

Mr Pedro Solbes
EFRAG
Square de Meeus 35
1000 Brussels
Belgium

Ref: IASB and IFRS Interpretations Committee Due Process Handbook

Dear Mr Solbes,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

ESMA has considered EFRAG's draft comment letter on the *IASB and IFRS Interpretations Committee Due Process Handbook*. ESMA would like to thank you for this opportunity to contribute to EFRAG's due process and is pleased to provide you with the following comments, which are aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

The *Due Process Handbook* is built on the principles of transparency, full and fair consultation and accountability. Though we agree with EFRAG that the objectives of the due process should be more clearly set out in the *Handbook*, we believe that the *Due Process Handbook* should be more clearly linked to the objectives of the Foundation (i.e. to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles) and how to achieve them. We however have some concerns that the objectives proposed by EFRAG in its draft comment letter could potentially affect the independence of the IASB and the overriding principle of the public interest.

Our detailed comments are set out in the appendices to this letter. However, we would like to highlight the following:

- *Shared Due Process*: Stemming from the importance ESMA attaches to the independence of the IASB – but fully agreeing with EFRAG that all stakeholders should be fully consulted – we believe, as a general rule, that the IASB should drive its own agenda and perform its own activities. In some cases the Board may feel the need to work jointly with other standard-setters and we believe that the Board should always make sure that the output of these projects meets the objectives and high quality standards that it has set for its own projects.
- The creation of a Due Process Oversight Committee (DPOC) serves as a good counterweight to ensure that the IASB has duly considered the concerns raised by its stakeholders without jeopardising the independence of the Board. The DPOC should however go further and become a *guardian of the public interest*.

ESMA believes that it is important to bear in mind the public interest implications of the Board's work at all times, as even respecting the due process may not always guarantee protection of the public interest. ESMA is of the opinion that the DPOC should focus on the substance and not only on the process and should consider whether the (underlying) objectives of the *Due Process Handbook* are achieved with a particular focus on serving the public interest and producing high quality accounting standards. In ESMA's view this implies that in some cases the IASB will have to take a decision contrary to the views of a majority of its constituents.

- Referring to the objective of financial reporting, and the objective of the IFRS Foundation, we would like to express our strong support for the additional steps the IASB should take to consult investors on proposals for new IFRSs or major amendments to IFRSs. We believe that the DPOC should give due consideration to how the IASB reports on how it has consulted with investors and their intermediaries and, more importantly, how it has responded to their concerns. We however support EFRAG's request to the Trustees to provide more scope for meetings involving investor representatives and management representatives.
- Given the importance of the Interpretations Committee for achieving consistent application, ESMA strongly supports the Trustees' recommendation published in May 2012 and is looking forward to its further implementation. We however believe that in relation to the Interpretations Committee the *Due Process Handbook* could be further enhanced by setting robust criteria for rejection notices, more prominent inclusion of opposing or dissenting views when consulting on draft interpretations and to achieve a more balanced membership of the Interpretations Committee.



Our detailed comments are set out in the appendices to this letter. We would be happy to discuss these issues further with you.

Yours sincerely,

A handwritten signature in blue ink, appearing to be 'S/M' with a horizontal stroke extending to the right.

Steven Maijoor
ESMA Chair

APPENDIX 1 – GENERAL ISSUES

1. Like EFRAG, we welcome the efforts developed by the IFRS Foundation in its due process oversight responsibilities, and the choice to make it an ongoing process. ESMA believes that the IASB and IFRS Interpretations Committee *Due Process Handbook* should ensure the Foundation to achieve its principal objective. We would like to refer to the report of the Financial Crisis Advisory Group (FCAG), formed at the request of the IASB and Financial Accounting Standards Board (FASB), which served as direct input for the Trustees' recent strategy review:

“Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of business. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of these standards.”

2. ESMA strongly supports the IASB's focus on achieving consistent application of IFRS and prioritizing user's needs when developing new projects.
3. The *Due Process Handbook* is built on the principles of transparency, full and fair consultation and accountability. We believe that the work of the IASB and the IFRS Interpretations Committee should be built around these principles. We would however encourage the Trustees to explain the principles more upfront rather than defining them throughout the *Handbook*.
4. We disagree with the proposed objectives set out by EFRAG in its draft comment letter and believe that the *Due Process Handbook* should be more clearly linked to the objectives of the Foundation (i.e. to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles) and how to achieve them. We have some concerns that the objectives proposed by EFRAG in its draft comment letter could potentially affect the independence of the IASB and the overriding principle of the public interest.

Independence of the IASB

5. The independence of the IASB in the standard-setting decision-making process, within a framework of public accountability, must be maintained. Being a strong supporter of global accounting standards, we believe that the Board should actively liaise with all stakeholders to ensure that standards are accepted around the world. Consequently we believe that the Board should be led by the technical issues that are brought up by its constituents. Therefore, and seen the nature of global

standards, we believe that the Board should further invest in setting up dialogue with international bodies with an interest in financial reporting rather than seeking compromise positions of regional bodies. In any case, we believe that the network model the IASB is considering should not directly be involved in the activities of the IASB and may not harm the independence of the IASB.

6. Stemming from the importance ESMA attaches to the independence of the IASB – but fully agreeing that all stakeholders should be fully consulted as rightly argued by EFRAG – we believe, as a general rule, that the IASB should drive its own agenda and perform its own activities. In some cases the Board may feel the need to work jointly with other standard-setters. In those cases, we believe that the Board should always make sure that the output of these projects meets the objectives and high quality standards that the Board has set for its own projects.
7. On a more drafting point we note that paragraph 3.49 discusses the development of national and regional networks. ESMA thinks it might be better not to name specific groups such as ASOSSG, GLASS and PAFA as they may change over time.

Due Process Oversight / Public Interest

8. The creation of a Due Process Oversight Committee (DPOC) serves as a good counterweight to ensure that the IASB has considered duly the concerns raised by its stakeholders for IFRSs to be accepted globally without jeopardizing the independence of the Board. The DPOC should however go further and become a *guardian of the public interest*. We therefore strongly support the principle-based character of the *Due Process Handbook* and believe that due process oversight cannot be developed in a mechanical way.
9. It is important to be aware of the public interest implications at all times. Indeed, respecting the due process may not always guarantee protection of the public interest. For ESMA the DPOC should focus on the substance and not only on the process and should consider whether the (underlying) objectives of the *Due Process Handbook* are met with particular focus on serving the public interest and producing high quality accounting standards. It is clear that for ESMA this means that in some cases this might result in the IASB taking decisions that go against a majority of its constituents.

Agenda Consultation

10. We believe that the recently launched three-yearly consultation on the IASB technical work programme will prove to be an important and valuable contribution towards a more stable and transparent agenda-setting. We support EFRAG that the agenda consultation's current format cannot be the basis on which to determine what projects, and the scope of these, the IASB should

work on for the coming years. In that respect we consider it only a starting point and think that the due process should foresee a consultation on more detailed priorities.

Effects of Accounting Standards

11. The *Due Process Handbook* states that the IASB has begun the process of embedding the assessment to the (potential) effects of accounting standards throughout the development process.
12. Effects analysis answers a number of questions such as (i) is the standard operational, (ii) what is the cost of implementation of the standard, (iii) is the standard difficult to apply or not? We understand that IASB staff is already carrying out limited effects analysis during the standard-setting process (among others through meetings with constituents and academic research). ESMA would encourage the Board to further develop its efforts in this area further. We thus welcome the Trustees recommendation to establish a working group from the international community chaired by the IASB, to develop an agreed methodology for fieldwork and effects analysis. It is important for the Board and for the new working group to consider when and how the results of such activities could be made better publicly available.
13. Though we in principle would support EFRAG's position that the IASB should bring improvement at an acceptable cost we are concerned for the strong wording used by EFRAG in its draft comment letter. Indeed, there might be cases where the public interest should clearly outweigh the costs. In any event, we would like to emphasise that it would not be appropriate to consider the effects of accounting standards only through quantified analysis (such as comparing the net present values of different approaches). Although financial reporting is of great importance to investors and other financial market participants in their decision-making regarding allocation of resources and to regulators and other users, it is not an easy task to measure the benefits of an accounting standard. The confidence of all users in transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth. Moreover, experience teaches that it is easier to quantify the cost than the benefits within a cost-benefit analysis so preparers of financial information are naturally favoured by such analyses. As accounting standards are primarily set for the benefit of investors there will often be qualitative reasons making the IASB decide that a particular approach is more beneficial.

Post-Implementation Reviews

14. Linked to the increased use of effects analysis, ESMA strongly supports post-implementation reviews as they provide an opportunity to assess the effect of the requirements on investors, preparers, auditors and enforcers. We agree that the issues that were important or contentious

during the development of the publication as well as issues that have come to the attention of the IASB after the document has been published are relevant to consider.

15. It is the IFRS Foundation's objective to develop, in the public interest, a single set of high quality, understandable, *enforceable* and globally accepted financial reporting standards based upon clearly articulated principles. In line with the Foundation's vested interest in consistent application of IFRS, we believe that post-implementation reviews should consider whether the standards meets the objectives of the IFRS Foundation and have particular attention to the enforceability of the standards and whether further improvements are possible to the standard in order to better achieve that objective.

XBRL

16. Though we note that the due process requirements are in a separate document, the *Due Process Handbook for XBRL Activities*, the *Due Process Handbook* contains some references to XBRL. As set out in our letter on the *IASB 2011 Agenda Consultation* we believe that the IASB and the Foundation's XBRL team should think how mutual experiences could be shared in order to provide investors with the most-decision useful information. We therefore strongly welcome the Trustees commitment to review the *XBRL Handbook* over the next 12 months with a view to incorporating it into the IASB Handbook.

APPENDIX 2 – ESMA’s detailed answers to the questions in the Invitation to Comment IASB and IFRS Interpretations Committee

Question 1

The Trustees’ have included an introductory section dealing with ‘oversight’, and the responsibilities of the DPOC (see paragraphs 2.1-2.15).

Do you support the inclusion and content of this section? Why or why not?

17. As set out in Appendix 1 ESMA believes that the creation of the DPOC serves as a good counterweight to ensure that the IASB has considered duly the concerns raised by its stakeholders to be accepted globally without jeopardizing the independence of the Board. The DPOC should however go further and become a *guardian of the public interest*. We therefore strongly support the principle-based character of the *Due Process Handbook* and believe that due process oversight cannot be developed in a mechanical way. It is important to be aware of the public interest implications at all times. Indeed, respecting the due process may not always guarantee protection of the public interest. For ESMA the DPOC should focus on the substance and not only on the process and should consider whether the (underlying) objectives of the *Due Process Handbook* are met with particular focus on serving the public interest and producing high quality accounting standards. It is clear that for ESMA this means that in some cases this might result in the IASB taking decisions that go against a majority of its constituents.
18. ESMA believes that the principle that the DPOC is responsible for overseeing the due process procedures of the IASB and the Interpretations Committee should be applicable to all consultation papers and that those procedures should be aligned as much as possible. Consequently we do not support paragraph 4.20 that if an information request is narrow in scope and urgent the IASB may set a shorter period without consulting the DPOC before doing so. We believe that the DPOC should be consulted and believe that such circumstances will be rare as it seems unlikely that an urgent issue would need to be considered in the research phase.
19. Referring to the objective of financial reporting, and the objective of the IFRS Foundation, we would like to express our strong support for the additional steps the IASB should take to consult investors on proposals for new IFRSs or major amendments to IFRSs. We believe that the DPOC give due consideration to how the IASB reports on how it has consulted with investors and their intermediaries and, more importantly, how it has responded to their concerns. We however support EFRAG’s request to the Trustees to provide more room for meetings involving investors’ representatives and management’s representatives.

Question 2 –

The DPOC have created a Due Process Protocol in the form of a table that shows the steps that the IASB must, or could, take, as well as reporting metrics to demonstrate the steps that they have taken, in meeting their due process obligation (see Appendix 4).

Do you agree with the idea that such table should be maintained on the public website for each project? Why or why not?

20. ESMA supports the presentation in the form of a table that shows the steps the IASB must, or could, take as well as some reporting metrics to demonstrate the steps that they have taken, in meeting their due process obligations. However, referring to Appendix 1, the focus should not be on the presentation issues but on achieving the underlying objectives of the *Due Process Handbook*. Rather than a fixed tabular presentation the format should allow sufficient flexibility encouraging timely and transparent reporting.

Question 3 – Transition

A research programme is described, which we expect will become the development base from which potential standard-level projects will be identified (see paragraphs 4.9-4.22). In addition, a new section on maintenance has been added, which formalises the practice that the IASB and the Interpretations Committee have been following for addressing matters that are narrow in scope. It clarifies that more formal project proposal processes were always intended to apply to new IFRSs and major amendments. The IASB has the discretion to initiate changes that are narrow in scope to IFRSs as part of the general maintenance of IFRSs. The new section also explains how the activities of the IASB and the Interpretations Committee are closely related (see paragraphs 5.11-5.20).

Do you agree with the distinction between narrow-scope projects, which come under the heading of maintenance and comprehensive projects, which come under the heading of development of IFRSs? Why or why not?

Do you agree with the introduction of a separate research programme that will likely be the development base from which potential standard-level projects will be identified? Why or why not?

Maintenance versus Comprehensive Projects

21. We support the distinction between maintenance and comprehensive projects but would like to underline that both are important for investors to maintain trust in financial reporting. We think

that the IASB and the IFRS Interpretations Committee should have sufficient attention for maintenance projects as well.

22. ESMA agrees that the IASB should have the discretion to initiate changes that are narrow in scope to IFRSs as part of the general maintenance of IFRSs without being subject to the formal project proposals as in place for the bigger projects.

Research Programme

23. The introduction of the research programme phase in the standard setting process is an important step forward in achieving evidence based agenda setting following public consultation. As we understand that the research programme will focus on bigger projects, we believe that stakeholders should be provided with the opportunity to comment on the outcome of the research activities. In case of doubt or during the progress of a project the IASB could consider gathering input from the IFRS Advisory Council to see to what extent it should consult.
24. ESMA agrees with the suggestion that the IASB and its staff are not expected to undertake all of the activities on its research programme and that other bodies participate in these activities. Although we believe that national standard-setters should contribute to the IASB's due process we think that the research programme should primarily be carried out at a global level by the IASB and where that is not the case, that the IASB should be closely involved in the entire process as we note that in many jurisdictions the activities of national standard-setters may not always be driven primarily by investor's needs.

Question 4

Two changes to comment periods are proposed. The first would increase the minimum comment period for exposing the draft of a rejection notice of a request for an Interpretation request from 30 days to 60 days (see paragraph 5.16). The other change relates to the re-exposure of a document. The DPOC is proposing to allow the IASB to have a reduced comment period of a minimum of 60 days for documents it plans to re-expose, if the re-exposure is narrow in focus (see paragraph 6.26).

Do you agree with the changes in the comment period lengths for rejection notices and re-exposure drafts? Why or why not?

25. It being an answer to concerns expressed by many constituents over the years ESMA supports the proposals to increase the minimum comment period for draft rejection notes from 30 till 60 days. As set out in our response to question 5 where we consider some broader concerns on the efficiency and

effectiveness of the Interpretations Committee we believe that the Trustees should provide further guidance on the role of rejection notes.

26. We can accept the DPOC's proposal to allow the IASB to have a reduced comment period of a minimum of 60 days for documents it plans to re-expose, if the re-exposure is narrow in focus. However, we believe that further criteria should be developed to guide the IASB as to what is 'narrow in focus' and thus, what minor and non-controversial.

Question 5

Are there any other matters in the proposed handbook that you wish to comment on, including matters that are not covered by the handbook that you think should be?

27. We would like to refer to the general issues set out in Appendix 1.

Interpretations Committee

28. Referring to our letter of 25 February 2011 we believe that the efficiency and effectiveness of the IFRS Interpretations Committee could be further improved. Given the importance of the Interpretations Committee for achieving consistent application, ESMA strongly supports the Trustees' recommendation published in May 2012 and is looking forward to its further implementation. We however would like to support EFRAG in its belief that in relation to the Interpretations Committee the *Due Process Handbook* could be further developed in the following areas:

- a. *Robust criteria for rejections notes:* ESMA believes that the *Due Process Handbook* should better articulate the role of rejection notices and how they stand towards interpretations. In view of the importance of rejection notice for the accounting practice we would encourage the Interpretations Committee and its staff to foresee due quality control before final issuance, especially when they raise controversy.
- b. *Dissenting views:* we note that after addressing all the issues the IFRS Interpretations Committee votes to see whether there is general agreement that the staff should prepare the draft interpretation for balloting. General agreement is reached when no more than four members have voted against the proposal. We believe that it would stimulate the discussion if the consultation paper with the draft interpretation would reflect those opposing or dissenting views more explicitly.
- c. *Clarification as to the membership:*
We would encourage the Trustees to achieve a more diverse composition of the Committee and to ask the chair of the IFRS Interpretations Committee to pay particular attention to potential conflicts of interests that might arise for some of its members, especially in respect of audit firms. With that objective mind we would welcome increased participation of IFRS enforcers other than the International Organization of Securities Commissions (IOSCO) in the meetings.

We note that the Interpretations Committee has the right to invite members of securities regulatory bodies to act as official observers to its meetings. We welcome this proposal and

would suggest leaving that decision to the discretion of the Committee's chair.

On another matter, we note that institutions represented at the IFRS IC are mainly the large audit firms. We invite the Trustees to seek other organizations which could provide representatives with appropriate level of expertise and help diversity of inputs made to the Committee.

On a drafting point we note that paragraph 5.13 states that 'preparers, auditors and others with an interest in financial reporting are encourage to refer issues to the Interpretations Committee. We believe that all parties with an interest in financial reporting should be encouraged to refer such issues and would suggest not to refer to any specific stakeholders but to start the sentence with 'All parties with an interest in financial reporting are encouraged...'.