

SwissHoldings

Verband der Industrie- und Dienstleistungskonzerne in der Schweiz
Fédération des groupes industriels et de services en Suisse
Federation of Industrial and Service Groups in Switzerland

19 September 2008

IASC Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Comment Letter on Constitution Review

Dear Sir / Madam

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland, represents 46 large international groups, covering most of the country's industrial and commercial sector. Enterprises from the financial sector (banking and insurance) are not represented in our federation. We very much welcome the opportunity to comment on the above-mentioned Discussion Paper (DP), and our response below has been prepared in conjunction with our member companies.

A. General Remarks

Since more than ten years SwissHoldings has been actively involved in the standard setting process. We had an IASC delegation representing preparers at the IASC and have continuously tried to support the process through participation in round tables, discussions, field tests, etc. and through commenting on proposals both directly and in collaboration with other organisations. As a matter of fact, our members were among the first IAS preparers. We have also actively supported the efforts of EFRAG. Thus, we are naturally gratified to see how widely IFRS are becoming accepted around the world and are also cognizant and appreciative of the Trustees' efforts in recent years to improve the IASB's governance and due process. Nonetheless, our confidence – as preparers – in the **effectiveness of that governance and due process** has seldom been at a lower ebb. Why?

There are many concerns on technical and procedural issues we have repeatedly raised on various occasions. Most of these are expressed in the European Parliament's "Radwan Report", which has found wholehearted support by companies and business organisations. In essence, we appreciate that, by achieving acceptance of IFRS round the globe, the IASB is helping to improve the international acceptance of our own financial reporting. However, we do not believe that the standard setting process – for all the additional steps and safeguards which have been built in – is **resulting in the kind of standards which the capital and other financial markets need**.

Financial reporting is not an end in itself, and it is unfortunate that the IASB is, as both judge and jury, interpreting "**high quality standards**" in a manner which places prime emphasis on theoretical concepts but relegates practical usefulness to a fairly minor role. By practical usefulness we mean that standards should give preparers and users – the primary parties involved in financial reporting – the tools to communicate and exchange financial information which is meaningful and understandable in a form that reflects the way in which the business runs and which meets the needs of the users. How is it possible for this situation to arise if governance and due process are effective? The Trustees should particularly bear in mind that the IASB is now well on the way to having in effect a **world-wide monopoly on financial**

reporting standards, and market economies usually take special care to ensure that safeguards exist to protect their economies from the potentially deleterious effects of such market dominance.

To improve the congruence between standards produced and the markets' needs, we would invite the Trustees to consider the following governance and due process measures:

1. Change paragraph 2 of the Constitution on objectives to specify explicitly that the terms **"public interest"** and **"high quality standards"** are to be understood as reflecting practical usefulness for preparers and users, based on the way business actually operates. We agree that definitions are difficult. But it is necessary. Work on standards should only be undertaken when a need has been clearly identified and corroborated by preparers and users. (Regulators' needs may be considered in developing the detail of the standards themselves, e.g. in the disclosure requirements.) There is a clear need to specify that the Board's **"independence"** does not extend to the freedom to impose theoretical requirements which the participants in the markets do not need or support.
 2. The Monitoring Group being proposed should be **actively involved in the setting of the Board's agenda** – including rigorously testing proposed agenda items against the criteria of market needs and practical usefulness – and in **holding the Board to account**, on a regular basis, for the work it carries out – again against these criteria. To assist that body, a mechanism for consulting preparers and users on agenda proposals and on Board performance needs to be set up on a basis which is completely independent of the Board itself. We do have some reservations about the creation of an additional body, as there is a risk of **"transmission losses"** between various organs. However, as the Trustees unfortunately do not appear to see this important activity as part of their role, another body is probably necessary. The challenge will be to have a new Monitoring Body to improve the due process without interfering into the political independence of the IASB as an organisation.
 3. The Board has won acclaim for its **governance and due process system**. However, a system is only as good as it is **"lived"**. There is little to be gained from tweaking the system if the Board only pays it lip service and goes through the motions but then, for example, treats input from constituents in the due process dismissively. The Monitoring Group would need to be aggressively critical in this respect: it should not accept, for instance, that the Board receives overwhelmingly negative comments to a proposal but nevertheless presses ahead with it with the argument that the feedback did not bring to light any new arguments not previously considered or that the commentators obviously had not understood the proposal. Here, the Monitoring Group should make sure that the Trustees take the necessary measures that the **due process is improved and complied with**.
 4. As part of the governance system, the Trustees should not place too much emphasis on **cost/benefit analyses made at the end of the standard setting process** or on ex-post reviews done by the Board. In the case of cost/benefit analyses, the best that can be expected is an objective listing of the costs and benefits, but a meaningful and balanced evaluation would have to be done independently. In the case of the ex-post reviews, it is too late: preparers and users will already have incurred whatever costs are involved in implementing the standard. A due process that includes **intense field tests** at preparers would produce relevant ex ante information on costs and benefits of a change in Financial Reporting Standards.
 5. Finally, on Board representation, the Trustees appear to be focusing on **geographical representation**. We would urge them not to neglect at the same time the need to ensure that Board members have **practical experience**. A start has already been made here, which we appreciate, but opportunities could be sought to accelerate the process of enriching the Board in this sense.
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B. Questions related to the Monitoring Group

Q1 Do you support the creation of a link to a Monitoring Group in order to create a direct link of public accountability to official institutions?

In principle we support this proposal as means of promoting the IASB's public accountability, but we do have **some reservations**. Apart from those set out in responses to questions 2-4 we mention here:

- The **risks of fragmentation, duplication and omission of efforts and responsibilities** (see also point 2 above.)
- The **Memorandum of Understanding** between the Monitoring Group and the Trustees. This MOU will be absolutely crucial in ensuring proper public accountability and credibility of the Monitoring Body and the IASC and should be open for public consultation. As the Monitoring Group is part of IASCF/IASB also the Memorandum of Understanding should go through the due process as any other part of the constitution.
- The meaning of "**in the public interest**". The IASC and IASB are already supposed to act in this way, but we are not convinced by the results. A clear statement of how that phrase is to be understood will be essential.
- The **IASB agenda**. Of utmost concern to us is the setting of the IASB's agenda. From the proposals it is not obvious to us that either the proposed Monitoring Group or the Trustees would provide a mechanism for ensuring that the IASB focuses on work which is practically useful to the capital and other financial markets rather than devoting resources to theoretical matters. Without such a mechanism we would not be sanguine about the effectiveness of either body. (See also points 1 and 2 above under "General Remarks".)

Q2 The proposals contemplate a Monitoring Group comprising representatives of seven public authorities and international organisations with a link to public authorities. While recognising that the Monitoring Group is an autonomous body, the Trustees would welcome comments regarding the Monitoring Group's membership and whether other organisations accountable to public authorities and with an interest in the functioning of capital and other financial markets should be considered for membership.

There seems to us **excessive emphasis on regulatory bodies** in the proposal. When one recalls that financial reporting is about communication between preparers and users, who would not be represented, it seems a little bizarre that organisations like the World Bank and the IMF are regarded as being able to form a more informed opinion on such matters, while at the same time the Bank of International Settlement would not be part of the Monitoring Group. Alternatively, in establishing the Memorandum of Understanding, the Trustees may like to consider some mechanism for ensuring that both they and the Monitoring Group regularly receive input on how the whole due process is being perceived by the primary parties involved in financial reporting nearer the ground (see point 2 above under "General Remarks".)

One area where a more balanced approach is necessary is on the proposed **Monitoring Group's impartiality**. For instance, the proposed composition suggests a danger of leaning towards members from one country. If the outlined composition would become reality, up to four of the seven members of the Monitoring Group could be citizen of one country. Such a situation would not help IASB as a global institution that needs broad regional diversity in order to enhance its acceptance worldwide, especially among other national regulators and standard setters. A **balanced composition** would enhance the link between the Monitoring group and other regulators and standard setters world wide. Furthermore, clear rules of what mechanisms should be put in place to ensure the impartiality of the body are necessary. As regards international organizations, it is common practice that those countries with binding commitments or acceptance of the organization (or its rules/norms) are represented in the central parts of the

institution. This would not be the case with the Monitoring Group yet (See answer to question 6 below).

Q3 The Trustees will remain the body primarily responsible for the governance of the organisation and the oversight of the IASB. Their responsibility to a Monitoring Group will enable regulatory and other authorities responsible for the adoption of IFRSs to review the Trustees' fulfilment of their constitutional duties. Does the formulation of the Monitoring Group's mandate and the Trustees' reporting responsibilities, as described in the proposed Section 19, appropriately provide that link, while maintaining the operational independence of the IASC Foundation and the IASB?

It is difficult to judge from section 19 whether the Monitoring Group's responsibilities as proposed will actually work to eliminate the weaknesses in the whole standard setting process which we have alluded to above. Again, it all depends how they are "lived". If the Trustees are going to continue to accept the IASB's apparent understanding of its independence as meaning that it has no obligation to focus on matters which are practically useful and helpful to market participants and the Monitoring Group also accepts that acquiescence, we would not see much benefit for the markets.

While it will bring advantages to the IASB to have a formal link with standard setters and regulators via the Monitoring Group, it is not **clear whether the Trustees will remain sufficiently independent**. Section 19ff should clarify if the "reporting" by the Trustees to the Monitoring Group means that the Monitoring Group has a supervisory or leading function towards Trustees, and, indirectly, on IASB itself. For example, section 19.c can be "lived" to exercise direct control of the Trustees and the IASB by the Monitoring Group. Such a prominent function of the Monitoring Group would significantly reduce independence of the IASB and lead to a situation where a small Group of regulators would exercise factual control. To prevent this, the Constitution should lay down that the Trustees "inform" the Monitoring Group (section 17b). This would make clear that the Monitoring Group's main task is to establish a formal link to standard setters and regulators. However, if the Trustees decide to give the Monitoring Group a **factual steering function of IASB**, it might be better to evaluate the establishment of IASB as a public international organisation with national standard setters and regulators as its constituents.

Q4 Given the proposed creation of a Monitoring Group, would there be a continued need for the Trustee Appointments Advisory Group in the selection of Trustees? If so, what should be the role and composition of the Trustees Appointments Advisory Group?

We are not close enough to the actual functioning of this process to be able to give a meaningful, informed response. Discussions among preparers have shown that a preferable situation is where the Trustees select and propose new Trustees and the Monitoring Group concentrates its function to a **veto-right**. This would prevent a dominant role of the Monitoring Group and sufficiently maintain independence of IASB.

C. Questions related to the IASB's composition

Q5 Do you support the principle behind expanding the IASB's membership to 16 members in order to ensure its diversity, its ability to consult, liaise and communicate properly across the world, and its legitimacy?

We also see the IASB's diversity and ability to consult, liaise and communicate properly across the world as extremely important. In recent years we have found individual IASB members very willing to enter into dialogue with us as constituents, which we very much appreciate, and if it has been shown to be necessary to increase the Board's size to improve constituent cover we can

only **welcome the step**. We are unable to judge whether 16 is "the right number": presumably the Trustees have carried out the appropriate analysis. As far as legitimacy is concerned, we believe that this is not dependent on size and can only be achieved by having the appropriate mix of backgrounds in the Board (see Question 6 below) – and, even more importantly, by the quality and usefulness of the Board's output.

However, it seems to us unacceptable not to change voting majorities *pari passu*. To ensure legitimacy of decisions we suggest that the voting majority for a standard should at no time be **less than two-thirds of the IASB members**.

Q6 Do you agree with the geographical formulation suggested by the Trustees?

No. The proposals maintain a strong tendency to potentially give excessive weight to countries with an "**Anglo-Saxon**" accounting tradition. It would theoretically be quite possible for 15 of the 16 members to be chosen from such countries – and the South American could feel quite lonely. The Trustees may like to consider (e.g.):

- changing (a) to 4 members from Asia (only) and (c) to 4 members from North America and Australasia, and
- setting an overall maximum of 50% of members from the USA, UK and its dominions and ex-colonies.

Furthermore, we find that at least 2 of the North American places should **be contingent upon the USA committing to adopt IFRS within the next 5-6 years**, on the principle of "no representation without taxation"! Similarly we think that the Trustees need to review very critically the arrangements between the IASB and FASB. We see no reason for the favoured treatment of the latter over (e.g.) the Japanese standard-setter and hope that the Trustees will reconsider this situation.

Also very important for ensuring legitimacy is the continued enrichment of the Board with **practical experience**, on which a good start has been made over the last couple of years. We strongly recommend acceleration of this process to support legitimacy, along with a closer definition of "practical experience": at least 5 years' recent experience of actually preparing, using and front-line auditing of financial reporting enhances the Board's legitimacy and credibility amongst most constituents, while practical experience limited to the lecture hall and the technical desk does not automatically do so.

Q7 The Trustees are suggesting that the Constitution should provide flexibility on the matter of part-time membership. Do you support that proposal?

We agree that the Constitution should **provide the flexibility**. Where such an arrangement is workable, we think that the Board can only benefit from maintaining direct contact with actually preparing, using and front-line auditing of financial reporting. However, we fully realise the practical problems which part-time members face ($2 \times 50\% = 130\%$) and leave it to the Trustees to identify workable solutions.

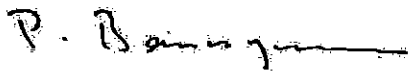
We trust that the Trustees – and the Constitution Committee in particular – will find our remarks useful in their deliberations. It is extremely important for us that those **deliberations achieve a useful outcome**. We hope that the Trustees take the opportunity to help prevent IFRS financial statements degenerating into mere filing documents, with preparer and analyst attention being focused on non-GAAP measures and the management commentary/financial review as the key vehicles for useful financial communication.

We thank you for the opportunity to submit our contribution to your due process.

Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland



Dr. Peter Baumgartner
Chairman Executive Committee



Dr. Jan Atteslander
Member Executive Committee

cc SH Board
