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Mr Tsuguoki Fujinuma
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24 February 2011

Dear Mr Fujinuma and Mr Glauber

Public consultation: Status of Trustees' Strategy Review

We are pleased to comment on the above document. Following consultation, this letter summarises the views of the BDO network[1].

As noted in the Appendix to this letter, we strongly believe that the primary audience for general purpose financial reporting is investors and lenders. While others, such as prudential regulators, might make use of these financial statements, where a conflict arises between investors and lenders, and prudential regulators, the former group should be given priority.

In our view, financial stability comes from a number of sources, one of which is transparency of financial information and the reporting of profits and losses as they arise. This promotes confidence as reliance can be placed on the financial information presenting the actual financial position of an entity. However, consideration could be given as to whether additional disclosures, showing adjustments that prudential regulators might require for items such as loan loss provisions as adjustments to reserves, could also provide users of financial statements with useful additional information.

While we support the current three tier governance structure, we believe that it would be appropriate for a number of changes to be made. At present, it is not entirely clear where the boundaries of responsibility lie for the IFRS Trustees and the Monitoring Board; it is essential that these are clarified, in particular to confirm that the Monitoring Board does not itself have the ability to direct the IASB in its standard setting process.

With regard to the IFRS Foundation Trustees, we believe that a more proactive approach is needed, with the Trustees taking on a stronger and wider external role to assist in dealing with concerns raised by IFRS constituents. This is particularly the case during the development and subsequent exposure of more controversial proposals, where there is a risk that IFRS constituents might attempt to bypass normal due process. A wider external role should also extend to cover liaison with members of the Monitoring Board.

We support the existence of the Monitoring Board but, as noted above, believe that its role and responsibilities need to be made clear. We also believe that the membership of the Monitoring Board should be extended to represent a wide range of capital market participants

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(this might be drawn from members of the G-20 in the context of the size and scope of related capital markets). In addition, while we do not believe that the primary focus of financial reporting should be directed towards the needs of prudential regulators, it would be appropriate for there to be a mechanism by which the IFRS Foundation can be made aware of regulatory developments and concerns. Consequently, the inclusion of a representative from the Financial Stability Board would be appropriate; it may also be appropriate to consider other international institutions such as the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors.

Our responses to the specific questions included in the consultation document are set out in the attached Appendix.

We hope that our comments and suggestions are helpful. If you would like to discuss any of them, please contact Andrew Buchanan at +44 (0)20 7893 3300.

Yours sincerely

BDO IFR Advisory Limited.

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Appendix

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

Question 1
The current Constitution states, "These standards [IFRSs] should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions." Should this objective be subject to revision?

We do not believe that this objective should be subject to substantive revision.

Public interest can be viewed as being satisfied in a number of ways; one of these is in the efficient and orderly functioning of capital markets. In order for these markets to function in this way, it is necessary for appropriate financial information to be made available to market participants. This financial information needs to be transparent and free from bias, in order to enable a true comparison of the financial performance and position of different entities.

While it may be appropriate for the IASB to be aware of the needs of a wider range of users of financial statements, such as prudential regulators, if there is a conflict between the requirements of investors and lenders, and those of prudential regulators, the interests of the former group should prevail (see our response to question 2 below).

The objective, as currently stated in the Constitution, limits the scope of information in financial statements and other financial reports to its use in making *economic* decisions (emphasis added). It is not entirely clear why the scope should be limited in this way, as some users might consider that their use of financial information (and their associated need for IFRS) is wider; 'economic' might be deleted.

It might be suggested that the IASB should consider expanding its remit to include the not for profit and/or public sectors (the latter potentially being through liaison with the IPSASB). However, we do not consider this to be appropriate, at least in the short to medium term, as the IASB's agenda is already very full in dealing with financial reporting in capital markets.

Question 2
The financial crisis has raised questions among policymakers and other stakeholders regarding the interaction between financial reporting standards and other public policy concerns, particularly financial stability requirements. To what extent can and should the two perspectives be reconciled?

As noted in our response to question 1, we believe that the primary audience for financial statements should be investors and lenders, and that their requirements should take precedence over those of others such as prudential regulators. There are two principal reasons:

1. Unlike prudential regulators, investors and lenders do not typically have the power to require an entity to provide detailed information in a particular manner and/or format. Consequently, they will typically obtain feedback about the financial

performance and position of an entity through the provision of financial information prepared in accordance with accounting standards. In contrast, prudential regulators typically have the ability to require entities to provide them with information, prepared on the basis of a framework that they can specify.

2. Financial stability comes from a number of sources. From a regulatory perspective, this might include a requirement to build up a specified capital base, with certain amounts being set aside during periods of economic expansion in order to provide a buffer to be used in times of recession. However, we believe that this approach would not be appropriate for financial statements used by investors and lenders; there is a need for that group to be able to have the confidence that they will see profits and losses reported in an appropriate manner when they arise. A mechanism by which genuine volatility of financial results was removed (whether in whole or in part) would not promote confidence, and would instead bring the risk of confidence in capital markets being undermined. In consequence, financial stability can and does arise from transparency of amounts reported in financial statements; it would not be helpful or appropriate for transactions which are in themselves volatile and uncertain to be reported as anything else.

As an example of appropriate financial reporting, we have consistently supported the IASB in its continued use of the mixed measurement model in accounting for financial instruments. This makes an appropriate distinction between those instruments that have simple contractual terms and are managed for the collection of contractual cash flows, and those instruments (such as structured products and derivatives) whose inherently volatile nature means that fair value accounting is appropriate. This also links to the manner in which amounts are reported in financial statements, in order that a clear distinction can be made between those transactions and events that are specific to a particular reporting period, and those which extend to cover a number of reporting periods.

However, we would encourage the IASB to work closely with regulators, such that there is an informative dialogue which assists both parties in better understanding the financial stability implications of developments in accounting standards. It may also be appropriate to consider whether, where a conflict exists between the needs of investors and lenders, and regulators, supplementary information might be provided showing adjustments that regulators might make (for example, for loan loss provisioning purposes). This might be achieved by an adjustment to reserves; investors and lenders might benefit from this information as it would provide them with a link between the shorter term transparency that they require, and the effect of applying a regulatory view.

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

Question 3

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

While the current three-tier structure may remain appropriate, the manner in which it currently operates lacks clarity with an absence of clear boundaries of responsibility. We believe that it is essential that the Monitoring Board does not, in itself, have the ability to direct the IASB in its standard setting process; it is not clear whether that is the case in practice. It is also not clear as to the extent to which the three tiers liaise and work together, which can make their operations appear less coordinated than would be ideal; an example is the separate (but overlapping) reviews that are currently being undertaken by the Trustees and the Monitoring Board.

We have suggested some changes and clarifications for the existing arrangements below. However, whatever changes are made, it should be ensured that governance concerns of key economies (both developed and emerging) are taken into account in order that there is full global support for the IFRS Foundation's governance procedures and, linked to this, IFRSs themselves.

The governance of the IFRS Foundation links to the due process of the organisation, and to the manner in which IFRS constituents can and do seek to apply pressure to the standard setting process (including the involvement of political process). We would suggest that consideration is given to the following:

IFRS Foundation Trustees

We believe that the Trustees' internal role of holding the IASB to account should continue. However, the Trustees need to take on a stronger and wider external role in order that they can deal with (political and other) lobbying from IFRS constituents (which has and will, particularly in the context of more controversial proposals, bypass normal due process) and associated governmental input that may arise, on behalf of the Board. This role needs to be proactive, with work being carried out in advance of the issue of due process documents by the IASB, and would involve a greater and more constant time commitment than is currently asked of the Trustees. We consider that, had this approach been in place over the past few years, the IASB might have come under less pressure from lobby groups and associated political interference than has been the case. While some might question whether an external role on behalf of the Board might conflict with holding the Board to account, we do not consider these to be mutually exclusive. The Trustees have a commitment to the IFRS Foundation and its objectives (as set out in paragraph 2 of the IFRS Foundation Constitution) which links to our suggested external role on behalf of the Board, together with a broad remit in respect of operational aspects of the IASB and IFRS Interpretations Committee (as set out in paragraph 15 of the same document) which links to holding the IASB to account.

In addition, and linked to their role in holding the IASB to account, the Trustees should strengthen their links with the IFRS Advisory Council. Some consider that the IFRS Advisory Council may not have had as significant role in shaping the IASB's agenda and priorities as might have been ideal. Appropriate liaison between the Trustees and the IFRS Advisory Council would enable concerns to be raised; the Trustees should then have a specified requirement to give due consideration to those concerns, to take action as appropriate and to report back to the IFRS Advisory Council.

It would also be appropriate for individual Trustees to liaise with one or more specified members of the Monitoring Board in order that issues arising are identified, and appropriate action taken, at an early stage. This is particularly the case if, as we have suggested below, the membership of the Monitoring Board is expanded significantly to include representatives of either all or some of the G-20 members.

In the context of this revised role, it may also be appropriate to revisit the criteria for the selection of Trustees. In particular, it is necessary for them to have strong influence within their own jurisdictions, such that they can work effectively and proactively at the right level (whether from a political perspective or otherwise).

Monitoring Board

While we support the existence of the Monitoring Board, its responsibilities need to be clarified and its membership expanded.

As noted above, we believe that it is essential that the Monitoring Board should not be capable, by whatever means, of directing the standard setting process or the agenda of the IASB. In addition, the Monitoring Board should not be in a position of acting in more than an advisory role. In that context, the Monitoring Board does have a role to play in the general direction of standard setting, which should be through discussions with the Trustees.

Question 4
Some stakeholders have raised concerns about the lack of formal political endorsement of the Monitoring Board arrangement and about continued insufficient public accountability associated with a private-sector Trustee body being the primary governance body. Are further steps required to bolster the legitimacy of the governance arrangements (including in the areas of representation of and linkages to public authorities)?

We believe that it is essential that the Trustees remain the primary governance body, in order that the IASB retains its position as an independent accounting standard setter.

However, we consider that it would be appropriate to make changes to the membership of the Monitoring Board which, in combination with the changes we have suggested should be made to the role of the Trustees (see above), would enable an appropriate advisory link to be made to political and regulatory bodies.

Linked to the need for IFRS constituents from a wide range of jurisdictions to be represented in the IFRS Foundation's governance structure, we believe that the membership of the Monitoring Board needs to be expanded. An appropriate approach may be for each of the G-20 members to be represented (or, if this is considered too large a group, either in the short term or in absolute terms, a subgroup of larger and economically more significant G-20 members in the context of the size and scope of their capital markets), together with representation from the Financial Stability Board (FSB). The inclusion of the FSB would enable a demonstrable link to be made with prudential regulators; as noted above, while we do not support an approach where regulatory concerns would take precedence in the standard setting process, we consider it important that the IASB has an appropriate dialogue with regulators and that there is a mechanism in place to enable it to be aware of regulatory developments. It may also be appropriate to consider the inclusion of other international institutions such as the Basel Committee on Banking Supervision and the International Association of Insurance Supervisors.

While it is important that, as far as possible, all jurisdictions that are IFRS constituents are represented in some way to assist in ensuring that the Monitoring Board is seen and perceived to be inclusive, it is also necessary to ensure that this is balanced by the quality of technical and other input that will be derived from an expanded membership.

<u>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?</u>

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

We would respond to the question with a qualified yes. However, the comments and suggestions that we have set out above in respect of the responsibility of the Trustees to hold the IASB to account (including enhanced dialogue and consultation with the IFRS Advisory Council), and the need to have clear boundaries for the role of the Monitoring Board are necessary steps to ensure that:

1. The IASB is properly accountable to, and is held accountable by, the Trustees; and
2. The IFRS Foundation, while taking account of the views and advice of the members of the Monitoring Board, remains independent in its accounting standard setting activities.

It will also be appropriate, as part of the IASB's post 2011 agenda, to give greater priority to the development of the revised Conceptual Framework. Without a clear structure and current rationale to underpin the requirements of accounting standards themselves, there is a risk of questions being raised about inconsistencies that can arise between the existing Framework and new accounting requirements, and about the purpose of financial reporting (whether this is from an overall perspective, or in respect of, for example, where certain gains and losses should be included).

We note, and support, the inclusion of a requirement in the Due Process Handbook for the IASB for an analysis of the anticipated effects of a new IFRS or a major amendment to an IFRS. This relatively new requirement remains in its early stages and, while it is welcome that progress has been made, further work may be needed fully to embed this into the IASB's due process.

Question 6
Will the IASB need to pay greater attention to issues related to the consistent application and implementation issues as the standards are adopted and implemented on a global basis?

In principle, we do not believe that it is the role of the IFRS Foundation to ensure the consistent application and implementation of IFRS. From a practical perspective, it does not have any enforcement powers and, even if it did, it does not have sufficient resource for this function.

In our view, this is a matter for regulators and others who do have this responsibility in their own jurisdictions. In this context, although it is outside the scope of the consultation, it would appear appropriate for consideration to be given to establishing some form of international liaison to enable those parties to discuss application and implementation issues. In the event that this identifies specific application issues, these might be referred to either the IASB or the IFRS Interpretations Committee.

However, this links to the role of the IFRIC and there are associated questions (and expectation gaps) around the extent to which the IFRIC should provide application guidance. While we would not advocate an approach that might result in an excess of detailed application guidance, there is a need to review the operations of the IFRS Interpretations Committee and how it should work in future; in this context, we note the consultation that has recently been carried out. In our view, changes are needed to make the IFRS Interpretations Committee more effective.

There is also the question of the IASB's own operational structure. In our view, the IASB cannot continue to operate almost exclusively from a single base, and we welcome the establishment of an office in Tokyo. We encourage the establishment of additional offices, with appropriate consideration being given to their role and authority within the IFRS Foundation structure to ensure consistency of approach. However, we also encourage the Trustees to explore how best the IASB can work with National Standard Setters in order to be as inclusive as possible with the full range of IFRS stakeholders.

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

Question 7
Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

It is essential that a funding mechanism is established, based on levies payable by capital market participants. This will require amounts to be raised with reference to specified criteria, such that the system is perceived to be free from bias or conflicts of interest.

While it may be appropriate (and helpful) for regulators or others effectively to collect funds and pass these to the IFRS Foundation, there is an associated risk that political interests could result in a degree of pressure being placed on the IFRS Foundation to adopt a particular approach when new accounting requirements are being developed. However, should the revised role of the Trustees and expanded membership of the Monitoring Board be implemented, it would be possible for steps to be taken to reduce this risk.

Other issues

Question 8
Are there any other issues that the Trustees should consider?

We have no other issues to raise at this point.