

IFRS Foundation
To the Trustees
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Dear Sir,

The Annual Improvements Process: Proposals to amend the Due Process Handbook for the IASB — Criteria for Annual Improvements to IFRSs

- 1 On behalf of the Supervisory Board of the European Financial Reporting Advisory Group (EFRAG), I am writing in response to the invitation to comment on the *Annual Improvements Process: Proposals to amend the Due Process Handbook for the IASB*.
- 2 EFRAG appreciates the efforts that the IFRS Foundation Trustees have already made to improve the due process of the IASB. The current initiative to formalise the detailed criteria in the IASB Due Process Handbook for assessing the appropriateness of amendments to IFRSs for inclusion in the Annual Improvements is therefore welcomed. In general, we support the Trustees' proposals.
- 3 In the past, EFRAG has expressed its concerns that some issues included in the Annual Improvements project were too significant to be dealt with via the Annual Improvements process, as they involved material, cross-cutting issues. In this respect, we refer to the general comments in our letter of 15 December 2008, in which we previously suggested to the IASB the need to set some explicit limitations on the issues to be addressed in an Annual Improvements project.
- 4 However, EFRAG's concerns are not limited to Annual Improvements. We believe that the Due Process Handbook should include more stringent criteria for due process, relating to those agenda decisions that result in other amendments to standards, as well as imposing limitations in the development of amendments once an agenda decision has been made.

- 5 We acknowledge that the Board has a difficult task in reconciling rather different, and occasionally conflicting, interpretations:
 - a. The Board and the Interpretation Committee are expected to be responsive to issues encountered in practice, to correct potential errors and unintended circumstances, and to avoid diversity in IFRS implementation;
 - b. Issuers and investors long for continuity in current standards. EFRAG's constituents have frequently expressed concern about the number of amendments and the pace within which amendments are introduced. Consistency from period-to-period characterises useful financial reporting and changes should therefore be kept to a minimum.
- 6 Extensive use of annual improvements procedures raises questions about the stability and quality of the original underlying standards. Through an adequate use of field testing and effect studies and other forms of impact assessments during the standard setting process and before the standards are final, the IASB should ensure that the final standards are of high quality and that the need for annual improvements or interpretations is kept to a minimum. In addition we would recommend to the IFRS Foundation to consider the frequency of issuing annual improvements: a bi-annual process instead of an annual process would reduce the burden for preparers and other financial reporting stakeholders and increase the consistency over time.
- 7 In light of the above, we comment below on some of the detail of the proposals for setting the criteria for Annual Improvements, but provide additional recommendations as to how and when amendments to IFRS – aside from major revisions – should be decided and carried out.

Introducing new principles or changes in principles

- 8 We believe that all amendments to IFRS, including the Annual Improvements, should share the principle that is proposed in paragraph 65A (a) for Annual Improvements, i.e. that an amendment should not introduce a new principle. Changes in principles should, in our view, be introduced only when major overhauls take place, or as a separate project in those cases where the performance of a thorough post-implementation review concludes that the existing principle fails to provide information as relevant as was initially expected.
- 9 We support the objectives set for Annual Improvements in paragraph 65A. However, we are concerned with the last sentence of paragraph 65A (a) (ii), which indicates that Annual Improvement amendments "...may create an exemption from an existing principle." We accept that in very rare cases this might be necessary. However, as Annual Improvements are meant to address narrow issues in response to identified practical difficulties, there is a high risk that setting exceptions from existing principles will generate rules, which in turn will eventually weaken those principles that are subject to a number of allowed exemptions. EFRAG therefore believes that the Annual Improvements project in those circumstances is not likely to be the right vehicle for these amendments. If there is evidence to suggest that an applied accounting principle is subject to several proposed amendments, then the proposed amendments should be reassessed in a separate project to ensure that further consideration is given to

potential consequential implications or breaches in overall consistency. As such, EFRAG suggests that the following clause be removed from paragraph 65 (a) (ii): "...but may create an exception from an existing principle..." This would not prohibit such changes, but would avoid acknowledging (and thereby possibly encouraging) what should be considered a highly rare event. In the most recent EFRAG-IASB Convergence meeting, we shared with the IASB our concerns about amendments which address issues on too narrow a basis and, in terms of applying IFRS as a principles-based set of standards, the potential damage that this may lead to.

- 10 The criteria for Annual Improvements provide guidance on whether or not an amendment should be made through the Annual Improvements project. However, the criteria do not provide guidance on the distinction between an Annual Improvement amendment and an interpretation, when providing clarification is the underlying reason for the Annual Improvement amendment. EFRAG believes it would be helpful to provide guidance in this case; specifically, when clarification is supposed to be made in the form of an Annual Improvement amendment or when it should be made in the form of an interpretation of a standard. Moreover, we note that criteria (b) to (d) are in substance the same as criteria (d) to (f) of paragraph 24 of the IFRIC Due Process Handbook. We encourage the IFRS Foundation to review how the IASB and the IFRS Interpretation Committee apply these criteria in practice.
- 11 EFRAG considers that the distinction between an Annual Improvement amendment – which changes the standard – and an interpretation, is more important than the distinction between an Annual Improvement amendment and an amendment through a separate project on a standard, as the latter two both result in changes to the standard. We consider that neither Annual Improvement amendments nor interpretations should make changes to the existing principles, and that only major revisions should introduce new principles.
- 12 Criterion (b) requires that the proposed amendment has a narrow and well-defined purpose. However, we have difficulties in ascertaining how the second part of the criterion follows logically from the first part, i.e. "...the consequences of the proposed change have been considered sufficiently and identified." Therefore, we suggest the introduction of a separate criterion, that consequences of the proposed change have been considered sufficiently and identified.

Notion of urgency/ pressing need

- 13 We appreciate the inclusion of criterion (d), such that the amendment can only be included in the Annual Improvements if there is a pressing need to make an amendment sooner than the current or planned IASB project on the standard. In our view, criterion (d) should not only refer to a pressing need, but also to the requirement that the amendment be of sufficient importance to be introduced in advance of a separate project. The concept of pressing need should focus on the likely timescale for completion of the IASB project, balanced with the possible enhancement of the IFRS and the needs of users. The notion of 'pressing need' in relation to Annual Improvements should also be placed in the context of those amendments being considered 'non-urgent,' in order to ensure that no contradiction or misunderstanding arises. It would be helpful if the notion of urgency in relation to the pressing need notion could be clarified. Our understanding is that the Board may, in certain circumstances, take an

amendment that meets all criteria to be included in the Annual Improvements as an isolated project – one such circumstance being, for example, when there are good reasons for wanting an amendment available for application in the current reporting year.

Link to agenda decisions

- 14 The IFRS Foundation Constitution and the IASB Due Process Handbook have set conditions in which agenda decisions are prepared and made. In light of past developments (such as IAS 37, IAS 1 and IAS 12) we believe it is important that any proposed amendment is consistent with the agenda decision made. As such, we recommend that the agenda decision clearly defines what shortcomings the project is intended to solve. If, in the course of developing an amendment, the Board sees benefits in enlarging the scope of its project, the enlargement decision should be subject to a separate agenda decision process. With this recommendation, EFRAG does not wish to encourage the IASB to engage in an overly-bureaucratic process or for the IFRS Foundation to create unnecessary hurdles in the IASB's standard-setting process. We do so because we believe it is of the utmost importance that constituents have, at all times, a clear understanding of what improvements the Board is intending to achieve and that changes to IFRS should, at all times, be based on agenda decisions which are supported by appropriate consultation.
- 15 IAS 37 is a clear example of a project that commenced with quite a narrow scope, but resulted in a complete overhaul of the standard, including major changes in measurement. The revision of IAS 1 is another example of a project being active on quite a generic basis. The Board finalised improvements to IAS1 in 2007, on the basis that these improvements were needed before an IAS 1 major overhaul could take place. Nevertheless, a supplementary exposure draft was issued earlier this year.

Options

- 16 We would like to use the opportunity of this consultation paper to bring another related issue that is of concern to the attention of the IFRS Foundation: the use of options as a tool for changing a standard. The IASB has often advocated the reduction of options in order to increase comparability and to facilitate internal consistency, as well as implementation. EFRAG supports this reduction of options in the standards.
- 17 However, we believe that the IASB is simultaneously introducing new options as a mechanism to bring about what may be considered a controversial change to a standard. Firstly, an additional (preferred) option is introduced and subsequently, at a later stage, the original treatment is removed. This frequently occurs as part of a series of successive changes, rather than replacing the existing treatment with the IASB's preferred treatment at the outset. This can result in the introduction of potentially significant and fundamental changes to the IFRS accounting model without debating those changes, as should be the case. This approach to standard setting is not acceptable, specifically as successive changes are then justified by the removal of options. The most recent example of introducing an option as a tool for changing the accounting requirement in a standard is the introduction of the Exposure Draft (ED), *Presentation of Items of Other Comprehensive Income* of May this year) in which it is proposed to eliminate the option of presenting performance in two

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statements – that option having been introduced in IFRS in 2007. In its draft comment letter, EFRAG strongly objected to this approach and called for a proper debate on fundamental issues in relation to performance reporting and fair value.

If you have any questions about matters raised in this letter, please do not hesitate to contact Saskia Slomp or me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Pedro Solbes', with a small dash at the end.

Pedro Solbes
Chairman, EFRAG Supervisory Board