



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via e-mail

Mr Tom Seidenstein
Chief Operating Officer
IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

26 July 2011

Report of the IFRS Foundation Trustees' Strategy Review

Dear Mr Seidenstein

The Basel Committee welcomes the opportunity to comment on the April 2011 *Report of the IFRS Foundation Trustees' Strategy Review* (hereafter referred to as the Report). 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".

The Committee broadly supports the Trustees' recommendations as explained in your Report.

Our comments below reiterate several observations made in our comment letter of 24 February 2011 on the *IFRS Foundation's Strategy Review* and in our comment letter of 8 April 2011 on the IFRS Foundation Monitoring Board's *Consultative Report on the Review of the International Financial Reporting Standards Foundation's Governance* (hereafter referred to as the Consultative Report).¹

Our detailed comments are set out below.

1. The notion of 'public interest' (referred to in section A of the Report)

We believe that the IFRS Foundation Constitution should describe what the notion of public interest means in the context of setting International Financial Reporting Standards (IFRSs). We are aware that your report states that the standards should serve investors *and other market participants*. We also note that the IASB's Conceptual Framework for Financial Reporting 2010 includes lenders as a target group within the objective of General Purpose Financial Reporting, which is to provide financial information about the entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing

¹ These comment letters are available from the BIS website:
<http://www.bis.org/bcb/commentletters/commentletters.htm>.

resources to the entity. However, we are concerned that *in practice* the Board is primarily addressing the needs of equity providers and not all suppliers of capital resources (eg debt investors) by using the term “capital markets” rather than all financial markets. We believe that the Trustees, through their Due Process Oversight Committee, can clarify this point to ensure that the Board acts as required by the Constitution and the Conceptual Framework.

We share with the IASB the view that transparency in financial reporting is an essential component of addressing the varying public policy perspectives. We would encourage the IASB to build upon its technical dialogue with prudential supervisors to support financial stability. We observe that financial stability and transparency are not mutually exclusive objectives as some stakeholders have suggested. A necessary prerequisite for financial stability is transparency, as it encourages market discipline amongst all key market participants. The Basel II Capital Framework consists of three Pillars.² The Third Pillar is exclusively dedicated to increasing transparency through additional disclosures by requiring banks to disclose information on their risks and regulatory capital requirements. Basel III is also calling for increased transparency.

Furthermore, we welcome the observation in the Report that financial stability is an objective of standard setting. We agree that financial reporting standards may have unintended consequences for financial stability as has been demonstrated during the recent financial crisis. In this regard, we would like to emphasise that our concern is not that financial reporting standard setters should address prudential regulators’ financial information needs. We acknowledge that prudential regulators have means to ensure that they get the information that they need (refer to paragraph A1). Rather, financial stability should be among the objectives considered in the standard-setting process because it is in the interest of all investors and other market participants (as described above) that unwarranted disruptions to the financial system and the financial markets that may destroy capital do not occur. For this reason, prudential regulators have supported the replacement of IAS 39 and supported the approach taken by the IASB with regard to the classification and measurement of financial instruments and the expected loss impairment model.

2. Governance arrangements (refer to section B of the Report)

We welcome the Trustees’ efforts in enhancing the role of their Due Process Oversight Committee, including this Committee’s review of the status of the IASB’s due process on major projects. However, we believe this recommendation needs to be clarified to be able to fully understand its impact.

We understand that the Trustees are in the process of drafting Terms of Reference for each of the Committees that they have set up, defining the mission of each committee, its composition, due process and reporting obligations. We recommend that these Terms of Reference should be approved by the Monitoring Board and that the Monitoring Board should monitor the proper application of these Terms of Reference. In addition, we would also recommend the publication

² The Basel II Capital Framework is available at <http://www.bis.org/publ/bcbs193.htm>. Basel III also has transparency and disclosure requirements.

of these Terms of Reference as this would increase the transparency of the various committees and of the Trustees' function.

We believe that the current three-tier governance of the IFRS Foundation is appropriate. In contrast, we have communicated to the Monitoring Board our concerns about its composition.

3. Strengthening the process and procedures of the IFRS Foundation and the IASB (refer to section C of the Report)

We believe that the standard-setting process could be strengthened if the Trustees' oversight role includes ensuring that the IASB clearly demonstrates how priorities on its agenda are set. It would be particularly helpful to learn how the Board has taken into account (or has not taken into account) public interest matters and how and why the Board has arrived at the approach taken in the final IFRS. This approach would strengthen the due process.

We would like to reiterate our position relating to the IASB's mechanism for setting its own Agenda from our comment letter on the Consultative Report. On page 10 of that letter, we stated the following:

"Overall, the IASB should be free to set its agenda after appropriate public consultation. However, the IASB has a duty to account to the Trustees for its agenda decisions, including the scope and priority of items on the agenda and the allocation of staff resources to projects.

The Trustees should challenge the IASB where necessary on its agenda and the allocation of resources in light of its agenda. In addition, the Trustees should have the right to ask the IASB to reconsider its decisions, for example when it is felt that certain strategic issues have not sufficiently been taken into account (see article 37 (d) of the Constitution). The Monitoring Board's role is to ensure that the Trustees fulfil this oversight role effectively."

While we support the ideas of field visits/tests and effect analyses/impact assessments, we would appreciate a more enhanced role for field testing and impact assessments.³ It would be appropriate for the impact assessment to ideally occur earlier in the process (as an impact assessment is about available options). Field testing should also be done as early as possible (as field testing is about whether a chosen option would work well in practice).

We welcome the recommendation that the IASB should undertake post-implementation reviews. However, we believe the scope of such reviews as suggested is too narrow, being limited to important issues identified as contentious during the development of the pronouncement and including any unexpected costs or implementation problems encountered. Regarding the selection of standards for post-implementation review, such reviews are limited to new IFRSs, major

³ The European Financial Reporting Advisory Group's work, for example, might be a starting point to consider what can be done in this regard.

amendments and major interpretations. We believe the IASB should give priority to standards causing application problems.

Finally, to ensure the consistent application of IFRSs, we believe that the IASB would benefit from enhancing its existing liaison with the International Auditing and Assurance Standards Board (IAASB). It would be helpful for the Trustees to clarify that the IAASB should be consulted about:

- the auditability and enforceability of the financial reporting requirements (in particular in the area of disclosures); and
- the consistent application of the IFRSs in the context of the post-implementation reviews.

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 National Bank of Belgium (+32 2 221 3999), or Rob Sharma at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely



Stefan Ingves