effects analysis (paragraph 4.2)? If not, why not? Please explain the reasons for your answer.

The AOSSG is not sure what is intended by setting 'key principles,' and some members wish to consider the relevance of setting key principles once a big picture is agreed. Nevertheless, some members suggest that 'principle' is not an appropriate term relative to the substance suggested and that they should be labelled as 'key steps.' Please refer to our response to Q14 for details.

Q14) Do you agree that the set of key principles underpinning effects analysis should be as follows (paragraph 4.2)?:

- Principle 1: Explain intended outcomes (refer to paragraph 4.2);
- Principle 2: Encourage input on anticipated effects (refer to paragraph 4.2);
- Principle 3: Gather evidence (refer to paragraph 4.2); and
- Principle 4: Consider effects throughout the due process (refer to paragraph 4.2).

If you disagree with the proposed set of key principles, or would like the principles to be amended, please provide an alternative set of key principles and please explain why you favour that alternative set.

As stated in our response to Q13, some members suggest establishing a set of key steps rather than a set of principles. A set of key steps that the IASB should take may be characterised as follows:

- Step-1: To formulate the entire plan of effects analysis.
- Step-2: To explain intended outcomes when agendas are set.
- Step-3: To encourage input on anticipated effects when due process documents are issued, by providing specific questions to stakeholders, with assistance from national standard setters.
- Step-4: To document summary of inputs from stakeholders by collating evidence that has been received either directly or through national standard setters.
- Step-5: To publicise the document and submit it to the IFRS Foundation Trustees or its Due Process Oversight Committee for their review.
- Step-6: To seek to measure actual effects during the process of post-implementation reviews.

Section 5: The practicalities of performing effects analysis

Q15) Do you agree that the process that a standard setter should apply for validating the intended outcomes of a proposed accounting standard or amendments should include steps 'a' to 'd' of paragraph 5.2?

If you disagree with the proposed steps, or would like the steps to be amended, please provide alternative steps and please explain why you favour those alternative steps.

The AOSSG believes that every aspect of operational issues around the proposal should be tested before the process is implemented so as to proceed in a structured manner. For example, although a partnership between the IASB and national standard setters is paramount, it is important to ensure that the process is sufficiently operational. Developing a solid protocol prior to conducting actual work is conducive to minimising the risk of trial and error.

Nevertheless, as indicated in our response to Q14, the AOSSG generally feels that it is premature to formulate views on various aspects of practical details set out in this section since application to practice is normally considered once a big picture is agreed. In line with our comment stated in the cover letter, the AOSSG recommends that operational arrangements should be scrutinised by the Trustees of the IFRS Foundation or IASB in their future consideration.

Q16) Do you agree that the process that a standard setter should apply for identifying and assessing the effects of a proposed accounting standard or amendment should include steps 'a' to 'f' of paragraph 5.3?

If you disagree with the proposed steps, or would like the steps to be amended, please provide alternative steps and please explain why you favour those alternative steps.

Please see our response to Q15.

Q17) Do you agree that the process that a standard setter should apply for identifying options for the proposed accounting standard or amendment (options for achieving the intended outcomes of the proposed accounting standard or amendment), and for choosing the preferred option, should include steps 'a' to 'f' of paragraph 5.4?

If you disagree with the proposed steps, or would like the steps to be amended, please provide alternative steps and please explain why you favour those alternative steps.

No, the AOSSG does not believe that the process should include providing several options. The AOSSG is afraid that providing and prioritising options might result in narrowing the scope of deliberations at the IASB, since stakeholders might think that there is no benefit of further deliberation if there is an objective prioritisation.

In addition, providing options may be seen as giving too much emphasis on effects analysis. We believe that effects analysis is one of the critical elements in the standard setting due-process, but it is not a determinant factor of the standard.

Therefore, we disagree that standard setters should identify options and choose preferred options as suggested in paragraph 5.4.

Q18) Do you agree that the IASB should, to some degree, delegate to national standard setters and similar institutions some of the activities involved in gathering evidence of the effects of accounting standards, particularly consultation with constituents, and that these bodies should play a more active part in the due process to ensure that IFRSs contribute positively to delivering improved financial reporting (paragraph 5.5)?

The AOSSG generally considers the proposal appropriate, but thinks there is some room for improvement. The AOSSG believes that effects analysis should be performed as a process of international and national standard settings. However, we believe that the IASB should lead the initiatives, taking into account that standard setting processes are increasingly integrated globally and that most of the financial reporting standards are, in substance, agreed at the international level rather than at the domestic one.

Accordingly, the AOSSG recommends that the proposal be clarified by stating that the IASB should lead the initiative, partnering with national standard setters and regional groups (such as the AOSSG or EFRAG), rather than the IASB 'delegate' some of the activities to national standard setters and the like.

Section 6: Next steps

Q19) Do you agree that the next steps in developing and, subject to the results of public consultation, implementing the proposals put forward in this paper should include steps 'a' and 'b' of paragraph 6.2?

If you disagree with the proposed next steps, or would like there to be additional next steps, please provide alternative and/ or additional steps and please explain why you consider that those alternative and/ or additional next steps are appropriate.

Although the AOSSG highly appreciates the initiatives by the UK ASB and EFRAG to formulate the proposal, we believe that the IFRS Foundation Trustees should take a lead in considering the next steps. As stated earlier, the AOSSG considers that effects analysis should be implemented, led by the IASB in collaboration with national standard setters or regional groups. Thus, we believe that the structure should ultimately be considered by the IFRS Foundation.

Further, we think that ‘field testing’ in paragraph 6.2 a) should be read ‘pilot testing’ to clarify that the initiative is used as a part of initial assessment in determining whether the proposed framework is operational.