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Your ref:

Mr Tsuguoki Fujinuma & Mr Robert Glauber
Vice-Chairs
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By email: strategyreview-comm@ifrs.org

Dear Sirs

STATUS OF TRUSTEES' STRATEGY REVIEW

ICAEW welcomes the opportunity to comment on your draft comment letter on the *Status Of Trustees' Strategy Review* published by the IFRS Foundation in November 2010.

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.

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

Yours sincerely

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STATUS OF TRUSTEES' STRATEGY REVIEW

Memorandum of comment submitted in February 2011 by ICAEW, in response to the IFRS Foundation's consultation paper *Status Of Trustees' Strategy Review* published in November 2010.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Status Of Trustees' Strategy Review*, published by the IFRS Foundation.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure that these skills are constantly developed, recognised and valued.

MAJOR POINTS

ICAEW AND IFRS

4. ICAEW believes strongly in the benefits to investors and business of truly international standards, and has been a persistent champion of the creation of a single set of high quality global accounting standards and their application by publicly traded and other companies around the world. In our view the *prima facie* case for moving to a single set of global accounting standards has been bolstered by recent economic events, which have clearly illustrated the interdependencies of capital markets worldwide, as recognised by recent G20 meetings. Differences between standards - even relatively small differences in detail - caused difficulty for regulators, investors and other users of reported financial information trying to understand global issues and to formulate an effective and internationally-coordinated response to the financial crisis.
5. ICAEW made a significant contribution to the successful adoption of IFRS by UK listed companies in 2005/2006, and our expertise in this area was reflected in our selection by the European Commission to deliver a comprehensive study in 2007 covering all aspects of first time application of IFRS by European Union member states. In 2008 ICAEW was commissioned by the United Nations to prepare a follow-up report on the UK experience of IFRS implementation. The reports can be found respectively at www.icaew.com/ecifrsstudy; and www.icaew.com/index.cfm/route/161454.
6. Our continuing support for the International Accounting Standards Board (IASB) and its standards is not offered lightly, or unconditionally. It is set firmly in the context of what we see as the fundamental aims of standard setting: the development of accounting standards that are high quality and neutral, providing the foundation for transparent and comparable financial statements that improve investor confidence in the reliability and transparency of published information. To that end we believe firmly that accounting standards should only be issued by an independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process and making decisions solely in the public interest, and more specifically to protect the interests of investors. We note - and welcome - the support of the G20 for these broad principles, and it is against these fundamentals that we have assessed the case for change to the Trustee's strategy and the IFRS Foundation Constitution. We have also taken the opportunity below to reiterate in more detail our views on independent standard setting.

REVIEWING THE STRATEGY AND CONSTITUTION

7. ICAEW has been closely involved at each stage of the review of the constitutional arrangements of the IFRS Foundation. We have submitted comments to all the consultation papers on the Constitution issued since February 2004 and have been represented at each of the public hearings held in London since that time. Although we do not advocate a more prescriptive Constitution or support significant change at this time, we regard the ongoing process of debate and reform as key to the success of the IASB and to wider acceptance of its legitimacy as a global standard setter. The importance of achieving an appropriate and widely-respected governance structure for the IFRS Foundation as the IASB increasingly assumes a global role of profound economic significance should not be underestimated.
8. We will also be responding in due course to the IFRS Foundation Monitoring Board's consultation *Consultative Report on the Review of the IFRS Foundation's Governance*. There are a number of areas within that consultation which touch upon issues discussed in this letter, and these will be developed further in that response. Consequently we would suggest that the Foundation may wish to consider the two letters in conjunction in their analysis of consultation responses. In particular, we expect to express grave concerns about some of the proposals of the Monitoring Board's consultation. The proposals do not appear to address properly the Monitoring Board's relationship with either the Trustees or the IASB in a way that safeguards the IASB's technical independence and promotes the efficient working of the organisation as a whole.

INDEPENDENT STANDARD SETTING

9. There appears to be wide acceptance internationally of the principle that accounting standards should only be issued by a properly constituted and independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process. However, there is less clarity over the meaning of 'independent' in this context. In our view, it means the ability to make decisions solely in the public interest, and more specifically to protect the interests of investors, without strong external pressure to reach particular conclusions not supported by the quality of the arguments deployed. Accounting solutions should be determined on their technical merit, not according to political weight or to further social or economic policy objectives. Where decisions are seen to be influenced unduly by pressure from governmental or regulatory organisations or the lobbying of particular interest groups, the result tends to be a lack of adequate due process or rigorous exposition of the technical or legal issues involved. Pressure in 2008/2009 on both the IASB and FASB to eliminate differences in their financial instruments standards, sometimes without full due process, is a case in point. It tended to damage the credibility of the standard setting process and any further occurrences are likely to lead to long-term damage to the credibility and quality of financial reporting and to the confidence of investors in capital markets.
10. Regulators are of course an important stakeholder in the financial reporting process, but often have a distinct focus, not necessarily aligned with the interests of investors - the primary users of annual financial statements under the IASB *Framework*. Regulators should in our view have no particular influence over the determination of the detailed requirements of accounting standards for general purpose financial reporting. Whilst it is desirable in principle for regulators to use GAAP financial information as their initial point of reference, they tend to have the power to obtain any extra information needed to supplement or adjust the published financial statements. In some cases they may not, but that does not mean financial reporting should be regarded as a proxy. Financial stability and prudential supervision should always be delivered principally through regulatory regimes. Any attempt in the light of the financial crisis to

align regulatory and financial reporting objectives very closely runs the risk of deep and lasting damage to the capital markets. We discuss these issues further in answering question 2 below.

RESPONSES TO SPECIFIC QUESTIONS

Mission: How should the organisation best define the public interest to which it is committed?

Question 1.

The current Constitution states, ‘These standards [IFRSs] should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world’s capital markets and other users of financial information make economic decisions’. Should this objective be subject to revision?

11. We agree with this objective and believe that it remains fit for purpose. However, we would like to suggest that there is a slight difference in the meaning of the term ‘economic decisions’ between Europe and the United States. We understand that in the US an ‘economic decision’ would be one taken by a capital provider in deciding whether to buy or sell instruments in the reporting entity. It is thus forward looking. The term also has this meaning in Europe, but here we believe it also means something more; that it additionally includes a backward looking assessment of the effectiveness with which management have discharged their stewardship responsibilities. We would support the latter interpretation and believe that this should be the position reflected in the Foundation’s constitution. If convergence with US GAAP proceeds, it may be desirable that this element of the objective be articulated more explicitly and we would urge the Foundation to consider whether any revision to it, or its associated material, is necessary to achieve this.

Question 2.

The financial crisis has raised questions among policymakers and other stakeholders regarding the interaction between financial reporting standards and other public policy concerns, particularly financial stability requirements. To what extent can and should the two perspectives be reconciled?

12. The relationship between financial reporting and stability in the macro-economic environment is a complex one. The receipt of relevant and faithfully represented financial information by capital providers is fundamental to their investment decisions and as such can be seen to underpin the efficient operation of the financial markets. But a note of caution should be sounded here. Financial reporting is an effective method for the communication of certain existing economic conditions pertaining to a reporting entity, but it does not create those conditions: it does not initiate the business transactions upon which it reports and neither does it determine the actual assets or liabilities of a reporting entity.
13. Some commentators have nevertheless suggested that the impact of financial reporting goes beyond this mere transparent communication of actual events. Moreover, that through the fair valuing of certain financial instruments, generally accepted accounting practice has, of itself, pro-cyclically determined the lending capacity, even the solvency, of banks. It has been claimed that, by reflecting the increased market value of financial assets in strong market conditions, and requiring their depreciation when markets decline, financial reporting amplifies the effects of the economic cycle. We do not accept this argument. Mark to market accounting merely requires the reflection in the financial statements of actual economic reality. By doing so we believe that far from precipitating

financial crises, financial reporting can act as an early-warning system, highlighting problems as they arise in the markets before management would otherwise become aware of them.

14. We would suggest that the Foundation bear these considerations in mind in their responses to policy makers and other stakeholders. Regulators are of course an important stakeholder in the financial reporting process, but often have a distinct focus, not necessarily aligned with the interests of investors - the primary users of annual financial statements under the IASB *Framework*. Regulators should in our view have no particular influence over the determination of the detailed requirements of accounting standards for general purpose financial reporting. Financial stability and prudential supervision should always be delivered principally through regulatory regimes. Any attempt in the light of the financial crisis to align regulatory and financial reporting objectives very closely runs the risk of deep and lasting damage to the capital markets.
15. We thus believe that a clear distinction must be drawn between the international accounting standard setter and regulatory bodies. The role of the Foundation is not to regulate individual companies, industries or markets; these duties must be discharged by the organisations established for this purpose. Moreover, the Foundation needs to be clear in resisting any moves to draw it into an ancillary relationship with these organisations. Whilst it is desirable in principle for regulators to use GAAP financial information as their initial point of reference, they tend to have the power to obtain any extra information needed to supplement or adjust the published financial statements. In some cases they may not, but that does not mean financial reporting standards should be regarded as a proxy. We are firmly opposed to the insertion of provisions into international standards for the sole objective of supplying information for regulatory purposes.
16. Furthermore, while we believe that there is a debate to be had on the relationship between financial reporting and financial stability, we believe that the linkage is typically much less clear in reference to other public policy concerns. Financial reporting can provide decision useful information to capital providers, but it may not be the best way to tackle other public policy objectives. We have observed in recent years many claims that particular objectives could be achieved through incremental disclosure. We are sceptical that this is the case. If certain behaviour is to be discouraged or prohibited, then direct action by legislators or other regulatory bodies would often appear to be the most appropriate method in achieving this. Disclosure is unlikely to be effective, and could in fact obscure other important information.

Governance: how should the organisation best balance independence with accountability?

Question 3.

The current governance of the IFRS Foundation is organised into three major tiers: the Monitoring Board, IFRS Foundation Trustees, and the IASB (and IFRS Foundation Secretariat). Does this three-tier structure remain appropriate?

17. We do not believe that of itself the three tier framework is a particularly elegant way of organising the Foundation's governance structure; in particular there is ambiguity and overlap between the roles of the Trustees and that of the Monitoring Board. Nevertheless, we regard the Monitoring Board as having a role in improving the public accountability credentials of the IASB. The scope of the Board's membership, and its success in allaying concerns over accountability should be kept under review in the light of experience and as the reach of the IASB's standards grows.

18. At the same time, we continue to hope that the appointment of the Monitoring Board will assist the Trustees and the members of the IASB, collectively and individually, to resist overt political pressure and lobbying in the technical standard setting process. Although the three tier structure is a little clumsy we feel that this is compensated for by the considerable knowledge and political expertise of the Monitoring Board. It would be shame indeed were the Foundation to lose this. Instead therefore of radical change we would suggest that the system could be improved through greater definition of the role of each element.
19. In light of the above, we expect to express grave concerns about some of the proposals of the Monitoring Board's consultation on governance. The proposals therein do not appear to address properly the Monitoring Board's relationship with either the Trustees or the IASB in a way that safeguards the IASB's technical independence and promotes the efficient working of the organisation as a whole.

Question 4.

Some stakeholders have raised concerns about the lack of formal political endorsement of the Monitoring Board arrangement and about continued insufficient public accountability associated with a private-sector Trustee body being the primary governance body. Are further steps required to bolster the legitimacy of the governance arrangements (including in the areas of representation of and linkages to public authorities)?

20. We question whether a formal political endorsement mechanism is either a desirable or even an operable outcome. In light of the widespread global adoption of IFRS, such a mechanism would have to be of a quite unfeasible size to be truly representative of its constituents. It could also serve to unduly politicise the standard setting process, obstructing and delaying the work of the Foundation and IASB. It is unclear what benefits could be expected from such a process, when it is the legal decision of any jurisdiction as to whether or not they adopt IFRS which delivers democratic accountability. The objective of the Foundation and of general purpose financial statements is clearly stated. By recruiting the best qualified and highest quality individuals to its Boards, the Foundation should be able to competently preside over the establishment of accounting standards that are fit for purpose and released on a timely basis. It is difficult to see how formal political endorsement, or the removal of the Trustee body from the private sector, could improve on this.
21. However, while we do not support formal political endorsement or the relocation of the Trustee body into the public sector, we recognise that the Monitoring Board has a role to play in enhancing accountability, and that its effectiveness depends upon how well it executes this in the context of the aims of the Foundation. Therefore we would stress that it is important that the legitimacy of the Monitoring Board is beyond question and that to this end it has robust policies in place to ensure that it is appropriately representative.

Process: how should the organisation best ensure that its standards are high quality, meet the requirements of a well functioning capital market and are implemented consistently across the world?

Question 5. Is the standard-setting process currently in place structured in such a way to ensure the quality of the standards and appropriate priorities for the IASB work programme?

22. Yes. We believe that the standard setting process is appropriately structured to deliver high-quality standards. As noted above, regular and inclusive due process with constituents is a hallmark of an effective and credible standard setting process, and we believe that an ongoing process of review and improvement is necessary to ensure that

IASB due process is the embodiment of best practice in global standard setting. Accordingly, we welcome the recent, significant improvements in due process arrangements and procedures, and note that the IASB is acknowledged to be very transparent in its due process and operations.

23. One key aspect of the due process undertaken prior to the publication in November 2009 of IFRS 9 was a greater willingness of the IASB Board to re-deliberate proposals which attracted significant adverse comment. There should be no turning back on this point. The Board has in the past been roundly criticised for its perceived unwillingness to reconsider decisions in such circumstances, especially where the staff concluded that no new substantive arguments had been raised by constituents. A widespread lack of support for proposals, whilst not a reason in itself not to proceed, should be seen to result in a process of reflection, further field testing and engagement with concerned stakeholders.
24. The Board should also in our view normally re-expose new requirements whenever significant changes are made to the original proposals which have not been prefigured in previous consultations. The Board should also expose IASB agenda priorities, and the scope and key elements of the Board's work programme, to periodic public consultation. We would prefer that consultations on the IASB work programme were conducted every two years, rather than tri-annually as present. This is particularly important at present given the need to plan for a change in focus from 2011 from convergence with US GAAP to post-implementation reviews and a small number of major projects crucial for the long-term improvement of financial reporting. This is potentially a significant change in direction, and one that is fast approaching. It is essential that adequate time is allowed to develop the post June 2011 agenda such that it may successfully deliver high quality accounting standards targeting those areas where development is most needed.
25. In this context we have an enduring concern with the convergence agenda. We were disappointed that a specific consultation was not conducted with regards this process. While the goal of achieving conformity in financial reporting standards between the world's largest economy and that of others is a laudable one, the process of achieving this has not been without criticism. Many concessions have been made along the way, which have been accepted by constituents, but from this point onwards we believe that the Foundation should adopt a more circumspect approach, and one that more firmly considers the interests of its own global constituents. Convergence in future - whether to US or any other national GAAP - should invariably play second fiddle to the overriding objective of setting robust, understandable and high quality standards.

Question 6.

Will the IASB need to pay greater attention to issues related to the consistent application and implementation issues as the standards are adopted and implemented on a global basis?

26. We agree that consistent global application of accounting standards is an issue of some concern and that the preferred outcome is to achieve consistent global reporting through the international adoption of IFRS. However, the responsibility both for mandating the accounting standards that companies must follow and for enforcing compliance, rests with the respective jurisdictional authority. The Foundation should certainly seek to engage with adopting jurisdictions, should facilitate education, should encourage the reporting of interpretation concerns, and should be watchful for indications that the drafting of a particular standard is unclear and thus causing variations in application. It might in this respect be useful to discuss with national standard setters, regulators and professional bodies whether 'early warning' mechanisms might be established. But it

would be both undesirable and impractical for the Foundation to attempt itself to undertake any kind of international enforcement activities.

27. Notwithstanding this, we do believe that the Foundation could usefully perform post-implementation reviews to assist with its future standard development activities, and that this may be particularly beneficial for the suite of new standards due in 2011. The work of the ASB and EFRAG in this area is of interest. Furthermore we would also welcome clarity over which body will be mandated to interpret those international standards that have been converged with FASB standards. In our view, it should be the IASB (and its interpretations committee) alone, not for example the EITF or FASB.

Financing: how should the organisation best ensure forms of financing that permit it to operate effectively and efficiently?

Question 7.

Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

28. We support efforts to achieve greater automaticity of financing and believe it is of great importance that the Foundation is established on a firm financial footing. In our opinion the preferred source of financing would be through a levy on companies listed on capital markets of those jurisdictions adopting IFRS. Such a scheme could operate in a similar way to the mechanism in place for funding the UK's Financial Reporting Council; there a levy is collected via the market regulator which is in turn subsumed in the fees borne by companies listed on UK markets. Such a fee would be an annual levy and not linked in any way to individual transactions.

Other issues

Question 8.

Are there any other issues that the Trustees should consider?

29. Please see our 'Major Points' above.

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