Christian Aid submission to the IFRS Foundation Public Consultation on the Trustee's Strategy Review

Christian Aid welcomes the opportunity to comment on the IFRS Foundation Trustees' Paper for Public Consultation.

Christian Aid is the official development and relief agency of 41 churches in the UK and Ireland. We exist to help those in need – regardless of religion, ethnicity or nationality – working in around 50 of the poorest countries in the world as well as some of the emerging economies. We work not only to help those in immediate need but also to challenge the structural constraints to development. Christian Aid is a preparer of financial statements and a capital market participant, through its investment in corporate bonds and through its contributions to pension funds. In addition many of our 780 staff and 1.8 million supporters are investors through their pension funds and as individual shareholders.

Some of the information required to ensure that listed companies make an appropriate contribution to economic development and poverty reduction in developing countries is only available from the financial statements issued by companies. Some of our work requires us to monitor corporate governance and the financial activities of corporations, taxation issues and the compliance of companies with international standards and with the law.

As such, the strategic framework of the IFRS Foundation and its impact on the reporting of companies has a direct impact upon Christian Aid's work and that of our partner organisations, as we work towards the eradication of poverty.

Our responses to the specific questions posed by the Trustees in the public consultation document are set out below.

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

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?*

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We note that this excerpt from the Constitution (recently amended and effective March, 1, 2010) is part of a larger paragraph which explicitly refers to the *public interest.* The full paragraph, Objectives of the IFRS Foundation 2 (a) reads as follows:

"to develop, <u>in the public interest</u>, 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 <u>other users of financial information</u> make economic decisions."

We are of the opinion that the public interest will only be truly served if the IFRS Foundation:

- highlights the importance of 'other users of financial information' in its Constitution and;
- widens the objective of IFRSs beyond just decision-useful financial information needed to make 'economic decisions'.

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?*

For the Foundation to achieve its objective of making IFRSs <u>the</u> single, globally acceptable financial reporting standards, it is necessary that it defines the appropriate scope of IFRSs as:

(i) requiring all those kinds of financial disclosure that are needed for the public interest and can only be systematically, reliably and comparably produced through such standards, i.e. where data in the public interest can only be derived from the general ledger of the corporations subject to IFRS, this represents financial data for which the suitable medium for disclosure is the financial statements of the reporting entity and the IFRSs should be the mechanism to require this.

(ii) meeting the needs of the <u>range of users</u> of financial information that can only access systematic, reliable and comparable information needed to fulfil issues of public interest when it is required by such standards.

Unless the IFRS are seen to meet the comprehensive needs of the full range of user groups for financial statements, and require disclosure of all the information that can reasonably be expected to be included in financial reports to meet the public interest, pressure will arise on other regulatory mechanisms to deliver what the IFRS should be able to do. We do not see that the IFRS is interpreting its mandate in this way to date. This is resulting in continued fragmentation and contradiction in reporting standards, and undermining the importance of the IFRS.

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For example, with regard to point (i), we strongly endorse the view that it is part of the public interest role of the IFRS Foundation to include standards that contribute to financial stability. One key aspect of this is the role that corporate financial transparency can contribute to good governance, including appropriate financial management and corruption avoidance.

This clearly relates to fostering good corporate governance and reduction of risks for investors generated by weak company management or malpractice.

However, it is also a key area of public interest for corporate reporting to foster good governance by governments - the generation of information through company reports on transactions with governments can also shine the light of transparency on public management and corruption. By improving the accountability and performance of governments, this not only generates direct impacts for the public good (public interest), it can also foster stability and reduced operating costs for companies that in turn support higher and more stable returns for investors.

A concrete example of this relates to the call for new standards to require companies to report key financial information on a country-by-country basis. Initial work has focused on the extractive activities. Investors have supported this call because they see that such disaggregation will give them greater information to assess risks generated by exposure to different country contexts and possible corruptions risks.[1]

However, they have also stated their support because they see the value that such corporate reporting can contribute to generating country contexts in which improved local accountability supports better performance by governments, which in turn fosters predictable operating environments for their investments.[2]

Yet, the IASB have given limited consideration to wider public interest benefits that corporate transparency can generate, both for long term investor stewardship and the contribution to citizen well-being.

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[1] See, for example, Calvert's submission to the consultation on the Discussion Paper for Extractives Activities in 2010 – submission CL6.
http://www.ifrs.org/IASCFCMS/Templates/Project/LetterList.aspx?NRMODE=Published&NRNODEGUID=%7b3B065C30-2A40-488B-9D7D-9207F3089E0%7d&NRORIGINALURL=%2fCurrent%2bProjects%2fIASB%2bProjects%2fExtractive%2bActivities%2fDPAp10%2fCL%2fCL%2ehtm&NRCACHEHINT=Guest

[2] See, for example, F&C's submission to the consultation on the Discussion Paper for Extractives Activities in 2010 – submission CL139.
http://www.ifrs.org/IASCFCMS/Templates/Project/LetterList.aspx?NRMODE=Published&NRNODEGUID=%7b3B065C30-2A40-488B-9D7D-69207F3089E0%7d&NRORIGINALURL=%2fCurrent%2bProjects%2fIASB%2bProjects%2fExtractive%2bActivities%2fDPAp10%2fCL%2fCL%2ehtm&NRCACHEHINT=Guest

With regard to point (ii), we raise this approach because, although the Constitution includes reference to the needs of “other users”, in practice, the IASB has focussed only on those needed for “investor protection”, and perhaps even more, on filer convenience. The Board contends that meeting the narrowly defined needs of investors will automatically address the needs of these “other users”. We, as representatives of such “other users” do not find that this is the case.

In defining relevant “other users” it is helpful to look at reports of the UK's Accounting Standards Steering Committee in 1975[3] and the United Nations Conference on Trade and Development in 2008[4]. It is apparent that over that period, there remained uniformity in those considered to have an interest in the accounts of multinational corporations, who are as follows:

- The equity investor group (shareholders);
- The loan creditor group (banks and bondholders);
- The analyst-adviser group who advise the above groups;
- Business partners;
- Consumers;
- Employees;
- The business contact group;
- The surrounding community;
- Civil society organizations; and
- Governments and their institutions.

Using the example cited above of the call for country-by-country reporting requirements for extractive activities, we have been repeatedly informed by the IASB that only benefits to investors and analysts carry any weight in the judgments about what should be included in the possible new IFRS. The enormous impacts that this sector has on governments and surrounding communities, and the resulting focus of large amounts of watchdog work by civil society organisations, highlights in stark relief the inappropriateness of such a narrow definition of the public interest and user groups.

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[3] The Accounting Standards Steering Committee, *The Corporate Report: a Discussion Paper published for comment by The Accounting Standards Steering Committee* (1975). See particularly, Section One, paragraph 1.9. http://www.ion.icaew.com/ClientFiles/6f45ef7e-1eff-41ff-909e-24eeb6e9ed15//The%20Corporate%20Report2.pdf.

[4] UNCTAD, *Guidance on Corporate Responsibility Indicators in Annual Reports* (2008). See particularly the section, “Stakeholders and their information needs”, page 6. http://www.unctad.org/en/docs/iteteb20076_en.pdf

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In relation to the issue of country by country reporting referred to above, due to the lack of meaningful engagement from the IASB on this issue, civil society organisations and investors have turned their attention to other stand setting bodies.

In 2010, US legislators passed a new law requiring company- and project-specific reporting of payments to governments by all companies registered with the SEC. In the same year, the Hong Kong stock exchange also passed rules for country-by-country reporting of payments. These are different from the US listing rules. The European Commission launched a consultation on country-by-country reporting and will issue a formal Communication in September 2011. Both the French and the UK governments have come out in support of the need for mandatory country-specific reporting requirements for extractive companies to be set by the EU, as have the European Commissioners for Development and Trade. The Organisation for Economic Cooperation and Development is also reviewing this issue.

The result is that the IASB has been effectively by-passed because it has been so slow to respond and so weak in its recommendations – this, in turn, is partly related to its dismissal of the needs of users other than investors and the broader public good that such reporting would generate. To others, these benefits to the public interest are so clear that the issue has been made a priority and new requirements have been developed, overtaking the IASB as the standard setter. If this continues to happen, the very raison d'être of the International Accounting Standards Board and IFRS Foundation is at risk.

We recommend that the IASB engage with a broad range of stakeholders in a more meaningful way or risk undermining the objectives of the IFRS foundation.

<u>Governance: how should the organisation best balance independence with accountability?</u>

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

Please see the response to question 4, below.

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 the 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?*

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There are three main problems where we see the need for reform of the governance structure of the IFRS Foundation:

(a) The inappropriately narrow profile of the members of the IASB and the Trustees

As outlined above, the Constitution refers to a range of 'other users' of financial reports. Yet the profile of IASB and Trustees members is extremely narrow. We strongly recommend that representatives from the full range of users of financial information, as laid out in the bullet point list above, should be included in both bodies. Only this way will the institution be well placed to consider the needs of, and improve accountability to, its core users.

(b) The lack of public accountability of these bodies

We know of no mechanism by which these bodies open themselves to direct discourse on key decisions to representatives of each of the key user groups outlined above, as well as elected representatives. Individuals may attend meetings but only as silent observers. We recommend that each body hold public hearings on key issues, and that these are interactive and discursive, as other policy setting bodies do. The proceedings of these hearings should also be open and on the public record.

(c) The lack of formal political endorsement

We support the call for greater linkage to public authorities. However, this must be associated with genuine engagement, debate and accountability to be of value and not a 'rubber-stamping' exercise.

<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>

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?*

Please see the response to question 6, below.

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 argued above, the best way to ensure the quality of standards and their implementation is to ensure their usefulness in meeting the needs of the full range of users of financial

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reports in the public interest. Our experience of consistent engagement with the IASB for six years suggests the need for significant changes to improve:

(i) consultation with the full range of users, and inclusion of the costs and benefits to them all in the selection of priorities and the development of reporting requirements;

(ii) much greater engagement with actors in developing countries and emerging markets;

(iii) much greater speed of responsiveness – three years is too long for stakeholders to wait for a Discussion Paper and four years for them still not to have a decision on whether an issue is on the agenda for action.

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

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

We are of the strong opinion that it is not in the public interest to have the IFRS Foundation funded even in part by private corporate donations. We see this as generating a conflict of interest with preparers and those companies who derive their incomes by supporting the financial reporting of others. We rather see the need to move to public funding by all adopting countries to spread the risk of undue influence by a particular country. This should also allow longer-term financial stability.

We welcome this opportunity to respond to the IFRS Trustees Strategy review and consultation paper and look forward to seeing the important shifts outlined above that are urgently needed.

Any questions or further correspondence should be referred to:

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