

Commission services working paper on governance and funding developments in the IASB (International Accounting Standards Board) and IASCF (International Accounting Standards Committee Foundation)

2nd Report

1. Introduction

In December 2006, the Commission issued its first Report on governance developments in the International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation (IASCF). This Report followed from the ECOFIN declaration of 11 July 2006, which adopted conclusions on funding of the International Accounting Standards Board and invited the Commission to monitor and regularly report on developments in the governance of the IASCF/IASB.

The European Parliament, Committee on Economic and Monetary Affairs, under supervision of Rapporteur Mr Alexander Radwan, presented a draft working document on International Financial Reporting Standards (IFRS) and the governance of the IASB. The European Parliament report should be adopted in October 2007.

The first Report of the Commission acknowledged a number of actions that the IASCF Foundation and the IASB have taken to address governance concerns. At the same time, the Report identified the following areas where further progress was needed:

- Firstly, the **governance structure** of the IASCF/IASB, should be improved to strengthen the accountability of the Board and of the Trustees to their constituents, in particular those jurisdictions which apply IFRS.
- Secondly, as regards the IASB's **due process with stakeholders**, strengthened consultation procedures are necessary, especially for IFRIC. In particular, the IASB should explain the reasons for not taking into account comments made by stakeholders and should perform impact assessment, as well as field testing, before adopting a standard.

The IASB could also intensify its informal liaison relationships with national standards setters and preparers.

- Thirdly, **adequate representation of stakeholders** in governing bodies of the IASCF/IASB should be achieved through a composition of these bodies reflecting experience from countries committed to use of IFRS.

This second Report on governance developments in the IASCF/IASB reports on measures the IASCF Trustees and the IASB have undertaken in order to address issues raised by the European Commission in its first report.

In addition, it identifies further issues to be considered by the IASCF/IASB.

2. Governance structure

a) Accountability and oversight role of the IASCF Trustees

As concerns accountability and oversight role of the IASCF Trustees and the IASB, in April 2007 the Trustees approved proposals designed to address concerns raised by the Commission's Report. In particular, they decided to implement a more effective interface between the Trustees and the IASB in considering IASB's work programme.

Notably, in addition to the IASB's routine reporting to the Trustees at meetings open to the public, members of the Trustees' Procedures Committee will meet the IASB at least twice a year to review the IASB's work and to reflect the views of leading stakeholders. The Committee will then report back during the public sessions of the Trustees. These proposals should be implemented immediately.

The Commission welcomes this initiative, which should strengthen the oversight role of the Trustees by improving their reviews of the IASB's work, giving them more opportunity to check how the IASB takes stakeholders' views into account and ensuring the Trustees are more frequently updated on the IASB's work. The Commission will closely follow developments and the practical application of the changes made in this area.

b) Role of the Standards Advisory Council (SAC)

The Standards Advisory Council (SAC), whose role is to provide advice on the working agenda of the IASB and to give direction on the development of ongoing projects, is currently undertaking an analysis of how to improve its efficiency. It is foreseen that these deliberations will be completed by October 2007.

The Commission believes that it is crucial for the SAC to strengthen its input into technical work performed by the IASB. This is all the more

important as major stakeholders are represented in the SAC. This implies that the functioning of this committee should be improved to be more efficient and better represent the public interest. The SAC oversees the technical work of the IASB, in so doing it should:

- appear clearly independent from the IASB;
- be able to organise its meetings and working groups on its own initiative and with enough dedicated resources;
- organise its working processes in order to solve potential efficiency problems that may come from its size and/or the difficulty to frequently gather all its members;
- have its advice and concerns addressed in a timely and appropriate manner by the IASB.

c) Public interest and financial stability

There is currently no formal mechanism which requires the IASB to take into account financial stability factors when developing standards. The Commission acknowledges that the IASB consults the regulatory community on certain of its projects and welcomes the statement of the Trustees that the IASB should continue to engage banking supervisors and the broader regulatory community in its consultations at the earliest stages possible.

The Trustees and the IASB have undertaken to analyze the potential impact of new accounting standards on market behaviour and also to take a proper account of public interest issues, including financial stability. The Commission will follow and assess the content of such analysis with the purpose of determining whether the IASB has taken proper account of the views of broader regulatory community on public interest issues, including financial stability. In addition, structured contacts with institutions dealing with financial stability, in particular BIS and ECB should be developed by the IASCF/IASB.

Should the analysis and assessment of new standards prove not to be adequate in this respect, the Commission believes that a formal mechanism would have to be put in place in order to ensure that the IASB takes a proper account of the regulatory community's views.

3. Due process with stakeholders

a) Impact assessment and field testing

In its December report, the Commission raised the need for impact assessment. Subsequently, the Trustees issued a statement that they are currently working together with the IASB to build a framework that makes more explicit how cost-benefit considerations are taken into account when the IASB addresses new standards. Using field visits and building upon its consultative processes, the IASB will seek to explain more clearly the impact of new standards on capital markets. The proposed framework will be discussed during the Trustees meeting in Madrid on 2 and 3 July 2007 and implemented directly after this meeting.

The Commission strongly encourages the Trustees to work further on this and set up an appropriate process that could provide reliable impact assessments and field testing. Moreover, the Commission also notes that a proper ex post analysis of already adopted standards and interpretations would also be appropriate in order to ascertain their practical functioning and that they provide relevant information to users. The Commission therefore invites the IASB to conduct ex-post evaluations of existing standards and interpretations.

b) Feedback to comment letters

As regards feedback of the IASB provided to comment letters, the IASB has undertaken to establish a feedback statement, in which it would deal with comments received throughout the consultation process, enabling respondents and others to see how the IASB dealt with comments received. The framework for provision of feedback statements will also be discussed at the next Trustees meeting in Madrid and implemented straight away beginning with IFRS 3 – Business combinations.

The Commission welcomes this initiative. It underlines the importance of the IASB taking due account of comments received in the consultation process and, when it does not take account of such comments, giving full explanations and reasoning for this.

c) IFRIC due process

In the first report, the Commission raised a number of concerns regarding the International Financial Reporting Interpretations Committee (IFRIC). A number of these have been addressed by the Trustees.

First, in order to improve the transparency of the agenda process, the Trustees have abolished the IFRIC Agenda Committee. Abolition of the IFRIC Agenda Committee and transfer of its functions to full IFRIC should guarantee publicity and transparency for the agenda-setting process and for

that reason the Commission considers its point on the transparency of the agenda process to be adequately addressed by the Trustees.

Second, the Trustees have addressed the Commission's request for clarification of the status of agenda decisions and expressly stated that the IFRIC will continue to emphasize that its agenda decisions do not have the same status as IFRIC interpretations and are provided for information purposes only. This is a very important statement from the European perspective as the IAS Regulation 1606/2002 only refers to IFRSs and IFRICs as issued by the IASB and as a consequence, IFRIC agenda decisions are not subject to the formal endorsement process and are therefore not binding upon EU companies.

Third, the Trustees are proposing an expansion of the IFRIC from 12 to 14 voting members to allow wider participation. Consequently, the blocking minority will increase from 3 members voting against Draft or final Interpretation to 4. This change, however, requires amendment of the IASCF Constitution and will take, therefore, more time for its implementation. The proposal of the Trustees is in line with the Commission's comments concerning IFRIC due process and the Commission believes that new IFRIC members with practical experience in the application of IFRS and analysis of IFRS financial statements will provide a useful contribution to the functioning of IFRIC.

Lastly, the Trustees undertook to continue allocating additional staff resources to ensure timeliness of IFRIC interpretations. The Commission considers this decision of the Trustees should be helpful in ensuring that more issues can be publicly discussed and be processed in a shorter timeframe.

The Commission welcomes the measures which Trustees undertook in order to improve due process of IFRIC, but it also stresses that measurable improvement in the work of IFRIC needs to be demonstrated. In particular, it is of utmost importance for the European Union that the comments from the Roundtable on consistent application of IFRS are taken into account in work of the IASB on standards and interpretations.

4. Adequate representation of stakeholders

Trustees

The position of Chairman of the Board of Trustees was filled at the beginning of this year by Mr Philip Laskawy – interim Chairman, whose term will expire at the end of this year. The IASCF Trustees are currently seeking a new Chairman of the Trustees to replace Mr Laskawy. The IASCF Foundation publicly announced that it is looking for a European Chairman of the Trustees.

The Commission strongly supports the commitment of the IASCF to have a European Chairman of the Trustees and encourages the Foundation to agree on a suitable candidate as soon as possible.

Board

The terms of office of two full-time IASB members and one part-time IASB member will end on 30 June 2007. The Trustees of the IASC Foundation have appointed the first board member from China to replace one of the US members and are in the process of filling the two remaining positions, for which the Trustees advertised.

The Commission will closely observe the appointment process and its transparency in order to ensure that proper emphasis is given to candidates with practical experience with IFRS accounting in Europe and other jurisdictions requiring use of IFRS.

IFRIC

The composition of IFRIC should reflect a balanced representation of all stakeholders, in particular those with practical experience of using IFRSs. The IASCF Trustees have recently added three new IFRIC members from Europe with sufficient expertise in preparation of IFRS accounts, which is a welcome move. Moreover, the Trustees have recently announced expansion of IFRIC members from 12 to 14. This decision should ensure timeliness of IFRIC interpretations and improved justification and feedback to questions and comments from stakeholders.

5. Update on Funding

IASB/IASCF has informed the Commission that the efforts to create a new funding system are proceeding well. The Trustees have concentrated their fundraising efforts so far only on larger economies with biggest contributions. They, however, started recently to shift their fundraising endeavours to companies in smaller Member States in order to guarantee a broad based financing system. According to their latest information, the current state of play may be described as follows:

IASB funding seems to be secured in Denmark and Germany. Businesses in these countries have accepted to contribute for the next years. In the UK, the Financial Reporting Council (FRC) has taken on responsibility for collecting the UK contribution by way of levy for listed companies. In France, around 50 companies have committed to financing for the next couple of years raising nearly 1 million EUR. Negotiations in France, however, continue with a view of reaching the full target amount. The situation in Austria is subject to confirmation because of the recent change of government.

There are ongoing discussions as concerns contributions from Italy and the Netherlands. Authorities in these Member States are considering introduction of a possible listing levy. Swedish financing will be temporarily resolved using fees required from stock-exchange listed companies by a self-regulatory body.

Discussions are still in early stages in Belgium, Greece, Ireland, Spain and the 12 "new" Member States.

Other major jurisdictions

Australia – The funding issue is solved. Commitments are being collected through FRC Australia.

China – China has confirmed its commitment to reach the target amount. The funding method is by way of indirect arrangements with companies through the China Accounting Standards Committee, with the support of the Ministry of Finance.

Japan – The Financial Standards Foundation of Japan has agreed the target amount in principle and will be collecting this in bulk for transfer to the IASCF.

USA – Approaches are continuing. 2,5 million USD was agreed so far from the target amount of 8 million. Work on financing is accelerating in the United States.

The accounting profession has also voiced its commitment to continuing financial support of the IASCF/IASB.

The Commission puts emphasis on balanced contribution by a broad-base of market participants and it also views as important that no specific group is dominant in the funding.

6. Conclusion

The Commission welcomes recent announcements of the IASCF/IASB and the steps taken in order to address governance concerns. In particular, the Commission welcomes measures taken to establish a more effective interface between the Trustees and the IASB, and to put in place a framework to provide impact assessment studies for new standards, the commitment to provide appropriate feedback to comment letters, abolition of the IFRIC agenda Committee, reinforcement of administrative capacities of IFRIC and ongoing analysis of efficiency of SAC.

However, it remains to be seen how the IASCF/IASB will apply these changes in practice, in particular on impact assessment, feedback to comment letters and on SAC, so as to guarantee proper due process and accountability towards stakeholders. It is also very important that the comments from the Roundtable on consistent application of IFRS are taken into account in work of the IASB on standards and interpretations.

The Commission also considers that in addition to ex-ante impact assessments, it is equally important that the IASB makes a proper ex post analysis of already adopted standards and interpretations to determine whether their functioning in practice is appropriate and whether they provide relevant information to users.

As regards the legitimacy of the endorsement process for IFRSs and IFRICs in the EU, it is important that Member States and the European Parliament are informed about intention of the IASB to adopt new standards at early stages. The Commission therefore invites members of the Board to appear regularly (2 or 3 times a year) before Member States and the European Parliament to present standards, which are on its work programme.

As concerns implementation of new funding scheme, the Commission is encouraged that the collection of funding from private sources is proceeding well. Nonetheless, the Commission urges those Member States which have

not acted yet to do so rapidly and underlines the importance of proper diversification of sources and full participation of all interested jurisdictions.