



European Financial Reporting Advisory Group ■

**STRENGTHENING THE EUROPEAN CONTRIBUTION
TO THE INTERNATIONAL STANDARD-SETTING PROCESS
FINAL REPORT ON ENHANCEMENT OF EFRAG**

DECEMBER 2008

STRENGTHENING THE EUROPEAN CONTRIBUTION TO THE INTERNATIONAL STANDARD-SETTING PROCESS

ENHANCEMENT OF THE GOVERNANCE, ORGANISATION STRUCTURE AND OPERATING PROCEDURES OF EFRAG

1. INTRODUCTION

In July 2008 EFRAG (European Financial Reporting Advisory Group) issued its public consultation document “Strengthening the European Contribution to the International Standard-Setting Process” for comment by 22 September 2008. EFRAG received 36 comment letters from a wide variety of geographical and professional backgrounds. These comments are discussed in a separate feedback statement published by EFRAG together with these final proposals.

As a result of recent developments, the environment in which International Financial Reporting Standards (IFRS) are set is undergoing significant change. With more and more jurisdictions moving towards IFRS, and some able to mobilise significant resources and expertise, European input to the International Accounting Standards Board (IASB) standard-setting process needs to be strengthened. This has also been demonstrated by the call for global responses to the current financial crisis, including the further development of IFRS and related guidance. The importance of appropriate European input to international standard setting has also been expressed at the highest political level.

The requirements of European Union (EU) stakeholders need to be articulated and their interests represented effectively. In order to speak with one voice, Europe needs to enhance its processes for providing input and advice to the IASB on financial reporting matters. Strengthening the European voice regarding financial reporting standards is therefore a key issue for the EU institutions.

There was general support by respondents to the consultation document for the enhancement of EFRAG and the need to build on existing structures for articulating Europe’s requirements and representing European interests. EFRAG’s main objective was originally to influence the international standard-setting process and to advise the European Commission (EC) on endorsement of IFRS for use in Europe. Over the years it has gained considerable recognition within Europe and around the world for the quality of its work. However, due to limited resources, EFRAG has focussed less on proactively influencing future standard setting developments. The proactive work has been performed in cooperation with National Standard Setters (NSS) as part of the Pro-Active Accounting Activities in Europe (PAAinE), which was initiated by EFRAG three years ago.

EFRAG must therefore be strengthened in order to be capable of providing timely and effective proactive input in the early phase of the IASB process. Co-operation with NSS must also be reinforced, with the latter playing a more active role in shaping Europe's proactive input to the IASB. The need for timely and effective proactive European input to the IASB is urgent.

The proposals put forward in this paper should be seen in light of these developments. There is a clear and urgent need, as expressed by the European Parliament¹ (EP) and in the conclusions of the ECOFIN Council of 8 July 2008, to strengthen the European financial reporting voice.

2. OBJECTIVES AND ACTIVITIES OF EFRAG

It is generally accepted that the principal objective of EFRAG should continue to be to ensure that European views on the development of financial reporting are properly and clearly articulated in the international standard-setting process. It is also important that appropriate importance is attached to those views by the International Accounting Standards Committee Foundation (IASCF)/IASB.

EFRAG's work has been concentrated on responding to proposals issued by the IASB, such as discussion papers and exposure drafts of new standards, and on advising the EC whether to endorse new financial reporting standards and interpretations. In order to exercise greater influence over the future direction of financial reporting, however, EFRAG needs to place more emphasis on developing its own research and discussion papers at an early stage of the IASB's consideration of the topics concerned, and also to monitor the ongoing IASB activities in order to give feedback to the IASB on a continuing basis.

More specifically, the main functions/activities of EFRAG should include:

- Proactive work providing input to the IASB on topics on its work programme and related priorities and for example by the preparation of discussion papers;
- Commenting on IASB/International Financial Reporting Interpretations Committee (IFRIC)/IASCF consultation papers (discussion papers and exposure drafts);
- Impact assessments and effect studies on IASB standards and IFRIC interpretations at the request of the EC;
- Endorsement advice to the EC.

It is anticipated that the work of EFRAG on impact assessments and effect studies regarding newly issued standards and IFRIC interpretations will be phased out gradually as the IASB is expected to carry out impact assessments at an early stage of the standard-setting process in the future.

¹ See esp. paragraphs 53 and 26 of the own-initiative report of Mr. Alexander RADWAN MEP, available at <http://tinyurl.com/6ddah5>.

In order to achieve the objective set out above it is essential that members of the Supervisory Board (SB), of the Planning and Resource Committee (PRC) and of the Technical Expert Group (TEG) are independent and are committed to acting in the European public interest, thereby ensuring that EFRAG views are not unduly influenced by any interest group or constituency. At the same time, it is essential that EFRAG maintains an open dialogue with the various stakeholder groups through a transparent consultation process.

The recent activities of EFRAG are described in the 2007 EFRAG Annual Review (attached).

3. PUBLIC OVERSIGHT, ACCOUNTABILITY, RELATIONSHIP WITH THE EUROPEAN COMMISSION

Increased public accountability will be achieved by the changes to EFRAG's governance structure set out below, by regular liaison with the EC at relevant levels and by opening meetings of the SB and PRC to the public, as is the case today for TEG meetings. In addition, nomination processes will be open and wider consultations will be held than in the past. There will also be greater transparency in the reporting process: the SB and the PRC will publish regular reports of their activities in the form of summary minutes and in the annual report currently published by EFRAG, and EFRAG will continue to report in coordination with the EC to the Accounting Regulatory Committee (ARC) and also to relevant EU institutions.

EC approval of the budget and submission of audited financial statements will be required when, as is envisaged and as discussed in section 5 below, the EC contributes to the funding of EFRAG. As described in section 4.2 below, the reformed composition and procedures of the SB incorporate features to ensure that EFRAG operates in the European public interest and in a manner that supports the EU accounting legislation process.

4. STRUCTURE OF THE NEW EFRAG

EFRAG needs to represent all financial reporting stakeholders and not only its founding European organisations. The following proposals seek to establish a balanced structure that can represent effectively all European stakeholders in IFRS.

A key element of the proposals is the setting up of the PRC and the enhanced role of the NSS that are committed to contributing significant resources and expertise to proactive projects.

The proposed governance structure of EFRAG is shown in the chart in Annex I.

Regular public review

A review of the governance arrangements, management structure and operations of EFRAG will be initiated two years after the new arrangements have been implemented and thereafter every five years or more frequently if the circumstances require it. The first review will assess the first experiences of the new arrangements, and will in particular consider i) the effectiveness of the arrangements in securing cooperation between EFRAG and National Standard Setters (NSS) and ii) the overall governance of EFRAG. The review will evaluate the scope for enhancing further the effectiveness of EFRAG's governance, organisation structure and operating procedures, in particular seeking to simplify them where possible, and to ensure appropriate stakeholder representation in the Supervisory Board, including the representation of users of financial reports.

4.1 General Assembly (GA) and Governance and Nominating Committee (GNC)

The EFRAG General Assembly (GA) will continue to consist of representatives of the European organisations that are members of EFRAG, and the voting rights of members in the GA will continue to be based on the level of their contribution to the base funding of EFRAG. The responsibilities of the GA are set out in the EFRAG statutes and include approving EFRAG's annual accounts, approving EFRAG's budget, approving EFRAG's internal rules and, most importantly, appointing SB members. The GA members seek constantly to maintain a fair balance between various stakeholder groups with regard to voting rights and responsibility for financial contributions.

EFRAG invites additional European organisations, in particular organisations representing users of financial reports, to become members of EFRAG. The minimum contribution for membership will be maintained at 50.000 euros. The GA may, exceptionally, decide on a lower contribution from certain stakeholder organisations, in particular user organisations, subject to a minimum of contribution of 25.000 euros. EFRAG invites additional user organisations to become members.

The GA will establish a Governance and Nominating Committee (GNC) to make recommendations to the GA on the appointment of SB members. The GNC will consist of seven members of whom four will be appointed from amongst GA members and three from amongst the National Funding Mechanisms (NFM)². The GA may approve or reject proposals from the GNC but may not appoint anyone who has not been nominated by the GNC.

² NFM are the bodies established in some Member States to organise the private sector funding contributions to EFRAG, some of which also contribute to the funding of the IASCF by the same means.

EFRAG will facilitate an informal Consultative Forum for NFM as a process to coordinate the NFM in the various countries, one of the roles of which might be to identify possible NFM nominations for membership of the GNC. Another role of the Consultative Forum might be to identify candidates for the SB. Although EFRAG will facilitate the setting up of the Forum, it will be an informal mechanism that will set its own agenda and the NFM will decide themselves on its procedures.

After the new structure has been in place for two years, the GNC will evaluate, in dialogue with the EC and NFM, the size and the composition of the SB based on its efficiency and effectiveness but having regard above all to the need for a balanced representation of all European stakeholders. Based on its findings, the GNC will make recommendations to the GA.

The composition of the SB and the process for nominating and appointing SB members is explained in more detail in section 4.2 below.

The GA will meet at least once a year to, amongst other things, assess the performance of EFRAG by considering and, if it so decides, approving EFRAG's annual report, appoint members of the SB and approve the budget.

4.2 Supervisory Board (SB) and its Committees

Role of the SB

The SB will have the following principal responsibilities:

- Appointing TEG and PRC members;
- Fund-raising, including liaison with NFM;
- Approving the overall strategy of EFRAG;
- Recommending approval of budgets to the GA;
- Monitoring the independence, efficiency of organisation and quality of consultative and other due processes of TEG;
- Monitoring the progress of the work of TEG and PRC;
- Reviewing internal rules and recommending any changes to the GA;
- Liaising with the EC (and EP);
- Liaising with IASCF Trustees;
- Monitoring cooperation with NSS.

The SB is accountable to the GA and reports to the GA on the discharge of the SB's responsibilities.

Composition of the SB

The SB will consist of high level persons with an interest in the global development of financial reporting and with an appropriate balance of professional backgrounds, including users, preparers, and accountants. All SB members will act in a personal capacity and will be required to commit themselves formally to acting in the European public interest, independent of their professional or sector affiliation. The SB will no longer be composed of representatives of the European organisations that founded EFRAG and the current direct link between funding, voting and seats on the SB will cease.

The SB will include four members whose background will be based on experience of public policy, either at national or at European level. These persons could be drawn from public authorities or other relevant public bodies, as well as from academia. The background of public policy members should be such as to give them a good understanding of public policy aspects of financial reporting and to put them in a position to contribute to the SB by ensuring that appropriate account is taken of public policy aspects in the deliberations and decisions of the SB. As members of the SB, the duties of the public policy members are no different from those of other SB members.

Observer seats

The EC will continue to participate in the SB as an observer in order to enhance the public accountability of EFRAG as a whole and to monitor the SB's performance of its oversight role.

CESR (The Committee of European Securities Regulators) will be invited to participate in the SB as an observer to ensure that the regulator and enforcer perspective is sufficiently considered in the deliberations and decisions of the SB.

The initial composition of the SB will include persons with the following backgrounds:

Preparers	5 (industry, commerce and financial institutions)
SMEs	1
Users	4 (including 2 from financial institutions)
Accountants	3
Public policy members	<u>4</u>
Total	17
EC (observer)	1
CESR (observer)	1

In the event that sufficient high quality candidates with a particular background cannot be found at any time, temporary minor deviations from the above composition will be allowed.

Appointment of SB members

The GA will appoint SB members upon a recommendation from the GNC (see section 4.1) and following consultations with the EC. Candidates for the SB will need to meet a number of pre-established criteria as set out in EFRAG's internal rules and will be sought by means of a public call for candidates. All stakeholders including European organisations and NFM will have the opportunity to nominate candidates.

The members with a public policy background will be nominated by the EC in liaison with the GNC of the GA.

Decision-making and rules of procedure

The SB will aim to reach decisions by consensus. However, each member of the SB will have one vote in a simple majority voting system and will have the right to request a particular issue to be added to the agenda of the SB. The EC, despite being an observer, will also have the right to request the Chair of the SB to add an item to the agenda should a situation arise in which, in the view of the EC, EFRAG is failing to carry out its work in accordance with its due process or governance rules.

SB meetings will be open to the public (with the exception of certain issues such as nominations and funding). Reports on the SB meetings in the form of summary minutes will be made available on the EFRAG website. The SB will include a separate section within the EFRAG annual report on the exercise of its oversight role and other responsibilities, and on the funding and resources of EFRAG.

The SB will review the internal rules for the SB, TEG and PRC on a regular basis and make recommendations for any changes to the GA.

4.3 Planning and Resource Committee (PRC)

Proactive work – contributing to and influencing early thinking on significant financial reporting issues – is a crucial element of the work of EFRAG and the NSS. It constitutes the main and most appropriate means of influencing the agenda and thinking of the IASB.

EFRAG and NSS that are able and willing to commit significant resources to proactive work will coordinate their efforts through the PRC in order to increase significantly the extent and to enhance the quality of proactive work that is carried out in Europe.

A Memorandum of Understanding (MoU) with each NSS involved in the PRC will be negotiated by EFRAG and approved by SB, and the MoU will be a condition for membership of the PRC. The MoU will, in particular, specify the commitments of the NSS in relation to the proactive work including the extent of the staff resources the NSS will make available for this purpose.

Role of the PRC

The role of the PRC will be to set the agenda for proactive work that results in the issuance of discussion papers and position papers, or other outputs. The PRC will provide guidance on the allocation of resources from EFRAG and the NSS to proactive projects and will monitor the progress of the work concerned. In addition, the PRC will have the following tasks:

- Coordinating surveys of financial reporting to see whether the practical experience calls for agenda items to recommend the IASB to add to its agenda;
- Commenting on the IASB agenda following the normal EFRAG public consultation procedures (due process) including consultation with the boards of the NSS and with TEG;
- Recommending who should represent EFRAG and/or the NSS on IASB working groups and advisory groups. The representatives will be nominated following more specific procedures than hitherto;
- Organising meetings of the new Consultative Group (as described in section 4.5 below);
- Possibly assisting in organising the practical work of NSS to provide input to impact assessment reports prepared by EFRAG.

The PRC should ensure that the long-term proactive agenda reflects the most important accounting issues seen from a European point of view.

Composition of the PRC

The PRC will be composed of nine members appointed by the SB as follows:

- Four senior NSS representatives (normally the Chairs of the NSS but, alternatively, may be another senior person such as the Vice-Chair provided that he is able to commit the NSS concerned in agenda and resource decisions) will be members;
- Two members from the SB and two additional members (who may have other professional backgrounds or alternatively could be members of the SB);
- The TEG Chair.

All members should be of high professional standing who have recent experience of financial reporting (but who are not necessarily technical accounting experts) and insight into the major reporting issues and objectives of European stakeholders.

The Chair of the PRC will be selected from amongst the SB members on the PRC. He will report on the work of the PRC at every SB meeting.

An informal Coordination Group, consisting of a wider range of NSS that are prepared to contribute resources and other input into the proactive work of EFRAG, will be set up. The Coordination Group will support the PRC as an informal sounding board to advise on the potential proactive projects to be added to the PRC agenda, with the aim of establishing an informal process for wider coordination of the activities with the relevant NSS beyond the four NSS involved in the PRC. The Coordination Group will be an informal group that meets on an ad-hoc basis when needed, at the invitation of the PRC Chair.

Appointment of PRC members

The PRC will be appointed by the SB after a public call for candidates for the four representatives of the NSS and for the two additional members.

Decision-making and rules of procedure

The PRC will aim to reach decisions by consensus. However, if consensus cannot be reached, each member of the PRC will have one vote in a simple majority voting system.

PRC meetings will be open to the public (with certain exceptions).

All technical papers, including the proactive papers, will need to be approved by the TEG for issue by it and are subject to the EFRAG public consultation process.

4.4 Technical Expert Group (TEG)

No major changes will be made to the current scope of the work of TEG (further details can be found in EFRAG's internal rules). Participation by three of the NSS continues and is focused on high quality technical contributions to the discussions in TEG.

Role of the TEG

The key objectives of EFRAG TEG include:

- To provide high quality input to the IASB and IFRIC on their discussion papers, proposed standards and draft interpretations;
- On the basis of the priorities identified by the PRC, to develop proactive discussion papers in order to influence the IASB's agenda-setting process at the early phases of the standard-setting process. Such discussion papers should also enhance the debate and understanding in Europe in order to provide high quality, widely supported input to the IASB;
- To monitor ongoing IASB activities in order to give feed back to the IASB on a continuing basis;
- To issue endorsement advice to the EC on final pronouncements issued by the IASB;
- To issue effect study reports (until such time as the IASB includes such work in its own due process).

Composition of the TEG

The TEG will have nine to twelve voting members drawn from throughout Europe and from a variety of backgrounds (details are specified in EFRAG's internal rules) and up to three non-voting members being in principle the chairs of the NSS, but other senior representatives of the NSS would be allowed provided that they can commit the NSS. In addition, there are observers from the IASB, EC and the Committee of European Securities Regulators (CESR).

Members of TEG will be required to commit themselves formally to act in the European public interest, independently of their professional or sector affiliation. Moreover, the membership of TEG will ensure that no group or country has a majority or can determine TEG's views, thereby ensuring that TEG's conclusions are not unduly influenced by any interest group or constituency.

Members of NSS may be nominated for membership of TEG (although as members of TEG they are expected to act in the European rather than their national public interest).

Working Groups

EFRAG TEG will continue to make use of working groups in order to obtain advice from experts on specific areas of accounting. EFRAG will continue its working groups on insurance accounting, financial instruments and joint ventures and other areas. A special SME focused working group will be created within the EFRAG Structure to advise TEG on issues in relation to non-listed companies.

Appointment of TEG members

As at present, the members of TEG will be appointed by the SB, with the assistance of a Nominating Committee, following an open call for candidates.

The SB may appoint in principle chairs of up to three NSS or other senior NSS representatives to be non-voting members of the TEG.

The quarterly meetings with the NSS (the Consultative Forum of Standard Setters (CFSS)), to which all bodies in Europe are invited, will continue and the members of the PRC will be encouraged to participate in these meetings.

The Chair of the TEG is responsible for external communication on behalf of EFRAG.

4.5 Consultative Group

A high level Consultative Group will be established in order to provide strategic input into the work of EFRAG. The Group will operate on an invitation basis under the coordination of the PRC and should meet at least once a year. The Group will focus on conceptual and policy issues. Members of this group might be drawn from CFOs of major European commercial, industrial and financial services enterprises, and high level representatives from the accountancy profession, users and the academic world.

The Group will be an advisory body to the PRC and the TEG and might also be used by the SB, when appropriate.

The Consultative Group will replace the present Advisory Forum.

5. INVOLVEMENT OF NSS AND NFM

5.1 NSS

The proposed enhancement of the EFRAG structure is also driven by a closer partnership with NSS. EFRAG and NSS interact at two levels: participation in proactive work by those NSS that have the appropriate resources to do so, and through the CFSS, which meets quarterly and to which all European NSS are invited.

Under the enhancement proposals, four NSS will participate in the PRC, setting the agenda of EFRAG's proactive work. In addition, an informal Coordination Group involving the other NSS participating in the proactive work will be created. Up to three representatives of NSS will continue to be non-voting members of TEG. Moreover, members of NSS can be nominated as voting members of TEG.

There will be continued consultation processes with all NSS. All NSS have the opportunity to make significant contributions to the impact assessment work coordinated by EFRAG. NSS have an important role to play, both when providing feedback to EFRAG about national issues and in the other direction, by providing feedback to their national constituencies on developments at European level, including the work of EFRAG.

5.2 NFM

EFRAG's governance is primarily built on European organisations representing stakeholders throughout Europe. NFM have been or are in the process of being created in Member States with the objective of supporting EFRAG's funding. The EC will seek to encourage the creation of NFM in Member States where such bodies are not yet in place. For the future, NFM are expected to contribute to the funding of EFRAG, together with the European organisations and the EC, and as a consequence will have the following involvement in the EFRAG structure:

- Representation in the GNC for the SB;
- Members of NFM can be appointed members of the SB (e.g. as public policy members);
- Participation in an informal Consultative Forum of NFM;
- Annual liaison meetings between the EFRAG SB and NFM;
- Close liaison between the EFRAG SB and NFM regarding changes in EFRAG's funding requirements.

6. FUNDING OF EFRAG

It is envisaged that a three-tier funding model will be applied, as follows:

- Base funding from European organisations;
- National funding mechanisms (NFM);
- EC funding.

In addition, it should be noted that members of TEG are not paid, with the exception of the Chairman from 2010 onwards, and that some of the staff are seconded at subsidised cost.

The funding requirements discussed below are based on estimates prepared for 2009 and 2010.

6.1 Base funding from European organisations

In the short term (2009), until the engagement of additional stakeholder representative organisations has been achieved, the proposed base funding of EFRAG is 1 million euros from European member organisations.

6.2 National Funding Mechanisms (NFM)

NFM are expected to contribute a total of 2 million euros annually.

6.3 Long-term funding

The cash budget as from 2010 is envisaged to be approximately 6 million euros depending on the speed of build up of resources. In addition to the base funding from European member organisations, 1 million euros and requested contributions from NFM, 2 million euros, the EC³ has indicated its willingness to consider contributing up to 50% of the budget of EFRAG, provided that the reforms in EFRAG's governance set out in this paper are adopted, and that a legal basis for this funding contribution can be established. Any funding from the EC would be available at the earliest in 2010.

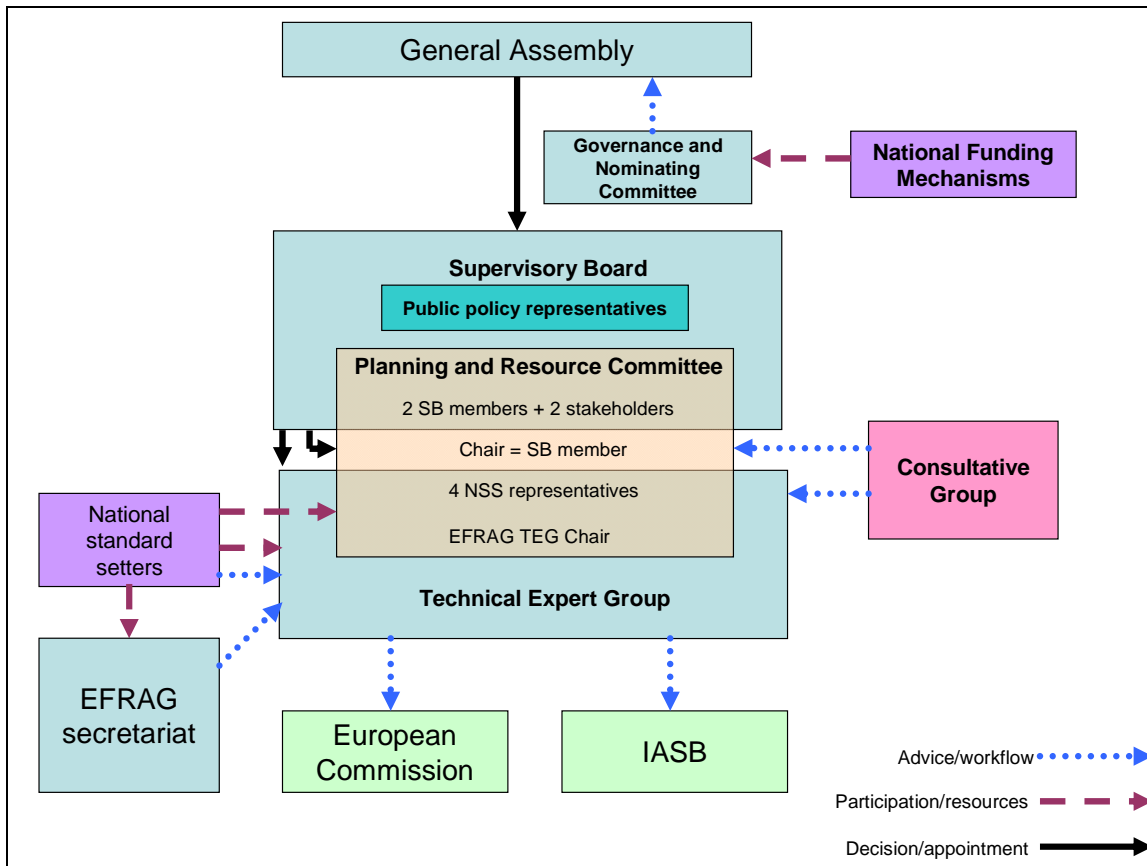
The contributions in kind consist of TEG members contributing their time without a charge and of staff seconded by European organisations or their members and are at present at the level of 1.5 million euros annually. As from 2010, it is expected that the TEG Chairman and all technical staff in the EFRAG Secretariat will be paid fully and therefore the contributions in kind are expected to be approximately 1 million euros. In the future, the possibilities to change to a model where all resources are paid will be evaluated.

This budget will allow the EFRAG secretariat to be gradually increased from 8 to 20 technical and 5 administrative staff and will enable the Chair of TEG to be paid by EFRAG. It will also include a full time person to support the SB and its committees as well as a communication manager and resources to support the Consultative Group. Since the present level of cash expenditure is around 2 million euros and recruitment of additional people is likely to take time, it may not be possible to increase staffing to the desired level until the second half of 2010. If this will be the case, the full amount of 6 million euros in cash may not be used for 2010 but the target when the enlarged organisation has settled is at the level of 6 million euros in cash. However, in the longer term activities such as field testing, work on feedback statements, and public hearings may require additional resources but not leading to a total exceeding 7.5 million euros.

EFRAG is not a standard setter but the participation in proactive work on forthcoming issues and standards require resources to be a credible voice. If one compares EFRAG's situation with the resources of the Financial Accounting Standards Board (FASB) in the US and with the IASB itself, the FASB has total revenues/contributions of some 37 million USD (+/- 25 million euros), and the IASCF has total revenues of some 17 million GBP (+/- 22.5 million euros) and employs some 90 staff, including IASB members.

³ Commissioner McCreevy, in his address to the EP on 24 April 2008, stated "we should build on the European Financial Reporting Advisory Group and I am ready to pursue this as a matter of urgency, including the possibility of using funding from the Community budget to support such a structure"

ANNEX I: EFRAG GOVERNANCE STRUCTURE





European Financial Reporting Advisory Group ■