European Securities and Markets Authority

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EFRAG

Square de Meeus 35
1000 Brussels
Belgium

EFRAG's Discussion Paper *Considering the Effects of Accounting Standards*

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as by enhancing investor protection.

ESMA has considered through its Standing Committee on Corporate Reporting the discussion paper *Considering the Effects of Accounting Standards* published by EFRAG and a selection of European national standard-setters. We thank you for this opportunity to contribute to EFRAG's due process and to comment on your discussion paper.

The issue whether the IASB should consider the effects of its accounting standards is an important one. ESMA believes that it merits further discussion as part of the strategy review that the Trustees of the IFRS Foundation and the Monitoring Board are currently carrying out, which could result in some strategic direction to the IASB on how to develop specific guidance. In what follows ESMA provides some initial views without pre-empting any proposals coming from the Monitoring Board, the Trustees of the IFRS Foundation or the IASB on how it could potentially improve the consideration given to the consequences of accounting standards. ESMA has not considered EFRAG's discussion paper in detail but thinks that it is worth sharing some of its initial thinking with EFRAG. The fact that ESMA does not provide comments to all questions identified in the discussion paper does not necessarily imply that ESMA would agree with everything set out in that paper.

The discussion paper suggests four key principles underpin effects analyses: (a) explain intended outcomes, (b) encourage input on anticipated effects, (c) gather evidence and (d) consider the effects throughout the due process. ESMA believes that the principles represent the key phases of how effects analyses should be carried out but has significant concerns regarding how the principles have been further developed. We have set out our concerns below.

We believe that the IASB is already performing many of the suggestions the discussion paper puts forward, be it on a more informal and ad hoc basis, and would support the integration of effects analyses into the IASB's standard-setting due process as an overarching objective that should guide the whole process. ESMA sees effects analyses as an evolutionary mindset - documented along the different phases of the IASB's consultation process (e.g. an annex to discussion papers and exposure drafts) rather than formal stand alone effect studies.

(a) *Effects Analyses*

ESMA believes that the IASB could further improve its standard-setting due process by allocating sufficient resources to meeting market participants and to preparing market impact analyses, or market failure tests in the case of pursuing amendments, prior to developing exposure drafts, in order to assess the need for new proposals and their scope, as well as to assess their impact. There have recently been a number of projects where, at least to ESMA, it has been unclear why such projects were put on the agenda or why they were given priority. It is crucial to understand what a new standard or an amendment to existing standards aims to fix. In short: we believe that the IASB should better explain from the beginning what it would like to achieve and its expected impact on stakeholders.

Once a new or amended standard has been in effect for two years, the IASB should perform at least some sort of (limited) post-implementation review by, for example, organising round table meetings or other outreach activities in order to be sure that revised or new standards have not led to significant interpretation or implementation issues. Post-implementation reviews should not be limited to major standards, although their scope should be balanced with the relevance of the new or amended standards.

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 the 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. Distinguishing between the initial and the recurring costs that preparers incur should improve understanding of the impact of such costs. 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.

(b) The concept of effects

EFRAG makes a distinction between micro-economic and macro-economic effects in deciding which effects should be captured. ESMA feels sympathy for the alternative approach presented in footnote 34 on page 24 identifying three subgroups: primary economic effects on investors and preparers, secondary economic and behavioural effects on preparers, investors and other stakeholders and tertiary economic and behavioural effects on markets and society as a whole. Although we would support the analysis of the first and second effects, we doubt whether a separate analysis of economic and behavioural effects on markets and society as a whole should take place. We believe that the best contribution accounting standards can make is to present investors with information (with a reasonable cost to prepare and collect that information) which is in accordance with the economic substance of the asset or liability, the income or costs. Achievement of this objective could be generally demonstrated by the first two analyses.

Enforceability

An element that is not considered within the discussion paper but very important for ESMA when considering the effects of a new proposal is the enforceability of the standard. A proposal is not likely to have its intended effect if it is not possible to enforce it. Experience has shown that consistent application of an accounting standard cannot be achieved in practice if its principles are not or difficult to enforce.

(c) The key principles underpinning effects analyses

ESMA agrees with the suggestion in the discussion paper that constituents should be actively encouraged to provide input on the anticipated effects and that evidence should be gathered to support statements that the proposals reflect the underlying reality and are useful for investors. It is however important that such evidence is not biased as it is likely that preparers and auditors have more resources to contribute to this process.

(d) *The practicalities of performing effects analyses*

ESMA thinks that that the suggested effects analysis should be carried out by the IASB. We are not convinced that all jurisdictional-specific issues across multiple jurisdictions (paragraph 5.5 of the discussion paper) should be taken into account as IFRS is a global set of accounting principles. Although we believe that national standard-setters should contribute to the IASB's due process applied on the future effects analyses, we think that they should be carried out at a global level by the IASB and not by national standard-setters which are in many jurisdictions not driven primarily by investor needs.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

J. Galbo

Julie Galbo

Chair of ESMA's Corporate Reporting Standing Committee