

IFRS Foundation
To the Trustees
30 Cannon Street
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United Kingdom

strategyreview-comm@ifrs.org

xx February 2011

DRAFT COMMENT LETTER

Comments should be sent to Commentletters@efrag.org by 10 February 2011

Dear Sir,

Re: Status of Trustees ‘Strategy Review’

On behalf of the Supervisory Board of the European Financial Reporting Advisory Group (EFRAG), I am writing in response to a request from the IFRS Foundation Trustees (‘the Trustees’) to respond to the paper for public consultation *Status of Trustees ‘Strategy Review’*.

EFRAG appreciates the opportunity to provide input to the strategy review. We welcome the Trustees’ intention for a comprehensive review of the strategy of the organisation.

On 23 November 2010 we wrote to you requesting an extension of the deadline for input on the strategy review. We welcome the decision of the IFRS Foundation as announced on 26 November to postpone the deadline to 24 February 2011. This will give all European stakeholders that wish to do so, the opportunity to provide input whilst respecting their own due process. This will also give them the possibility to provide comments to the IFRS Foundation in the light of the Monitoring Board’s proposals for the evolution of the IFRS Foundation governance.

We call on the Trustees to cooperate and coordinate the strategy review with the governance review conducted by the Monitoring Board as this will allow constituents to respond consistently regarding possible areas and subjects where there appear to be overlapping issues.

We would like to thank the Trustees and the IASB for the significant efforts made over the years to improve the due process, operational effectiveness and transparent manner in which the IASB presently operates.

We have decided to limit our input to responding to the third question raised in the IFRS Foundation strategy review, i.e.: *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?*, since this addresses the heart of the EFRAG work relationship with the IASB. EFRAG's main objective is to provide the European perspective on the international standard setting process to ensure that the resulting global standards are appropriate for use in Europe. The quality of the standard setting process has a significant influence on the acceptability of the resulting standards in Europe and elsewhere. Our detailed comments are provided in the appendix to this letter. Below we have summarised our most significant concerns and suggestions for improvement:

- (a) *Objectives:* We support that public policy objectives, including financial stability, should be given due consideration and be taken into account to the extent possible without impairing transparency and the neutrality of information in the standards.
- (b) *Convergence:* We support the position expressed by the Trustees on recent occasions that the emphasis should be on the adoption of high quality global standards. Changes to the standards or the development of new standards should only be made where this results in better standards and improvements to financial reporting, and where there is available evidence that change is worth incurring the costs and disruption of consistency from period to period.
- (c) *June 2011 deadline:* We call on the Trustees to omit the June 2011 deadline which in our view has become artificial, since in our view all original reasons for its existence have disappeared. The G20 called in their Seoul meeting for completion of the convergence project by the end of 2011. Moreover, standards finalised under heavy time pressure may give rise to more changes in the later period either by IFRS interpretations or revisions of the standards.
- (d) *Work programme and IASB agenda:* We suggest that the Trustees ensure that the consultation process should also address the setting of priorities and scoping of the agenda items.
- (e) *Due process:* We have concerns about the implementation of the due process of the IASB in the following areas:
 - Responsiveness of the IASB when a majority of commentators or a significant minority have expressed the same significant concerns
 - The use of options as a tool for changing a standard
 - Finalising individual standards in phases
 - Risk of voting on standards that are not ready for publication
 - Lack of a comprehensive process for decisions about re-exposure of proposals
- (f) *Bringing improvements at the right time:* We wish to emphasize that improvements to financial reporting must be fully understood if standards are to be properly implemented and the resulting information to be understood by, and be useful to, investors and other users. For that reason, EFRAG believes that fundamental changes to IFRS should not be made if the changes have not first been debated at a conceptual level.
- (g) *Impact assessments:* We call on the Trustees to ensure that impact assessments in the form of effect analyses or field testing are carried out and published early in the standard setting process *as well as* at several phases of

the standard setting process. EFRAG is about to publish a discussion paper on Effect Studies Methodology. EFRAG would welcome to present its discussion paper to the Trustees.

- (h) *Complexity of financial reporting and standards:* We call on the Trustees and on the IASB to continue to ensure that its (proposed) standards are clear and comprehensible, as well as capable of being implemented and audited in a practical manner.
- (i) *A period of calm:* We call on the Trustees to allow for adequate time for implementation of standards without stakeholders frequently being faced with further changes to the standards and to consider a regime for changing standards only at periodic intervals.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact Saskia Slomp or myself.

Yours sincerely

Pedro Solbes

EFRAG Supervisory Board Chairman

Appendix

Objectives

- 1 The primary objective of the IASB should be to continue to provide high quality global accounting standards required by the world's capital markets. Public policy objectives, including financial stability, should be given due consideration and be taken into account to the extent possible without impairing transparency and the neutrality of financial information. Where solutions are available that are acceptable to both regulators and shareholders they should be adopted in preference to solutions acceptable only to shareholders. Financial stability and prudential reporting have different objectives and financial stability objectives cannot always be met through the medium of financial reporting. Financial reporting is driven primarily by the information needs of shareholders and investors. However, presentation requirements should be assessed and examined even more diligently in a pragmatic way so as to identify possible ways of reconciling these divergent needs.
- 2 To the extent that the powers of regulators are deficient, the IASB should not have to make up for these deficiencies by being required to prepare financial reporting standards that include information that is provided for the sole purpose of meeting specific regulators needs. Only regulators can decide what specific information they need for their purposes, and they should preferably require that such information be provided to them separately from the financial statements process. Financial reporting is not designed to serve macro-economic objectives, including financial stability. Such objectives are better achieved by other means such as through macro-economic policy making and regulatory actions. Standard setting has become of greater interest to public policy makers and regulators as a result of wider international adoption of IFRS and the economic crises. For that reason EFRAG recognises that continued cooperation between the IASB and global regulatory networks such as IOSCO and FSB is important.
- 3 EFRAG believes that the objectives in the Constitution need be aligned with the Conceptual Framework by addressing stewardship as well as economic decision-making. We are convinced that the reporting for the purpose of stewardship is a basic characteristic of accounting and financial reporting. Therefore, the public accountability of management is important to enable users and existing shareholders to make decisions about managements' ability to generate economic value. Stewardship has historically been an important reason for producing financial statements in Europe.

Convergence

- 4 As already indicated in our letters on the Constitution Review in 2009 and in various meetings, EFRAG strongly believes that convergence is no longer sustainable. The emphasis should be on the adoption of high quality global financial reporting standards. The drive for convergence should be replaced with the objective of promoting and facilitating the national adoption of IFRS as a means of achieving high quality, globally accepted, financial reporting standards. All available resources should be applied towards that objective: EFRAG is fully committed to contribute to this.

- 5 We are also concerned about the undue time pressure the IASB and FASB MoU on convergence has caused and its impact on the quality of the resulting standards. Sufficient time needs to be allowed to carefully adjust the proposals where needed, making them fully operational, and to ensure that the proposals result in better standards and improve financial reporting.
- 6 In EFRAG's view this also means that none of the jurisdictions or regions that are applying IFRS or are in the process of adopting IFRS should have a dominant influence on the agenda setting or standard setting process of the IASB.

June 2011 deadline

- 7 At present there are four major proposed and potentially controversial standards in progress: financial instruments, insurance contracts, leasing and revenue recognition. There is a clear tension between wishing to ensure that these standards, when issued, are of high quality and its related due process and the wish to finalise these standards quickly in order to meet the convergence deadline. As a result there is widespread concern that the final standards may not be of sufficient high quality, thereby causing problems for endorsement in Europe. In addition, there may be an increased need for subsequent interpretation and change if sufficient time is not allowed to carefully adjust the proposals and make them fully operational. We stress the importance of the IASB being irreproachable in its due process when finalising the four main projects to which it has now given clear priority and where it confirmed this priority in the IASB and FASB Progress report on commitment to convergence of accounting standards and a single set of high quality global accounting standards of 29 November 2010.
- 8 EFRAG fully understands that timing is important in the context of the forthcoming SEC decision in the course of 2011 whether to adopt IFRS for US domestic issuers. However, we urge the Trustees to consider that it is at least as important that European stakeholders can remain satisfied that their main concerns have been appropriately dealt with. In addition the interrelations between the priority projects need careful consideration which in itself requires time and can only be done near the end of the process.
- 9 We wish to raise the question whether June 2011 is not an artificial self – imposed deadline given the current developments. G20 called in their Seoul meeting on the IASB and FASB to complete their convergence project by the end of 2011 and also the SEC is no longer calling for the June 2011 deadline but rather emphasising the need for sufficient quality in the standard setting process. A number of the current projects will benefit if more time is allowed for deliberations, field testing and effect studies. This could be even seen in terms of months rather than years. EFRAG believes that a relatively minor extension of the timetable will pay itself off in the form of enhancing the quality of the ultimate standards.
- 10 We are not convinced by the argument that with three IASB Board members stepping down in June 2011, the loss of knowledge would be such that the projects would be hindered in their progress. Staggering the replacement of Board members has been specified in the IFRS Constitution to ensure the continuity of the Board and we believe that this is working well. In addition, Trustees can in their upcoming nomination process select candidates that have had more involvement in the IASB work programme.

- 11 We therefore suggest that the IASB project plans are revised with the objective of meeting the end of 2011 deadline. This will provide the time to include the field test and effect study stages that are needed to adjust the Board proposals as necessary to make them robust and efficient. For example such effect studies could take place on basis of the staff drafts issued before the final standards are issued.

Work programme and IASB agenda

- 12 We welcome the requirement in the revised Constitution that the IASB in addition to the annual consultations of the Trustees and the IFRS Advisory Council, should also carry out “a public consultation every three years, the first of which shall begin no later than 30 June 2011”. The increased transparency and accountability that public consultation will bring, will enhance the legitimacy of the IASB’s agenda decisions. An appropriate timing of the work plan/technical agenda consultation is of high importance. At this stage it is not known which projects will be accomplished by June 2011 even though the IASB and FASB Progress Report of 29 November 2010 has confirmed the target completion date of the priority projects to be June 2011 or earlier. We want to stress that any decision on the work plan needs to be taken with proper involvement of the new leadership of the IASB.
- 13 At present we do not have insight into the process and contents of the consultation. We are strongly of the view that the consultation should not only address the issues included in the IASB agenda but also the priorities setting and scoping of the agenda items. Decisions about the priority to be attached to agenda items and the scoping of those items should be subject to the same procedures and consultation as decisions about whether an item should be added or removed from the Board’s agenda.
- 14 An agenda item is only a label and an indication of the issue to be addressed without its scope being defined. We strongly believe that an agenda decision should start with the examination and description of what improvement is expected to be made to the resulting financial reporting. Over the recent years we have seen the performance reporting project becoming the financial statement presentation project with inclusion of the revision of segment reporting. Another example is IAS 37, which commenced with a narrowly defined scope, but resulted in a complete overhaul of the standard, including major changes in measurement. We believe that the Board should not be allowed to make such substantial changes to the scope of a project without proper consultation with the Trustees and the IFRS Advisory Council.
- 15 We recognise that the prioritisation of projects is a complicated issue in practice and involves consideration of a number of detailed factors including technical considerations (for example, linkage between projects) and operational considerations (for example, staffing). As a result, it is not feasible to expect every decision about priority and scoping to be subject to full due process and we also do not ask for this to happen. However, we see no reason why the IASB should not consult on major re-prioritisation and re-scoping programmes and on the priorities to be attached to and scope of major new projects.

Due process

- 16 Although we believe that the IASB's due process procedures as documented in the requirements are very good, we think there is room to improve the way they are implemented. For example, there is very widespread concern about how due process is operating in practice and we think consideration needs to be given to what could be done to address this concern. The IASB's constituents clearly put a lot of effort and resources into writing comment letters responding to the IASB's proposal, yet many feel the comments are not taken into account when the final standards are issued.
- 17 We want to take the opportunity to reiterate one of our earlier expressed concerns on the responsiveness of the IASB, which has not been addressed so far. Situations have continued to arise where a clear majority of significant commentators or a significant minority have expressed serious concerns about a proposed standard but their comments are rejected on the grounds that they have raised no new arguments and that these arguments have already been considered by the IASB during the development of the proposed standard. The fact that the comments continue to be raised by a substantial majority of significant commentators or a significant minority of commentators during every stage of the standard-setting process should, in itself, oblige the Board to address the concerns again, and to reconsider the impact assessment and needs analysis in order to assess whether all practical implications have been appropriately considered. Furthermore, any reassessment should be transparent and the results communicated to the commentators directly.
- 18 We are encouraged by hearing the IFRS Foundation Chairman taking the view that when a choice is to be made between two different accounting solutions, the solution that is most widely accepted would be superior. We believe that the IASB should also apply that notion in its standard setting process. The Board is currently taking positions and making changes on the basis that a majority of Board members firmly believe that their chosen solution is superior. Different accounting solutions can be of equally high quality, and among them, the solution that is the most acceptable to the public at large is usually the one that should be retained. IFRS have the objective of issuing "globally *accepted* standards". In this regard well accepted and well understood standards are likely to be better applied in practice (both by preparers and users).
- 19 In EFRAG's letter of 6 December 2010 on The Annual Improvements Process: Proposals to amend the Due Process Handbook for the IASB, we have brought to the attention of the Trustees our concern that the IASB is simultaneously introducing new options as a mechanism to bring about what may be considered to be a controversial change to a standard. We see first that an additional (preferred) option is introduced in a standard and that at a later stage, the original treatment is removed. This frequently occurs as part of a series of successive changes, rather than replacing the existing treatment with the IASB's preferred treatment at the outset in one revision of the standard. This, we believe, can result in the introduction of potentially significant and fundamental changes to the IFRS accounting model without having these changes been subject to full due process. We are of the opinion that this approach to standard setting is not acceptable.
- 20 We also wish to express our concerns about the IASB's intention to finalise some of the standards on a phased basis. Examples are hedge accounting requirements (portfolio hedges to be addressed in a second phase) and accounting for leases (standard for lessees only). EFRAG believes that final standards should only be issued when the phased projects are totally finalised

given that various requirements in the individual standards are interrelated and require internal consistency. Moreover in Europe the endorsement process of a partial standard has turned out to be difficult given that European constituents wish to assess the relevance and the appropriateness of each standard as a whole.

- 21 We are also concerned that in the desire to meet the June 2011 deadline a final vote will have been taken on some standards in June 2011 before they are ready for effective use and publication. We wish to ensure that the IFRS 3 Revised Business Combinations case does not repeat – voted in June 2007 (with 5 dissents) – and published in February 2008 (with two of the assenting members having been replaced in the meantime). The final outcome when a vote would have been taken in February 2008 could have been significantly different.
- 22 Furthermore we would like to reiterate another concern about the lack of comprehensive process for decisions about the re-exposure of proposals. EFRAG believes that there should be some form of explicit process that requires the IASB to explain the basis of its judgement where it has decided that re-exposure is not necessary in cases where significant changes to the ED's are made.

Bringing improvements at the right time

- 23 Improvements to financial reporting need to be fully understood if standards are to be properly implemented by preparers and the resulting information well understood by and useful to investors and other users. As a result, forcing changes into financial reporting that in the Board's view are improvements, may not result in improvements in practice if appropriate steps are not undertaken in advance of the proposed changes. This is the reason why EFRAG believes that fundamental changes to IFRS should not be made before these changes have been debated at conceptual level first.
- 24 We would like to illustrate this with some examples:
 - Deciding whether expected value for single risks is an appropriate measurement – a proposal that is strongly rejected by many constituents – can only take place following a conceptual debate what measurement of assets and liabilities should be reflected in the balance sheet.
 - No infringement of the reliability criterion should be made before the role that this criterion ought to play in financial reporting has been examined.
 - The IASB fair value measurement guidance should not be extended to non-financial assets and liabilities before this measurement debate has taken place and the issue of how to differentiate between entry and exit markets has been fully debated.
 - Recycling should not be eliminated before the debate on its relevance has taken place.
- 25 Whenever the IASB encounters strong or extensive objections and even rejections by the public to its proposals this may indicate that either the

proposed changes would not bring improvement in practice, or the proposed changes are premature. In these circumstances, we believe that the IASB should be prevented from going ahead. This type of significant objection and rejection should also be seriously considered when a whole region shows opposition – even if other regions express no such concern. The reason for this is often that proposed changes may fundamentally impact specific economic conditions in a region.

- 26 In addition to ensuring that final standards are better understood and implemented, more effective, launching debates of proposals at a conceptual level would also impose greater discipline on the Board when making its technical decisions. Technical decisions that are not subject to oversight – the independence of the standard setter has to be ensured – need to be made with great discipline. Another discipline that the IASB should observe is consistency in its bases for conclusions. Bases for conclusions are not helpful – or convincing - where they are inconsistent with each other. If such discipline were to be adopted in the IASB standard setting process, many IASB projects would raise substantially less concerns.
- 27 The Conceptual Framework should have more substance and be further developed. While the Framework states the objective of financial reporting as bringing useful information to investors, it stops short of featuring what is useful to users. Therefore in the development of standards the Framework cannot be referred to for guidance as to what is useful for investors. For example, it is proposed by the Board that the concept of control forms the basis for the reporting entity concept, but no discussion has been held as to why control is the basis for useful information to investors or why exclusive control is what matters and joint control being rejected.

Impact assessments

- 28 It is important for the credibility of the standard setting process that impact assessments in the form of effect analyses or field testing are carried out and published at several phases of the standard setting process, notably early in the process. Impact assessments ensure that the resulting final standards are sufficiently robust, allow for implementation in practice and result in relevant financial reporting. Time should be allowed for adequate field testing of new proposed standards and major proposed changes to standards before a final standard is agreed, in particular when the proposals turn out to be controversial and significant concerns are expressed by the constituents. Post implementation reviews have their own merits but cannot be replaced through field testing and effect analysis during the standard setting process.
- 29 EFRAG is about to publish a discussion paper on Effect Studies Methodology. The purpose of the Discussion Paper is to stimulate discussion on how standard setters should integrate further into the standard setting due process a systematic process for considering the effects of accounting standards as those standards are developed and implemented. The Discussion Paper is primarily addressing the IASB. The IASB is fully informed about the development and progress on this paper given that the draft discussion paper was presented to and discussed at the Global National Standard Setters meeting and at EFRAG TEG meetings. EFRAG would welcome an opportunity to present its discussion paper not only to the full Board but also to the Trustees. Effect studies are in our view an essential part of the standard setting process.

- 30 We would also like to see the Trustees encourage the IASB to fully implement the recent enhancements in the IASB's due process, particularly feedback statements and field testing before any further new final standard is agreed.
- 31 EFRAG together with the National Standard Setters in Europe representing one of the regions is ready to contribute actively to the field testing and other forms of impact assessments in Europe of the proposed standards in order to enhance the quality of the standards and the acceptability in Europe.
- 32 Another form of impact assessment is the post implementation review after a standard has been issued to assess whether the IFRS meet their intended financial reporting objectives and are considered useful and effective once the standards are in place and implemented. We believe that it should be considered and examined whether post implementation reviews should be carried out independently from the IASB.

Complexity of financial reporting and standards

- 33 As the business environment in which we operate today has grown increasingly complex, it is unavoidable that accounting standards also reflect in their requirements the increasing complexity of many business transactions, which in turn may result in more complex financial statements. The IASB should continue to ensure that its (proposed) standards are clear and comprehensible, as well as capable of being implemented and audited in a practical manner.
- 34 EFRAG is of the opinion that changes to the standards should be made only when they result in a more faithful representation of economic reality, in better presentation or increased transparency and thus an improvement of financial reporting. A proper balance needs also to be struck between the goal of improving financial reporting and the ability of preparers, auditors and, importantly, users of accounts, to be able to produce, audit and interpret the resulting financial information in a meaningful way. When standards become too conceptually purist, rules-based or complex, the financial statements prepared on the basis of these standards are no longer understood by management and as a result no longer considered relevant for internal management purposes. The result of this would be that financial reporting would become a compliance exercise, rather than a tool for internal and external decision-making. This would be highly undesirable.
- 35 To avoid such a situation, it is important that standard-setters find the appropriate balance between the ideal theoretic solutions and practical standards that limit complexity to the necessary minimum. The Trustees have an important role to play in setting guidance for criteria to be considered in making this analysis before new standards projects are added to the agenda.

A period of calm

- 36 Adequate time should be allowed for the implementation of standards in Europe and elsewhere. Frequently changing standards at the pace we have seen over the last years cause in addition problems for consistency from period to period. It should be considered if another regime for changes should be introduced to ensure stability in financial reporting. One possibility would be to introduce a system as currently applicable for IFRS for SMEs and making changes only at

periodic intervals unless there is a pressing need for changes to be made immediately.

- 37 The costs associated with educating preparers and users in application and understanding of existing and proposed accounting standards, as well as keeping such knowledge current are increasing dramatically. In addition there are the costs and risks associated with frequent substantial system changes resulting in many cases from changes in the application of accounting standards. Though standards may need to be improved and adapted in a fast changing environment, care should be taken to ensure that preparers and users can have confidence that there will be a certain amount of continuity of current standards.