EUROPEAN COMMISSION
Internal Market and Services DG

Director General

Brussels, 23 February 2011 Ares(2011)209337
DG MARKT F3/AFM/ab (2011) 222254

IFRS Foundation
To the Trustees
30 Cannon Street
London EC4M 6XH
United Kingdom
E-mail: strategyreview-comm@ifrs.org

Re: Trustees' Strategy Review

Dear Sirs,

The IFRS Foundation published on 5 November 2010 its paper "Status of Trustees' Strategy Review" for public consultation.

I appreciate the opportunity to provide input to the strategy review.

Our detailed comments on issues raised in your consultation paper are set out in the appendix to this letter. They represent the response from the European Commission services, with input from the European Parliament and Member States of the European Union.

I would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Jonathan Faull

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Annex : Comments from the European Commission services, with input from Member States of the European Union and European Parliament

Comments from the European Commission services, with input from the European Parliament and Member States of the European Union, to the Trustees' Strategy Review

Introduction

The Trustees have recently launched a number of exercises that have a bearing on the IFRS Foundation's future strategy, including:

- a comprehensive review of the International Financial Reporting Standards (IFRS) Foundation's strategy (consultation document issued on 5 November 2010);
- a review of the effectiveness of the IFRS Interpretations Committee (questionnaire issued on 2 November);
- a review of the IFRS Advisory Council (announced as part of the conclusions of the Constitutional review on 15 February 2010; the Advisory Council has also carried-out a self-assessment).

The IFRS Foundation's Constitution also foresees that the IASB must launch a public consultation about its technical agenda no later than 30 June 2011.

There are various inter-linkages between these different processes, which can therefore not be treated in isolation. For example, the conclusions of the strategy review may have important implications for the overall direction of the IASB's technical agenda, as well as for the roles of both the IFRS Interpretations Committee and Advisory Council.

It would be useful if Trustees could clarify how these different processes will be coordinated.

In addition, the Monitoring Board is currently conducting a review of the IFRS Foundation's governance. The Monitoring Board Working Group has issued a draft report for public consultation on 7 February 2011. In this context, it would be unfortunate if the Trustees took decisions about the organisation's future strategy and/or governance before they have had the chance to consider the recommendations that will result from the Monitoring Board's review.

It is therefore crucial that the comprehensive review of the IFRS Foundation strategy and the Monitoring Board exercise run in parallel and lead towards an integrated action plan to implement the necessary reforms.

In light of the abovementioned context, the rest of this paper should be seen only as a preliminary contribution to the general issues raised in the Trustees' consultation document. It does not attempt to respond in detail to each of the questions raised by the Trustees. Moreover, this paper will focus on **due process** issues. It does not address questions related to the accountability of the IASB (composition and role of the governance bodies), which are covered in the IFRS Foundation governance review carried out by the Monitoring Board.

(1) Overall assessment of the IFRS Foundation

All jurisdictions that have independent accounting standards setters have some means of creating independence but without removing accountability. The current governance model, institutional structure and procedures of the IFRS Foundation are based on those of the US Financial Accounting Foundation (FAF), the parent body of the US Financial Accounting Standards Board (FASB). In essence, this governance model is based on an independent standards-setting board composed primarily of full-time technical experts, overseen by a Board of Trustees whose primary purpose is to insulate the standards-setter from external pressure and hence maintain the quality of standards set. In addition, the Sarbanes-Oxley Act of 2002 introduced a stable, non-voluntary funding arrangement.

The FAF's governance model is primarily intended to guarantee the independence of the FASB, including full discretion over its technical agenda. However, there are both formal and informal constraints on the actions of the FAF and of the FASB. From a legal point of view, the SEC (and the US Congress) maintains its statutory authority to adopt accounting requirements. It may therefore reject or override standards adopted by the FASB. This is however a very unusual occurrence (as it is in other jurisdictions with independent standard setters), largely because the SEC and FASB have extensive informal interactions at staff and leadership level that, as a purely practical matter, inevitably influence the FASB's standards-setting work; senior staff of the SEC and FASB has referred to the relationship between the two organisations as a policy of "no mutual surprises." These features, i.e. mainly informal cooperation backed by a credible threat of sanction, are essential – though partly uncodified – elements of the FASB's governance model and of its accountability towards US authorities.

The IFRS Foundation's governance model has adopted the formal aspects of the FAF's governance model. However, this model appears not to be fully suitable for the legal and political context in which an international standards-setter operates. First, as a growing number of countries adopt IFRS, the ability of individual jurisdictions to use an *ex post* override by not adopting an international accounting standard is constrained. Moreover, the partial or full rejection of an international accounting standard by individual jurisdictions is inconsistent with the objectives of a single set of international accounting standards, i.e. the creation of a global level playing field and the global integration of capital markets. Such an *ex post* override can therefore not act as the sole "safety valve" within an international system. Second, for purely practical reasons, the IASB cannot replicate the close informal cooperation that exists between the SEC and the FASB in its own relations with the multitude of jurisdictions that apply, or are converging towards, international accounting standards. The governance of the IASB has therefore not incorporated the uncodified elements of the FASB's governance model.

Europe therefore expects a stronger formal accountability of the IASB and higher weight of public authorities in its governance and oversight. Furthermore, there is certainly a need for a wider range of nations, particularly emerging nations, to be engaged in the governance of the IFRS Foundation, including at the Monitoring Board level. This should assist both in improving accountability and the diversity of views presented. On the other hand, jurisdictions not applying IFRS or not moving in this direction at the speed expected should see their relative influence in the standards setting process decrease.

(2) Options for the future

The preceding analysis has implications for all the issues raised in the consultation document and suggests the need to incorporate more formal *ex ante* checks and balances in both the governance framework and due process to reflect the *sui generis* context in which the IASB operates. However, as already said in the introduction part, this paper will focus on **due process** issues and will not address questions related to the accountability of the IASB, which will be covered by the Monitoring Board Working Group in charge of the IFRS Foundation Governance Review.

<u>Mission</u>

We suggest that *legitimate public policy objectives must be given appropriate consideration ex ante in the standards-setting process*, while recognising that the primary objective of accounting standards is to deliver decision-relevant information to investors, other participants in the world's capital markets and other users of financial information. A key challenge is to ensure that the IASB's mission of producing high-quality accounting standards should not undermine other important policy objectives. These include prudential regulation or financial stability. For example, accounting standards should not induce excessive risk taking behaviour and must provide an accurate representation of preparers business models. This may imply a revision of the respective provisions in both the IFRS Foundation's constitution and in the IASB's conceptual framework in order to give due consideration to legitimate public policy objectives, including a revision of the current definition of the public interest within the Constitution of the IFRS Foundation.

<u>Governance</u>

Not under the scope of this contribution (see above).

<u>Process</u>

While we acknowledge that the Board has recently made significant efforts to improve its outreach activities, the *participation of all relevant stakeholders, including relevant regulatory and supervisory authorities, in the agenda-setting and standards-setting process should be further improved.*

In addition, we suggest that the IASB should develop a more robust due process, in particular through systematic use of impact assessments (cost-benefit assessment) at an earlier stage of the standards-setting process. The objective of such impact assessments is to achieve greater transparency about the technical choices faced by the standard-setter <u>before</u> decisions are taken to adopt a specific solution in the final standard.

While we recognise that developing an appropriate methodology for such impact assessments presents practical challenges, this is not a reason to settle for the *status quo*. We think that there is a real need to assess, quantitatively wherever possible, the relative costs and benefits that would flow from the standards proposals. More importantly, this assessment has to be made far earlier in the standards-setting process than is the case today. For example, a preliminary effects assessment could be issued together with the Exposure Draft so that both the content and the possible impacts of the proposed Standard would be subject to consultation. The impact assessment could then be updated in light of any changes incorporated in the final standard. In the absence of an ex ante assessments, the robustness of the IASB's due process and the quality of the standards that will ultimately be adopted may both be called into question. We strongly encourage the Trustees to establish a process to expeditiously define an operational methodology for impact assessments in order to ensure the acceptability of its standards. We note that the European Financial Reporting Advisory Group has recently issued a consultation document on "Effects studies" that could provide a first contribution to the development of such a methodology, that needs to be further defined. The services of the European Commission are also available to share practical experience with the IASB about the implementation of impact assessment in other sectors and to assess their applicability in accounting standards-setting.

A key requirement of such an impact assessment process should be to demonstrate that current accounting rules do not (or no longer) meet the needs of users and to demonstrate that the proposed solutions result in a tangible improvement in the quality of accounting information without imposing disproportionate costs on preparers and users of financial information and without negative impact on the economy in general. This would also imply that the rate at which standards are amended would in all likelihood slow down, resulting in greater stability and comparability of financial information.

We agree that the IASB should pay greater attention to issues related to the consistent application and implementation of its standards. Key issues for reflection in this context are the *role of the IFRIC and of post-implementation reviews* to identify areas in which implementation issues arise. However, IFRS should remain principles-based standards.

Funding

The Trustees have made progress over the years to diversify the IFRS Foundation's funding base but questions remain about the appropriateness of both the level and sources of this funding.

In our view, this highlights the need for a stable, non-voluntary funding model that provides resources commensurate with the IASB's tasks. This issue is addressed in the consultative report on the review of the IFRS Foundation Governance published by the Monitoring Board.

As a general principle, participation in the governance of the IFRS Foundation could also be linked to funding and to the legal application of international accounting standards.

Other issues

As the consultation document notes, the next 18 months will be critical in determining whether the goal of a single set of globally accepted standards is achieved. The SEC's forthcoming decision about the incorporation of IFRS in the US financial reporting system is fundamental in this context. However, the quality of standards should remain the primary driver of the IASB's work.

In our view, convergence is not an objective on its own but only a means to facilitate the adoption of a single set of globally-accepted accounting standards, in line with the G-20 recommendations. However, convergence cannot be a never-ending process. Moreover, convergence between IFRS and US accounting standards imposes costs on EU companies that are increasingly difficult to justify without a firm commitment by the US to IFRS. Consequently, following the completion of the current convergence agenda, the IASB should focus on providing high quality standards meeting the needs of those jurisdictions that apply IFRS.

The winding-down of the IASB-FASB convergence program, combined with a more rigorous agenda-setting and due process, should in practice lead to a reduction in the pace of the IASB's standards-setting activity. This should enhance stability and comparability across time of financial information produced on the basis of IFRS, which should benefit all users of this information – investors, preparers, regulators, etc.