CESR

COMMITTEE OF EUROPEAN SECURITIES REGULATORS

IFRS Foundation

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RE: Status of Trustees' Strategy Review

The IFRS Foundation published on 5 November 2010 its paper *Status of Trustees' Strategy Review* for public consultation. The Trustees of the Foundation are seeking the advice of its stakeholder community on its ongoing strategy review.

CESR notes the ambitious timeline for the IFRS Strategy Review that is provided as an appendix to the consultation paper, and we can understand the decision to launch the consultation paper early. However, we believe that a paper soliciting views from market participants on the *raison d'être* of the organisation warrants a wide debate, and we question whether the Trustees' timetable provides sufficient time for reflection and for a consensus to emerge on these important issues, especially as the Trustees are at a preliminary stage in their own thinking.

CESR shares the concern that many policymakers and stakeholders seems to have that all relevant public policy objectives should be taken into account in the standard-setting process. We believe that such a debate is a crucial for the Foundation when reviewing its Strategy. We however note that the Financial Crisis Advisory Group (FCAG), formed at the request of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (US FASB), has already made an important contribution to this debate. CESR believes that the IFRS Foundation should ensure that the IASB's primary objective is to serve the needs of investors and other providers of capital.

We are supportive of the existing three-tier model and believe that the most effective and efficient way to enhance the public accountability of the accounting standard-setter is to build further on the existing governance structure. In our view, the role of the Monitoring Board is one of governance and should consist of designing the mission, fundamental structure, composition and due process of the IFRS Foundation and overseeing that it is functioning as anticipated. Trustees should however develop their oversight activities further and communicate appropriately on the process and outcome of that oversight to its stakeholders.

In general, we believe that the IASB is a transparent organisation and has made significant steps in developing its outreach programme to ensure that stakeholders' views are taken into account during the standard-setting process. The organisation could develop this further by foreseeing sufficient resources to understanding the impact of proposals prior to the issuance of Exposure Drafts, giving greater consideration of the number of amendments that users and preparers of financial information can reasonably absorb within certain time frames, more formalised feedback statements and carrying out more systematically post-implementation reviews.

Our detailed comments are set out in the appendix to this letter.

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

Yours sincerely,

Carlos Tavares
Chairman of CESR

APPENDIX 1 – GENERAL COMMENTS

The IFRS Foundation published on 5 November 2010 its paper *Status of Trustees' Strategy Review* for public consultation. The Trustees of the Foundation are seeking the advice of its stakeholder community on its ongoing strategy review.

A more comprehensive Consultation

CESR appreciates the Foundation's intention for a comprehensive review of its strategy and its continuous efforts to reach out to the international stakeholder community at an early stage. However, we note that the Trustees have not reached any conclusions and are at a very preliminary stage of their working.

Considering the ambitious timeline for the IFRS Strategy Review that is provided as an appendix to the consultation paper we can understand the decision to launch the consultation paper while the Trustees are still at an early stage of their deliberations. Noble though the intentions of the IFRS Foundation are, we believe that a clearer explanation of the reasons why the Foundation decided to review its strategy at this stage would have been welcome.

It is our understanding the Trustees' primary aim is to gather stakeholders' views on possible improvements, triggering an open and wider debate resulting in another public consultation. We are concerned in that respect to read that the Trustees seek to conclude the Strategy Review at their meeting in London in March 2011.

Cooperation with the high level Working Group of the IFRS Monitoring Board

The IFRS Foundation Monitoring Board announced on 2 July 2010 that a high level Working Group will undertake a review of the governance framework around the Monitoring Board and the IFRS Foundation. The Trustees' consultation paper focus is on the long term strategy of the IFRS Foundation, while the one of the high level Working Group is on the governance related to the Monitoring Board. We understand that the two projects have a different scope but are of the opinion that the two projects will inevitably be interdependent and will affect each other. This will also become clear from our views set out below on how the public accountability of the IFRS Foundation could be improved. Some of the reforms CESR is suggesting might not be within the remit of the Trustees of the IFRS Foundation.

We believe that the Trustees and the Monitoring Board by way of its Working Group should have synchronized their initiatives. We would still encourage them to do so.

Appendix 2 – CESR'S RESPONSES TO THE QUESTIONS IN THE CONSULTATION PAPER

A. 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 revisions?**
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?**

CESR shares the concern that many policymakers and stakeholders seem to have that all relevant public policy objectives should be taken into account in the standard-setting process. We believe that such a debate is crucial for the Foundation when reviewing its Strategy. We however note that the Financial Crisis Advisory Group (FCAG), formed at the request of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (US FASB), has already made an important contribution to this debate. In its Report[1] the FCAG concluded that:

> *"Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of these standards. Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth. Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those standards should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting".*

CESR consequently supports the Foundation's current mission statement focusing on decision-relevant information for investors and other users of financial information. Nonetheless, regulators (and particularly prudential regulators) have a role to play within the standard-setting process. While we believe that the IASB and supervisors should try to align reporting requirements as far as possible (in order to reduce the burden on reporting entities), we acknowledge that it is not possible to remove all differences between financial reporting standards and regulatory requirements. We believe that, if a conflict does arise between the wide range of measures that prudential regulators may require reporting entities to adopt and the needs of investors, investors' needs should take precedence for the development of accounting standards. Relevance, transparency and enforceability are crucial elements for CESR in the development of accounting standards.

We believe that achieving a good cooperation in practice with authorities with responsibility for financial stability is more appropriate than including a reference to financial stability in the Foundation's Constitution. The different initiatives that were developed in the aftermath of the financial crisis to encourage closer engagement between regulators and the IASB should be carried out on a more structured basis. We believe that it would be beneficial for the IFRS Foundation if the

[1]http://www.iasb.org/NR/rdonlyres/2D2862CC-BEFC-4A1E-8DDC-F159B78C2AA6/0/FCAGReportJuly2009.pdf

Trustees would enhance their pro-active outreach activities and further improve the transparency of its activities.

The IFRS Foundation: more than setting IFRSs

Over the last decade the IFRS Foundation has developed various other initiatives and activities in support of its objective of IFRS standard-setting (through the IASB and the Interpretations Committee), including:

— The IASB developed and published IFRS for Small and Medium-sized Entities (SMEs). We believe that setting accounting standards for listed entities should remain the main focus and priority of the IASB; and

— The creation on an XBRL Taxonomy for IFRS to facilitate the electronic use, exchange and comparability of financial data prepared in accordance with IFRSs. Given the growing interest around the world in XBRL we believe that these activities and the due process applied on them might warrant closer attention in the future.

B. 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?**
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)?**

First of all we would like to reiterate our support for the importance of independence of the standard-setting process and would here also like to refer to the Report of the FCAG where it states that:

> *"To develop standards that are high quality and unbiased, accounting standard-setters must enjoy a high degree of independence from undue commercial and political pressures, but they must have also a high degree of accountability through appropriate due process, including wide engagement with stakeholders, and oversight conducted in the public interest".*

We believe that the IASB and the Foundation have made important progress in better involving stakeholders in the standard-setting process but believe that there is room for wider improvement. The IFRS Foundation remains a private organisation and its standards have significant impact on the reporting entities and on the capital markets of the jurisdictions that have adopted IFRSs into their internal regulations. The IFRS Foundation has for example been given the role of lawmaker for the European Union by Regulation (EC) No 1606/2001. There is clearly a need to ensure that the IASB and the IFRS Foundation are committed to the public interest, whilst preserving the technical independence of the IASB.

We believe that the existence of the Monitoring Board has contributed to the independence of the IASB and believe that the IFRS Foundation's independence could be strengthened by a more stable and diversified funding. We believe that the principle of ensuring the independence of the IASB in technical matters should guide any reform to be undertaken as a result of this review.

The Trustees ask whether further steps are required to bolster the legitimacy of the governance arrangements. Although CESR believes that the development of the Monitoring Board is in the scope of the review that is currently prepared by the Monitoring Board high level Working Group we have set out our views below.

The need and role for a Monitoring Board

In line with our view that the role of the Monitoring Board should be one of governance while the Trustees should be responsible for the oversight of the IASB, we are supportive of the existing three-tier model (the Monitoring Board – Trustees – IASB). We believe that the most effective and efficient way to enhance the public accountability of the accounting standard-setter is to build further on the existing governance structure and the initiatives that have already been taken. For example, we believe that the IFRS Advisory Council has already proven to add value in promoting the widespread use of IFRS around the globe and in the development of the standards.

The role of the Monitoring Board – as link between the Trustees and public authorities – should clearly be to assess to what extent the Trustees, the IASB and other committees within the IFRS Foundation act or have acted in the fulfilment of the public interest. We also believe that there is a need for the Monitoring Board to develop the transparency and effectiveness with which it carries out this important role.

One of the main issues is thus to determine the basic nature and main functions of the Monitoring Board: either public oversight or to be in charge of the governance of the Foundation. In our view, the role of the Monitoring Board should consist of designing the mission, fundamental structure, composition and due process of the IFRS Foundation and overseeing that it is functioning as anticipated. It should be responsible for its designated competences and leave remaining governance issues to the Trustees and other bodies the Trustees might appoint. Excessive involvement in managerial issues could conflict with its governance responsibilities. Improvements to the accountability and governance of the IFRS Foundation and the IASB should not result in excessive bureaucracy and technical issues should not become politicised.

As a result, the Monitoring Board should be more closely involved in strategic decisions related to the use and development of IFRSs and the IFRS Foundation. We for example believe that the Monitoring Board should:

- Discuss and approve a general strategic mission statement (and strategic plan) developed by the Trustees on the adoption of IFRS in various jurisdictions, convergence, relationships with national/regional financial reporting bodies and the development of IFRSs – including work agenda and convergence programs;
- Review and provide advice to the Trustees on the fulfillment of their responsibilities (such as the duties of the Due Process Committee, the involvement of stakeholders…);
- Be involved in the nomination of the organisation's key senior positions such as the Chairman of the IASB and Trustees…;
- …

Accountability and independent standard-setting

CESR thinks that it is important to differentiate between the need for independent high quality execution of standards and the need for a strong accountability framework. The former would help to ensure the latter. We believe that the IASB should

- Improve participation of all relevant stakeholders, including relevant supervisory authorities, in the standard-setting process (see also our response above). The IASB should organise a forum of technical experts representing securities and other relevant regulators to discuss the potential impact on supervision of upcoming standards; and

— Introduce a more robust due process, in particular through systematic use of impact assessments and clearer communication on the reasons for changing accounting standards at an earlier stage of the standard-setting process in order to achieve greater transparency about the technical choices the standard-setter has. We believe that, post-2011, the IASB should strive for a period of calm in accounting standards.

In addition, the Trustees should continue their assessment of the IFRS Interpretations Committee and clarify its position vis-à-vis the IASB. Trustees should ensure that the appointment procedure is transparent and due account is taken of the interest of various interest groups.

Composition of the Monitoring Board

Without pre-empting any proposal coming from the Monitoring Board's high level Working Group CESR believes that the Monitoring Board should be composed mainly of public oversight bodies responsible for regulating and enforcing transparency in capital markets. We also believe that organisations with clear international mandates (for example, the International Monetary Fund and the Financial Stability Board) should play a role in the Monitoring Board. Observer status could be given to other important stakeholders within the international regulatory environment. Members should be selected from jurisdictions using IFRS or in the process of converging towards IFRS.

CESR believes that it would enhance the public accountability of both the Foundation and the Monitoring Board if it would be possible for jurisdictions where there is more than one relevant authority to nominate a second representative as an observer. CESR acknowledges the important role of the European Commission in the area of financial reporting in the EU and its membership of the Monitoring Board but believes that CESR (soon becoming the European Securities and Markets Authority – ESMA) should also take part in the activities of the Monitoring Board. CESR believes that, as enforcers of IFRS and securities regulators of the by far largest economic area and the area with the most entities applying IFRS, it should be part of the Monitoring Board and that its experience would prove to add value to the activities of the Monitoring Board.

We note that the Trustees have already increased their involvement in supervising the IASB and its work plan but believe that the Trustees should develop its oversight activities further and communicate appropriately on the process and outcome of that oversight to its stakeholders.

C. 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?

6. Will the IASB need to pay greater attention to issues related to consistent application and implementation issues as the standards are adopted and implemented on a global basis?

For CESR independence of the standard-setter remains key to ensure that its standards are high quality and meet the requirements of well-functioning capital markets. As we believe that the IASB's technical agenda-setting could be more consultative, we welcome that the IASB will begin its deliberations on its future agenda later this year by launching its first triennial public consultation process (as requested by many of its constituents). We hope that this better engagement with stakeholders will avoid a future extremely congested IASB agenda as it has been recently (even though the IASB has postponed some projects, it will still be challenging for the IASB to complete all the remaining projects within the current deadlines).

Given the many uncertainties surrounding the post-2011 agenda (and the impact of a possible decision of the US SEC on extending the use of IFRS to its domestic issuers) we note that such a consultation will not be straightforward. CESR believes that the IASB should ensure that the IASB's primary objective should be to serve the needs of investors and other providers of capital. Post-2011, the IASB should strive for a period of calm in accounting standards.

CESR believes that the following could lead to other possible improvement in the standard-setting process:

— Greater consideration of the number of amendments to IFRSs that users and preparers of financial information can reasonably absorb within certain time frames. An overload of new accounting standards could affect the proper implementation of standards by preparers;

— Sufficient allocation of resources to meet market participants and to prepare market failure analyses prior to developing Exposure Drafts, in order to assess the need for new proposals and their scope, as well as to assess the impact. Wide consultation also promotes excellence, neutrality, the identification of unintended consequences and, ultimately, broad acceptance of the legitimacy of the standards that are adopted;

— The IASB should introduce formalized feedback statements for comments received in public consultations;

— To carry out post-implementation reviews of the major standard-setting projects; and

— Setting clearer criteria for re-exposure of Exposure Drafts.

As stated above in our response to question 2 we believe that the IASB and the Foundation have made important progress in the area of better involving stakeholders in the standard-setting process. This engagement, particularly with regulatory authorities, should be put on a more structured basis.

In addition we believe that preparers of financial statements will face significant changes when they implement all the new standards that the IASB is currently developing, and so the implementation process will inevitably reveal issues that the IASB will need to consider (especially as it has completed many of the projects on a rather compressed timescale). The increasing number of countries adopting or converging towards IFRS could accentuate these pressures. We would encourage the Foundation to ensure that the agendas of the IASB and the IFRS Interpretations Committee allow sufficient time and resources to deal with these issues.

Consistent Application and Implementation

Consistent application and implementation of IFRS is of the utmost importance for users' confidence in financial statements and thus important to for the IASB take into account when developing accounting standards. Consistent application is however a shared responsibility of the IASB with the audit profession and enforcers.

The IASB already reaches out to audit firms (and in particular the global networks) to discuss the auditability of proposed amendments. It is also important for enforcement authorities to consult with each other and reach common ground on the application and implementation of IFRS. CESR has contributed to this by setting up the European Enforcers Coordination Sessions (EECS) in order to achieve consistent application of IFRS within the European Union. CESR has and will invest in future dialogue with third country enforcers to achieve mutual exchange of experiences. The IASB (and the Interpretations Committee) has and will remain in that respect a valuable partner.

Although CESR would stress that consistency in application and implementation is essential to its success, we believe that IFRSs are principle-based standards and that therefore consistency should not be pursued to the detriment of professional judgement.

We believe that the IASB should continually critically examine during the standard-setting process whether the standard under development is capable of consistent interpretation, application and enforcement. In line with our comments set out above we think that the IASB should perform at least some sort of (limited) post-implementation review by, for example, organizing round table meetings or other outreach activities in order to be sure that standards have not led to significant interpretation or implementation issues. In that respect we believe that it might be better to not issue new standards or to renew old standards without clear evidence of issues in practice (or only because they are old), so as to provide stability, consistent application and comparability. Continuous dialogue with enforcers of IFRS could provide fruitful results.

CESR would however like to reiterate that the Trustees should continue their assessment of the IFRS Interpretations Committee and clarify its position vis-à-vis the IASB. Trustees should ensure that the appointment procedure is transparent and due account is taken of the interest of various interest groups. In addition, an assessment of more operational issues should be considered, including considering the role of interpretations, the annual improvements project and the use of rejection notes.

D. Financing: How should the organisation best ensure form 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?

CESR believes that the necessary independence of the IASB and the Foundation could be strengthened by more stable and diversified funding. A stable funding mechanism benefits the IASB by allowing it to carry out its technical agenda and attract high-quality staff. It also provides greater assurance to jurisdictions using or in the process of adoption IFRSs on the quality and independence of the accounting standards. Sufficient and independent funding is key to achieving this objective.

Although CESR would not, in principle, exclude the use of voluntary contributions (many of which come from the global audit firms), we believe that the different regulators within the jurisdictions using or in the progress of moving to IFRS should further consider developing stable funding mechanisms to fund the IFRS Foundation. We note in that respect that the European Commission decided recently to contribute the Foundation and that National Funding Mechanisms have been set up in some European jurisdictions.