Non-authoritative Guidance

Extract, IFRS Discussion Group Report on Meeting – December 9, 2014

A publicly accountable entity is required to follow International Financial Reporting Standards (IFRSs) in determining its accounting policies for transactions, other events or conditions addressed by those standards1.

In paragraph 9 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, it states:

> "IFRSs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of IFRSs. Guidance that is an integral part of the IFRSs is mandatory. Guidance that is not an integral part of the IFRSs does not contain requirements for financial statements."

Guidance that is an integral part of an IFRS (for example, Application Guidance) is mandatory, whereas guidance that is not an integral part of an IFRS (for example, Implementation Guidance, Illustrative Examples and the Basis for Conclusions) are not mandatory.

Paragraphs 10-12 of IAS 8 prescribe an approach to be followed when IFRSs are silent on the accounting for a particular event or transaction. For the purposes of this discussion, this prescribed approach is referred to as the "GAAP hierarchy."

Paragraph 12 of IAS 8 states:

> "In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11."

Management will sometimes encounter transactions or events for which explicit guidance does not exist in IFRSs and will often look to sources of non-authoritative guidance within the GAAP hierarchy, which could be seen to fall within the scope of "other accounting literature." These forms of non-authoritative guidance might include IFRS Interpretations Committee agenda decisions, staff agenda papers prepared for the IASB or IFRS Interpretations Committee and educational materials produced by the IFRS Foundation.

In some cases, the IFRS Interpretations Committee may decide not to add an issue to its agenda for reasons such as the matter is already the subject of a proposed standard (or a proposed amendment to an existing standard), the subject is so complex that the IFRS Interpretations Committee cannot address the matter within a reasonable period of time, or existing IFRSs are sufficiently clear such that little to no diversity is expected. If the IFRS Interpretations Committee decides not to add an issue to its agenda, it publishes a tentative rejection notice with a comment period of normally not less than 60 days.

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1 IFRSs are Standards and Interpretations issued by the International Accounting Standards Board (IASB) and comprise of the International Financial Reporting Standards, International Accounting Standards, IFRIC Interpretations and SIC Interpretations.

The IASB website states:

"Rejection notices do not have the authority of Standards and they will therefore not provide mandatory requirements but they should be seen as helpful, informative and persuasive. The IASB is not asked to ratify rejection notices."

When the IFRS Interpretations Committee staff reviewed the status of rejection notices in [February 2012](), it observed that the rejection notices fall within the class of considerations referred to as "other accounting literature" that management may consider when developing or applying an accounting policy in the absence of an IFRS that applies to the transaction or event.

For other materials, such as IASB or IFRS Interpretations Committee staff agenda papers, they set out the issue or question being considered but are not meant to be conclusive as they are just one step in the IASB's due process. The IFRS Foundation sometimes produces educational materials relating to IFRSs but they do not form part of IFRSs because such materials are non-authoritative and have not been approved by the IASB.

Issue 1: How should Canadian preparers consider the non-authoritative guidance described above when preparing their financial statements?

View 1A – Non-authoritative guidance should be followed.

Under this view, it is considered that non-authoritative guidance from the IASB (or any of the bodies associated with it) should be followed even though it is not mandatory and does not form part of IFRSs.

View 1B – Non-authoritative guidance is not required to be followed.

Under this view, it is considered that non-authoritative guidance is not mandatory as it has not been approved by the IASB and does not form part of IFRSs. Therefore, the non-authoritative guidance should not be required to be followed because a preparer is required to prepare their financial statements "in accordance with IFRSs, as issued by the IASB."

To the extent that an entity has a transaction or event for which guidance does not exist in the body of IFRSs, a preparer would follow the GAAP hierarchy and determine whether there are any requirements in IFRSs dealing with similar or related issues based on guidance in IAS 8. An entity is not bound to follow the non-authoritative guidance and can develop an accounting policy based on its own research and reference to the existing words in the standards, including the GAAP hierarchy. In situations when those words allow for more than one interpretation, an entity can apply the interpretation that produces relevant and reliable information about the transaction in the financial statements.

View 1C – It depends

Under this view, whether non-authoritative guidance should be followed depends on the type of non-authoritative guidance and the facts and circumstances of the situation. If the rejection notice provides clear guidance on how to apply a standard in a given situation, it could be supported that the guidance would be followed when an entity is faced with the same situation. However, professional judgment should be applied when the facts or circumstances differ. There is an expectation that rejection notices will be carefully considered by preparers.

Educational material is similar in a sense that it is non-mandatory. If the educational material provides guidance on factors to consider, it may be seen as informative. In other cases, if the educational material provides guidance on a particular fact pattern or situation, it may need to be carefully considered. Unlike rejection notices and educational material, which are considered "final" when issued, staff agenda papers are an intermediate step in a process and are preliminary views expressed by the staff. Similarly, there is no suggestion that proposals in exposure drafts be followed.

The Group's Discussion

Group members shared a common view that while IFRS Interpretations Committee rejection notices are non-authoritative guidance, it is expected that preparers would carefully consider them, especially if the fact pattern is similar to the situation being contemplated by the preparer. Group members noted that it may be difficult to assess whether an entity's facts and circumstances align with the specific fact pattern being addressed by the IFRS Interpretations Committee because a limited amount of information is provided in a rejection notice. Alternatively, other factors in the transaction may exist that need to be considered (for example, the preparer's situation involves more complexity than the factors discussed in the rejection notice). Therefore, the guidance in a rejection notice needs to be assessed together with the specific facts and circumstances of the preparer and the intent of the underlying principles in IFRSs and T*he Conceptual Framework for Financial Reporting* in order to determine if the guidance should be applied.

With respect to staff agenda papers and educational materials, Group members observed that this information has not gone through any form of public deliberation, or public scrutiny like rejection notices. It was noted that staff agenda papers are prepared for the purpose of facilitating discussions at the IASB or IFRS Interpretations Committee meetings. While these papers may be useful in following the status and progress of a financial reporting issue, they could potentially be misleading if considered in isolation. Group members emphasized that preparers need to also look at subsequent IASB Updates and IFRIC Updates to obtain a complete and holistic understanding of the views being deliberated. Discussions by the IASB or IFRS Interpretations Committee could lead to a different outcome than what is recommended in a particular staff agenda paper.

Representatives from the Canadian Securities Administrators also shared their perspective that while it is important to consider rejection notices, they are not viewed as definitive. However, if a preparer decides to take a divergent path from the guidance in the rejection notice, staff of the Canadian Securities Administrators may query the treatment taken. A preparer will need to be able to explain the difference between their specific situation and what is being addressed by the IFRS Interpretations Committee, and support why the selected accounting treatment is appropriate rather than following the guidance in the rejection notice.

The Group's discussion raises awareness about this item and did not recommend any further action to the AcSB. Group members observed that there is currently a challenge for stakeholders to keep up-to-date with published decisions from the IFRS Interpretations Committee. If it is made easier to search and access this information, it would help stakeholders assess the implications of rejection notices on its financial statements on a timelier basis.

Issue 2: What alternatives might be considered if an entity's current accounting policy is not consistent with sources of non-authoritative guidance such as IFRS Interpretations Committee rejection notices?

Fact Pattern:

For simplicity, the question is considered in the context of the IFRS Interpretations Committee rejection notice. It is assumed that the rejection notice provides clear guidance as to how a standard should be applied in a given set of circumstances and the entity's fact pattern corresponds with the circumstances addressed in the rejection notice.

For the fact pattern described above, is the entity required to retrospectively change its accounting to conform with the view stated in the rejection notice?

View 2A – The entity is not required to retrospectively change its accounting to conform to a view stated in the rejection notice.

This view is based on the fact that an issue has come before the IFRS Interpretations Committee because there is some ambiguity in the wording of the Standard or how it was intended to be applied. For that reason, preparers may reasonably come to different judgments.

View 2B – The entity is required to retrospectively change its accounting to conform to a view stated in the rejection notice.

This view is based on the fact that if the entity's fact pattern is addressed by the rejection notice, the views expressed by the IFRS Interpretations Committee in its rejection notice reflects its interpretation of how the IASB "intended" the Standard to be applied.

If View 2B is accepted, how should the retrospective change be described (i.e., as a change in accounting policy, a correction of an error, or the change is not labelled?)

View 2B.1 – Change in accounting policy.

This view presumes that the entity's previous accounting treatment was considered a reasonable interpretation of the Standard based on the facts and circumstances and guidance available at that time. It could be argued that the issuance of the rejection notice provides "reliable and more relevant information", which is a criterion in paragraph 14 of IAS 8 in assessing whether it is a change in accounting policy.

View 2B.2 – Correction of an error.

This view presumes that the entity's previous accounting treatment was not considered a reasonable interpretation of the Standard based on the facts and circumstances and guidance available at that time.

The IFRS Interpretations Committee staff agenda paper in February 2012 states that "we are unaware of any situation in which an accounting standard setter or its interpretative body has ever branded a change in accounting policy arising from its efforts to clarify its own literature as a correction of an error." In the end, the IFRS Interpretations Committee staff recommended "the Board affirm that the Committee's agenda rejection notices are not intended to characterize the accounting practices in question as errors. Rather, that is a judgement that is left to companies, their auditors, and their regulators."

In the event it is determined that the change arose because of an error, the entity would provide the disclosures required in IAS 8 for a correction of an error.

View 2B.3 – Change is not labelled.

This view presumes that it is not immediately clear, in the short period of time since the issuance of the rejection notice, whether the change is a change in accounting policy or a correction of an error.

The Group's Discussion

Group members supported the view that when an entity has determined a change is required as a result of the IFRS Interpretations Committee rejection notice, it should generally be applied retrospectively (unless the rejection notice addressed a matter involving an estimate, wherein the change might be considered a change in estimate). However, Group members observed that since there are no transitional provisions, it is difficult to rule out prospective application even though retrospective application would be more appropriate from a comparability perspective. It was noted that challenges also exist for entities in determining when to make such a change. Preparers are encouraged to wait until the final rejection notice is published but consider whether additional disclosures are needed if tentative agenda decisions appear to have potential implications on currently adopted accounting policies.

Some Group members noted it is important to distinguish if the change is considered an error correction or not. Group members expressed the view that it is difficult to consider the change as an error if the entity's fact pattern is not aligned with the circumstances addressed in the rejection notice, and that the entity had performed its due diligence of applying professional judgment when interpreting the Standard.

On the notion of labelling the change, some Group members expressed support for View 2B.3 because the change is not akin to an error correction or a change in accounting policy. Under this approach, detailed disclosure is critical to explain the rationale behind the retrospective change to the users of financial statements. Other Group members expressed support for View 2B.1 because of new information becoming subsequently available, or that it is closer to a change in accounting policy rather than to leave it unlabelled. One Group member noted that it was unnecessary to distinguish (unless it was an obvious error) between an error correction and a change in accounting policy as the impact under either scenario would be a retrospective application of the change.

It was noted by a securities regulator that under National Instrument 51-102 *Continuous Disclosure Obligations*, if an issuer has determined that it will retrospectively refile or restate comparative information for reasons other than applying a new or amended standard, or changing an accounting policy, an issuer is required to immediately publish a news release to explain the change. If View 2B.3 is pursued, this is an important consideration to take into account.

Overall, the Group's discussion raises awareness about these items. No further action was recommended to the AcSB. The Group made a general observation that if the rejection notice states that a particular standard is clear, it would help clarify application requirements if the IASB ratifies the conclusions reached by the IFRS Interpretations Committee.