



**KPMG LLP**  
8 Salisbury Square  
London EC4Y 8BB  
United Kingdom

Tel +44 (0) 20 7311 1000  
Fax +44 (0) 20 7311 3311  
DX 38050 Blackfriars

EFRAG  
35 Square de Meeûs  
1000 Brussels  
Belgium

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Dear Sirs

### **Considering the Effects of Accounting Standards – Discussion Paper**

We welcome the opportunity to comment on this Discussion Paper and we support EFRAG's publication of this discussion paper to stimulate debate of these issues. We congratulate EFRAG on the paper, which is a balanced exposition of the many arguments for and against the issues discussed. This views expressed in this letter are those of the European member firms of the KPMG network.

The existing due process of the IFRS Foundation envisages the preparation of an analysis of the likely effects of a new standard or major amendment as the IFRS Board moves towards completion of the relevant project (Due Process Handbook, paragraph 50). However, we believe that an enhanced, integrated process of considering the effects of proposed accounting standards based on their objectives throughout the standard setting process may be of benefit to stakeholders.

We believe that a clear understanding of the objectives of a standard setting project and an assessment of the effects of the proposals against those objectives can contribute to better standards and improved financial reporting. It may contribute to better selection of agenda items, better proposals, enhanced transparency and understanding of the issues by constituents and improved input (comments) from constituents.

We are hopeful that a properly developed, integrated and visible effects analysis process would help address any expectation gap (Discussion Paper paragraphs 3.16-17) between the intention of standard setters when developing standards and the expectation of interested parties. It will help to build consensus on the issues and proposed solutions, leading to wider acceptability of final standards. A well thought-out and integrated effects assessment also should boost the accountability and credibility of the standard setter by demonstrating that it is considering the consequences of its work.

An important stakeholder group are the regulators who either are responsible for mandating the final standards and / or have a regulatory role that is affected either directly or indirectly

by the resulting financial statements (eg prudential regulators). Earlier communication of possible “effects” to which such regulators may need to respond (see paragraph 3.17) may help to maintain the independence of the standard setting process from any subsequent ‘political’ concerns and reduce the risk of regulatory rejection or delay in implementation.

However, we do not believe that it is practical on a global basis, nor is it necessary, that the standard setter “obtain confirmation from [the relevant regulator] that they will respond appropriately [to the proposals]”, as is suggested in paragraph 3.17. We believe that a collaborative approach is needed in which the standard setter publicises its assessment of effects in a timely, open and transparent manner and the relevant regulator takes responsibility (as do all other stakeholders) to understand the proposals and respond appropriately.

We support including all effects in the analysis, including both ‘micro-economic effects’ and ‘macro-economic effects’. We also agree that an assessment of the relative importance of the individual effects will be key to the implementation of this systematic analysis. In applying judgement to balance those effects, we consider that the objectives of high quality standards and improved financial reporting, including the agreed objective(s) of the proposed change to accounting guidance, should be paramount. For example, it may be desirable from a macro-economic or socio-political perspective to encourage investment within certain sectors, to provide incentives for certain arrangements (such as pension plans for employees) or to promote financial stability. However, we believe that any such policy objectives should be implemented independently of high quality, transparent and neutral financial reporting standards that contribute to improved financial reporting.

An important aspect acknowledged in the paper is that the requirements that will be replaced themselves will have had effects (paragraph 3.24-25). Existing requirements may, for example, currently result in sub-optimal capital allocation because they have the potential to influence an entity’s business transactions (eg off balance sheet arrangements), resulting in their effect not being neutral for investor decision making. We agree that care will be needed to ensure that the effects analysis reflects an understanding of the effect of the status quo and the relative effect of a change that is proposed.

Ultimately, it is for the relevant standard setters and their oversight bodies, notably the IFRS Foundation, to consider how to implement effects analyses into their standard setting process, in consultation with their constituents and in accordance with their governance arrangements.

Therefore, as a next step we recommend that EFRAG update its discussion paper for comments received and then forward this valuable contribution to the IFRS Foundation for its consideration.

To assist with implementation, we believe that the updated discussion paper should focus on the objectives of effects analyses and broad principles for their implementation. To the extent that it includes detailed implementation recommendations, it should acknowledge that there may be different ways to achieve those objectives. This will ensure that, in considering how best to achieve agreed objectives, there is appropriate flexibility for individual standard setters to tailor implementation to the organisation’s evolving governance and consultation arrangements.

We note that a credible, integrated effects analysis must be subject to appropriate oversight, for example from the Trustees Due Process Oversight Committee at the IFRS Foundation. This is particularly important at the post-implementation stage when it will be important to

demonstrate that the analysis is impartial. A post-implementation effect study also may form the basis of an agenda decision for a subsequent project, which we consider to be a key stage that warrants enhanced oversight.

Key to implementation will be a deeper understanding of the resources required to achieve the objectives in an effectively and timely manner and the impact on the standard setting timetable.

We set out our responses to the specific questions raised in the Discussion Paper in Appendix 1 to this letter.

If you wish to discuss any of the points raised, please contact Mark Vaessen on +44 207 694 8589 or David Littleford on +44207 694 8083.

Yours faithfully



KPMG LLP



## Appendix 1

### Responses to specific questions raised in Considering the Effects of Accounting Standards – Discussion Paper

#### 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.

We agree.

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.

As further explained in the covering letter, we can envisage benefits to the appropriate integration of an enhanced process of effects analysis into the standard setting due process.

We note that the IASB already has a due process step to prepare an analysis of the likely effects of a forthcoming IFRS or major amendment. However, the due process requires this to be prepared only in considering comments on an ED and finalising the new standard. In practice, the earlier steps in the IASB’s due process include aspects that might (in part) be an effects analysis and might be tailored to integrate effects analysis into these earlier stages.

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.

We agree that the standard setter may be best placed to perform an effects analysis, particularly if that analysis is intended to be performed during the standard setting project. This should allow closer co-ordination of the effects analysis and standard setting process and allow the standard setter to modify their proposals based on the results of the evolving effects analysis.

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 believe that an effects analysis completed only when the final standard or amendment is issued (D above) misses an opportunity for the standard setter to enhance its assessment of its objectives against the possible effects of a project at a stage when that analysis still can influence the proposals.

We agree that the nature and extent of the effects analysis should reflect the stage of development of the proposals. We believe that in the initial stages of a standard setting project (for example A and B above), the standard setter may yet to have reached any conclusions as to the proposed requirements. Accordingly, the nature of any effects analysis at this stage necessarily will be different to the analysis that may be possible once, for example, proposals are developed in an Exposure draft (C above). However, we agree that some analysis of the effects at the early stages of a project based on the objectives of the project may contribute to more effective agenda and scoping decisions and ultimately to the development of high quality standards.

Regarding the post implementation review (E above), we note that an effects analysis at this stage also might be characterised as part of the analysis of a new agenda decision to amend, or not to amend, the standard (ie A above). However, an effects analysis performed as a post-implementation review is an opportunity to prepare a *comparative* effects study, based on practice pre- and post- the new requirements and therefore may warrant a different approach to other stage A effects analyses that relate to ‘old’ standards.

*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 an effects analysis should be completed for all projects and that the scale of the analysis should be proportionate to the expected effects.

### ***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.*

Overall we agree with how effect is defined.



The term “serving the public interest by contributing positively to delivering improved financial reporting” appears to be a general objective for a standard setter’s work. An individual standard setter might elaborate this using the standard setter’s own criteria to ensure consistency in the assessment of agreeing changes to financial reporting and the assessment of the effects of those changes.

*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.*

Yes we agree. However, we note that the objective of improved financial reporting implicitly must consider the benefits to users in the context of the costs and practical implication of the application of the proposed requirements.

*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.*

As further explained in the covering letter, we agree that the scope of ‘effects’ should not be restricted to particular types of effects.

*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.*

As explained in the covering letter, an important stakeholder group are the regulators who are either responsible for mandating the final standards and / or have a regulatory role that is affected either directly or indirectly by the resulting financial statements (eg supervisory regulators).

It always has been important that changes in financial reporting requirements be clearly communicated with relevant regulators to allow them to understand any proposed or actual changes to their particular area of interest. As such the IFRS Foundation should consider the current mechanism for communicating these changes to regulators to assess how improvements can be made in this area.

Earlier communication of possible “effects” to which such regulators may need to respond (see paragraph 3.17) may help to maintain the independence of the standard setting process from any subsequent ‘political’ concerns and reduce the risk of regulatory rejection or delay in implementation.

However, we do not believe that it is practical on a global basis, nor is it necessary, that the standard setter “obtain confirmation from [the relevant regulator] that they will respond appropriately [to the proposals]”, as is suggested in paragraph 3.17. We believe that a collaborative approach is needed in which the standard setter publicises its assessment of effects

in a timely, open and transparent manner and the relevant regulator takes responsibility (as do all other stakeholders) to understand the proposals and respond appropriately.

*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.*

As further explained in the covering letter, we agree with the overall definition.

*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.*

Overall we agree with the clarifications of effects. As explained in our covering letter, an important aspect acknowledged in the paper is that the requirements that will be replaced themselves will have had effects (paragraph 3.24-25). Existing requirements may, for example, currently result in sub-optimal capital allocation because they have the potential to influence an entity's business transactions (eg off balance sheet arrangements), resulting in their effect not being neutral for investor decision making. We agree that care will be needed to ensure that the effects analysis reflects an understanding of the effect of the status quo and the relative effect of a change that is proposed.

*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 with the overall comment on how effects should be considered and we agree that the standard setter should be transparent with regard to how it has considered the, at times, varying effects.

Given the complexities involved in considering all of the effects, we expect that any ranking will be highly subjective and judgemental based on qualitative characteristics. Accordingly, it is important that no expectation gap is created as to the veracity of this aspect of an effects analysis.

As explained in our covering letter, in applying judgement to balance the varying effects, we consider that the objectives of high quality standards and improved financial reporting, including the agreed objective(s) of the proposed change to accounting guidance, should be paramount. For example, it may be desirable from a macro-economic or socio-political perspective to encourage investment within certain sectors, to provide incentives for certain arrangements (such as pension plans for employees) or to promote financial stability. However, we believe that any such policy objectives should be implemented independently of high quality, transparent and neutral financial reporting standards that contribute to improved financial reporting.

***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.*

Yes we agree. These discussions should arrive at a set of key principles, which should assist the standard setter in integrating an effect analysis process within its own existing process.

*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.*

Yes we agree. The key principles appear to be the logical way to proceed. We suggest that Principle 3 refer more explicitly to reaching a conclusion based on the evidence gathered.

As noted in our covering letter, we believe that the updated discussion paper should focus on the objectives of effects analyses and broad principles for their implementation. To the extent that it includes detailed implementation recommendations, it should acknowledge that there may be different ways to achieve those objectives. This will ensure that, in considering how best to achieve agreed objectives, there is appropriate flexibility for individual standard setters to tailor implementation to the organisation's evolving governance and consultation arrangements.



**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.*

See answer to question 17.

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.*

See answer to question 17.

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.*

We believe sections 5.2-5.4 set out a logical process. Ultimately, it is for the relevant standard setters and their governance bodies, notably the IFRS Foundation, to consider how to implement effects analyses into their standard setting process, in consultation with their constituents and in accordance with their governance arrangements. We believe that there may be alternative ways to achieve the valid objectives of an integrated process of effects analysis.

As noted in our covering letter, we believe that the updated discussion paper should focus on the objectives of effects analyses and broad principles for their implementation. To the extent that it includes detailed implementation recommendations, it should acknowledge that there may be different ways to achieve those objectives. This will ensure that, in considering how best to achieve agreed objectives, there is appropriate flexibility for individual standard setters to tailor implementation to the organisation's evolving governance and consultation arrangements.

We also have some concerns that, were the final paper to identify a too detailed or prescriptive process, this would restrict the standard setters' ability to implement proposals to achieve the agreed objectives in a reasonable timescale.

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)?

National standard setters and similar institutions are a valuable resource and may be able to collate information from their members and local stakeholders to assist the IFRS Foundation in

its effect analysis, for example on the identification of issues with current accounting requirements.

However, we believe that the IFRS Foundation will need to co-ordinate the work completed by these organisations to ensure that the project being considered is communicated clearly to interested parties and that any evidence collected is comparable.

***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.*

Integrating an effect analysis process into a standard setting process is, we believe, a significant project that will require careful thought to ensure proper integration into the existing standard setting due process and governance arrangements.

Ultimately, it is for the relevant standard setters and their governance bodies, notably the IFRS Foundation, to consider how to implement effects analyses into their standard setting process, in consultation with their constituents and in accordance with their governance arrangements. We believe that there may be alternative ways to achieve the valid objectives of an integrated process of effects analysis.

We note that the completion of an effects analysis may require incremental resources and that the completion of an effects analysis may extend the time taken by the standard setter to complete projects. Further consideration of the proposals by the standard setter is needed to consider the extent to which any delay is justified by the potential to improve financial reporting.

As noted in our covering letter, we believe that the updated discussion paper should focus on the objectives of effects analyses and broad principles for their implementation. To the extent that it includes detailed implementation recommendations, it should acknowledge that there may be different ways to achieve those objectives. This will ensure that, in considering how best to achieve agreed objectives, there is appropriate flexibility for individual standard setters to tailor implementation to the organisation's evolving governance and consultation arrangements.

We agree that a field test approach to implementation may allow a process to be developed based on experience. To obtain the most benefit from any field test, a project in its very early stages (preferably before an agenda decision has been taken) should be selected.

Therefore, as a next step we recommend that EFRAG update its discussion paper for comments received and then forward this valuable contribution to the IFRS Foundation for its consideration.