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IFRS Foundation Trustees
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Dear Trustees,

Trustees' Strategy Review

The Australian Institute of Company Directors welcomes the opportunity to comment on the IFRS Foundation Trustees' Strategy Review.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 28,000 individual members from a wide range of corporations; publicly-listed companies, private companies, not-for-profit organisations, charities and government and semi-government bodies. As the principal Australian professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

In 2005, Australia adopted International Financial Reporting Standards (IFRS) for all private sector reporting entities (listed and unlisted). The strategic direction set by the Trustees of the IFRS Foundation (Trustees) and the quality and relevance of IFRS is therefore of keen interest to Australian directors.

We set out our comments in response to several of the questions raised by the Trustees below.

1. Summary

In summary, the Australian Institute of Company Directors if of the view that:

(a) it is critical for the information required by directors, management and investors to be the primary drivers of the development of IFRS;

(b) the setting of public policy, particularly in regard to financial stability requirements is a task best reserved for the governments of States;

(c) there needs to be recognition by the IFRS Foundation and governments of States that high quality accounting standards are only one element in an effective corporate governance framework;

(d) IFRS must be applied within the legal frameworks of different jurisdictions, for this reason the objective to achieve a 'single set' of globally accepted standards that is consistently adopted and implemented worldwide may not be possible;

(e) the Trustees should take an active approach to overseeing the work of the IASB to ensure that the strategic direction set by the Trustees is actually implemented by the IASB and is reflected in the standards produced; and

(f) in order for IFRS to be high quality, relevant and credible:
   i) the standards must strive to reflect commercial reality;
   ii) directors responsible for signing off on accounts prepared pursuant to IFRS should be involved in the standard setting process; and
   iii) the development of IFRS and IFRS guidance should be confined to the reporting of financial information.

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

The IFRS Foundation Constitution provides that one of the objectives of the Foundation is:

> "to develop, in the public interest, a single set of high quality, understandable, enforceable, and globally accepted financial reporting standards based upon clearly articulated principles. These standards 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."

The Australian Institute of Company Directors is of the view that defining the 'public interest' in regard to international financial reporting standards is inherently difficult as the interests of stakeholders in using financial statements will be diverse. However, 'public interest' should be defined with reference to the original purpose for requiring companies to prepare financial statements.

Initially, the financial statements of companies were designed to assist those responsible for running the business to track performance and monitor risk. The financial statements also provided a way for investors to make investment decisions and to monitor company performance. For this reason, we are of the view that the information required by directors, management and investors should be the primary drivers of IFRS development rather than the information required by other stakeholders.

Unfortunately, five years after the adoption of IFRS in Australia, Australian directors are of the view that there are now potentially three reporting systems in Australia. First, the information required by companies to comply with statutory requirements and IFRS, secondly the information directors need in order to run the business and thirdly the information required to meet the needs of analysts and investors.

For IFRS to be relevant and to allow investors and capital market participants to make 'economic decisions', the financial statements prepared in accordance with IFRS should first assist directors to oversee the affairs of the business. It is therefore in the 'public interest' for directors and investors to have access to financial statements that present an understandable and accurate assessment of the underlying financial position and performance of the entity. Unless the standards developed by the IASB result in financial statements that reflect commercial reality (rather than technical accounting theory) the objectives of the IFRS Foundation will not be achieved.

In this regard we recommend that the Trustees focus on ensuring that the IASB produces outcomes consistent with the Trustees objectives rather than substantially amending the objectives themselves. The current objectives of the IFRS Trustees will only be as effective as the extent to which they are *implemented* by the IASB in the development of IFRS. Effective oversight of the IASB to ensure that standards align with the objectives of the IFRS Foundation is essential.

While we are of the view that the current objectives are largely appropriate, we believe that achieving a 'single set' of high quality globally accepted accounting standards may not be possible. We note the Trustees' concerns that even if the standards are adopted universally there is a risk that practices related to implementation and adoption will diverge. However, having applied IFRS in Australia since 2005, it is becoming increasingly apparent that IFRS must be workable within the legal framework where it is applied, otherwise, conflicts between domestic law and accounting standards will be inevitable.

On this basis, unless there is recognition by the IFRS Foundation and governments worldwide that financial reporting standards are just one element in an equation that leads to good corporate governance, the desire for a 'single set' of standards without any small variations may in fact hinder, rather than enhance, corporate governance internationally. Jurisdictions should be able to adapt to the changing needs within their regulatory frameworks where necessary, without being unduly constrained by accounting standards that have been formulated without regard to the legislation, regulations and guidance existing in that jurisdiction. In certain circumstances, small variations to IFRS should be allowed, so long as jurisdictional variations are transparent to end users and made publicly available.

For example, suggestions for reforming and simplifying the remuneration reports in the annual reports of listed Australian companies have been impacted by the inability within this jurisdiction to make changes to any aspect of IFRS. In order for Australia to remain "IFRS compliant" definitions or standards cannot be amended by the Australian Accounting Standards Board, even if a view is taken domestically that such a change would facilitate improved disclosure to investors and enhance the corporate regulatory and governance regime.

The Trustees have also sought views regarding the interaction between financial reporting standards and other public policy issues such as financial stability requirements. The Australian Institute of Company Directors is of the view that the setting of public policy, particularly in regard to financial stability requirements is a task best reserved for the governments of States. IFRS should not be used as a mechanism designed to provide a solution for every issue arising as a result of the global financial crisis. As set out above, financial reporting standards are only one element in an effective corporate regulatory and governance regime. We therefore recommend that the IFRS Foundation refrain from extending its ambit to consider wider public policy issues and focus instead on ensuring that financial statements reflect commercial reality and provide useful financial information to directors, management and investors.

3. Governance: How should the organisation best balance independence with accountability?

The Australian Institute of Company Directors agrees that the independence of the Trustees from the political process is a strength and that governments should decide whether, and to what extent, they will apply IFRS. For this reason, we are view that at this stage, the Trustees and the IASB should operate independently from the political process.

From a governance perspective, we are of the view that it is important for the Trustees to perform a strategic role and to ensure that strong oversight of the IASB is occurring.

It is important that the governance arrangements in place make sure that the strategic direction set by the Trustees is actually implemented by the IASB. To achieve this, it is important that the Trustees have the ability, through the IFRS Foundation Constitution (Constitution) to effectively monitor and oversee the work of the IASB.

We note that amongst other things, the Constitution provides that the Trustees shall:

- review annually the strategy for the IFRS Foundation and the IASB and its effectiveness, including consideration but not determination of the IASB's agenda; and
- review broad strategic issues affecting financial reporting standards.

To ensure that the Trustees are effectively able to monitor the strategic direction of IFRS and perform their duties, we are of the view that the Trustees should be given the ability to approve the IASB's agenda and work program. At this stage, the Constitution only provides that the Trustees 'review' the strategic direction of the IASB. Similarly, the IASB is only required to 'consult' with the Trustees, it does not appear that the IASB is in any way required to follow the suggestions or recommendations provided by the Trustees.

It is unclear to us whether these arrangements are creating, what Australian directors perceive to be, the increasing disconnect between the objectives of the IFRS Foundation and the effectiveness of the actual standards developed by the IASB.

The objectives of the IFRS Foundation include; to produce financial reporting standards that are high quality, understandable, enforceable, globally accepted, transparent and that help investors and other participants in the world's capital markets to make economic decisions. Unfortunately, the recent experience of Australian directors in applying IFRS is that:

- IFRS is becoming increasingly complex;
- IFRS is continually changing;
- IFRS creates outcomes that are not commercially intuitive; and
- IFRS is an exercise in technical accounting that does not assist directors, management or investors to make economic decisions.

In recent years Australian directors have become increasingly concerned that the statutory profit figure arrived at by the application of IFRS does not reflect the directors' assessment of the result for the ongoing business activities of the company. To overcome this concern many Australian companies in addition to reporting a statutory profit figure also now include an 'underlying profit' figure in their annual report. To encourage companies to provide this non statutory information in a responsible and consistent manner, the Australian Institute of Company Directors and FINSIA published *Underlying Profit: Principles of Non Statutory Profit Information* in 2009. This is one example where Australian directors are of the view that financial statements produced in accordance with IFRS do not necessarily create an outcome that is commercially intuitive.

In summary, we query whether the IFRS Foundation's governance framework is working as effectively as it could be to prevent the disconnect described above and to achieve the outcomes intended. If not, we recommend that the Trustees look for ways to ensure that the work product of the IASB aligns with the strategic objectives of the Foundation.

4. Process: How should the organisation best ensure that its standards are high quality, meet the requirement of a well functioning capital market and are implemented consistently across the world?

We note that the Consultation Paper provides that: "the IASB must continue to demonstrate the quality and relevance of its standards to ensure global acceptance..." and "even as the standards are adopted universally there is a risk that practices related to the implementation and adoption will diverge."

We re-iterate our comments set out in section 2 above that there needs to be recognition that IFRS must work within the legal frameworks of each jurisdiction. For this reason, the objective to achieve a single set of globally accepted standards that is consistently adopted and implemented may not be possible. On this basis, we are of the view that in certain circumstances, small variations to IFRS may be appropriate so long as jurisdictional variations are transparent to end users of financial statements.

To ensure that the organisation produces standards that are of a high quality we are of the view that the tiered structure of the IFRS Foundation should involve at all levels, directors who are responsible for approving the financial statements of their companies.

Further, we are of the view that the IASB should focus on developing and improving standards for the reporting of only financial information (rather than the non-financial information commonly included in company reports). In Australia, the corporate reporting of non-financial information is comprehensively addressed by the Corporations Act 2001 (C'th), the ASX Listing Rules and the ASX Corporate Governance Council Principles and Recommendations. Standards or guidance produced by the IASB on non financial reporting issues may therefore overlap or conflict with existing legislation, regulations or guidance in these areas. This type of overlap can create confusion for preparers. An example of this occurred in Australia when the IASB released its guidance on *Management Commentary*. Our submission to the Australian Accounting Standards Board on the draft *Management Commentary* pointed out that many aspects of the 'guidance' were actually mandated in Australia by the Corporations Act (2001)(C'th) and required to be included in the Directors' Report of the company's annual report.

In summary, to ensure that the standards are high quality, relevant and credible we are of the view that:

- the standards must strive to reflect commercial reality;

- directors responsible for signing off on accounts prepared pursuant to IFRS should be involved in the standard setting process; and
- the development of IFRS and IFRS guidance should be confined to the reporting of financial information.

We hope that our comments will be of assistance to you. If you are interested in any of our views please do not hesitate to contact me on +61 3 8248 6600.

Yours sincerely,

L Watterson

per: Rob Elliott
General Manager Policy