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

16 February 2011

Re: Status of Trustees' Strategy Review

Dear Sirs

The Roche Group has a turnover of CHF 47 bn. a year (EUR 37 bn.) derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs over 80,000 worldwide. We have a market capitalisation (end 2010) of CHF 118 bn. (EUR 95 bn.) We have been preparing our consolidated financial statements according to IFRS/IAS since 1990 and therefore have a substantial interest in how these develop, so we appreciate this opportunity to give input to the Trustees on future strategy.

You begin your "Paper for Public Consultation" with an assessment of the IASB's achievements since formation. Knowing where one is and has come from gives the starting-point for where one is going. We therefore think it important to critically examine this assessment.

The first reported success is the indeed astounding spread of international acceptance for IFRS. While we would not wish to diminish the efforts of the Trustees and the IASB to help bring this about, perhaps the development can also be assessed from a different angle. It does seem that, without the foresight and vision of European politicians and officials, none of this might have come to pass, and their contribution must not be underestimated. The improved transparency and comparability of the financial statements of EU-quoted groups might even be said to be owed as much to the EU institutions as to the IASB. It must also be borne in mind that the EU move was in fact founded not on IFRS but on the existing IAS, now so often denigrated by some members of the IASB but of sufficient standing and international acceptance even at that stage to commend themselves as a basis for financial reporting in the whole of the EU. With regard to those jurisdictions which subsequently followed the lead that the EU had set in motion, it can be argued that what was being bought was not specifically IFRS for themselves but whatever it was that had the greatest chance of international acceptance as a global standard.
Secondly one needs to consider the actual output of the IASB in its first 10 years. Here too we cannot entirely share the Paper's rosy assessment. Along with several other large Swiss multinationals, we (Roche) were already preparing our consolidated financial statements in line with IAS at the start of the 10 years, so we are in a good position to evaluate the developments which have taken place over the period. The early

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elimination of some options in legacy IAS brought certain advantages to users, and the joint efforts of both the IASB and the FASB to resolve the question of share-based payment led to a greater transparency in such transactions, even if there is much room for criticism of the relevant standard itself. Finally, the decade has seen an enormous increase in the disclosures required by IFRS: doubtless some of the additional information has been of help to users, even if there are many doubts about the relevance of much of the extra data and the costs and benefits of providing it – "layers of often irrelevant disclosure that have accrued over the years", as the Financial Times recently commented. This achievement was, however, at a certain price paid in terms of useful, helpful financial reporting standards for IFRS users at large.

What was the result of the IASB's strong focus on convergence in its programme?
- An immense amount of effort and political capital was expended on a converged approach to business combinations. The IFRS result, IFRS 3, was characterised by the Corporate Reporting Users Forum (CRUF) as "a retrograde step", and it was indeed more intellectually satisfying to theoreticians than practically useful for investors.
- At the same time and in the same context, the IASB started work on provisions which has still not led to any improved (i.e. more useful) standard: indeed, we very much doubt whether the project is at all necessary and fear that it might even lead to a more complex and less useful standard.
- A similar fate seems to have befallen the IASB's work on accounting for income taxes: this focused purely on convergence issues and unfortunately did not investigate the substantial long-standing weaknesses in present tax reporting from the investors' viewpoint, for which relatively simple disclosure solutions would have been easy to define.

In sum, a rather disappointing output. This convergence-dominated work programme has not overall produced better, more useable or more decision-useful financial reporting standards for IFRS preparers and users, and in some areas standards have even been made worse: new standards have often given rise to a subsequent stream of amendments and interpretations as a result. We strongly believe that this was due at least in part to a tendency to write standards which would find favour with US authorities for whom the reporting environment is in many ways different from that of jurisdictions actually using IFRS. Apart from this we note also the tendency for the IASB to look at high-quality standards as an end in themselves. They are not. They are only a means to an end, to provide information to help participants in the world's capital markets make economic decisions, and it is the markets which are the final arbiters of "high-quality" – which they will do in terms of decision-useful information – not the IASB.

So where do we go from here?

For the immediate future we need to see two new focal points in the IASB's strategy, namely ***a capital market-oriented, evidence-based approach to standard setting*** and ***a focus on developing high-quality standards instead of on convergence.***

A capital market-oriented, evidence-based approach to standard setting

We have mentioned above what we perceive as the IASB's tendency to treat the standards as if they were an end in themselves. The Board has often appeared to make the assumption that the development of a conceptually consistent set of standards following a certain vision of an ideal accounting system was what was being called for, doubtless in the sincere belief that this could indeed help the capital markets. However, this does not appear to us the right approach for the markets: the key must be standards that work and produce decision-useful information which is more valuable to real, active users than the costs of producing and using it. The emphasis must be on meeting the practical, straightforward needs of market participants for decision-useful information, based on evidence of existing issues, not fundamental changes in the nature of the accounting model.

However, identifying users' needs in a way that adequately represents the large population of investors and other capital market participants has sometimes proved challenging for the IASB, as for the FASB. Sometimes, a variety of views are expressed, though there are generally sufficient areas of consistency for overall conclusions to be drawn. Hence it represents an unsatisfactory legitimisation of IASB proposals when these are presented as "what users want" although they do not align with what we hear directly and consistently from the investors with whom we are in regular daily contact. Similarly we often cannot relate to views put forward by bodies as being representative purely on the basis of their membership numbers or of large surveys with very low response-rates, but the IASB appear to have favoured such input – and thus ended up with inappropriate standards. One example of this is in the Exposure Draft on Presentation of Other Comprehensive Income in which the IASB claimed that a single statement of comprehensive income had "overwhelming support" from users, while we were unable to ascertain any particular enthusiasm for a single statement among our own investors. A second example is in the staff paper on Financial Statement Presentation where a direct cash flow statement was claimed to be promoted "on the basis of input from users", while our user contacts were in no way pressing for such a change, in fact rather the opposite. The IASB's future standard-setting process must be supported by a substantial improvement in the systematic and credible identification of investors' and other capital market participants' financial reporting needs.

A focus on developing high-quality standards instead of on convergence

Used, or shortly to be used, as the basis for financial reporting in so many important jurisdictions in the world, as the IASB's well-known map shows, IFRS are now the only realistic candidate to be the globally accepted single set of financial reporting standards. A single set of global high-quality standards already exists, to which one particular national jurisdiction has not yet felt able to subscribe. The future focus of the IASB should reflect that fact, concentrating on developing high-quality standards to help capital market participants make economic decisions, in the interests of its constituents and the jurisdictions applying IFRS.

Even at the G20 level there appears to be much confusion between convergence and high-quality standards. As we have already mentioned, the standards development through the convergence process followed up until now, primarily as a converging of IFRS and US GAAP, has not led to significant positive improvements in standards for us and our investors as capital market participants. The convergence strategy adopted has absorbed very significant amounts of IASB and staff resources, deflecting the Board's attention away from projects which might have brought greater practical improvements in IFRS. Recent standards have given rise to increased complexity and persistent change to accounting standards which have already caused appreciable additional costs with little sign of a pay-back.

Moreover, while acknowledging that appreciable convergence has already been achieved, we have serious doubts whether, under present circumstances, further convergence is desirable or realistically achievable in the short term, at least in a manner such as to positively support capital markets applying IFRS.

- Firstly, there is a large question mark over the US authorities' willingness to co-operate in a way which we would find acceptable. For example, despite the fact that world political leaders in the G20 have requested the IASB and FASB to produce a single, converged standard for financial instruments, the FASB unfortunately felt unable to comply but, rather than in a co-operative spirit, launched their own Exposure Draft in competition with the IASB's work and with a fundamentally different conceptual basis. This lack of agreement between the IASB and FASB on a common solution demonstrates how the convergence strategy, while attractive in theory, is at present extremely difficult to put into practice, even with immense political

encouragement. As in several other cases the lack of ability or willingness on the part of the FASB to embrace convergence in a cooperative fashion unfortunately even threatens to create new divergences rather than eliminate existing ones. Similarly, in the FASB's Exposure Draft on Financial Instruments, IFRS are described implicitly as inferior to US GAAP because they are "less developed": if by "less developed" is meant less voluminous, less complex and more understandable, we concur – but not with the conclusion that IFRS are therefore inferior to US GAAP. Also, the SEC is on record as not being happy with having US standards made in Europe: many other jurisdictions were also reluctant to surrender their standard-setting but were finally able to put aside that reluctance in the interests of the capital markets. We can therefore only assume that an SEC decision in 2011 to adopt IFRS for domestic filers would be based on the presumption that IFRS would be developed along US-GAAP lines and with dominant US influence. For us such a one-sided approach would be quite unacceptable.
- Secondly, there appear to us to be fundamental peculiarities in the US environment which seem to be basically incompatible with other jurisdictions. For instance, we note the need in the US for clear rules (e.g. "black lines") to reduce the threat of litigation, rather than use of judgment, and the absence in the US of the same degree of pragmatism as in Europe - where "as much as necessary, as little as possible" to achieve the end is a central tenet. In common with other European companies, we have incurred considerable costs as a result of the greater complexity and persistent change arising from various convergence projects. If the IASB's convergence strategy were continued, those costs would be likely to further mount: we would regard this as an unacceptable burden.

But what would be the benefit from continuing the convergence strategy to offset these costs? Naturally it would be preferable for both preparers and users if there were one single set of standards worldwide. We wonder, however, whether a situation in which US GAAP in the US and IFRS in the rest of the world continue a little while longer to co-exist – as now – is actually quite satisfactory for the next few years. Many of the potential benefits of convergence have already been achieved: compared to 10 years ago, the multitude of diverging national standards has in effect reduced to two, which does not at present seem to be giving preparers and users at large significant problems; many of the US GAAP/IFRS differences have already disappeared; and the SEC has finally accepted that IFRS are of sufficient quality for foreign private investors (FPIs) to use IFRS financial statements without reconciliation to US GAAP net income and equity. The cost of eliminating the remaining differences for full convergence appears to us disproportionate with any benefits for us and for most European companies not involved in the US capital market. So long as the world's capital markets can operate effectively with two sets of standards reflecting those different environments, which they patently already can, would there be any major benefit to further forced convergence at this stage? As so often the best may be the enemy of the good.

In the appendix we give our responses to the specific questions raised in the consultation paper.

Sincerely,

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APPENDIX

<u>Responses to the specific questions asked in the Paper for Public Consultation</u>

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

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?

The only revision which we would advocate is that the phrase "… to help investors … make economic decisions." should be heavily highlighted, to stress that IFRS are not an end in themselves but only a means to an end. Please see also our covering letter.

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 capital market participants' economic decision taking, financial reporting must reflect economic reality in a practical and understandable way. In many areas that reporting is also quite sufficient for regulators and others with an interest in financial stability. In other areas where it is not sufficient the regulator must mandate *separately* the additional disclosures he requires and not use – or rather abuse – the financial reporting system as a crutch for his own purposes, as many "special interest" groups seek to do.

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?

A long-standing problem has not been the organizational structure of the governance but how the governance arrangements are "lived". In the future we would hope to see the Trustees and the Monitoring Board being much more strongly active in carrying out their supervisory roles. A few specifics:

- In particular an active role in the agenda-setting procedure independent of the Board is urgently necessary to avoid misdirection of resources into fixing things that are not broken and ensure concentration on the absolutely key focus on generating information to help capital market participants make economic decisions.

- One might also imagine a far more active role for the Trustees in situations where a significant number of respondents strongly reject Board proposals but the Board wishes to push ahead regardless without demonstrating how the proposals can generate more decision-useful information.
- The Trustees need in addition to be firm in ensuring that meaningful impact studies and cost-benefit analyses are carried out before a project is taken on to the agenda as well as re-assessed during the course of a project. Such assessments must be made public with the opportunity for constituents to give input. Further, although we realize that it is resource-intensive, we also recommend the Trustees to encourage the Board to expand field-testing to ensure the practical feasibility and usefulness of proposals before they are cast in stone. This could also form part of due process governance.

All that said, we must commend the Board for their recent strenuous efforts at increasing outreach on certain crucial projects: we hope that the results of these activities will find their way into making the final products more useful for the capital markets.

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?

The necessary further steps are outlined in our response to the previous question, with emphasis on agenda-setting and on existing organs doing what they are supposed to do.

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?

See our response to question 3, especially on agenda-setting and situations where there is substantial opposition to individual proposals.

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?

Quite clearly, somebody should or will – as we have seen in the EU – though many of the issues will resolve themselves with time. However, we are not sure that it is the IASB which should carry out this role.

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 a governance reform, to ensure more automaticity of financing?

We are strongly opposed to automaticity of financing. Rather we would like to see the system linked to the agenda-setting where only projects for which solid evidence of practical need and net benefit is presented receive financial support - what could be termed a zero-base approach.

Other issues

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

Please see our covering letter.