20 December 2010

The Trustees
IFRS Foundation

Dear Sir/Madam,

Response to IFRS Consultation Document *Status of Trustees' Strategic Review*

1. I thank the Trustees of the IFRS Foundation (hereinafter referred to as the Foundation) for the opportunity to comment on the aforementioned Consultation Document (CD). Before I proceed to articulate my views on this CD, I would like to emphasise upfront that the comments that are expressed herein are solely my ***personal views*** and strictly do ***not*** reflect those of any organisation to which I may be associated presently and/or previously in various capacities.

2. In setting the context for the Trustees' strategic review in Section 2 of the CD, the Foundation recounted that the IFRS framework has achieved acceptance in more than 100 countries with active near-term consideration in a dozen more jurisdictions. The Foundation pronounced the first decade of its existence as a success and the objective of a single set of high quality globally accepted accounting standards as "within reach". While this appears to be the case now, I would like to caution that the next decade – particularly the next three to five years - shall be "moments of truth" for the Foundation and the IASB. Over the next three to five years, many of the IASB's joint projects with the US Financial Accounting Standards Board (FASB) under the Memorandum of Understanding (MOU) are expected to come into effect, with IFRS 9 being perhaps the most watched standard by the global investor community. Whether or not these joint standards actually deliver the promise of more transparent and decision-useful financial reporting for investors and other primary users of the financial statements at a sustainable cost to preparers, remains to be seen.

3. As I survey the near-term horizon, I see significant derailment threats and risks to the attainment of a high quality globally accepted accounting standards. Firstly, in the rush to complete the joint MOU projects with the US FASB by the stipulated mid-2011 timeline, the IASB is manifesting what I would describe as "organisational impatience", compromising careful deliberation for short-term expediency in order to meet highly compressed and unrealistic completion timelines. Secondly, in yet another adverse turn of events since the global financial crisis, some members of the European Union (EU) are now facing acute sovereign debt crises. As I see it, there is a high risk of these troubled members' financial woes triggering a domino effect on the rest of the EU and the global

economy at large. The EU has been a primary engine driving the global acceptance of the IFRS framework in recent years. If the EU disintegrates as a result of the ongoing sovereign debt crises of some of its members, nationalistic sentiments may re-surface, leading to a reversion back to national GAAPs in Europe. This would deal a coup de grace to the decade-long work and efforts of the Foundation and the IASB, potentially triggering similar GAAP reversions in other regions of the world. Thirdly, the US Securities and Exchange Commission (SEC) will be making a decision in 2011 whether to adopt the IFRS framework. While the SEC has sounded a supportive note towards IFRS adoption, the US administration as a whole is now heavily burdened by pressing economic concerns arising from the global financial crisis as well as other domestic agendas. As such, the US administration's policy stance on IFRS adoption remains unclear and volatile at this juncture. The stakes are high. As Trustee Harvey Goldschmid rightly pointed out in a recent keynote speech at the FEI conference in New York, "...a negative decision on IFRS in 2011 by the SEC – or, as bad, a decision to delay an adoption commitment – would likely have tragic consequences" (quoted from the *News* webpage of the IFRS Foundation's and the IASB's website). The Foundation should also pay particular attention to the two scenarios that he portrayed in his speech.

4. My responses to specific questions posed in the CD can be found in the **Appendix** to this comment letter.

Yours faithfully,

LINUS LOW

Appendix

Question	Comments
Mission 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?	 For standard-setting consistency and clarity, I think it is vital that the Foundation review this particular clause in the current Constitution vis-à-vis the explicit objective of general purpose financial reporting as stipulated in paragraph OB2 of *The Conceptual Framework for Financial Reporting 2010*. In particular, my concern is that the target user group of financial reporting – as identified in the *Conceptual Framework* - appears to be more specific than what is stated in the current Constitution. In paragraphs BC1.14 -1.15 of the said document, the IASB had explained that the revised *Conceptual Framework* now specifically identifies the "primary user group" of financial reporting as comprising existing and potential investors, lenders and other creditors. In comparison, the phrase "…other users of financial information" in the current Constitution seems to indicate a much broader target user group for financial reporting. As I see it, a broader target user group could impede the IASB's efficiency and effectiveness in standard-setting. For instance, going by the provision in the current Constitution, it would seem to me that financial reporting should also satisfy the information needs of regulators, who are not within the ambit of what is defined as the "primary user group" in the revised *Conceptual Framework*. For the IASB, this may trigger standard-setting issues such as those encountered at the height of the recent global financial crisis, during

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	which there was tremendous political pressure on the Board to address "pro-cyclicality" criticisms and financial stability requirements of regulators. I view such political pressures from regulators as unhealthy, given that this may potentially interfere with the Board's objectivity and independent professional judgement in its standard-setting work. See my response to Question 2 for further discussion on the interaction between standard-setting and public policy. From a wider perspective, as a professional body seeking to develop and promulgate a robust set of accounting standards for the financial markets, it is inevitable that there is a "public interest" dimension to the IASB's standard-setting mission. As such, I see an imperative need for the Foundation to undertake a thorough review of whose "public interests" the IASB seeks to serve through its development, improvement and promulgation of the IFRS framework. To this end, the Foundation may wish to take reference from the International Federation of Accountants (IFAC). IFAC has recently published a policy position paper entitled *A Public Interest Framework for the Accountancy Profession* to seek the global accounting profession's views on its proposed definition of the public interest. Whatever the conclusions reached by the Foundation, my view is that it is critical that the definition of the public interest and the target user group for financial reporting be consistently expressed throughout the contents of both the Constitution as well as the revised *Conceptual Framework*. This is to ensure that the Foundation and the Board remain strategically focused in the mission to deliver a set of high

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	quality accounting standards that is versatile enough for global adoption, in the post financial crisis world.
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?	The subject matter of financial reporting standards and the global standard-setting process have always been highly politicised for various reasons. In my view, this is inevitable and probably reflects the relevance of financial reporting and its wide-ranging impact on the real world of global commerce. Not surprisingly, the latest global financial crisis has again cast financial reporting standards into the limelight, though not for the right reason. Specifically, one school of thought held by many policymakers was that the "pro-cyclical" nature of fair value accounting - as embodied in the financial instruments standard of IAS 39 - was partly to blame for magnifying the economic impact of the financial contagion. A corollary of that view was that the "pro-cyclicality" of financial reporting should be tempered and balanced against the wider public policy objective of maintaining financial stability in the global capital markets. While I agree that the financial reporting standards have a highly relevant role to play in promoting the efficient functioning of the global capital markets, my view is that this role is and should be limited to one of providing a robust reporting framework that enhances the generation and dissemination of transparent, relevant and comparable financial numbers of entities. As I see it, extending the role of the financial reporting standards - or the IASB, for that matter - from one of developing and promulgating a reporting

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	framework for high-quality financial information to one of promoting financial stability, is inappropriate. Such an augmented role effectively puts the IASB in the league of governments and other related multilateral global institutions (e.g. the International Monetary Fund, the World Bank, etc.), who are charged with various macroeconomic and/or developmental missions. On this issue, I therefore tend to concur with the conclusions reached by the IASB in paragraph BC1.23 of *The Conceptual Framework for Financial Reporting 2010*. In particular, I am of the view that it is appropriate and entirely consistent with the remit of the IASB for it to focus on the fundamental mission to "serve the information needs of participants in capital markets" in a politically neutral fashion. To a certain extent, if the Board is able to discharge this fundamental mission well, it should *indirectly* contribute towards creating a virtuous cycle in which better financial information engenders higher users' confidence in the product of financial reporting and in turn, promotes financial stability. I further note and agree with the point that the IASB neither has the resources nor expertise to resolve policy-related conundrums that may arise from expanding the objective of financial reporting to encompass public policy concerns such as financial stability. The primary responsibility for meeting and balancing those public policy concerns should rightfully rest with governments and those related global multilateral institutions entrusted with delivering such missions for the economic betterment of humanity.

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Governance	
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?	At the current juncture, I think the three-tier structure remains fundamentally sound and relevant to ensuring the integrity and robustness of the IFRS standard-setting process of the IASB. In my view, each of the three tiers in the present governance structure has a specific and vital role to play in preserving and enhancing the IASB's public accountability as the Board discharges its mission of developing, promulgating and improving the IFRS framework for global adoption. However, from a forward-looking perspective, the present public accountability and governance structure may need to be further fortified in a number of aspects to ensure its continued relevance in the context of a dynamic and fluid global financial reporting environment. ***Firstly, I think it is necessary to broaden the composition and representation of the Monitoring Board, in light of the ever growing adoption of the IFRS framework globally.*** It is probably true that the EC, the IOSCO, the JFSA and the US SEC "together represent authorities responsible for setting the form and content of financial reporting in the majority of the world's capital markets" (quoted directly from the *Memorandum of Understanding to Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation*, dated 1 April 2009). Nevertheless, as the pace of IFRS adoption accelerates and with an increasing number of jurisdictions relinquishing their national GAAPs in favour of the

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	IFRS framework, I see a justifiable need for the Foundation to review the sufficiency and representativeness of the present membership of the Monitoring Board. In this regard, I think there is merit in the Foundation's prevailing geographic selection policy for the Trustees. Under this policy, six of the Trustees must be chosen from the Asia/Oceania region, six from Europe, six from North America, one each from Africa and South America, and two from the rest of the world. Such a Trustee geographic selection policy ensures good representation on a global basis. As such, the Foundation may wish to consider putting in place a parallel mandatory geographic selection policy for the capital markets authorities composition of the Monitoring Board. For greater legitimacy and enforceability, this policy should be explicitly incorporated in Article 1 of the *Charter of the IASCF Monitoring Board*. ***Secondly, I think there should be greater transparency in the selection process for the Foundation Trustees in terms of seeking constituents' views on potential Trustee candidates.*** As the body entrusted with the responsibility of appointing the Trustees (per the *Charter of the IASCF Monitoring Board*, dated 1 April 2009) for the Foundation, the Monitoring Board should perhaps follow the same due process as the IASB's standard-setting work. Specifically, I would like to see the Monitoring Board publicly publish formal consultation documents to seek global constituents' views on its short list of Trustee candidates. The Monitoring Board should take global constituents' feedback in its internal deliberation and selection of the successful candidate. In its announcement of the successful Trustee candidate, the Monitoring Board should clearly set out its reasons for

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	selecting that candidate, à la the *Basis for Conclusions* that accompanies newly-issued or revised accounting standards. ***Thirdly, I think the same level of transparency should be followed when the Foundation Trustees appoint the future IASB Chairman and Board members.*** In particular, the Trustees should formally seek global constituents' views on their short list of candidates through the publication of a public consultation document, take those views into account in their internal deliberation and selection, and justify clearly their basis for selecting the successful candidate. As the IASB gains further global traction in terms of the adoption of the IFRS framework, the extent of its public accountability correspondingly increases. As I see it, greater procedural justice would be served through a more transparent and consultative selection process for the IASB Chairman and Board members. ***Last but not least, I urge the Foundation to review whether there are significant threats to independence in appointing new Monitoring Board members, Trustees as well as IASB Chairman and Board members, when those persons have previously served in any of the other tiers within the three-tier governance structure.*** My concern is that objectivity might be compromised by the potential presence of latent "self-review threats". Such threats to independence might surface when such persons deliberate on an issue that they previously evaluated while serving in a different capacity in another tier within the three-tier governance structure.

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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?	Kindly refer to my response to Question 3 for suggestions on how the governance arrangements and process of the present three-tier structure can be further enhanced.
<u>Process</u> 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?	 As officially pronounced in the *Preface to International Financial Reporting Standards* and the *Due Process Handbook for the International Accounting Standards Board (IASB)*, the IASB has put in place what it calls an "international due process" (as mentioned in paragraph 18 of the *Preface*) for its international standard-setting work. From a purely institutional perspective, I think there is little dispute insofar as the theoretical soundness of the structure of the Board's international standard-setting process is concerned. However, from an implementation standpoint, I see disturbing signs that do not bode well for the healthy evolution of the IFRS framework. While the IASB has instituted a structurally sound "international due process" on paper, it does not seem to have implemented that process in a manner that would ensure the quality of the IFRS framework, going forward. This is evident from the Board's recent standard-setting decisions and actions, particularly in relation to those "accelerated" projects under the MOU signed with the US FASB. In the rush to complete those projects by the

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	stipulated mid-2011 timeline, the Board is manifesting what I would describe as "organisational impatience", compromising careful deliberation for short-term expediency in order to meet highly compressed and unrealistic completion timelines. Allow me to cite some recent instances as empirical evidence of the Board's "organisational impatience": • *Other comprehensive income (OCI)* – In ED/2010/4, the Board recommended that the portion of the fair value changes of a financial liability attributable to changes in the entity's own credit risk be taken to OCI, with recycling prohibited. This recommendation was made in the absence of a robust conceptual framework that clearly defines OCI, delineates its components, specifies whether recycling should be permitted, and if so, in what contexts and circumstances. It has since been hastily incorporated into IFRS 9 in October 2010, without there being any attempt on the part of the Board at initiating a serious conceptual debate on OCI. Neither was this conceptual issue mentioned or considered in ED/2010/5, which deals with the presentation of OCI items. • *"Control" model in revenue recognition* – In ED/2010/6, the Board proposed to shift away from the existing "risks and rewards" model to the "control" model for recognising revenue. Notwithstanding the significant impact that this would have on entities presently reporting revenue based on the "percentage-of-completion" method (e.g. the construction industry), the Board

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	recommended this paradigm shift, without making any attempt to lay a strong and sound conceptual foundation to demonstrate that the "control" model is superior to the existing "risks and rewards" paradigm. As far as I am aware, there is hitherto no attempt on the part of the Board to initiate a high-level conceptual debate on "control" and its meaning for financial reporting. Given the pervasiveness of the notion of "control" in several aspects of financial reporting (e.g. consolidation, reporting entity, revenue and leases), there is a high risk of this notion being inconsistently applied within the IFRS framework if its meaning is not clearly articulated and understood. • *Inconsistency between proposed revenue and lessor accounting* – To further obfuscate the "control" model issue, the Board proposed in ED/2010/9 what appears to be in substance a "risks and rewards" model for lessor accounting while concomitantly recommending a "control" model for revenue accounting in ED/2010/6. It is evident here that the Board is itself divided and unsure as to whether the "control" model is indeed superior to the "risks and rewards" model for financial reporting. This has transpired because the Board is in a rush to meet the mid-2011 timeline and has failed to "put the horse before the cart" to comprehensively consider what "control" means at a conceptual level. From the above instances of recent developments, it is clear to me that the mid-2011 timeline for the completion of the MOU projects with the US FASB is undermining the IASB's "international due

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	process" and the quality of its internal deliberations. If this trend is left unchecked, there is a considerable risk of the world being confronted with a barrage of conceptually weak accounting standards over the next few years. As I see it, the Foundation should exercise closer oversight and monitoring of the IASB's work on a discretionary basis. For instance, with respect to the IASB's MOU work programme with the US FASB, I would like to see the Foundation taking on a more active role in moderating standard-setting project timelines vis-a-vis external demands and political pressures from various stakeholders. The Foundation should also be looking at introducing systematic "checks and balances" within the Board's work processes to ensure quality and completeness in the Board's deliberation of technical issues. If it has not already done so, the Foundation should perhaps consider establishing a regular "accountability reporting" process from the Board in the way of predetermined performance indicators.
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?	As an accounting standard-setter for the global capital markets, I would think that the IASB's foremost priority should be on ensuring the conceptual soundness of the IFRS framework. As I see it, a financial reporting framework based on weak conceptual foundations can never provide investors and other primary users of financial statements with decision-useful information, irrespective of how efficiently, effectively and consistently those standards are applied in practice. Unfortunately, as elaborated in my response to Question 5, the

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	"organisational impatience" that the IASB is exhibiting in recent times is putting the conceptual foundations of the IFRS framework at risk. I therefore strongly reiterate my call to the Foundation to exercise closer oversight of the conceptual quality of the IASB's standard-setting work under the MOU with the US FASB. I am deeply concerned that the IASB's present "organisational impatience", if left unchecked, could well result in the global capital markets being faced with an IFRS framework that is conceptually weak. This is not to say that consistent application and implementation issues are not critical in the IASB's standard-setting work. For sure, investors and other primary users of financial statements would not be able to benefit from decision-useful information if the IFRS-based financial statements are not prepared and presented consistently in the manner intended by the underlying accounting standards. As such, I certainly agree that the IASB should pay greater attention to issues pertaining to the consistent application and implementation of its standards in view of the IFRS framework being increasingly adopted on a global scale. In this regard, I see three major areas that require serious attention and further work by the IASB: • *Linguistic issues* – As the IFRS framework is increasingly being adopted by jurisdictions that are non-English speaking, the IASB will need to invest more resources and effort in ensuring the accurate and timely translation of the international financial

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	reporting standards into the various native languages. This is in itself a challenging undertaking, considering that those native languages may have different structures and nuances from the English language. The IASB's propensity to use convoluted and sometimes ambiguous language in drafting its standards poses further hindrance to accurate translation. Presently, even among English-speaking constituents, there are often differing interpretations and disagreements on the requirements in the standards. Thus, in my view, the first step that the IASB needs to take is to review the language it uses in its existing English standards with a view to improving understandability and clarity. • *Effective dates of new or revised standards* – As the IFRS framework becomes increasingly "globalised", another implementation issue that the IASB needs to pay greater attention to would be the effective dates of new or revised standards. Different jurisdictions have different institutional and legal processes for adopting these new or revised standards. A case in point is Europe, where new or revised standards have to undergo an endorsement process before adoption. As such, for the benefit of global comparability of financial statements to be realised, it is vital that the IASB consult closely with constituents and the national standard-setters on appropriate timelines for the implementation of new or revised standards. • *Field-testing of standards* – Apart from effective dates, to ensure that new or revised standards are applicable to all IFRS-adopting jurisdictions, the IASB would probably need to undertake more

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	frequent and intensive field-testing of those standards at the discussion paper or exposure draft stages. The target constituents for field-testing should be selected based on robust statistical sampling principles, and not be driven by convenience or subjective factors.
<u>Financing</u> 7. Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?	 In my view, a sine qua non for the IFRS standard-setting process to remain independent and objective is the preservation of the Foundation's and the IASB's status as a private sector organisation that is neither politically linked to nor significantly dependent on any specific government, jurisdiction or region. As a private sector organisation, it is not possible for the Foundation to impose and enforce mandatory funding requirements from stakeholders around the globe. I therefore do not think that it is realistic for the Foundation to aspire towards attaining "automaticity of financing". As I see it, the Foundation Trustees have already put in place a viable funding framework, and have been successful in working with regulatory and other public authorities to establish national funding regimes in various countries. I would suggest that the Trustees continue their good work in establishing national funding regimes in more jurisdictions. However, I would like to voice my concerns with respect to the "country or jurisdiction specific" principle of the Foundation's present funding framework. This principle stipulates that the

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	"funding burden should be shared by the major economies of the world on a proportionate basis, using GDP as the determining measure" (cited from the *Financing* webpage of the IFRS Foundation's and the IASB's website). While it is probably equitable to set country or jurisdiction specific funding targets based on the particular jurisdiction's percentage contribution to the world GDP, I am concerned that this may inadvertently slant the IASB's standard-setting work towards the interests of the larger economies (considering that they contribute a larger share of the IASB's budget). To counteract such a bias, I would recommend that the Foundation consider broadening the basis for setting funding targets from one that is solely GDP-driven to one that is based on a more balanced mixture of publicly available and verifiable economic indicators. For instance, a judiciously weighted basis encompassing both absolute GDP numbers and GDP growth rates could counter the "economic size" bias, resulting in relatively more balanced funding targets between the larger economies and the smaller but emerging economies. While a sustainably predictable stream of monetary contributions is essential for the IASB to continue to be adequately resourced to perform its standard-setting work effectively, I think the Foundation should also look increasingly towards securing staffing contributions from more jurisdictions to support the IASB's standard-setting work programme. This could materialise by way of secondment of staff from various national standard-setters on either a project-by-project or term basis. To ensure transparency and impartiality, the secondment process needs to be initiated via an open invitation to all

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	interested national standard-setters, with selection being based on objective evaluation criteria and merit.
<u>Other issues</u> 8. Are there any other issues that the Trustees should consider?	 I have no further issues to raise at this juncture.