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Mr Tommaso Padoa-Schioppa
Chairman
IFRS Foundation Trustees
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM
Email: strategyreview-comm@ifrs.org

Re: Trustees' Strategy Review

Dear Tommaso

The Financial Reporting Council (FRC) is pleased to provide comments on issues raised in your Strategy Review. The FRC is accountable to the Australian Parliament, and is responsible for providing broad oversight of the process for setting accounting and auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia and giving the Minister reports and advice on these matters. Members of the FRC are appointed by the Australian Government and represent key stakeholders in financial reporting including investors (retail and wholesale), issuers, directors, regulators (market, exchange and prudential), the accounting profession, and State and Federal Treasuries.

The FRC discussed your strategy review at a recent formal meeting, and notwithstanding the extension of your deadline for submissions, we have decided that I should write this letter at this time. We may choose to provide further input once we have had a further chance to consult with our colleagues within Australia, in the Trans-Tasman community, and in the broader Asia Oceania region.

Before commenting directly on the specific questions in the strategy review, it is worthwhile outlining Australia's continuing commitment to the concept of high-quality global accounting standards, as represented by International Financial Reporting Standards (IFRS). Australia currently contributes A$1 million per year to the IFRS Foundation, and regularly encourages other jurisdictions who have not yet adopted IFRS to progress to that goal. Australia clearly considers that the IFRS project is one of great importance. As a G20 nation, we also support their resolution for a single set of high-quality global accounting standards by 2011. We see that the IASB has a clear mandate and responsibility in this regard.

That said, clearly the Global Financial Crisis has exposed some of the weaknesses of the existing global system, including the incompleteness of the convergence process, and also the persistence of standards that have long warranted substantial reworking. Ultimately, individual jurisdictions will have to decide whether to adopt IFRS or not and, as they will be held accountable, these decisions are appropriately made by governments or their accountable agencies. The IFRS Foundation will need to be able to move forward on the important issues facing it, whatever the decisions by individual jurisdictions. It is important that the IFRS Foundation keeps pace, firstly to meet the expectations of the G20 and also because there is a body of opinion that holds that the future belongs to integrated reporting and IFRS will be subsumed by it.

We also note the stated intention of the Monitoring Board to undertake its own strategy review, without public consultation. We consider this apparent duplication unfortunate and arguably beyond the current remit of the Monitoring Board. We would also like to draw your attention to the fact that many involved with issues of accounting standards are facing a heavy burden from the massive workload incurred to maintain the convergence agenda on the appropriate footing for the US decision in 2011 and the revamping of standards necessitated by the global financial crisis. Thus, the level of reflective thinking and analysis required to fully resolve the issues you have raised may not be possible at this time, and the issues should in our view be revisited again in a few years when the outcomes and consequences of the convergence process are clearer and better understood. That said, we agree with you that it is time to begin consideration of these issues, and to start working toward some of the solutions but suggest that a stated intention of again reviewing the IFRS Foundation strategy in 2012 be made at the conclusion of the current review.

Mission

A. In its submission to the Trustees' Second Constitution Review last year, the FRC highlighted the need to ensure that public sector users of IFRS were brought within the ambit of the organisation's goals. In this regard, we are concerned that the expression of the Trustees' mandate, and the language that follows in IFRS concepts and standards, is increasingly being made specific to investors in certain capital markets without regard for the fact that the information needs of providers of resources to entities, whether in the private for-profit, not-for-profit or public sectors, are often very similar and all involve capital markets, broadly defined. In our experience the public sectors throughout the world are significant participants in capital markets and accordingly it is clear that the IASB standards should allow for this reality.

Though the view may be taken that the for-profit sector should be the current priority, being too specific in language is going to make eventual convergence of reporting for the various sectors more difficult and increase the incentive for different parties to write incompatible standards. The Trustees can mitigate this risk by identifying a direction that sees IFRS embracing all capital markets in due course. This would give the lead to the IASB to be cautious about expressing requirements without regard to how other standard-setters are addressing the same issues in sectors other than the private for-profit sector.

We do believe that it is in the public interest that the users of financial reporting are well served no matter in which sector they reside. The Global Financial Crisis has reinforced the fact that the sectors are fundamentally interconnected. We propose that the IFRS Foundation might alter its objective to:

These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to provide economic decision makers, notably investors and other suppliers of resources to reporting entities, with the financial information needed to make their decisions and accountability to those providing resources to entities.

B. In terms of any procyclicality of the financial instruments standard, this might imply that the standard should neither be strongly procyclical nor prevent regulators from imposing counter-cyclical requirements on these institutions. In order to achieve this, the IASB will need to continue to consult not just with investors and accountants, but also with central banks, finance departments and regulators. This does not mean that there is any need for accounting standards themselves to be used for a broader social objective; merely that they should not prevent this from happening. If for some reason it is technically necessary for accounting standards to contradict a broadly held social objective, this should be done in such a way that the trade-off is explicitly recognised and that another policy instrument can be applied in the cases where regulators need to do so.

The focus of financial reporting needs to be on facilitating efficient and effective economic decision-making. There should be no deliberate biasing of information towards a predetermined objective. In our view, the reconciliation of the needs of users of financial reports and also of the broader society, including those with stability objectives, can be achieved by including as a goal:

Ensuring that financial reporting standards facilitate, to the greatest extent possible, the ability of regulators to achieve social objectives, while acknowledging the broad objectives of financial reporting, and without making standards, or financial reports, unduly complex. Involving regulators in the design of standards may ensure that the information requirements of financial reporting mesh, as much as is possible, with those of regulators, and will go much of the way to ensuring that the reporting burden on reporting entities is not excessive.

Governance

The critical element to ensuring the independence of the IASB, which must be a primary goal of the governance process for the entire institution, is to ensure that IASB members are chosen by merit by a group outside the Board, and not directly part of government or any other body, such as representatives of the firms or accounting bodies. The Australian accounting standard setting system might offer an interesting parallel for the Trustees to consider. The Australian Accounting Standards Board (AASB) is an independent accounting standard-setter. The Chairman is appointed by a Minister while members, from a variety of backgrounds, are appointed by the FRC. The FRC is responsible for providing broad oversight of the process for setting accounting and auditing standards.

We understand that the triple tiered structure currently in place for the governance of the IFRS Foundation institutions is partly modelled on the framework in place in the US and might be regarded as replicating that. However, the two key flaws when applied internationally are appropriate global representation and the Monitoring Board's accountability, i.e. the SEC is accountable to Congress, whereas the Monitoring Board is not accountable to any party, and certainly not representative of the approximately 120 jurisdictions that utilise IFRS. The IFRS Foundation might consider a substantial revamping of the Monitoring Board to:

- *Reconstitute the Monitoring Board to provide democratic accountability for jurisdictions that have adopted IFRS or at least are undertaking a formal process of convergence and consideration of IFRS adoption.*

There seems little point for the IFRS Trustees and the IASB to be accountable to specific bodies representing jurisdictions that have not adopted IFRS. Nor are these necessarily the right representatives – these should be Finance Ministers or similar representatives, who are accountable to jurisdictions' parliaments. There *is* a case for broader global accountability and that has clearly been provided by the G20. The connection with the work of regulators is better made at the level at which the IASB is currently working with the Financial Stability Board.

The other fundamental issue that needs to be resolved in this review is having a clear assignment of roles, responsibilities and authorities to the Trustees and another set to a reconstituted Monitoring Board. At present there are considerable and confusing overlaps. To resolve this, the FRC suggests two possible models:

- A model where the IASB continues its fundamental role as provider of independent accounting standards, the Trustees continue their oversight and appointment roles, and that of raising funds; and the Foundation as a whole is accountable to the G20 at a political level. This model obviates the need for a Monitoring Board, and gives much broader political accountability than to the current Monitoring Board. The Trustees would address in their 2012 review, a mechanism to provide accountability to those jurisdictions adopting IFRS or at least undertaking a formal process of convergence and consideration of IFRS adoption.

- A model under which the IASB and the Trustees continue their current roles; with a reconstituted Monitoring Board providing political accountability to those jurisdictions adopting IFRS or at least are undertaking a formal process of convergence and consideration of IFRS adoption, with funding responsibilities and a role in appointing the chair of the IASB shifted to the Monitoring Board. This model clarifies some of the actions the Monitoring Board has actually taken, but may lead to some confusion in relations with the G20. In this case the Monitoring Board might better comprise representatives from the Financial Stability Board than being selected from IOSCO.

Process

To date, individual jurisdictions have pursued their own regulatory impact analyses (RIAs) in addition to the IASB's effect analysis; however national RIAs tend be dominated by the need to remain compliant with IFRS. It would help avoid repetition of process if the IASB were to undertake a full RIA able to meet the requirements of national RIAs when developing a new (or revised) standard. Many jurisdictions using IFRS mandate the use of RIAs that meet the standards established by the OECD. The OECD is regarded as authoritative in this field even by jurisdictions that are not members, and might be able to assist the IASB in developing new guidelines. As a first step the Trustees could oversee the RIA process, and the IASB would ensure accountability by publishing the RIA. In the longer term the Trustees might determine an appropriate body to review the RIAs.

The current standard setting process generally produces standards of a high quality, but has shown itself to be somewhat unresponsive and unable to deal with big issues in a timely way. For example, the IAS 39 Financial Instruments standard was long recognised as being in need of serious revamping, but it took the global financial crisis and G20 deadlines for the work to (hopefully) be finalised. In addition, the current process could be criticised for producing too many "tweaks" –

endless streams of minor changes to numerous standards, that while worthy, do anything but provide a “stable platform” for those jurisdictions considering adoption.

A process that could lead to a systematic and considered review of existing standards on a more *irregular* basis – in the absence of the need for an urgent patch – should be the ideal. In addition the process for putting new items on the IASB agenda for their consideration warrants reworking to make it more transparent. We suggest that the existing processes by which the IASB receives input on its agenda (i.e. Trustees, IFRS Advisory Council, and public roundtable meetings) are appropriate. However we believe the IASB should subsequently publicly respond on the final decisions taken on the agenda.

The FRC believes that consistent application and implementation has not been a key issue with IFRS to date. However, with a number of emerging market economies and potentially two large rules-based jurisdictions adopting IFRS in the near future, this will become more of an issue. The IASB staff is likely to need to work more closely in a hands-on way with jurisdictions implementing IFRS, although regional cooperation solutions also offer a lot of scope.

In the long run the FRC believes that there is a need to work toward a parallel international auditing standard framework to complement IFRS for accounting, and that this will ultimately prove essential to achieving consistent application of standards.

Financing

The FRC is of the view that public funding from jurisdictions proportional to their GDP is the ideal model for the funding of the IFRS Foundation. However, we acknowledge that very large jurisdictions, such as the EU and US, are likely to prove problematic in this regard in the short term. It is important that the power of the purse string not be seen to be able to give larger members the ability to dictate the treatment of specific accounting issues and hence we consider the existing role of the Trustees in this regard as important.

Yours sincerely,

Jeffrey Lucy, AM
FRC Chairman

Cc: Australian Accounting Standards Board

New Zealand Accounting Standards Review Board

Asian-Oceanian Standard-Setters Group