*European Federation of Accountants and Auditors for SMEs*

European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
B-1000 BRUSSELS
Brussels, 31 August 2011

Dear Sir

**APB and EFRAG Discussion Paper ("DP") - Considering the effects of accounting standards**

The European Federation of Accountants and Auditors for SMEs ("EFAA") represents accountants and auditors providing professional services primarily to small and medium-sized entities ("SMEs") both within the European Union and Europe as a whole. Constituents are mainly small practitioners ("SMPs"), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, and tax and business advice) to SMEs.

EFAA, the European Federation of Accountants and Auditors for SMEs, is pleased to comment on the discussion paper 'Considering the effects of accounting standards'.

General comments

We welcome the focus of the project and believe that such a project is long overdue. We have in the past made representation that the economic impact of standards has not played a visible role in the standard setting process (whether it be in relation to a new or revised standard) and have questioned whether the interpretation of such standards has reflected the economic reality and whether the revisions have succeeding in meeting the principles of the conceptual framework.

We further note that consideration should not be limited to the due process of the International Accounting Standards Board ("IASB") but should also be given due consideration by other European and/or National Standard Setters, noted in the EFRAG DP. This should also extend to the ongoing project dealing with the revision of the 4th and 7th Directives by the European Commission.

Specific comments

**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.**

Yes, we believe that such a process would help to ensure that the objectives and principles of accounting standards are able to be realised, serve the public interest and are transparent.

**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.**

Yes, we agree that effects analysis should be embodied into every standard setting due process.

**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.**

Yes we agree. If a standard setter intends to issue a new standard or change a current standard then there is a substantial need for evidence to be presented to attest to the fact that the newly issued or revised standard fully meets the demands of the users. This is, in our opinion, the ultimate task of the standard setter.

However, we also believe that the standard setter should perform post implementation reviews and should consider soliciting the views of the preparers, auditors and users of the standard by, for example, a questionnaire, similar to this DP, for public consultation and input which the standard setter could then use in its future endeavours whilst considering potential revisions.

**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.**

We consider it very important for standard setters to produce evidence of the problems they intend their new standards or revisions to solve at the time they are issued. We believe that there have been instances in the past when it has been unclear as to whether there was a serious problem that needed to be addressed and this may well be an example of action being taken without proper due process on the analysis of effects.

It is most important that the effects are disclosed and transparent to potential users at the time a DP, Exposure Draft or standard is actually issued.

We acknowledge that post-implementation review is an important tool but its benefits will vary when assessing both new and revised standards when the former have the potential to result in radical changes to accounting systems.

**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.**

We agree that effects analysis should be undertaken for all new accounting standards and that the depth of the analysis work should have regard to materiality and practicalities. Only those effects that are expected to have a significant effect on a major group of preparers, auditors and users or whose magnitude of consequences could be of significant public interest should be quantified.

If following a post-implementation review, an effect had not been properly evaluated or even neglected the effects could then be quantified at that time such that a revision to the standard or amendment could then be identified.

**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.**

We would prefer a wording that highlights the importance of delivering improved financial reporting and therefore we propose that paragraph 3.2 be modified to "consequences that flow or are likely to flow from an accounting standard, referenced against the objective of delivering improved financial reporting in the public interest". We believe that the main objective of the standard setting process is to promote good financial reporting which is ultimately in the public interest.

We further assert that the public interest must be served at both micro-economic level (referenced to appropriate principles) and macro-economic level (serving the public interest).

**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.**

We do not believe that "effects" and "costs and benefits" should be mutually exclusive. In certain circumstances we would consider that an effects analysis may even require a CBA to be performed and, accordingly, it does not seem appropriate to replace one with the other. This is of particular relevance as the materiality concept within financial reporting implicitly assumes some sort of CBA in its approach as evidenced by the following definition. *"Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."*

**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.**

We agree. The discussion about a potential adoption of the IASB standards in Europe versus a reform of the original $4^{th}$ and $7^{th}$ Directives revealed significant disadvantages for the individual entities (micro-economic effects) but potentially more favourable information for the public interest (macro-economic effects). As a result, the effects of both options should have been determined and disclosed in the standard setting due process.

**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.**

We believe that the effects analysis should be transparent and it should be made clear what actions have been taken in respect of communications with relevant regulators or government bodies when the analysis of the effect would be outside the remit of the standard setter. We would assert that even in the situation where a standard setter does not have all the information, such as on the macro effects associated with the new standard, it would be able to request relevant information from government bodies and/or specific users in advance, to estimate the effects.

**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 world's 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.**

Please refer to our answer to question 6 with respect to our proposed reference for an objective.

The objective of any standard should be consistent with the conceptual framework and the objective of good financial reporting (in terms of the public interest) should also consider that the users of financial statements are much more diverse than the those of capital markets and investors as question 10 appears to propose. We would assert that good financial reporting (in the public interest) covers all entities involved with it and not solely those whose capital is listed on the world's capital markets.

**11) Do you agree with the following clarifications of the term "effects"?:**

**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);**

**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);**

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

**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).**

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

Yes we agree that effects can be positive, negative or neutral but the focus should be on the negative effects as the positive anticipated effects would surely have been the driver for the issuance of the new standard or the revision in the first instance. We would assert that all effects should be identified whether marginal, one-off or ongoing with the objective of effect analysis being to ascertain the actual effects and compare those to the anticipated effects across all users of financial reports.

**12) Do you agree with the following further considerations concerning effects?**

**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).**

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

We agree. Transparency and disclosure of the magnitude of the effects is very important and we believe that disclosure of the magnitude in a sensitivity analysis format would be of merit.

## 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.**

We agree that there should be key principles but question whether the detailed narrative on the principles highlights more of a rules based approach.

**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).**

Yes we agree that it is absolutely essential that the intended outcomes of all new accounting standards are explained and the standard setter should seek to encourage input from constituents on anticipated effects. It is equally important that effects analysis should be based on evidence gathered from constituents and that the evaluation of the effects should be a continual process and could also be supported by independent bodies.

**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.**

We broadly agree. In the case of a new or amended standard one has to be clear on the current problem, evaluate this against micro-economic objectives (the conceptual framework) and macro-economic objectives (the public good) and then weigh the advantages and disadvantages of actions.

**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.**

Not exactly. Preliminary research by the standard setter is acceptable but as soon as judgment is involved, independent analysis is necessary. For example, the IASB does not always seem to have considered the effects and has not always provided a sufficient level of acceptance that the judgment was appropriate.

Accordingly, we would strongly recommend that following the exposure of a new accounting standard (for example on the issuance of IFRS for SMEs) a field testing exercise is initiated by the potential users with the intention to support the judgement of effects of the standard setter or show that the standard may be disadvantageous for one party or another. We also believe that an independent analysis by a third party outside of the IASB could possibly be performed by EFRAG.

**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?**

*European Federation of Accountants and Auditors for SMEs*

**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.**

Not exactly. We do not believe that the standard setter should identify and evaluate options solely on its own. Independent analysis and judgement would be advantageous.

**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)?**

Yes we agree and consider this to be important from the point of view of better serving the public interest. We would also recommend the use of universities, further and higher educational institutions and "think tanks".

**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.**

Yes we agree.

I trust that the above is comprehensive but should you have any questions on our comments, please do not hesitate to contact me.

Yours faithfully,

Federico Diomeda
Chief Executive Office