Accounting Standards Board
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AcSOC Accounting Standards Oversight Council
CSNC Conseil de surveillance de la normalisation comptable

February 17, 2011

Via email: strategyreview-comm@ifrs.org

IFRS Foundation Trustees
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

This letter is the response of the Canadian Accounting Standards Oversight Council ("AcSOC") and Accounting Standards Board ("AcSB") to the Paper for Public Consultation, "Status of Trustees' Strategy Review," issued on November 5, 2010 ("the Paper").

The AcSB is Canada's national standard setting body, which has adopted a strategy of importing IFRSs into Canada for publicly accountable enterprises. AcSOC is the body that plays the same role nationally in Canada relative to the AcSB that the Foundation Trustees play relative to the IASB.

The staff of the AcSB has discussed the issues raised in the Paper with stakeholders, including the AcSB's User Advisory Council. The views expressed in this letter take into account the comments and perspectives raised by those stakeholders as well as the views of individual members of the AcSOC and the AcSB.

We commend the Trustees for undertaking a review of key strategic issues at this time, as the IASB approaches some significant milestones, including a wider adoption of IFRSs globally. The views in this letter reflect Canada's long-time involvement in the development of a single set of high quality, globally accepted financial reporting standards and its current status as a country in transition to IFRSs.

The AcSOC has recently gone through the process of reviewing its own mission and that of the AcSB in revising the two bodies' terms of reference and operating procedures. In the course of that process, the issues raised in the Paper were evaluated from a domestic perspective and the following comments reflect the considered views of the AcSOC and the AcSB.

We agree with the Paper's description of the context for the current strategic review and the issues its raises. Further, we agree that the four specific issues on which comments are sought are the most important issues for the Trustees to consider in carrying out the strategic review.

Mission

We believe most strongly that the main question posed in the Paper is not the right one because it is based on the premise that the Constitution should define "the public interest." We think that paragraph 2(a) of the current Constitution is directionally right in indicating that it is in the public interest to develop "a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles." We think it would be clearer if the language were modified to reflect the point in the previous sentence, namely that *it is in the public interest to develop* such standards or, preferably, that *the Foundation serves the public interest by developing* such standards (emphasis added). We think that it is unnecessary to define "the public interest" and that any attempt to do so could breed significant controversy, difficulties and confusion.

We believe that it is in the public interest to have efficient and effectively functioning capital markets. High quality, globally accepted accounting standards are a necessary, but not sufficient, contributor to the achievement of this objective. In our experience, the world's capital markets are very fragile and very sensitive to any perceived attempt to restrict the quality (relevance and representational faithfulness) or transparency of the information provided to participants in those markets. Thus, we believe that a perception that accounting standards are serving objectives other than meeting the needs of investors and other users with similar information needs will, inevitably, lead to a loss of confidence in financial reports and, thus, less efficient and effective functioning of these capital markets. We believe that this would be contrary to the public interest.

A standard setter needs to be able to demonstrate that a proposed standard will contribute to improved financial reporting, consistent with the objective of financial reporting and the qualitative characteristics of useful financial information. Current due process steps require the IASB to provide a basis for its conclusions in developing a proposed standard and an opportunity for stakeholders to comment on the rationale before a standard is finalized.

We note that stakeholders commenting on a proposal they do not like sometimes claim that the proposal is not in the public interest. For example, some have expressed concern that a particular method of accounting, such as a method of accounting for pension costs and obligations by employers, could lead to results that are contrary to the best interests of some segment of society, such as the reduction or elimination of certain types of socially desirable pension schemes by employers, due to concerns with the resulting accounting. We doubt that anyone has the skills and resources to undertake a thorough analysis of the macro-economic effects of accounting standards in such cases. Claims about such effects are difficult or impossible to confirm or refute. While we think that standard setters should be aware of the possible macro-economic effects of accounting standards, we do not think that such effects should be specifically factored into the criteria used by the standard setter to establish accounting standards. Rather, the primary focus of the standard setter should be on improving the information received by capital providers, subject to cost/benefit constraints, as discussed in the IASB's Conceptual Framework for Financial Reporting.

The recent changes to the IASB's Conceptual Framework reflect this primary focus on the needs of "existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity".[1] We support the objective as articulated in the revised Conceptual Framework. Accordingly, we recommend that the objectives in the Foundation's Constitution be made more congruent with this revised Conceptual Framework. There is currently common ground between that document and the Constitution but it would clarify the organization's mission statement if they were made the same.

As discussed above, in carrying out its mission, the organization needs to be fully aware of the effects of the standards it issues. We encourage the Trustees to refer to a recently issued Discussion Paper, "Considering the Effects of Accounting Standards", developed by the UK Accounting Standards Board and the European Financial Reporting Advisory Group.[2] The National Standard Setters group has reviewed drafts of that paper and we think that it would provide useful guidance that the Foundation should introduce into the Due Process Handbook to improve on the current discussion of cost/benefit analysis. In summary, the draft discussion paper on effects studies asserts that a standard setter should (i) explain the intended outcomes of a proposed standard in terms of improvements to financial reporting, (ii) encourage input from stakeholders concerning anticipated effects, (iii) gather evidence concerning those effects and (iv) consider them throughout the various stages of due process in reaching conclusions.

When carrying out an effects study, the IASB may encounter public policy issues outside its mandate. The issues may be the responsibility of such groups as capital markets regulators, prudential regulators, auditing standard setters or government agencies that deal with public

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[1] The Conceptual Framework for Financial Reporting 2010, IASB, September 2010, paragraph OB2. Also, Statement of Financial Accounting Concepts No. 8, FASB, September 2010, paragraph OB2.

[2] Available on the website of the European Financial Reporting Advisory Group at: www.efrag.org/files/News%20related%20documents/Jan31%202011%20Effects%20Analysis%20DP_Final.pdf.

policy issues. The IASB should bring such issues to the attention of the responsible parties. The IASB should also co-operate with those other parties in resolving issues to the extent it is reasonable to do so within its own mission. However, financial reporting cannot hope to satisfy a variety of potentially conflicting objectives nor can an accounting standard setter. We note that other bodies have the overall responsibility for financial stability and also the authority and the tools to achieve it, which accounting standards setters lack. We think that financial reporting can contribute most effectively to macro-economic stability through promoting the efficient operation of capital markets, which is essentially the objective in the current Constitution. We think it would be inappropriate to dilute the IASB's current mission by adding other objectives.

Governance

We think that the current governance structure is appropriate, as long as it is applied well. The IFRS Foundation, as a private body, does need to be accountable to the stakeholders it seeks to serve through some form of public agency. The Monitoring Board can serve that function if it is properly constituted and operates appropriately. We have no concerns with the current membership of the Monitoring Board but we have little experience on which to draw conclusions about its operations.

In our view, accountability and independence are not antithetical characteristics. They should be complementary. The Monitoring Board and the Trustees need to agree on an appropriate balance between preserving the Foundation's independence and providing a safety valve for the concerns of public authorities. The Foundation should be answerable to the Monitoring Board, in the sense of explaining its actions, and it should heed the advice of the Monitoring Board. However, the accountability relationship should not give the Monitoring Board any right to interfere in the Foundation's activities.

We believe that the independence of the IASB, in both fact and appearance, is critical to the acceptance of the resulting accounting standards in the world's capital markets. We are firmly of the view that any perception that regulators or politicians can influence the accounting standards established by the IASB will give rise to a general lack of trust in reported information, periodic panic reactions by market participants, decreased efficiency of these markets in allocating capital and an increase in the cost of capital generally.

We also believe that acceptance of the standard setter's independence by capital markets regulators, prudential regulators and governments depends upon their faith in the quality of the due processes that the Foundation and the IASB follow in achieving their mandate. Therefore, we believe that significant improvements are necessary to the IASB's due processes to justify public authorities in accepting the Board's independence. We discuss our views on this issue in the following section.

We also believe that the Foundation, as part of its due process, needs to be open to input from all members of the public and should not be accountable solely through the Monitoring Board.

We think that the Monitoring Board needs to organize itself in a manner that makes it most effective in representing the public interest, as the members of that body view it. It is the responsibility of the Monitoring Board and the governments it represents to develop a suitable accountability structure and process, which must be fully transparent.

We think that, as a term related to governance, "accountability" has been difficult to define and operationalize effectively. It is frequently described as an account-giving relationship between individuals, e.g., "A is accountable to B when A is obliged to inform B about A's (past or future) actions and decisions, to justify them, and to suffer punishment in the case of eventual misconduct"[3]. What we find missing in the three-tiered accountability relationship between the

[3] Schedler, Andreas (1999). "Conceptualizing Accountability" in Andreas Schedler, Larry Diamond, Marc F. Plattner, *The Self-Restraining State: Power and Accountability in New Democracies*. London: Lynne Rienner Publishers, pp. 13–28.

Monitoring Board, the IFRS Trustees and the IASB, or not directly articulated, is the mechanism for identifying the need for corrective measures and the form such measures may take. We think that the Monitoring Board and the IFRS Trustees need to articulate clearly the circumstances that would call for intervention and the various steps the Monitoring Board could choose to take in those circumstances. Absent this transparency, we are concerned that capital market participants may believe there is not true oversight and accountability. Alternatively, market participants may believe that the Monitoring Board is acting in a secretive and coercive manner, leading to suspicions of unacceptable interference with the IASB's independence that impugns the quality of the accounting standards it sets.

Process

The organization's processes are fundamentally sound in principle but their application has not always been sufficient to ensure high quality standards that are consistently applied. As we discuss above, we think that the IASB and the Trustees have to earn their right to be independent by having unassailable due processes. We commend the Trustees and the IASB for the steps they are taking currently to rectify some of the more significant shortcomings in their processes, and encourage further improvements.

The IASB needs to continue the work already begun to improve the due process for standard-setting, including processes for establishing the work plan and assessing project priorities and undertaking thorough effects studies and post-implementation reviews. In setting its priorities for the post-2011 work plan, the IASB should focus on filling in significant gaps in coverage of the current standards and reviewing current standards to ensure that they are of high quality.

We think that the IASB should achieve better control over agenda-setting in the future. Consistent application of laid-down procedures, including public consultation concerning decisions to add or delete individual projects, should replace ad hoc decision-making on agenda-setting questions. The processes applied to determining the work plan initially should be applied subsequently in making any decisions to add, delay or delete individual projects or change their scope. Such decision-making processes need to include consideration of knock-on effects on other projects as well as the overall improvement to financial reporting generally.

We think it important for the IASB to observe the spirit and not just the letter of the requirements of the Due Process Handbook. In particular, we urge the IASB to give stakeholders sufficient time to respond in a thoughtful fashion to invitations to comment on agenda decisions, discussion papers, exposure drafts and other documents. The IASB also has to take the time to listen to stakeholders' views and weigh their input thoroughly. The IASB has rushed its projects on some major issues currently under discussion. Setting arbitrary and unnecessary deadlines that curtail discussion and analysis by stakeholders and the IASB creates a significant risk of developing standards that are not high quality, as we have commented to the IASB in respect of several current projects. It will require considerable effort to repair poor quality standards after their issuance. Accordingly, quality should trump adherence to timelines.

We are also concerned with what we perceive to be a growing perception among stakeholders that comments on proposed accounting standards submitted to the IASB are summarily dismissed. We think that the IASB has to spend significantly more time in evaluating comments received thoroughly and challenging the original conclusions reached by the Board based on those comments. If this extends the timeframe required to finalize a new standard, in our view it is time well spent, as it will lead to a higher level of "global acceptance" of the resulting standard as well as higher quality.

We think that the IASB needs clearer requirements in the Due Process Handbook concerning when it should re-expose a proposed standard. We have seen recent examples of standards being changed very substantially through redeliberations following exposure and then finalized directly. We think that, in such circumstances, a significantly revised draft standard needs to be exposed for public comment unless there are compelling reasons for not doing so. Proceeding directly to issuance of a standard effectively means that stakeholders have not had an opportunity to comment on the standard that is issued and must be applied.

We encourage the timely conduct of post-implementation reviews of IFRSs. We note that the US Financial Accounting Foundation Trustees have decided that post-implementation reviews of FASB standards should be undertaken by the Foundation, and not by the FASB, so as to avoid a conflict of interest. We think that the IFRS Foundation Trustees should consider this issue relative to IFRSs.

The Trustees must appoint IASB members with the highest degree of technical competence to sustain the quality of the board's deliberations and decision-making, thereby maintaining the organization's independence and ensuring high quality standards. The IASB also requires sufficient staff and other resources to carry out its work.

We think that the Trustees need to become more engaged in oversight of IASB activities, through more extensive public accountability sessions with IASB representatives. More extensive direct consultation between stakeholders and Trustees would ensure that Trustees are aware of matters of general concern and better able to challenge the IASB when exercising oversight. In addition, the Trustees need to ensure that a sufficient number of their members are close enough to the front lines of financial reporting practice to be able to appreciate fully what the IASB and stakeholders tell them about current issues of concern.

We also encourage the Trustees to increase direct contacts with other senior organizations involved in what has sometimes been referred to as "the financial reporting supply chain[4]" to address systemic issues that impede high quality financial reporting. One such issue relates to

[4] By this term, we mean all those involved in the preparation, dissemination, enforcement and audit of high quality financial information, directly and indirectly. The best standards in the world will not have the desired outcome if others in the supply chain do not contribute to the quality of the information provided to investors and others. The supply chain includes standard setters, financial statement preparers and managements, audit committees and boards of directors, securities market regulators, auditors and audit firm quality control, audit oversight bodies, and analyst and institutional investor organizations.

various regulatory bodies that want special-purpose financial information suited to their specific needs (as noted above). The Foundation should co-operate where it can but must ensure that it remains true to its own mission – i.e., a focus on investors.

Another systemic issue is ensuring sufficiently consistent application of IFRSs globally. Neither the Foundation nor the IASB alone can *ensure* that consistent application is achieved. However, they can ensure that accounting standards set by the IASB are of sufficiently high quality that consistent application is facilitated. The Foundation needs to consider issues such as the tendency to country-specific and auditor-specific versions of IFRSs. The former can arise from countries feeling it necessary to supplement IFRSs with additional guidance to address a perceived lack of consistency. The latter is created by audit firms that feel compelled to issue their own interpretations due to the lack of interpretations provided by the IASB and its Interpretations Committee. Market participants tell us that these auditor-specific interpretations of IFRSs are sometimes inconsistent with each other but enforced globally on a firm-by-firm basis, leading to globally inconsistent application of IFRSs.

The IASB should take maximum advantage of reports by regulators, academics and others concerning actual practices in applying IFRSs, as well as undertaking thorough post-implementation reviews of its standards. In consultation with other organizations that make up the global financial reporting supply chain the IASB should assess what "consistency" means and how much is necessary and achievable without lapsing into overly rigid and prescriptive approaches to standards interpretation.

In that regard, we think that interpreting the application of IFRSs and providing timely guidance on financial reporting issues not specifically addressed in IFRSs are critical parts of the IASB's standard settting process. The challenge lies in determining the right degree of guidance to be provided so that the standards are operational but not rules-oriented. As matters currently stand, we think that there is significant and unacceptable diversity in practice on a number of implementation issues, many of which could, and should, be addressed by the IASB or the IFRS Interpretations Committee. We think that the Trustees need to become more aware of this issue and take action to correct it.

Financing

We agree with the Trustees that financing is a critical issue, as it is for all public goods, and think that it is probably the most urgent. Without adequate financing, both in the near term and the longer term, the Foundation will be unable to fulfill its mission. We think that the four criteria that the Trustees have already established in seeking contributions from donors are necessary. Those criteria (broad-based, compelling, open-ended and country-specific) should be adhered to as closely as possible even though they may make fundraising more challenging.

Maintaining both the fact and the appearance of the Foundation's independence is a critical constraint in fundraising. We think that the Foundation must reduce its current dependence on funding from a relatively small number of donors that each provide relatively large amounts. In this regard, we are particularly concerned that the European Commission has proposed offering substantial lump-sum contributions for the next few years. To sustain the independence of the IASB, the Foundation will need to attract and retain high quality IASB members by offering them personal remuneration that is both adequate in amount and secure over the longer term. IASB members will also require sufficient staff and other resources to do their work properly. The Trustees need to be able to protect the IASB from financial challenges to its independence while also sustaining the Foundation's other essential activities.

We think that a direct levy on investors, the principal beneficiaries of IFRSs, in proportion to the benefits they derive would be an ideal system for funding the Foundation. Such a levy might take the form of a fee on market transactions that is collected by a capital market exchange or regulator and passed on directly to the Foundation. Another approach might be to levy a right to use royalty on all entities that use IFRSs, based on the Foundation's copyright (which may need to be confined to public companies or collected differently by private companies using the IFRS for SMEs). An important attribute of both these approaches is that the costs are recovered relatively directly from affected financial market participants who benefit from IFRSs. Accordingly, the IASB's funding would not rely on a decision by any political, regulatory, professional or other agency that might choose to withhold funding either to affect IASB decisions or to achieve other objectives.

We recognize that neither of those approaches may be practicable in some jurisdictions. Suitable funding arrangements may need to be made through one-on-one discussions between the Foundation and individual jurisdictions that adopt IFRSs to create an arrangement suited to the circumstances of each jurisdiction and type of reporting entity, and also acceptable to the Trustees.

When assessing the adequacy of its financing, the Foundation should look beyond cash contributions and consider both other sources of revenues and its cost structure. Consideration should be given to increasing revenues from sales of publications and related products and services (primarily educational) other than the standards, which we think should be freely available. The Foundation should also recognize the current extent of non-cash contributions it receives, and look to increase such support. In Canada, for example, the AcSB lends staff to the IASB and provides translation services (costing in excess of £200,000 annually) at no charge, and we are aware of some other countries making similar contributions. It may be a good idea to increase the level of such contributions in the near term while longer term cash contribution arrangements are being worked out.

While pursuing secure and adequate funding, the Foundation should also review its current cost structure to identify possible savings. For example, we think that the IASB's membership could be reduced in size with no adverse effects on the quality of the accounting standards issued, and possibly some improvement in operating efficiency. We also note that the post-2011 work plan might allow for some reduction in the staff complement through normal attrition and that some of the work of post-implementation reviews, effects studies and stakeholder outreach should be outsourced to national and regional standard-setting bodies or other organizations.

The AcSOC is committed to working with others in Canada to develop an appropriate, long-term basis for securing Canada's fair share of the cash contributions necessary to support the Foundation.

Conclusion

We thank you for the opportunity to provide input to your review of the four key issues raised in the Paper. We would be happy to elaborate on or clarify any of the points raised in our letter. Please address any questions to the undersigned or Peter Martin, Director, Accounting Standards at +1 416 204-3276 (email peter.martin@cica.ca).

Yours truly,

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