BUSINESSEUROPE

THE DIRECTOR GENERAL

Trustees of the IFRS Foundation
IFRS Foundation
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Dear Sirs,

BUSINESSEUROPE commends the Trustees of the IFRS Foundation for launching a comprehensive stakeholder consultation on the Foundation's strategy review. The review is timely and appropriate as 2011 will mark a major transition in the development of financial reporting for European capital markets.

After 10 years with relatively constant core membership the International Accounting Standards Board (IASB) will see several new faces, including the chairman. The year will also mark the end of the IASB's accelerated programme to make international financial reporting standards (IFRS) ready for possible adoption by the US. Moreover, it will mark the end of the present Memorandum of Understanding between the IASB and the US Financial Accounting Standards Board (FASB).

This constellation of events will provide a rare opportunity for re-setting the strategy for developing international financial reporting standards for several years to come, and we strongly urge the Trustees to form that strategy.

To properly serve the future needs of European capital market participants, a substantial change in the strategic direction of standard setting is in our view essential at this point. We see two key focal points in such a change of direction:

- ***A capital-market-oriented, evidence-based approach to standard setting*** – focusing purely on those areas of financial reporting where capital market participants, and investors in particular, perceive there to be an issue with scope for improvement. The last 10 years have seen a complete change of landscape in the relevance and application of IFRS in the world, particularly with their adoption by the European Union and the subsequent domino effect of other major capital markets following suit. However, as far as the financial reporting standards themselves are concerned, the yield in terms of more decision-useful information has been somewhat disappointing, partly due to concentration on the convergence process (discussed below) at the expense of the practical needs of capital market participants. This has been despite the

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considerable efforts of BUSINESSEUROPE to help the IASB understand their practical needs and constraints.

- ***Focus on developing high-quality standards instead of on convergence*** – as we explain below, we believe that the convergence process followed hitherto, primarily between IFRS and US GAAP, has not led to significant positive results for European capital market participants (with the exception of the relief from the burden of reconciliation for the small number of – admittedly important - US-listed companies.) Although much convergence has already been achieved, the process now needs to be suspended, at least for the moment in its present form. 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 become the globally accepted single set of financial reporting standards.

The focus of the IASB should reflect that fact, focusing on developing high-quality standards to help capital market participants make economic decisions, in the interests of its constituents and the jurisdictions applying IFRS. We suggest that this is also explained at G20 level. In their deliberations on accounting for financial instruments following the financial crisis, the world's political leaders appeared to confuse convergence with high-quality standards and not to appreciate that there already exists one single set of global standards, to which one particular national jurisdiction has not yet felt able to subscribe. The immediate focus in this particular context needs to be on improving IFRS on financial instruments, not on convergence – and as soon as possible rather than waiting for the end of 2011. While we still support convergence as a long-term aim, we do not see closer convergence as realistic at present without negative consequences for the quality of standards and their appropriateness for European capital market needs.

We trust that the Trustees will be able to play an active and constructive role in ensuring that such a change of strategic direction based on these two focal points indeed comes about.

Please see the appendix for a more extensive discussion on these and also the other issues raised in the paper for public consultation.

Yours sincerely,

p.p.

Philippe de Buck

APPENDIX: TRUSTEES' STRATEGY REVIEW

Introduction

The years since the formation of the IASB have been astonishing, to say the least. At the start it was scarcely credible in most circles that the standards which the IASB produced would come to dominate the world financial reporting scene within a decade. The IASB put considerable effort into taking account of the specific circumstances of individual jurisdictions interested in adopting IFRS while not eroding its basic principles. In particular, the development of IFRS 1, First-Time Application of IFRS, simplified immensely the transition to IFRS from existing national standards for 7,000 European firms.

Yet it may be speculated 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 massive advantages in improved transparency and comparability enjoyed by users of the financial statements of EU-quoted groups might even be said to be owed to the EU institutions rather than 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 unjustly 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 jumped on the bandwagon which the EU had set in motion, one must also congratulate the IASB on its willingness to work together with local jurisdictions to smooth transition, but here also one cannot escape the possibility 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.

In the latter half of the decade the IASB became increasingly focused in its standards development on working towards obtaining US adoption of IFRS and therefore on converging IFRS and US GAAP. It did indeed achieve the elimination of the SEC's US-GAAP reconciliation requirement, which was warmly applauded by those European groups with a US listing and not reporting under US GAAP. The early elimination of some options in legacy IAS brought certain advantages to users, and the joint efforts of both Boards 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, despite the many doubts expressed about the relevance of much of the extra data and the costs and benefits of providing it.

This achievement was, however, at a certain price paid in terms of useful, helpful financial reporting standards for IFRS users at large. What else was achieved through this strategy of convergence? An immense amount of effort and political capital was expended on a converged approach to business combinations. The IFRS result, IFRS

3, which has had to be revised and fixed several times since issuance, was characterized by the Corporate Reporting Users Forum (CRUF) as "a retrograde step", and it was indeed possibly more intellectually satisfying to theoreticians than practically useful for investors.

At the same time and in the same context, the IASB started work on revising IAS37 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 may 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, which 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.

Convergence also resulted in a copy-paste exercise in connection with segment reporting and the issuance of an IFRS that had to include the Basis of Conclusion of the "original" FASB pronouncement.

Since the financial crisis, world political leaders in the G20 have requested the IASB and FASB to produce a single, converged standard for financial instruments. Recently, with the June 2011 deadline in mind, the IASB undertook an ambitious work programme for completion with respect to almost all fundamental aspects of accounting (Revenue Recognition, Leases, Financial Instruments, and Consolidation). We believe that there is a risk that such a comprehensive exercise will not result in high quality standards. Constituents are under significant pressure to provide input on fundamental accounting questions with insufficient time to consider all relevant consequences of proposed changes.

Indeed, overall, the output from this convergence-dominated work programme has not been better, more useable or more decision-useful financial reporting standards: new standards have often given rise to a subsequent stream of amendments and interpretations as a result. This may be at least in part due 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 (see also below.)

Following the request of world political leaders in the G20 to produce a single, converged standard for financial instruments, it is most unfortunate that the FASB has felt unable to comply but, rather than in a cooperative spirit, has launched its 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. There have also been instances where the IASB has foregone an opportunity to adopt a converged approach. We have been encouraged by signs in recent weeks that some change of attitude - at least in the FASB – towards a somewhat less dogmatic approach may have begun, and we will watch developments with interest.

Overall, while we can continue to support convergence as a long-term process, the convergence strategy adopted has in our opinion absorbed very significant amounts of IASB and staff resources, deflecting the Board's attention away from projects which would have brought greater practical improvements in IFRS for the benefit of European capital markets. For most European groups the convergence agenda has 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.

Defining the public interest
For the immediate future, the IASB strategy should firstly focus on ***a capital-market-oriented, evidence-based approach to standard setting.***

According to the IFRS Foundation's Constitution the first objective of the IASB is:

> *"to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted 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."***

In the previous version of the Constitution the highlighted phrase was actually part of the main sentence of the objective. Though perhaps producing an inelegantly long sentence, the original wording did better emphasise the purpose of the standards, that they were a means to help capital market participants. Although the change seems relatively minor, it does seem to characterise the IASB's increasing 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. Various user presentations to the Board have clearly identified what is needed, and this is frequently difficult to relate to the Board's agenda. These are practical, straightforward needs of market participants for decision-useful information, based on evidence of existing issues, not requests for fundamental changes in the nature of the accounting model.

A precondition for such a capital market-oriented strategy in standard setting is that clear indications of users' needs can be ascertained. However, it appears to be challenging, for various reasons, to pull together assessments of views adequately representative of the large population of investors and other capital market participants. One should be mindful that the term "users" is not synonymous with "analysts" in view of the fact that the needs of users can differ significantly.

Apart from the difficulties involved in activating otherwise very busy people to participate in debate, there is often diversity in the views which are expressed, with the responses on the Exposure Draft on Leases being a recent example. However, there are generally sufficient areas of consistency for overall conclusions to be drawn. Hence it represents an unsatisfactory legitimation of IASB proposals when these are presented as "what users want" although they do not align with what our preparer members hear directly from the investors with whom they are in regular daily contact or, for instance, with the simple empirical evidence provided by the interview-based investor surveys such as those carried out in recent years by PwC.

Similarly we often cannot relate to views advocated by bodies which are assumed to be representative purely on the basis of their membership numbers or to the conclusions of large surveys with very low response-rates, but the IASB appears to have favoured such input – and thus has ended up with inappropriate standards. One example of this is in the staff paper on Financial Statement Presentation where a direct cash flow statement is claimed to be promoted "on the basis of input from users", while most of our members' user contacts view it as far from clear that simply switching to a direct cash flow approach would solve the existing problems with the IAS 7 cash flow statement.

The IASB's future standard-setting process must be supported by a substantial improvement in the systematic and credible identification of European investors' and other capital market participants' financial reporting needs.

Financial reporting involves first and foremost two primary parties: the users, to whom we have referred above, and the preparers. To effectively achieve their objective of generating and communicating decision-useful information, financial reporting standards must be set in consideration of the needs of both primary parties. Currently, preparers are not considered to be users of financial statements. And yet, reporting entities and management are in fact the main users of accounting information. This information, and the financial statements which are derived from it, are key elements both in management's decision-making process and in communication between management and investors and analysts. Consequently, preparers are extremely well positioned to judge the quality of standards and assess whether they measure performance in a way that is useful for both management and analysts.

The primary objective of financial reporting standards should be to represent the performance of the entity in a way which is understandable by management and users alike and thus will enhance communication. BUSINESSEUROPE thus suggests that the Constitution explicitly refers to reporting entities as users of financial information whilst setting out that their interests are taken into account without privileging those of other users.

Lastly, the objective of achieving global, regional or national financial stability should not be an objective for financial reporting. If this were to be the case, there would be a risk of political intervention or the exertion of pressure on the IASB to solve perceived problems of financial stability or other related problems. BUSINESSEUROPE believes that such an objective would not lead to financial reporting of high quality.

Governance
The IFRS Foundation's current governance structure should be maintained. It is also important that the IASB remains independent.

Having said this, BUSINESSEUROPE believes that more Trustees should be from a preparer background and that the role of the Trustees should be enhanced as described hereafter.

The body of Trustees should ensure that the IASB's agenda is fixed only after proper consideration of all the relevant views. In our view, the current agenda was set without adequate consultation and without the consensus of all stakeholders. It places too much weight on the convergence with US GAAP and too little weight on the needs of current users of IFRS (as defined broadly above).

It should also be able to challenge the current situation in which IASB projects are based on an evolving Conceptual Framework which we think has been modified without prior consultation of, and support from, stakeholders and without adequate debate about the underlying principles. The Trustees should be more involved in these matters, setting the objectives and key due process, and be involved in the agenda-setting process through ensuring that the appropriate selection criteria have been rigorously applied, e.g. only evidence-based items which improve decision-useful information. The Board should ensure that this is put into practice and account for that to the Trustees. For new standards or revisions to existing ones, the Board should explain to the Trustees the major approach for the project, the objectives and reasons for it and the underlying principles. The Trustees should validate the justification of the project.

The Trustees should have a right of oversight to ensure that the spirit and letter of the "due process" procedure have been respected, that proper account has been taken of the responses received from all constituents and that decisions made by the IASB are based on a robust rationale.

Regarding the Monitoring Board, BUSINESSEUROPE believes that this Board should be more involved in the decision to appoint the IASB Chair and be able to reject an appointment. It should also oversee other governance matters and issues regarding the Constitution. Lastly, it should watch over the financing of the IASB and Foundation.

Process

As set out above, BUSINESSEUROPE does not believe that the standard-setting process that is currently in place is structured in such a way to assure the quality of the standards and appropriate priorities for the IASB work programme. The performance of independent and objective quality reviews and post-adoption effect appraisals could help establish whether standards are actually useful in practice. Impact assessments should be carried out more consistently and duly taken into account prior to the final decision about standards becoming mandatory. This assessment should include formal confirmation that the proposed standard meets the objectives identified for it, and that it is useful, operational and based on economic reality and not theoretical purity. Furthermore, as also stated above, stakeholders must be much more effectively involved in the setting of objectives, underlying principles and agenda setting.

We think that the role described above could be assigned to the Advisory Council.

We have also expressed our view that convergence and IASB collaboration with the FASB over the last 10 years have not led to better IFRS. Could this change in the near future? We believe that the signs are at present not all favourable. We therefore recommend that the IASB should for the moment pursue a strategy of focusing on improving IFRS and refrain from a convergence programme with the FASB after 2011 until such time as circumstances suggest a more acceptable outcome for European capital markets and others relying on IFRS. Below we explain further why we take this view.

What are the costs of US GAAP/IFRS convergence to European companies and capital markets? As described above various convergence projects have already involved them in greater complexity and persistent change, with corresponding costs. Given that in many areas the US have a different environment from other jurisdictions, e.g. the need for "bright lines" rather than use of judgment to reduce the threat of litigation, those costs would be likely to continue to mount. Similarly, 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 - would also be likely to continue to impose an undesirable burden on Europe.

What benefits could be foreseen from a continuing convergence programme for European companies and capital markets? Naturally it would be ideal 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 to co-exist a little while longer– as now – would not in fact be quite satisfactory.

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 been 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 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 to any potential benefits for European companies and capital markets.

Is complete convergence possible in the immediate future anyway? In the present situation we think not. As the financial instruments example mentioned above shows, the Boards have been in many cases unwilling or unable to find workable compromise solutions to issues. Although it always takes two to disagree, we sense that there is an issue with US attitudes to IFRS which is unlikely to be resolved in the near future. 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 sublimate that reluctance in the interests of the capital markets.

Similarly, in the FASB's Exposure Draft on Financial Instruments, IFRS are described implicitly as inferior because "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. 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. We cannot imagine that this one-sided approach would be acceptable to, or beneficial for, European companies and capital markets. We would be delighted if, in 2011, the SEC felt able to commit to bringing their domestic financial reporting standards into line with IFRS, as so many other jurisdictions have done – but only if they accept to participate in a cooperative fashion in the IASB's due process with a focus on producing high-quality standards which serve the world's capital markets at large, not just the US.

And perhaps it would also be better to continue for the moment with two separate sets of standards, each best serving the needs of its constituency, with mutual acceptance of equivalence. The US environment is indeed unique in many ways, and US capital market participants may also view certain things differently from Europeans, as the differing attitudes to net debt illustrate. 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 a major benefit to forced convergence at this stage? As so often, the "best" may be the enemy of the "good".

Financing

More automaticity of financing is of course crucial to the effective functioning of the organisation. All users should contribute as well as national standard setters and regulatory authorities. Currently, most contributions are provided by preparers and auditors, with the former, as has been amply set out above, not believing that their interests are taken into account on the same footing as other stakeholders (or jurisdictions). BUSINESSEUROPE thus suggests that before devising a system of automatic financing, our suggested changes for reform are carried out to ensure that automatic financing does not lead to work being undertaken to fill up capacity rather than to meet a significant need.

Other issues

Jurisdictions which have announced their intention to adopt IFRSs must be involved within the IASB process to foster consistent application and implementation on a global basis. Yet, representatives of jurisdictions currently applying IFRSs can be outvoted by representatives of other jurisdictions. Even though IASB members are supposed to be independent, BUSINESSEUROPE believes that there is an imbalance which should be rectified.

Lastly, we also believe that the objective of the IFRS Interpretation Committee (IFRIC) should be kept free from any convergence considerations and that its members should be selected from companies with actual IFRS reporting experience. After all, the goal of the IFRIC should be to interpret existing IFRS and not to promote convergence, e.g. with US GAAP, for the sake of consistent application.

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