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Dear Sirs

Considering the Effects of Accounting Standards

I am writing on behalf of the Association for Financial Markets in Europe (AFME) to comment on EFRAG's January 2011 Discussion Paper: Considering the Effects of Accounting Standards ("the DP"). AFME is, as you know, the leading European trade association for firms active in investment banking and securities trading; it was established in 2009 as a result of the merger of LIBA (the London Investment Banking Association) and the European Branch of SIFMA (the US-based Securities Industry and Financial Markets Association), and thus represents the shared interests of a broad range of participants in the wholesale financial markets.

We welcome the publication of this important DP, and we commend both EFRAG and the FRC for its very thorough exposition of the issues considered, and also of the "preliminary views" which are set out therein. While supportive of the great majority of these views, we do have concerns over the suggested approach to the "macro-economic" category of effects, as described in paragraph 3.14 of the DP. These concerns may be summarised as follows (and are elaborated in our responses to Q8-10 below):

- The Conceptual Framework defines the objective of financial reporting as "to provide financial information about the reporting entity that is useful to existing or potential investors, lenders and other creditors in making decisions about providing resources to the entity", and the resource and expertise of the IASB¹ are geared towards the development of standards which best meet this objective. While this does not preclude the IASB from taking account of any possible macro-economic effects of a new or modified IFRS, it suggests that their analysis of any such effects should, at least in the first instance, be confined to examining the extent to which these effects may influence the decision-making of "existing or potential investors, lenders and other creditors". The IASB could, at their discretion, undertake further analysis of any such macro-economic effects, but we do not believe this should be either a prescriptive requirement or a primary focus of the standard setting process.

¹ We have in this letter generally preferred to refer to the IASB, rather than to "a standard setter", although we believe the majority of our comments would also apply, mutatis mutandis, to a national standard setter.

- We agree with (the counter-argument section of) paragraph 3.15 c) of the DP that macro-economic effects “tend to be qualitative rather than quantitative, and ... are often based on subjective judgements about what is likely to result from a new pronouncement”. Requiring the IASB to undertake a detailed study of such effects introduces, we believe, a risk that the standard setting process could be unduly influenced by “political” factors, with a possible reduction in the quality of new IFRS.
- It must be a reasonable presumption that financial statements prepared under a new or modified IFRS will (at least in the view of the IASB) provide a better reflection of the underlying economics of the reported transactions than those prepared under the predecessor standard. While it is part of the IASB’s role to ensure that users of financial statements have a good understanding of how the changes inherent in a new or modified IFRS relate to the underlying economics, so that any consequential changes in decision-making are soundly based, it is not (and should not be) within the IASB’s remit to attempt to influence the decision-making processes of these users. We see a risk that requiring the IASB to focus on “macro-economic effects” could indirectly result in the exercise of this kind of influence, particularly as this term is capable of wide interpretation (as illustrated, for example, by the quotation from paragraph 3.15 in the previous bullet).

We have two other general comments on the DP:

- We see a risk that the integration of a formal “effects analysis” into the standard setting process could impose a significant burden on the IASB and thus dilute the effort put into the production of high class IFRS, which must remain their paramount objective.
- We believe that appropriately designed field-testing should be an integral part of the development process of any new (or materially amended) accounting standard. Such testing would, inter alia, contribute significantly to the analysis of the “micro-economic effects” of the new/amended standard.

Subject to the above, our comments on the “questions for respondents” in the DP are set out below.

Q1 Do you agree that ‘effects 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.

- A We agree with the proposed definition of “effects analysis”, subject to the important proviso that the associated “systematic process” should be

defined in such a way as to permit a degree of pragmatic flexibility in its application to the analysis of any particular accounting standard.

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.

A We accept in principle that “effects analysis” should be integrated into the standard setting due process, but this must not be at the expense of extending the time required to develop those standards which have a time-critical deadline for implementation (as with some of the work prompted by the G20 report on the financial crisis). A possible solution to this would be to incorporate “a comply or explain” approach, whereby the IASB could in exceptional circumstances omit or defer some or all components of the “effects analysis” process, provided that this is fully explained, and that proposals are made for any appropriate retrospective corrective action.

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.

A We agree that the standard setter should be ultimately responsible for performing effects analysis. While some parts of the analysis (such as the field-testing referred to in our general comments above) should be carried out by the standard setter, we anticipate that other parts could on occasion be more appropriately carried out by other bodies; the process should therefore allow for the IASB to delegate parts of the process. It is however essential, inter alia for the reasons set out in paragraph 2.13, that the IASB retains full overall control of any such delegated analysis, and therefore retains full responsibility for the outcome. (See also our responses to Q8 and Q18).

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.

A We agree that the key elements of the effects analysis should be set out, as a minimum, at the suggested points A to E of a project life-cycle; it should however be made clear i) that the level of analysis will vary significantly between the different points of the life-cycle, and ii) that any duplication of work must be kept to an absolute minimum.

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 the 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.*

A We agree with the principle of the suggested approach, although we observe that it implies a degree of circularity, in that the "likelihood" of a specific effect occurring and the magnitude of any resulting "consequences" may not be fully apparent until at least some of the analysis has been carried out. We would also expect that the depth of the analysis work will in practice depend at least partially on the political sensitivity of the issue, and on the likely strength of any opposing views. We suggest the Board should consider incorporating some reference to such factors into the guidelines for carrying out the analysis.

Q6 *Do you agree that 'effects' 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.

A We agree with the proposed definition of "effects", but we have concerns - set out in our response to Q10 below - about the meaning of the phrase "serving the public interest".

Q7 Do you agree that the term 'effects', rather than the term 'costs and benefits', should be used to refer to the consequences of accounting 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.

A We agree with the proposal to use the term “effects”, but it must be made clear that its use in this context relates to the specific definition contained in the process.

Q8 Do you agree that the scope of the 'effects' 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 the 'effects' to be considered should be, and please explain why you favour that alternative.

A We think it essential that the IASB focus firmly on the “micro-economic effects”, which relate directly to the fundamental purpose of financial reporting: as noted in our opening remarks, we do not in general see the IASB as having either the resource or the technical expertise to assess any perceived “macro-economic effects”, nor do we believe it should be part of its remit to be able to cover this class of possible effects in any detail. The causes of any perceived macro-economic effects can, furthermore, be difficult to identify, and their inclusion in the scope of the IASB work risks importing a degree of subjectivity which could be highly detrimental to the standard-setting process. Having said that, the IASB should as part of its due process make it clear that stakeholders may provide comments on all classes of perceived effects, including macro-economic, and it may, on occasion, choose to invite specific external bodies to comment in more detail on particular aspects thereof.

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.

A We believe communication with relevant regulators or government bodies should be an integral part of the due process of developing any new IFRS, but we do not see it as part of the IASB’s remit “to obtain confirmation” that such bodies “will respond appropriately” to any given specific issue. A strict interpretation of any requirement “to obtain confirmation” could bring the standard setting process to a halt if such confirmation is either not forthcoming, or is available only in a form which the IASB finds unacceptable.

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 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.

A We agree that “effects” should be defined by reference to an objective, but we believe the suggested definition of “serving the public interest” is too wide, and potentially too subjective: we do not see it as appropriate for the IASB to commit to take into account the interests of “other participants in the world’s capital markets and other users of financial information”, and we believe this definition should therefore be confined to “the interests of investors”. This does not of course prevent the IASB from listening to representations from “other participants” and “other users”, but it is important that the interests of these other stakeholders do not dilute the paramount objective of addressing the interests of investors.

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.

A We agree with the suggested clarification of the term “effects”, but we would caution against any attempt to force the classification of effects into “positive”, “negative,” and “neutral”: such a classification will of its nature be essentially subjective, and different stakeholders may well have different views on the appropriate classification of a particular effect. It is therefore necessary that the process allow for a degree of flexibility around the application of these terms. (This need for flexibility also applies, mutatis mutandis, to the additional categorisations of “effects” which are suggested in Q11b), c) and d) and in Q12).

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.

A We agree with the proposed “further considerations”.

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.

A We agree that there should be a set of key principles underpinning effects analysis, but it is important that these should not be too rigidly applied, and that a “common sense override” should be available for use where appropriate.

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.

- A We suggest that Principle 4 be amended by the addition of a phrase along the lines of “and demonstrate progress on the analysis at each stage thereof”.

Q15 Do you agree that the process that a standard setter should apply for validating the intended outcomes of a proposed accounting standard or amendment 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.

- A We agree with the essence of the steps set out in steps “a” to “d” of paragraph 5.2, subject to the caveat that these steps should not be regarded as an exclusive list, and that the standard setter should be able to incorporate appropriate additional and/or suitably modified steps at its discretion. We would also restate our view that the overriding remit of the IASB is to develop high quality IFRS, and the effects analysis process must always be seen in the context of that objective.

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.

- A We agree, subject to the same caveat as in 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.

- A We agree, subject to the same caveat as in our response to Q15.

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)?

A We would strongly support the suggestion that the IASB should delegate some parts of the effects analysis process to other appropriate parties. Consistent with our response to Q3 above, it is however critically important that the IASB retain overall responsibility for co-ordinating the process, for synthesising the input received from different bodies, and for taking a final decision on the results of the analysis.

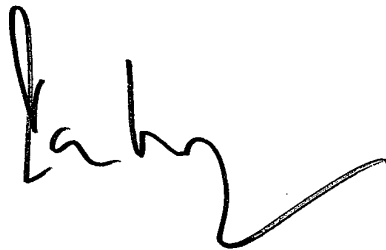
Q19 Do you agree that the next steps in developing and, subject to the results of public consultation, implementing the proposals put forward in this paper should include steps 'a' and 'b' of paragraph 6.2?

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.

A We agree with the proposed next steps.

We hope the above comments will be helpful, and would of course be delighted to provide further information on any aspects which may be unclear or where more detail would be helpful.

Yours sincerely



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