

Financial Reporting Council

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23 February 2011

Dear Tom,

Status of Trustees' Strategy Review

I am responding on behalf of the UK Financial Reporting Council (FRC) to the above consultation.

The FRC's responses to the questions in the consultation document are set out in the appendix. In this covering letter, I would like to highlight the FRC's main concerns and suggestions.

The FRC welcomes the reviews of governance being undertaken by the Trustees and the Monitoring Board (MB) although, as noted below, we believe they should be better co-ordinated. The governance of the IFRS Foundation is of crucial importance, in particular as more and more countries around the world adopt IFRS and the goal of a single set of globally accepted accounting standards comes closer to being achieved. It is vital that the governance of the organisation is, and is seen to be, exemplary, so that the independence of the IASB is matched with a high degree of accountability.

That said, the FRC's main concern relates to the governance of the organisation. While the establishment of the MB was an important step in improving the accountability of the Foundation, the operation of the three-tier structure that has resulted has, in our view, created confusion. This is highlighted by the fact that the MB and the Trustees are conducting separate reviews on governance at the same time, with separate consultations coming out at different times, with little overlap. At the very least, the reviews should be better co-ordinated and constituents given more opportunity to consider the two in tandem. In that respect, the FRC welcomes the comments made by the MB in its 'Consultative Report on the Review of the IFRS Foundation's Governance', which was issued on 7 February, about the reviews being co-ordinated going forward, with a view to achieving an integrated package of proposals.

The FRC recognises that the current governance structure has only been in place for around 18 months, but from our perspective the arrangements do not appear to be working as they should. The FRC believes that, if the current governance structure is to be retained, then there is a clear need for the respective roles and responsibilities of the Trustees and the MB to be clarified and communicated to all constituents. The MB appears to acknowledge this in its review document and is seeking views on whether the allocation of responsibilities between the two bodies should be further clarified. The FRC has stated publicly in the past that the membership of the MB needs to reflect a wider range of interests than securities regulators and we welcome the fact that the MB is examining its membership as part of its review. We will be responding to MB on this issue.

The FRC also has concerns about the IASB's due process and the Trustee's oversight of it. While we acknowledge the improvements that have been made over the years and the extensive nature of the due process as set out in the 'Due Process Handbook', and the establishment by the Trustees of a Due Process Oversight Committee, we still have concerns with how it has operated in practice, not least given the burden on constituents in recent years to comment upon a vast number of discussion papers and exposure drafts that have been produced by the IASB. The pressure imposed by the IASB-FASB convergence programme and the 2011 deadline in particular has raised legitimate concerns that proposed standards are being rushed through without adequate time for consultation and field testing. As the FRC made clear in its response of 13 March 2009 to the Trustees' Review of the Constitution, in our view the Trustees should have played a more active oversight role in challenging the IASB on its priorities and the application of its resources. More detailed comments on due process are set out in the answers to Questions 5 and 6 in the appendix.

Finally, as highlighted in the answer to Question 8 in the appendix, the FRC believes that the Trustees should consider as a priority changing the composition of the IASB from a full-time Board and bring in at least half the membership on a part-time basis. We note that the MB's review document also raises the issue of whether the appointment of part-time members to the IASB should be considered as a means to potentially enhance the involvement of those with practical experience of IFRS. We would strongly support such a move.

Should you have any queries on the above, please do not hesitate to contact me or David Loweth on 020 7492 2420.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stephen Haddrill', with a stylized, cursive script.

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

Q1. 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?

FRC Response

1. The FRC supports the capital markets focus of the Foundation's primary objective as set out in the Constitution.
2. In the FRC's view, there needs to be an alignment between the primary objective of the Foundation and the objective of financial reporting as set out in the IASB's conceptual framework (as revised in September 2010). The IASB has recognised that, along with decision-usefulness, financial reporting also plays an important role in demonstrating the stewardship of resources by management. This should be reflected in the primary objective of the organisation.

Q2. 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?

FRC Response

3. The FRC is aware that during the recent financial crisis there have been calls for the objectives of accounting standards and prudential rules to be aligned. In our view, such calls need to be resisted, as they do not take into account that financial reporting and regulatory reporting are seeking to satisfy two different objectives. The purpose of financial reporting is to portray a neutral (unbiased) view of economic reality for investors and other users with a need for financial information. The purpose of prudential regulation is intentionally biased towards protecting depositors (and policyholders) ahead of shareholders.

4. Where solutions are available that satisfy the perspectives of both participants in the global capital markets and prudential regulators, they should be adopted. However, the needs of regulators, where they differ, should not override the information necessary for investors. That said, the FRC agrees with the view expressed by the Financial Crisis Advisory Group (FCAG) in its July 2009 report that: "The confidence of all [these] users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth. Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those differences should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting". In this context, we welcome the regular and enhanced dialogue that has been taking place the IASB and bodies such as the Financial Stability Board, the Basel Committee on Banking Supervision and senior banking regulators.

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

Q3. 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?

Q4. 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)?

FRC Response

5. While we understand the reasons for the establishment of the MB, the FRC believes that the operation of the current three-tier structure has created confusion about who is responsible for what, despite the existence of a Memorandum of Understanding between the Trustees and the MB. At this stage, we think that the emphasis should be on making the three-tier structure more effective and clarifying the roles and responsibilities of the Trustees and the MB. Any moves to involve the MB more in the management of the Foundation would run the risk of blurring those roles and responsibilities, and could potentially lead to a lower level of representation on the MB, whose membership currently consists of the most senior representatives of its constituent organisations. In the longer term, if the current arrangements are not made more effective, we think that consideration should then be given to simplifying the organisation's governance into a two-tier structure.

6. It is also the case that the membership of the MB, which concentrates on securities regulators, is too narrow and does not encompass official global organisations with a wider range of responsibilities, notably those with financial stability, banking and insurance mandates. It is also the case that a number of the world's major capital markets are not included in the current membership. We therefore think further steps are necessary. We will be responding in due course to the MB's proposals on these issues.

7. The FRC also observes that the governance of the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA) is also under review. The oversight of those bodies is the responsibility of the Public Interest Oversight Board (PIOB), with the accountability link to public authorities provided by a Monitoring Group (MG) comprising representatives of the main international committees of financial regulators. Given the overlap of membership organisations of the MB and the MG, the FRC believes that, in the future, there would be merit in looking to combine the public accountability arrangements for both accounting and auditing.

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?

Q5. 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?

FRC Response

8. No. The IASB has developed extensive due process arrangements over the years, which on paper look impressive and should deliver high-quality standards. However, in practice, the picture has been very mixed and dominated by the IASB's focus on the convergence projects with the US Financial Accounting Standards Board (FASB). This has, in the FRC's view, contributed to the IASB pushing an extensive agenda (on which stakeholders have to date not been consulted) and the publication of a large number of consultation documents, which has placed a heavy burden on constituents and compromised their ability to give full and proper consideration to them. This remains a problem with the IASB's continuing desire to finalise a number of major new standards by the arbitrary deadline of 30 June 2011. Constituents need an appropriate period of time to examine and respond to IASB consultations, and to feel that their views are considered carefully by the IASB (even if ultimately they are not accepted). Proposals on all major projects also need to be field-tested to test their practicability, and the results made available, so that constituents can assess them.

9. In our view, the Trustees should have exercised a greater oversight role in challenging the IASB on the above issues.

10. The IASB's due process arrangements already provide for feedback statements, effects (impact) analyses and Post-Implementation Reviews (PIRs), but while feedback statements are now produced as a matter of course, the latter two have yet to be produced on a regular basis. We understand that PIRs will be proposed as an important component of the IASB's post-2011 agenda, but the role and importance of effects analyses as an important feature of the IASB's due process should also be emphasized. On this subject, the FRC's Accounting Standards Board (ASB) and the European Financial Reporting Advisory Group (EFRAG) have recently issued a DP 'Considering the Effects of Accounting Standards' to stimulate discussion as to how standard setters should integrate further into their due process a systematic approach for considering the effects of accounting standards as they are developed and implemented.

11. While the FRC welcomes the requirement in the latest revision of the Constitution for the IASB to carry out a public consultation on its forward agenda every three years, the first of which is due to begin before 30 June 2011, in our view it does not go far enough. The IASB should consult more regularly on its forward work programme and priorities, and subsequently produce a feedback statement with the final programme which justifies its agenda choices and the priorities attached to them. In our view, this would improve the agenda-setting process, without compromising the IASB's independence in determining its technical agenda, by subjecting the IASB to a high degree of accountability to ensure that its actions and the decisions it reaches on its work programme are evidence-based and consistent with the objective of developing high quality standards.

12. The IASB needs to consider more actively input from constituents on which standards give problems and changes which can deliver real improvements to financial reporting. The move away from a convergence agenda should help in this respect. The focus for the future agenda of the IASB needs to be on developing and reviewing standards which can deliver demonstrable improvements.

Q6. 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?

FRC Response

13. Yes. The FRC believes that the IASB should pay greater attention to these issues in its future work. Standards should articulate clear principles and be written in a way that makes them capable of being applied in practice without the need for extensive further interpretations or guidance, or excessive additional work by those using them. The standards should also be auditable.

14. Problems with the adoption and implementation of standards may be evidence of problems with the way in which those standards have been written, not just difficulties on the part of those implementing the standards. In this respect, the role of PIRs will be critical.

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

Q7. Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

FRC Response

15. The FRC supports the efforts of the Trustees to achieve a secure and sustainable long-term financing system. In the UK, there is already automaticity of funding, in that the FRC raises the UK contribution to the cost of the Foundation by issuing invoices and collecting monies on its behalf. The FRC pays over to the Foundation the amount it requires up to the amount collected.

Other issues

Q8. Are there any other issues that the Trustees should consider?

FRC Response

16. Yes. Under the current Constitution, up to three members of the IASB may be 'part-time' (with 'part-time' meaning that the members concerned commit most of their time in paid employment to the Foundation). In practice, the IASB members are now all full-time. A consequence of this is that, in effect, the IASB operates without the benefit of the perspective and challenge of members who have current practical experience of the application and use of IFRS. We note that the Board, for its meetings, is provided with numerous and very detailed papers. For example, at its December 2010 meeting, the IASB was provided with nine papers for the agenda item on post-employment benefits. All this has, in our view, resulted in the IASB sometimes getting bogged down in some very detailed and very technical debates without an opportunity to step back and think more widely about the implications of its proposals and decisions.

17. In the FRC's view, the Trustees should consider, as a priority issue for the IASB in taking forward its post 2011 agenda, changing the balance of the IASB to make at least half the members part-time. We recognise that this proposal brings with it the challenge of how to make it work, but we believe it would be preferable for the IASB to include members drawn from a range of interests to provide some external perspectives and to allow the opportunity for a different, more strategic, nature of debate at the Board.