european
accounting
association

Hans Hoogervorst
Chairman - IASB
IFRS Foundation
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Dear Mr Hoogervorst

Agenda consultation

Further to your invitation to comment, I have pleasure in enclosing the comments of the European Accounting Association. The EAA has been in existence for about 40 years. It currently has about 2,500 members, primarily based in European academic institutions.

The EAA is committed to encouraging research relevant to standard-setting and to assisting standard-setters in that area. Through its Financial Reporting Standards Committee, of which I am currently chairman, it responds to IASB due process documents and works with EFRAG. We hope to be able to contribute to the research initiatives outlined in the agenda consultation.

Yours sincerely

Peter Walton
Professor of Accounting, ESSEC Business School
Chair: EAA-FRSC

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Response of the European Accounting Association to the IASB's Agenda Consultation

Preamble

The European Accounting Association welcomes the IFRS Foundation Trustees' decision to have a regular agenda consultation, and welcomes the opportunity to respond to the IASB's 2011 document. Our response is based on observation of the IASB, experience and analysis, and not on dedicated research as such. We are responding as people who are 'interested in and affected by financial reporting'.

In general terms, we note that despite the due process provisions for considering agenda items in public standard-setting meetings, lack of participation in the agenda fixing process is one aspect that is mentioned very frequently in governance and accountability discussions (e.g. the Monitoring Board governance review). We think formal public consultation may be helpful in that respect and may also help clarify what are the organisation's objectives and priorities at a more detailed level, even if we suspect most claims for input to the process are looking to remove items rather than add them.

We would suggest, in passing, that a consultation every three years may be too frequent. The current consultation was started in 2010 and envisages a feedback document towards the end of 2012. 2013 would seem a little soon to start the process again.

We note that although the agenda consultation document is not specific on this point, it appears to address only those items of the IASB's strategy that are likely to be dealt with through collective board or staff action. It does not appear to address activities undertaken by individual board members, and particularly the chairman and deputy chairman, to meet national standard-setters, regulators, government officials etc. as part of what we would describe as political liaison duties. Nor is there, for example, any discussion about work undertaken to encourage more countries to adopt IFRS. There is potentially a difference in scope between a 'work plan' of the kind that Hans Hoogervorst refers to in his introductory letter, and a consultation about the board's formal agenda as such.

Before addressing the agenda consultation specifically, we should therefore like to comment on a wider issue, a work plan issue, something we would label attitudes to and understanding of the IASB's mission. An aspect of this was highlighted in the SEC's July 2011 roundtable on IFRS. Greg White, chairman of the CFA Institute's corporate disclosure policy council, expressed concerns that the objective of decision-useful information for investors received only lip service at best outside of the US, Canada and the UK. Tricia O'Malley, former IASB member, supported this saying she thought people had signed up to IFRS without understanding its fundamental philosophy.

It is clear to us as well from the academic literature that there is a strong element of the academic community who do not support that objective, in part no doubt as a result of living in a culture which has different traditions in corporate reporting and communication. We think the IASB's wider strategy should include an initiative to combat misperceptions and explain the context of IFRS. As Mr White pointed out, how people perceive the basic philosophy impacts the way in which they apply IFRS.

Another significant 'non-dit' in the document is any discussion of convergence with the US. Our view is that while both boards have made heroic efforts since 2002 and have a number of significant achievements to their credit, but it may be that the law of diminishing returns is setting in. The FASB's constituents and political environment are not the same as those of the IASB, leading to a number of incompatibilities in decision-making. Financial instruments and insurance have consumed enormous resources but the FASB's involvement seems only to have delayed progress without being likely to lead to convergence. We would suggest that the IASB should avoid any further joint projects in any circumstances. If the US adopts IFRS, the situation would change but in any event the FASB should no longer be treated as a supremely privileged partner.

Another observation that we would make outside of the work plan, is that the financial reporting environment is changing, but that the IASB's standard-setting does not appear to be changing to reflect this. Clearly the IFRS Foundation has a major investment in the development of XBRL reporting, through the development of an IFRS taxonomy, however, aside from the subject being raised from time to time by Robert Garnett who is no longer on the Board, the issue of how XBRL will impact standards is not considered during the standard-setting process.

The second related observation is that there is also a move towards considering financial reporting more holistically, for example in Integrated Reporting. We think there is a case for the IASB or the Trustees considering whether the present approach to standard-setting is not too narrowly focused on the financial statements alone.

Agenda consultation

1. *What do you think should be the IASB's strategic priorities, and how should it balance them over the next three years?*

Clearly the most important priority is to finish the outstanding major projects: revenue recognition, leasing, financial instruments and insurance. It is far from clear how long it will take to re-deliberate revenue recognition and leasing, and a target of final standards by the end of 2012 may be too optimistic.

For financial instruments and insurance there are clearly tough decisions ahead. The FASB is unlikely to adopt the insurance standard when it is finalised, and the IASB is committed to exposing the FASB's next financial instruments proposals when they are published. The FASB's financial instruments position, on the evidence to date, will be fundamentally different from the IASB on classification and measurement (three categories, including available for sale, instead of two) and is unlikely to be as radical on hedge accounting. The IASB will have to decide whether to head for a converged solution or not. If it tries for convergence, final standards could be two to three years away.

The other commitment that the IASB has is post-implementation reviews. It is committed to doing these, and they should be coming on line sooner rather than later. This is likely to be time-consuming, not least because there is no agreed procedure for such reviews – this must be constructed first – nor any clear criteria at this point.

Essentially then, our high level view is that the commitment to post-implementation reviews and dealing with the overhang from the financial crisis will permit very little freedom of manoeuvre to the IASB in the next three years unless it makes some radical decisions about working with the FASB. Those decisions will presumably be impacted by the SEC's decision on endorsement of IFRS.

1(a) Do you agree with the two categories we identified and the five strategic areas within them? If you disagree, how do you think the IASB should develop its agenda, and why?

We agree with the two categories of developing financial reporting and maintaining existing IFRS, although we are conscious that the objective of 'developing financial reporting' taken in its own could alarm constituents by conjuring up images of future boards moving to full fair value etc. It could be that 'responding to changes in the reporting environment' would be a better way of expressing that aspect (the strategic area of filling gaps in the existing literature could be treated as part of the objective of 'maintaining existing IFRS').

As regards the five strategic areas, we would add a sixth, that of developing a more widespread understanding of the IASB's fundamental stance. Our comments are as follows:

Updating conceptual framework: we agree that the project in hand should be completed as soon as possible with the development of a measurement section and disclosure framework – to say nothing of the definitions of asset and liability.

Researching strategic issues: of course we agree that researching an issue should precede and decision-making and we applaud the suggestion here (as also in the Trustees' strategy review, and the decision to bring more academic representation to the IFRS Advisory Council). Our experience is that finding an operational way of doing this will require thought. IASB staff members generally have little or no experience of research methods or of academic research generally. Academic researchers these days typically have little or no experience of the application of financial reporting standards by preparers, auditors and users.

Our experience of working on committees that commission research is that it is often difficult to align the research in a way that provides the answers that are sought. We would therefore suggest that the IASB explore creating joint teams by asking for researchers to be seconded to work with permanent IASB staff, or some such mechanism. We think that the IASB would probably be helped by forming a working group of researchers to support the research initiative. We are, of course, very willing to participate in that area.

Filling gaps in the IASB literature: we think this is essential. Only in 2005 did IFRS start to be used across a wide range of industries and countries and we think that the IASB should devote resources to reviewing practice and addressing issues that may arise. We note that when the board started to work on offsetting its outreach showed that there was significant diversity in practice in the application of IAS 32, which had not come to light previously. We think the next phase of the IASB's life should be reviewing how the standards work in practice and improving that.

Conducting post-implementation reviews: we are aware that the IASB is committed to this. We think that in principle this is a worthwhile task and has the potential to feedback into the standard-setting process and improve it. We think the IASB may have difficulty in confining such reviews to questions of implementation, and those who opposed the standard in the first place may seek the opportunity to attempt to change it. There is a risk that such reviews may become bogged down by opponents who create a lot of 'noise' around the process and distract from an appropriate evaluation of implementation as such.

Improving consistency and quality of application: this seems to us very close to the area of filling gaps in the literature. We think that worldwide application of the standards is bound to have revealed problem areas that should be addressed.

Developing an understanding of the IASB's fundamental approach: it seems to us (and here there is evidence in the research literature) that many people either do not understand or do not accept the focus on decision-useful information for suppliers of capital. We think this potentially impacts on the consistency and quality of application, and it would be helpful to conduct an initiative to explain the IASB's notion of 'public interest' and how that is fulfilled by an investment decision focus. It would also help to explain in this context the fundamental difference between consolidated financial statements and those of individual companies.

1(b) How would you balance the two categories and five strategic areas? If you have identified other areas for the IASB's agenda, please include these in your answer.

As indicated above, we think there is a third category which is completing the existing 'priority projects' and we believe that this and starting the post-implementation reviews are likely to be the main focus in the next three years. However, we would note that research takes time, and if future decisions are to be informed by research, the sooner this is commenced the sooner its fruits would be available.

Our third priority would be to complete the work on updating and developing the conceptual framework, although we are aware that there are operational issues here as regards working with the FASB. However, failure to have completed work on asset and liability definitions and exploit the considerable amount of work done on measurement has consequences for future standard-setting. We would suggest that in the immediate phase it would be appropriate to finalise those aspects of the conceptual framework on which work has been done, while potentially deferring the disclosure framework until the next phase – when the IASB would have material from EFRAG as an input.

In a second phase we would give priority to completing gaps in IFRS and addressing application issues that have arisen. In neither phase would we recommend starting work on major new standards. We think that the IFRS application infrastructure has been put under great pressure by the financial crisis and will soon enough be put under further pressure by the projects on leasing, revenue recognition and insurance. We think that the IASB should commit to at least six years of consolidation and improvement of quality of the existing standards, while researching new issues.

2. *What do you see as the most pressing financial reporting needs for standard-setting action from the IASB?*

We see the most pressing need as being to stop working on joint projects with the FASB, for the reasons given above. We think the more important priority is to look to the countries that actually apply IFRS and see what needs to be done to improve the quality of the standards and their application.

2(a) Considering the various constraints, to which projects should the IASB give priority, and why? Where possible, please explain whether you think that a *comprehensive project is needed or whether a narrow, targeted improvement would suffice.*

As indicated above, we think the constraints are very significant and that the need to complete the 'priority projects' and to start the post-implementation reviews will not leave a great deal of time to start new projects. We think a research programme should be initiated sooner rather than later, and if there is time, we believe priority should be given to the conceptual framework, partly because of the central role this plays in standard-setting and partly because much work has been done and should be made use of.

In a second phase we believe the focus should be on improving the existing literature, rather than seeking to expand it to new areas. We accept there may be a need to fill gaps, but we are also mindful of 'scope creep' in such projects. From the list of project suggestions we would make the following comments:

Agriculture: we are unaware that there are application difficulties, but if there are, these should be addressed.

Country-by-country reporting: we do not see this is part of the IASB's remit. We also see the basic idea as extremely difficult to operationalise. We note that the European Commission is proposing to mandate such disclosures for mineral extraction and logging companies.

Equity method of accounting: we see this as an anomaly. We would suggest research be done on using fair value instead. The research should evaluate (a) the impact on financial statements, and (b) the practicality of making fair value measurements for such investments.

Extractive industries: IFRS 6 is a temporary standard which maintains non-IFRS GAAP. It seems investor information could be improved in this area and this should be done, given that national standard-setters have already prepared proposals.

Foreign currency translation: we are unaware of a need to revise IAS 21.

Inflation accounting: we are unaware of the need to revise IAS 29.

Intangible assets: we thought this topic was on the IASB's research agenda and that the AASB had done significant work in this area, now published by the National Standard-setters. We do not believe there is significant investor appetite for this information, although we acknowledge it is a major inconsistency in the accounting framework.

Interim reporting: it seems to us that IAS 34 could benefit from updating and would provide better information for investors.

Shariah compliant accounting: Mr Upton's presentation to the board earlier this year seemed to indicate that there is no consensus that this is required.

Presentation and disclosure standard: we are not certain that such a project would bring the hoped-for simplification, but it would seem to be worth investigating in order to improve the existing standards an could improve investor information by bringing related pieces of information to the same place.

Rate-regulated activities: we are aware that this poses a problem in North America, and do not share the IASB's view that this would involve recognising assets and liabilities that do not meet the conceptual framework definition. The only alternative is to leave national jurisdictions to add local supplements to IFRS.

Share-based payment: in light of the many queries generated from this standard, it would seem worthwhile trying to re-write it, especially as preliminary work has been done.

> *2(b) Adding new projects to the IASB's agenda will require the balancing of agenda priorities with the resources available. Which of the projects previously added to the IASB's agenda but deferred would you remove from the agenda in order to make room for new projects, and why? Which of the projects previously added to the IASB's agenda but deferred do you think should be reactivated, and why? (Please link your answer to question 2(a))*

Taking the list of projects shown as added to the agenda but deferred, our views are as follows:

Business combinations of entities under common control: it is not clear that there is a need for investor information in this area.

Earnings per share: if this is seen as an improvement, it should be addressed in the second three years.

Emissions trading schemes: it appears that such schemes have not taken on the importance that it was once expected they should have. This should be removed from the agenda.

Financial instruments with the characteristics of equity: this is a good example of a standard that could not be resolved by a joint project. The FASB has failed to agree despite working on it for many years. The joint discussions were unsuccessful and frustrating for staff and board members. It should be dropped as unlikely to be cost beneficial.

Financial Statement Presentation: a heroic project that has consumed vast resources, but this is probably a step much too far for constituents. Incremental change may be preferable as preparers get thoroughly comfortable with applying IFRS. The project should be dropped as unlikely to meet cost/benefit criteria.

Government grants: we are unaware that this standard poses application problems. It should be removed.

Income taxes: we are aware that this project too has consumed enormous resources without leading anywhere. EFRAG is doing research in this area. We would suggest that further action along the lines of the past attempts to improve this standard are likely to be a waste of resources. The IASB should remove this project from the agenda and later evaluate EFRAG's research.

Liabilities: it is a pity that the measurement issue has held up the other operational improvements to this standard. We think this should remain on the agenda and be finalised as part of looking at application issues.

Other Comprehensive Income: many constituents have noted the growing use of this presentation and asked for some discipline. It may not be possible to resolve that satisfactorily, but this is clearly an area of existing IFRS that could benefit from review.

Post-employment benefits: when the IASB set out on its improvements to IAS 19 it identified that there was a new and growing class of pensions where risk was split between employer and employee. Research should be done in this area to check whether IAS 19 still reflects the real world issues.