The World Bank

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IFRS Foundation Trustees
30 Cannon Street
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UNITED KINGDOM

Dear Trustees:

Subject: Strategy Review

Please find attached the World Bank's response to the IFRS Foundation Trustees' Consultation Document: *Status of Trustees' Strategy Review*.

I would like to take this opportunity to place on the record, on behalf of the World Bank, my sincere condolences at the sudden death late last year of Tommaso Padoa-Schioppa. Tommaso had an enormous impact on the development of the IFRS Foundation, and the re-positioning of the IASB as the premier international financial reporting standards-setter. His influence on the organization will be his lasting legacy, and he will be greatly missed.

If you have any questions regarding this submission, or would like further information, please do not hesitate to contact me.

Sincerely,

Charles A. McDonough

THE WORLD BANK
COMMENTS ON THE IFRS FOUNDATION TRUSTEES' PAPER FOR PUBLIC CONSULTATION

The World Bank welcomes the opportunity to comment on the IFRS Foundation Trustees' Paper for Public Consultation.

The World Bank has an enduring commitment to the development of a single set of high-quality, harmonized international financial reporting standards. Good corporate financial reporting helps promote investment, develop capital markets, and thereby acts as an engine for economic growth. For this reason, we have supported the work of the IASC, the IASB and the IFRS Foundation for many years, in a variety of capacities.

This paper comes at a critical time for the medium-term prospects and ultimate future direction of International Financial Reporting Standards (IFRS), and it is therefore appropriate for the Trustees to be seeking constituents' views on the key questions of mission, governance, process and financing. However, several issues call into question the timing of this review:

- The IFRS Foundation Monitoring Board is undertaking its own review of the governance structure supporting IFRS, and has recently issued a Consultative Report for public comment. The Monitoring Board's review addresses issues that overlap with those of the Trustees' review, but will be completed only after the conclusion of the Trustees' review. It is unclear how the two reviews will be co-ordinated, and what steps will be taken to ensure consistency in the conclusions of the two processes. The absence of apparent co-ordination of the two reviews risks undermining the standing of the IFRS Foundation as a substantive and responsible organization in the eyes of key stakeholders. We would therefore strongly recommend further dialogue between the Trustees and the Monitoring Board, as soon as possible, to agree on the way forward.
- The second part of the Trustees' five-yearly review of the Constitution was completed relatively recently. That review touched on – directly or indirectly – many of the issues that are the subject of this strategy review. Respondents may therefore question the need for this review to follow so soon after the review of the Constitution.
- As the Paper notes, the US Securities and Exchange Commission (the SEC) is expected to make a decision in 2011 on IFRS adoption in the United States. Whatever the outcome, this decision will be of enormous strategic significance for the IASB and will in large measure influence its future direction. Accordingly, it might make sense for this strategic review, and the Monitoring Board's governance review, to defer reaching any final conclusions until the SEC's decision is known.

Notwithstanding these misgivings as to the timing and conduct of the strategy review, we have considered the four strategic fronts and questions, and our responses 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?

This section of the Constitution was most recently amended effective March 1, 2010, following the completion of Part 2 of the Trustees' review of the Constitution. We would agree with the notion that elements of the Constitution – especially those that touch directly on the activities of the IASB – should be subject to review more frequently than is envisaged under the Trustees' formal five-yearly review. But this should nonetheless be a structured process – the Constitution should not be considered to be a "living" document, subject to constant review and revision. Accordingly, we do not consider there to be a need to revise this section of the Constitution at this time – ten months after it was last revised.

That being said, it is our view that this excerpt from the Constitution, as well as Chapter 1 of the Conceptual Framework which contains broadly similar wording, should not limit the scope of the objectives of financial reporting to decision-usefulness. In our opinion, providing information that is useful in making assessments of issues of stewardship/accountability should also be acknowledged as one of the objectives of financial reporting.

We recognize that this set of issues was debated at length as part of the recent Constitution Review, and that different interpretations may be placed on the wording in the description of the objectives of financial reporting. Some argue that framing the objectives as currently drafted actually encompasses the provision of information that is useful in making assessments of management's stewardship. The opposing argument is that the term "decision-usefulness" in this context conveys a meaning that implicitly excludes stewardship. For clarity, we would suggest that there be specific mention of information useful for stewardship purposes in the definition

The need for this broader focus for financial reporting has become more compelling in the wake of the financial crisis. Defining the objective of financial reporting solely as decision-usefulness for investors and other capital market participants risks an over-emphasis on earnings, future cash flows and relevance (as a qualitative characteristic). Balancing this with a stewardship objective will mean that questions of risk management, historical information and reliability are not overlooked.

Clearly the two parallel perspectives are closely linked: investors are concerned with the quality of an entity's management; and any assessment of stewardship will have regard to earnings trends. But acknowledging the stewardship concept explicitly will ensure that those aspects of financial reporting that are of relatively greater interest to those concerned with stewardship[1], remain on the agenda.

Accordingly, when the Constitution is next revised, we would recommend that the objective of financial reporting, as currently defined, be broadened to embrace the concept of stewardship.

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 financial crisis was caused by the interaction of several complex factors, including: failures in financial regulation; the separation in many countries of macroeconomic policy-setting from the monitoring of financial stability; inadequacies in corporate governance and risk management; and fragmentation/lack of co-ordination in the global financial architecture.

It is clear that the lack of consistent financial reporting practices around the world is hindering the efficient operation of global financial markets, as well as the optimal functioning of the constituent parts of the global financial architecture. In this context, the single most important contribution the IASB can make to reconciling financial reporting objectives with broader public policy goals is to complete the current convergence program in order to deliver on the G20's call for a single set of high quality improved global financial reporting standards.

The primary focus of IFRS reporting, as currently defined, is on meeting the information needs of investors and other market participants. As we have outlined above, we are of the view that this should be defined more broadly, to embrace the concept of stewardship. Moreover, the perspectives of investors, potential investors, capital market participants and regulators are not necessarily mutually exclusive insofar as standard-setting is concerned. In our view, general purpose financial reports prepared according to IFRS should, as far as possible, be able to satisfy the needs of these various user groups.

We recognize that financial reporting – in a collective sense – is one of many factors that can have an impact on financial stability. Financial stability is a global public good: international financial reporting standards should be drafted in a way that minimizes the risk of exacerbating financial instability, whilst not diluting the decision-usefulness of financial information to investors and other users of financial statements.

[1] For example, related party disclosures, share-based payment, disclosures of alternative asset valuation bases, and recognition of unrealized gains and losses.

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

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?

This is a complex area that is difficult to address properly by means of a binary question such as this. In theory at least, the three-tier structure should be efficacious, given appropriate clarity around the following respective roles and responsibilities:

- The IASB runs the technical agenda independently.
- The Trustees appoint the members of the IASB and related Boards and committees, oversee strategy and operations, and ensure ongoing financing.
- The Monitoring Board appoints the Trustees and monitors their operations.

Given the relatively recent introduction of the Monitoring Board into the governance structure, it is a little premature to draw conclusions as to whether the arrangements, overall, are working well or not. We do have concerns as to the degree of apparent consultation between the Monitoring Board and the Trustees, as outlined above; and we comment further below on issues associated with the mandate, accountability arrangements and membership of the Monitoring Board. But in our view further time is required to bed down and refine the current arrangements before a well-informed conclusion can be drawn as to whether the three-tier structure remains appropriate.

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?)

In our view, the first of these concerns has some legitimacy. In order for the single set of global financial reporting standards to be successfully implemented internationally, the IASB's governance arrangements must have, and be seen to have, the confidence of public authorities.
According to the IFRS Foundation Constitution, the Monitoring Board is intended to provide a formal link between the Trustees and public authorities. This relationship aims to replicate, on an international basis, the link between accounting standard-setters and those public authorities that typically oversee the activities of standard-setters – recognising that the institutional arrangements for such oversight may vary between countries.

A typical set of arrangements is for a country's accounting standard setter to be overseen by its securities regulator (or equivalent). The latter is in turn subject to oversight by executive government, the legislature, or both. The Foundation's aim to replicate these arrangements on an international basis is not entirely effective in that the Monitoring Board is a largely self-governing organization, its Charter having been agreed by representatives of its member organizations[2]. Whilst individual Monitoring Board members may be accountable to their national authorities or the bodies they represent, the Board as a collective is not accountable to any organization or body. This is not an ideal arrangement for a body that is tasked with acting in the public interest.

In our view there should be formal political endorsement of the Monitoring Board, and appropriate accountability and oversight arrangements should be put in place for its operations. We therefore propose that the Monitoring Board and the Trustees should jointly enter into a dialogue with the FSB with a view to:

- Securing an explicit mandate for the Monitoring Board.
- Strengthening the existing governance arrangements by means of proposing an appropriate set of oversight arrangements for the activities of the Monitoring Board, as well as the appointment of its members.

We appreciate that the FSB is probably not an appropriate body to take on this oversight function, given its particular focus on stability issues. But it is nonetheless a good forum in which to initiate the debate, given that its membership is broadly representative of jurisdictions that have adopted or are converging with IFRS.

Consideration should also be given to expanding and making more representative the membership of the Monitoring Board, beyond the additions already planned. IFRS require financial information to meet the needs of investors, other participants in the world's capital markets and other users of financial information. Accordingly, the Monitoring Board membership should be representative of all three of these user groups – not just the investor community.

Provided that there is a more direct and transparent link to public authorities as suggested above, we do not regard the fact that the primary governance body is a private sector board of Trustees to be a particular problem.

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?

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?

Subject to one specific reservation (see below), in our view the standard-setting process is fit for its current purpose – which is to complete the convergence programme – and is

[2] In this respect, we observe that the Charter refers to "capital markets authorities" – by which it means securities regulators – rather than "public authorities" (the term used in the Constitution), which we interpret to mean legislatures or their equivalent – i.e., the bodies that are ultimately responsible for overseeing the activities of securities regulators in individual jurisdictions.

structured in a way that is likely to ensure the quality of the standards. The arrangements incorporate many elements of best practice: the IASB comprises the world's leading experts in the field, and is able to draw on the expertise of a highly capable staff.

We reiterate our objection to the "fast-track" procedure that was incorporated into the Constitution following the recent review. We see this as neither appropriate nor necessary: the "exceptional circumstances" under which a shorter exposure period might be adopted are not defined, and could be subject to misuse. We are concerned that external pressures on the Trustees to bypass or dramatically reduce the due process period below the existing minimum (30 days) could undermine the integrity of the process and the Board's reputation.

Notwithstanding our high degree of confidence in the standard-setting process, in our view it should be kept under constant review and subject to continuous improvement, drawing on emerging best practices from the standard-setting community around the world. In this respect, we support the current review of the Interpretations Committee; and we also encourage the Trustees to find ways to more effectively leverage the expertise of the IFRS Advisory Council insofar as the standard-setting process is concerned.

The question of whether the standard-setting process ensures an appropriate prioritization of the IASB work programme is less straightforward. As the Consultation Paper notes, since 2002 the work programme has been dominated by the intensive joint convergence programme with the FASB. Completion of this programme is the highest priority for the Board at this time. But this necessarily means that other important topics are on hold for the time being. Once the convergence agenda has been completed, there needs to be a thorough evaluation of the work programme - involving some public consultation - to determine the most important priorities for the medium-term. This evaluation should incorporate a survey of the capital markets landscape in the wake of the financial crisis, to identify any gaps in the coverage of IFRS.

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?

The IASB needs to be concerned about the quality of implementation of its standards, and responsive to emerging application and implementation issues, especially in light of the large volume of new standards that will become effective in the short to medium-term. That being said, the adoption and implementation of standards is primarily a matter for preparers, auditors and regulatory authorities in individual jurisdictions, and any application and implementation issues that arise from the adoption of IFRS should be dealt with locally as far as practicable. In this respect, we would suggest that the IASB partners with the network of national standard-setters so that the latter takes on the lead role in addressing application and implementation issues. For technical/interpretation issues that cannot be resolved locally, there will be a need for the Interpretations Committee to respond quickly as issues emerge.

The extent to which the Board (as opposed to the staff and/or the Interpretations Committee) responds to implementation issues, will require careful analysis and planning. The Board's comparative advantage lies in the development of standards, and as noted above there will be a full standard-setting agenda once the convergence programme has been completed. The risks in taking on an additional substantive role in the form of post-implementation reviews are that the combined work programme expands at an unsustainable rate; the urgent crowds out the important, and the standard-setting role suffers as a result.

It might also be useful for the IASB to work with national standard setters in those countries that have adopted the standards to identify best practices and challenges encountered, to use as a knowledge base for countries considering adoption.

There are two overarching strategic issues concerning adoption that the Board will need to remain concerned about as the standards are adopted on a global basis:

- Firstly, the issue of "false" adoption, which can take two forms:

    i. Firstly, where corporations assert that their financial statements comply with IFRS when they do not. In countries with a strong audit function this will be less prevalent, but in countries where capacity is less well developed it may be more of an issue.
    ii. Secondly, where a country elects to comply with IFRS, as amended/adapted to take account of jurisdiction-specific conditions - but which makes additional amendments to IFRS that are not only reflective of local issues[3]. Monitoring these situations is made more challenging in jurisdictions where the primary language is not English.

- Second, the enduring issue of financial reporting by small and medium-sized entities (SMEs), particularly in countries where the notion of general purpose financial reporting by private sector corporations is unfamiliar. We encourage the Board to maintain its focus on the specific issues and challenges for the SME sector. One of the practical issues many countries face as they adopt the SME standard (and also the main standards) is translation into the local language. A local-language version of the SME standard is arguably more important than for the main standards which are meant for public-interest entities whose financial statements are normally audited.

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

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

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[3] In these situations the financial statements may contain an assertion to the effect that they were prepared in compliance with "IFRS as adopted in country XX".

The financial situation of the Foundation is precarious, and a long-term solution needs to be found. We have noted above a suggestion that the Trustees explore the possibility of changing the existing governance arrangements in order to secure an explicit mandate for the Monitoring Board. Initiating a discussion with the FSB for this purpose would also provide an opportunity to explore options for securing a long-term funding base.

Given that, in countries that have adopted IFRS, securities market regulators have a vested interest in seeing that such adoption is genuine, and since the public-interest nature of the IFRS Foundation is now clearer with the creation of the Monitoring Board, it would also seem logical for the Trustees to seek the financial support of those securities market regulators, through a levy or grant system.