8 September 2011

Our ref: ICAEW Rep 83/11

Mme Françoise Flores
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European Financial Reporting Advisory Group
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By email: commentletters@efrag.org

Dear Mme Flores

Considering the Effects of Accounting Standards

ICAEW is pleased to respond to your request for comments on *Considering the Effects of Accounting Standards*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REP 83/11

ICAEW REPRESENTATION

CONSIDERING THE EFFECTS OF ACCOUNTING STANDARDS

Memorandum of comment submitted in September 2011 by ICAEW, in response to the EFRAG / ASB discussion paper *Considering the Effects of Accounting Standards*, published in February 2011.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the discussion paper *Considering the Effects of Accounting Standards* published by EFRAG / ASB in February 2011, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

This is the right time to tackle the assesment of effects

5. We welcome the publication of this paper. The issue of whether, when and how an assessment of the effects of an accounting standard should be performed has been under deliberation for some time. Although progress has been made in recent years, the standard setting due process, and the credibility of both the accounting standards and the standard setter itself will benefit from the establishment of a robust framework for effects analyses. As referenced in the discussion paper, Katherine Schipper's 2009 report *How can we measure the costs and benefits of changes in corporate reporting regulation?,* commissioned as part of ICAEW's 'Information for Better Markets' thought leadership initiative, clearly establishes the limitations of the cost / benefit approach and we therefore welcome EFRAG's lead in suggesting an analysis based upon effects. The IASB's agenda is scheduled to be redrawn in 2011 so this is an opportunity to launch such a framework and if the final document can be released to coincide with the agenda deliberations it would be beneficial. The proposed framework could help considerably in identifying priorities and managing expectations among stakeholders in the standard setting process going forward.

'Effects' are a better basis for analysis than 'costs / benefits'

6. We strongly agree that the concept of 'effects' is far more practical and inclusive than a 'cost benefit' methodology. As it is not possible to quantify precisely, or practically, all of the possible effects a particular standard may have, it would be beneficial to establish a framework that allows a more judgmental, proportionate and tailored exercise to be performed. The current proposals require a little further thought, particularly on how the scope of the exercise is to be limited, if at all, but overall they provide a solid basis for moving forward.

Further consideration necessary of the extent to which macro-economic effects are included in the analysis

7. EFRAG / ASB have selected a relatively broad definition, which allows macro-economic factors to be included within the scope of the effects analysis. We welcome this wider definition; an analysis that failed to identify these factors would struggle to answer the criticisms of due process that led to this consultation in the first place. However, we do not believe that a definitive solution to the issue has yet been provided and feel that further consideration of how, and the extent to which, macro-economic factors should be taken into account (as opposed to being merely identified) would be valuable.

8. A distinct but related issue is the question of how macro-economic effects should be dealt with where it is identified that developments under consideration may have such effects. In our view it would be appropriate in these cases for the standard setter to inform interested regulators or other authorities. This would allow them to both contribute to the debate on the standard's development and take action, if they wish to do so, to allow for the expected effects of the accounting changes. This may not always be practicable as the IASB cannot be in touch with every relevant national authority around the world. But in some cases there will be relevant international organisations – such as IOSCO or the Financial Stability Board – that the IASB should be in touch with. In other cases, it should be incumbent on national standard setters to speak to relevant authorities in their jurisdiction and to feed views back to the IASB.

9. We therefore suggest that EFRAG / ASB perform further work on the requirement in paragraph 3.2 that effects be 'referenced against the objective of serving the public interest by contributing positively to delivering improved financial reporting'. Further deliberation is, in our opinion, desirable to ensure that this really is the most appropriate way of defining the exercise, and in paragraphs 23 to 27 below we set out some issues that EFRAG / ASB may wish to consider.

Interpretation of 'public interest'

10. A further difficulty with the exercise arises from the term 'public interest'. Although the concept of acting in the public interest appears to be a natural one to guide the work of the standard setter, in practice whether a particular outcome is successful in serving the public interest or not relies upon judgment and can vary between different interest groups. We refer below (paragraph 25) to the example of the UK standard FRS 17 *Retirement Benefits* on which different people came to quite different views, on the basis of the evidence available, as to whether its effects were in the public interest.

11. Society is increasingly mistrustful and public choice theory suggests that this is not wholly unjustified. Transparency is a useful safeguard. In our view it should be assumed that where an accounting treatment gives users a better understanding of a company's performance and financial position than the alternatives, and is therefore likely to give rise to better economic decisions, its adoption would be in the public interest. This is a rebuttable presumption, and there may be reasons in any particular case why adoption of the accounting treatment in question would be inappropriate. But the important point is that accounting treatments that allow users to take better decisions will generally be in the public interest.

12. Where 'public interest' is established as a test, the exercise of some judgment will be necessary in its interpretation. We believe the key elements of that judgement should be explained. We therefore urge EFRAG / ASB, before the term 'public interest' is formalised in the standard setting due process, to further consider this matter to determine whether some change to or further elaboration of the phrase may be possible.

Benefits to users

13. It is important that in proposing change standard setters demonstrate that this will indeed benefit users. Changes should not be justified simply by showing that they would achieve greater consistency with the conceptual framework. It should be explained how users will benefit from them.

RESPONSES TO SPECIFIC QUESTIONS

SECTION 2: The process of 'effects analysis'

1) 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.

14. We agree. It is useful to establish the effects analysis as a defined, systematic process. It is also useful to recognise from the outset that the effects analysis is a process that takes place both during the development (pre-release) and implementation (post release) phases. Previously these phases may have been the focus of different types of review exercise (for example the impact assessment and the post implementation review); to bring them together into one continuous due process is a welcome development.

2) 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.

15. We agree. Integration of the effects analysis into the standard setting due process is a welcome development that would enhance the quality of the IASB's due process and should help to bolster particular accounting standards against any allegations that they were introduced without proper consideration of the consequences.

16. Indeed, the effects analysis process should be commenced at as early a stage as possible. An early determination of the likely positive and negative effects to be considered in the development of the standard could allow limited resources to be targeted more efficiently and should reduce subsequent calls for revision. One recent example of where this process could have led to greater efficiency and stability is with IAS 24 Related Party Disclosures. In its original form this standard was simply not operable in China and therefore to achieve Chinese convergence it was subsequently necessary to make amendments to the standard. A proper effects analysis process may have been able to detect this consequence and have allowed measures to be taken to pre-empt amendment.

3) 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.

17. We agree. There is a real danger that by opening up the standard setting due process to external bodies the exposure of that process to political influence is increased. A disaggregation of responsibility could serve to channel criticism toward the standard setter rather than deflecting pressures away. Appropriate and demonstrable due process is an effective defence against subsequent criticism and it is therefore desirable that the standard setter should be given responsibility for this process.

4) 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.

18. We agree, the process should include all the stages A to E. Although this appears to be a substantial commitment, we believe that in practice significant efficiencies could be achieved as each of the subsequent stages would be an updating exercise on the stage before. The post-implementation exercise should be more extensive, but nevertheless it should still be possible to build on the groundwork of the previous stages. It may be beneficial to build up the exercise in stages as this may establish a base line expectation which can be useful in informing the exercise as it progresses.

19. We believe that the process should commence at least as early as stage A and there may be merit in considering starting it even earlier – at the point at which potential agenda items are identified and ranked. And we further believe that items should only be considered for the agenda where there is a robust demonstration of deficiencies in current practice, supported by evidence from outreach amongst preparers and users of financial statements.

20. At stage B it should also be demonstrated why the proposed change would be an improvement and at stage C that it is clearly understandable.

21. We particularly agree with point E. By performing a post implementation review, not only is the accountability of the standard setter improved and discipline enforced in the process, but the conclusions drawn can constitute a valuable learning experience.

5) 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.

22. Yes. The extent of the exercise to be performed should be designed to be proportionate to the scale of the effects expected. In some cases this will be natural as the scope of the potential effects will fall to be either extremely wide or will be limited by the subject matter in question. However, in some cases a relatively minor amendment may be found to have a

wide field of potential effects and in these instances it is important to ensure as far as possible that all its effects are taken into account, including unintended ones.

SECTION 3: The concept of 'effects'

6) 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.

23. We believe that further development is necessary in this area. We agree with the adoption and definition of the concept of 'effects' but we question whether the process of effects identification and assessment sits naturally with a reference to specific objectives. In our opinion these are two separate processes. In the first stage the standard setter should make a broad attempt to identify all of the particular effects that are likely to flow from an action. The second stage would then involve applying a set of criteria to either exclude or reduce the weighting of certain effects for consideration in the development of a standard.

24. There are different views on whether a second stage is desirable; some commentators hold that no effects should be excluded, all should be kept on the table for inclusion in the analysis. After all, building in an assumption that improvements to financial reporting will necessarily be in the public interest is a rather bold step, particularly in the absence in the discussion paper of a practical example to assess the assumption against. The bar is set rather low if the main purpose of the effects analysis is to examine whether or not a particular proposal is an improvement in reporting, and in such a process many potentially significant effects may be discounted. Ultimately it is unlikely that the criticisms of the standard setting process that this exercise is intended to deal with can be addressed without a demonstrable effort to show that all material effects have been taken account of in the standard setting process. And some of those effects have the potential to be extremely far reaching.

25. In the case of the UK standard FRS 17 *Retirement Benefits* the change to accounting practice ushered in by the standard, which required all defined benefit pension liabilities to be brought on balance sheet, preceded profound changes to the pattern of pension provision in the UK. It can reasonably be argued that such changes in pension provision would ultimately have occurred in any case because of other trends, notably in longevity and the taxation of pension schemes, including limits on the accumulation of surpluses. We also believe that the additional transparency introduced by the standard helped organisations to make better economic decisions, and that by precipitating recognition of the true extent of liabilities it enabled pension schemes to be placed on a sounder financial footing. But nevertheless the standard was perceived to have a profound effect that reverberated beyond the decisions of users of the financial statements.

26. Conversely, there are of course many advantages to pre-defining the scope of the effects to be given weight in the standard setting process. It would not be desirable for the standard setter to be obliged to complete a lengthy conceptual exercise for each individual standard to determine afresh each time exactly how it ought to be weighting different types of effects. The approach proposed in the discussion paper potentially reduces costs by containing the scope of the exercise as well as perhaps increasing its quality by improving its manageability and focus. The IASB's recent consultation on impairment of financial instruments is a case in point. This lengthy exercise encompassed much discussion at the conceptual level and although this could be useful in some contexts it may not have been

the most efficient way of completing the exercise in this instance. Ultimately there is a practical limit on the extent of the efforts the standard setter can employ in the effects analysis, and while it may be possible to initially identify a great many possible effects, it will clearly be much more of a challenge to examine each of these in detail as part of the standard setting process.

27. By pre-defining the scope of the effects analysis the standard setter may also be better able to resist external influence on the process. This is important because in some cases certain potential effects may be seized eagerly upon by government or other regulatory bodies for the contribution they could make to the achievement of other public policy objectives. In such cases the standard setter may come under significant pressure to develop the resultant standard in such a way as to bring about the desired effect. For example, currently in the United States there is strong government interest in banning the use of the LIFO method of inventory valuation (permitted under US GAAP but not allowed under IFRS) as this is seen as an opportunity to increase tax revenues. Consequently in any revision of the inventory standard the FASB may face significant pressure to prohibit LIFO without any reference as to whether such a move would actually improve reporting.

28. Finally, we also note that ‘improved financial reporting’ is not defined. If improvement is to form such an integral part of the assessment then it is essential that a clear benchmark is established such that any particular effect can be effectively evaluated as to whether or not it does result in improved financial reporting. In our opinion improvement would be achieved where an accounting treatment gives users a better understanding of a company’s performance and financial position than the alternatives, and is therefore likely to give rise to better economic decisions

7) 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.

29. We agree, ‘effects’ is a considerably more inclusive and versatile concept than ‘costs and benefits’. Defining relevant factors in terms of costs or benefits implies a limiting of the scope of enquiry to tangible, quantifiable factors. But many relevant factors may be intangible, many more difficult to quantify, and even where quantification can be attempted the result may be subject to such a degree of uncertainty as to be potentially misleading. In some cases it may be that intangible factors such as ‘understandability’ are a prime motivator to take action. In other instances it may be that the effects are so wide ranging or variable as to be impracticable to quantify. And quantification is likely to be even more difficult in a global context. In addition, as costs are usually easier to quantify than benefits, reliance purely on what is quantifiable can bias decisions. It is appropriate to also take qualitative effects into account and in those situations where quantification is impossible, to consider instead approximate orders of magnitude. And overall it is often possible to appropriately conclude that a certain course of action is better than an alternative withgout completing a detailed quantification of each. For all of these reasons we strongly agree that the concept of ‘effects’ is far more appropriate than ‘costs and benefits’ and therefore we broadly welcome EFRAG / ASB’s proposals.

8) 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.

30. We have in substance responded to this question in our comments at paragraphs 23 to 28 above. We agree that both macro- and micro-economic effects should be taken into account. But in relation to macro-economic effects a distinction needs to be made between (a) how and to what extent they should be taken into account, and (b) what is done to alert relevant authorities to such potential effects so that they can contribute to the debate or take appropriate action to allow for the expected effects of accounting changes. We believe that further work is needed on these issues.

9) 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.

31. We agree; the standard setter's remit is to set financial reporting standards that are effective in meeting its objectives, it is not responsible for any other public policy objectives. Where the effects analysis does conclude that there may be concerns in this respect it would be preferable to refer this to the relevant regulator or government body. However, we question whether an assumption should be established that a standard setter need 'obtain confirmation from' another regulatory body in any specific instance. It is desirable for the standard setter to remain aware of the effects of its work upon other regulatory areas and indeed to maintain regular dialogue with relevant regulatory authorities where, in the case of the IASB, appropriate international bodies exist. Dialogue with national authorities should normally be the responsibility of national standard setters. But these considerations should not be extended to become a formal rationale limiting the standard setter's mandate by having to seek approval from any particular regulatory authority.

10) 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 worlds 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.

32. Overall we support the concept of the standard setter acting in the public interest. We are conscious that an alternative approach may be to limit the sphere of reference to the interests of investors but we feel that this would be inappropriately restrictive. However, we feel that further deliberation is necessary as to whether it is desirable to limit the consideration of effects in the standard setting process by referencing them to a specific objective, as set out in paragraphs 23 to 28. We are also unsure as to the appropriateness of the concept of 'public interest' without further elaboration. Although this would initially appear to sit well with an assessment of effects, in assessing 'public interest' a degree of judgment is necessary and therefore the concept can ultimately be interpreted quite differently by different people. For example, some commentators may believe that a standard that had the effect of causing companies to alter the form of the retirement benefits they offered their employees would be against the public interest as it could detrimentally affect scheme members. Others may claim, conversely, that such a standard actually served the public interest, not only because it enabled companies and their investors to make better economic decisions but because the additional transparency precipitated decisions that were in the interest of the long-term security of the pension

scheme. We therefore suggest that further deliberation on the term 'public interest' is desirable.

11) Do you agree with the following clarifications of the term effects? If you do not agree with any of the below clarifications of the term effects, which one(s) do you disagree with and why? Please explain the reasons for your answer.

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);

33. This clarification could perhaps be worded more clearly. As written, it could be interpreted as meaning that as long as a positive contribution is made to improving financial reporting, the public interest consideration is by default met. We do not believe that this would be appropriate as it would justify action to improve reporting even where the costs of doing so were very high, for example a move to require fair valuing for all fixed assets may provide additional information for users, but this would come at prohibitive cost. It may be desirable to clarify the wording on this point.

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);

34. We agree that marginal effects are the most relevant to the decision making process. However, it must be borne in mind that marginal effects can be both positive and negative – both the positive effects of bringing in the new system and the negative effects of dispensing with the old. Both need to be considered.

c) The term effects can be used to refer to both one-off effects and ongoing effects (paragraph 3.26); and

35. We agree, and furthermore we believe that it would be beneficial to separate the two.

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).

36. We agree.

12) Do you agree with the following further considerations concerning effects? If you do not agree with any of the below further considerations concerning effects, which one(s) do you disagree with and why? Please explain the reasons for your answer.

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).

37. We agree in principle with this process, although it does appear – especially at (b) – to suggest a rather mechanistic approach. In reality the incidence and nature of effects and the range of groups affected will vary widely and it would be desirable to be able to flex the approach to the particular situation. We therefore have some reservations, particularly as an

overly mechanistic process risks a return to the cost / benefit approach that the current exercise is intended to avoid. Nevertheless we agree that this is a useful starting point.

SECTION 4: The key principles underpinning effects analysis

13) 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.

38. We agree; a set of key principles can provide a useful underpinning to the exercise.

14) 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 of key principles and please explain why you favour that alternative set.

39. We agree in principle that it is useful to establish a set of key principles to underpin effects analysis. However, the four principles above are rather generic and seem to represent the conflation of several different strands of the process. It may be desirable instead of these four principles, to attempt to establish the objectives of the effects analysis process.

SECTION 5: The practicalities of performing effects analysis

15) 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.

40. In general we agree with points a to d of paragraph 5.2. However, we have the following specific observations on these four points:

    a) We agree. The standard setter should review current practice as a first step in the standard setting process.

    b) We do not agree with the concept of there being ‘a net benefit of doing nothing’. Taking no action should be considered a neutral state that of itself has no effects at all. It is only if the removal or change of that existing state is proposed that marginal effects appear. On an allied point we also disagree that ‘the costs of the status quo’ are necessarily a relevant consideration. If one option is not to take any action then the status quo should not be attributed with any effects, either positive or negative. Otherwise, there would be double counting of effects. However, were the status quo to be removed or changed then these effects should be included.

    c) We agree that it is desirable for the standard setter to explain the intended outcome of the proposed accounting standard. However, it is not clear that there is any benefit at this stage in referencing this to an objective of serving the public interest by contributing positively to delivering improved financial reporting. And therefore we question the usefulness of the qualifier in this context.

d) We agree. It would be valuable to include exposure of the provisional analysis as part of the standard setting due process.

16) 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.

41. We agree with steps a to e. With step f, we note that the standard setter is asked to 'apply a routine and transparent process for identifying and assessing options'. While we agree that it is useful to follow a routine series of steps for most of the due process, ultimately a balanced judgement needs to be made on the basis of the particular facts and circumstances of the case. It is therefore important to ensure that any routine established does not become excessively mechanistic.

17) 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.

42. We question whether step (d) is not overly mechanistic. We agree that weighing positive against negative effects can help in selecting the preferred option. However, step (d) suggests that a precise quantification of the two is not only possible but, once performed, should alone be relied upon to automatically select the preferred option. This approach takes us back to the cost / benefit analysis which this exercise was intended to avoid. An effects analysis accepts that precise quantification is unnecessary and therefore supplants a mechanistic quantitative approach with a more considered application of judgement. The first sentence of step (d) could also be worded more clearly.

43. Furthermore, regardless of how the options are evaluated, the end result may be that none of them is felt to be desirable. In this instance the preferred option would be to do nothing, but strictly this is an additional option rather than the best of those considered, and therefore it does not fit naturally into the proposed process. Also, the fourth bullet of step (d) is the main objective of the effects analysis. If it is necessary to include this overarching objective in step (d) than it appears anomalous that it be relegated to the bottom of the list.

18) 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)?

44. We agree that conducting an effects analysis at the international level is a relatively complex requirement. To a degree, the advantage of the effects analysis is precisely that it makes such an exercise more practicable, and as currently worded it is rather unclear exactly what the extent and practical implications of delegation are likely to be. Therefore, while we agree that some collaboration with national standard setters is likely to be beneficial, the nature of this will need to be developed more clearly before we can comment further.

SECTION 6: Next steps

19) 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.

45. We agree that field testing and consultation with national standard setters appear sensible steps for taking the project forward.

OTHER OBSERVATIONS

46. In addition to our responses to questions 1 – 19 we also have the following observations on the discussion paper:

47. Paragraph 2.10 b) explores the relationship between financial stability and accounting standards. This is an important topic and we agree that addressing it is fundamental to the conceptual underpinning of the effects analysis process. However, the final sentence of the paragraph does not, in our opinion, succeed in addressing the issue. Ultimately we feel that the paper is deficient where it does not conclude on the interaction between financial stability and effects. Moreover, in this area the lack of a clearly articulated position risks exposing the standard setter to criticism, thereby negating the purpose of conducting the effects analysis in the first place. In our opinion the paper should set-out to consider the juxtaposition between the financial statements and the underlying economic reality being reported. Where the result of reporting is merely to bring transparency to a situation that has already occurred quite independently of any reporting process, it may not be appropriate to describe that situation as an effect of an accounting standard. The paper should be clear on this point.

48. Furthermore, nowhere in 2.10 is the simple objective of making financial reporting better mentioned. Point (f) could be construed as having this intention, but it appears to have been attached almost as an afterthought. We would prefer to see the improvement of financial reporting as the first consideration.

49. We strongly agree with paragraph 2.12; the standard setter is best placed to conduct the effects analysis. Indeed it could be added that the standard setter is not operating in a vacuum, that there are commercial and political effects to accounting standards, that these are likely to be brought up by constituents, and that therefore the standard setter needs to be able to demonstrate that an adequate analysis of effects has been performed.

50. We agree with paragraph 3.10 a). One of the criticisms of cost / benefit analyses, and one of the reasons for a lack of enthusiasm for their wider adoption, has been the difficulties of actually performing the exercise. The significantly greater practicality of the effects analysis is therefore the primary reason to favour it. Hitherto there has been resistance to the exercise in some quarters, and moving to an effects analysis model should help to allay this.

51. Paragraph 3.16 considers the issue of the ‘expectation gap’. We agree that this is an important concern and suggest that perhaps some additional efforts to further publicise the role, objectives and natural limitations of the standard setter may help to close this gap.

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