



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

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The Trustees
IFRS Foundation
30 Cannon Street
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24 February 2011

IFRS Foundation's Strategy Review

Dear Sir

The Basel Committee welcomes the opportunity to comment on the IFRS Foundation's comprehensive review of the organisation's strategy. The Committee has a strong interest in high quality financial reporting by banking organisations and strongly believes that governance issues are critical when developing financial reporting standards in the "public interest".

We have carefully considered the *Trustees' Strategy Review* and offer the following general comments:

1. We believe that the Foundation's Constitution should describe what the notion of "public interest" means in the context of setting financial reporting standards. We also believe that the "public interest" is broader than the interest of investors and includes prudential regulators that are concerned with safety and soundness and financial stability.
2. We encourage the Trustees to take into account the International Federation of Accountants' (IFAC's) efforts in this area and we generally support the type of public interest framework described in their recent work.
3. We note that special attention should be paid to the IASB "due process" and in particular to the Due Process Oversight Committee, whose responsibilities and authorities should be increased in order to ensure the accountability and independence of the IASB.
4. Any IFRS Foundation financing system should guarantee both the accountability and independence of the IASB. This would ensure that the "public interest" role of the IASB is always maintained.
5. Finally, we are withholding our comments on the Monitoring Board's governance arrangements in this letter. We intend to comment separately on the 7 February 2011 *Consultative Report on the Review of the IFRS Foundation's Governance*. As part of that comment letter, we will address specific aspects of the Monitoring Board's governance arrangements such as its structure, its composition and its relationship with the Trustees.

Our responses to some of the specific questions outlined in the *Paper for Public Consultation* are set out in Appendix A below. We trust you will find these comments helpful.

These comments have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat, Deputy Director General at the Banque of France. If you have any questions regarding our comments, please feel free to contact Mrs Mathérat (+33 1 4292 6579), Marc Pickeur at the Commission Bancaire, Financière et des Assurances, Brussels (+32 2 220 5253), or Rob Sharma at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Nout Wellink', with a large initial 'N' and a long horizontal flourish.

Nout Wellink

Appendix A

Responses to specific questions

Mission: How should the organisation best define the public interest to which it is committed?

1) The current Constitution states, “these standards [IFRS] 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 revision?

2) The financial crisis has raised questions among policy makers 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?**

Response to question 1

Several articles of the Constitution mention the “public interest” and highlight its importance when setting financial reporting standards. For example:

- Article 2 (a): the objectives of the IFRS Foundation are to develop, **in the “public interest”**, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles.
- Article 17 (a): the accountability of the Trustees shall be ensured inter alia through a commitment made by each Trustee to act in **the “public interest”**.
- Article 25: The members of the IASB shall be required to commit themselves formally to acting in the **“public interest”** in all matters.
- Article 29: Each member of the IASB shall agree contractually to act **in the “public interest”** and to have regard to the IASB’s framework in deciding on and revising standards.

We welcome your intention to define the notion of “public interest” in the context of financial reporting standard setting. A useful starting point for developing such a definition could be the definition in the International Federation of Accountants (IFAC) Policy Position Paper that was published for public consultation in November 2010.¹ This paper defines “Public” and “Interests” as follows:

- The “Public” is described as the widest possible scope of society and includes all users of financial information and decision makers involved in standard setting, financial report preparation, and financial report consumption (ie the financial reporting supply chain). This includes “preparers, corporate boards, stakeholders,

¹ The consultation paper title is *IFAC Policy Position Paper nr. 4 - A Public Interest Framework for the Accountancy Profession*. Comments are due by 25 March 2011. The IFAC Exposure Draft is available at <http://www.ifac.org/Guidance/EXD-Details.php?EDID=0145>.

auditors, governments, and financial industries (e.g., banking, insurance, legal, and investment services)", as well as "electors and taxpayers".

- "Interests" refers broadly to "*all things valued by society*". The paper describes more specifically the responsibilities that professional accountants have to society, including:
 - *Providing sound financial and business reporting to stakeholders, investors, and all parties in the marketplace directly and indirectly impacted by that reporting;*
 - *Facilitating the comparability of financial reporting and auditing across different jurisdictions; and*
 - *Reducing economic uncertainty in the market place and throughout the financial infrastructure (e.g. banking, insurance and investment firms, etc).*

We understand that the reference to economic uncertainty in the definition above is broad enough to include financial stability (see also our response to Question 2). As defined above, we believe that the IASB's standard setting activity is in the "public interest".

We would encourage the Trustees to consider the IFAC paper, which refers to a "public interest" framework that includes three criteria that can be used to assess whether or not (and the degree to which) any standard setting activity is in the "public interest" as this term is broadly defined in the paper.²

There would be considerable benefits for all financial reporting stakeholders in using the same approach and criteria to assess the "public interest" implications related to financial reporting, auditing, ethical and other standards (like education standards and public sector accounting standards). We recommend that the Trustees and IFAC (through its standard setting boards and the Public Interest Oversight Board) work together in this critical area and look to converge toward a common definition of "public interest".

Response to question 2

The recent financial crisis has shown that financial reporting standards and practices may have unintended consequences on a macro-economic level during periods of economic stress. The financial crisis has thus evidenced the potential impact of accounting standards on financial stability.

Financial stability, as a "public interest" matter, should be taken into account by the IASB in the financial reporting standard-setting process. A structured and regular dialogue between the IASB and "public interest" authorities is essential in this regard. Based on the constructive relationship between the Basel Committee on Banking Supervision's Accounting Task Force and the IASB, we recommend that "public interest" authorities, including those directly involved in financial stability matters, be consulted early in the development or modification of significant standards to identify potential implications for financial stability. In addition, field testing and ex-post analysis of new or revised financial reporting standards

² The IFAC paper's three criteria are:

1. Consideration of costs and benefits for society as a whole (this is larger than only preparers and users of financial statements and would include macro-economic impacts);
2. Adherence to democratic principles and processes; and
3. Respect for cultural and ethical diversity.

would be useful tools to assess the impact of such standards on markets. Here again, co-operation with “public interest” authorities would be mutually beneficial.

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 and linkages to public authorities?*

Joint response questions 3 and 4

The three-tier structure appears appropriate. In our view the governance of the IFRS Foundation could be improved.

The IFRS Foundation

Under the umbrella of the IFRS Foundation, we believe the standard-setting “process” could be strengthened if the Trustees serve the crucial role of integrating feedback about the “public interest” from the Monitoring Board into the IASB’s standard-setting process. On one hand, the Trustees should ensure that the IASB is aware of significant “public interest” issues that may require changes in accounting standards or guidance. On the other hand, the Trustees should recognise that changes in accounting standards often affect other standard setting activities (eg the International Auditing and Assurance Standards Board) and regulatory processes. We strongly encourage that the Trustees be responsible to ensure that the IASB is aware of such global considerations and that it engages with necessary stakeholders to avoid unintended consequences.

We also recommend that the Due Process Oversight Committee (DPOC), a Trustee Committee, should have increased responsibilities to safeguard the IASB’s independence and ensure the IASB is accountable. In our view, the IFRS Foundation Constitution should explicitly mention the DPOC’s role in the IASB’s due process, the DPOC should be able to meet with the IASB upon its request, and it should specifically assess the way the IASB complies with the *Due Process Handbook for the IASB* (mentioned in paragraph 37 (c) of the IASB Constitution). The DPOC should report on these activities and its conclusions to the Monitoring Board on behalf of the Trustees.

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 around 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 the consistent application and implementation issues as the standards are adopted and implemented on a global basis?*

Response to question 5

The standard-setting process currently in place is generally structured to ensure the quality of the standards if we consider the detailed *Due Process Handbook for the IASB* and progress made by the IASB regarding its outreach activities. However, there is always room for improvements with standard setting.

A recent revision to the IASB Constitution provides for public consultation on the IASB work plan every three years. This new feature of the Constitution combined with the proactive role that the Monitoring Board is expected to play should allow for identifying appropriate priorities for the IASB work programme.

Response to question 6

Yes, for the new and improved standards targeted for completion by June 2011, we would expect the IASB to focus during the transition periods on the quality and appropriateness of the implementation of the principles in these standards, especially by new adopters of IFRS.

To the extent possible, we encourage the IASB to have a period of stability with accounting standard setting after 2011 (ie have a “stable platform” of accounting standards for a period of implementation). This will allow preparers and national jurisdictions to carefully manage the challenges associated with implementing these standards.

Financing: how should the organisation best ensure forms 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?*

Response to Question 7

We would welcome a more automatic system of financing for the IASB. Stable, diversified financing would help promote the IASB's independence.