

THE WORLD BANK

COMMENTS ON THE IFRS FOUNDATION MONITORING BOARD'S CONSULTATIVE REPORT ON THE REVIEW OF THE IFRS FOUNDATION'S GOVERNANCE

The World Bank welcomes the opportunity to comment on the IFRS Foundation Monitoring Board's Consultative Report on the Review of the IFRS Foundation's Governance.

The World Bank has an enduring commitment to the development of a single set of high-quality, harmonized international financial reporting standards. Good corporate financial reporting helps promote investment, develop capital markets, and thereby acts as an engine for economic growth. For this reason, we have supported the work of the IASC, the IASB and the IFRS Foundation for many years, in a variety of capacities.

This paper comes at a critical time for the medium-term prospects and ultimate future direction of International Financial Reporting Standards (IFRS), and it is therefore appropriate for the Monitoring Board to be seeking constituents' views on the key questions of the Foundation's governance.

The IFRS Foundation Trustees are currently undertaking their own strategy review, and recently issued a Consultative Report for public comment. The Monitoring Board's review addresses issues that overlap with those of the Trustees' review, but will be completed only after the conclusion of the Trustees' review. It is unclear how the two reviews will be co-ordinated, and what steps will be taken to ensure consistency in the conclusions of the two processes. The absence of apparent co-ordination of the two reviews risks undermining the standing of the IFRS Foundation as a substantive and responsible organization in the eyes of key stakeholders. We would therefore strongly recommend further dialogue between the Trustees and the Monitoring Board, as soon as possible, to agree on the way forward.

Our responses to the specific questions raised in the Report are set out below.

Question 1:

Do you agree with the proposal to urge concrete efforts to deepen the pool of candidates for IASB membership from diverse geographical and professional backgrounds? Please provide reasons for your agreement/disagreement.

We agree with this proposal, at least insofar as it relates to diversity of geographical backgrounds. As an institution, the World Bank is strongly committed to diversity and inclusion, which are at the heart of how we define excellence, and key to our

success as a global development organization. We regard our diversity as our comparative advantage as a global knowledge and development organization.

In our view, any organization that purports to act in the public interest on a global basis – such as the IFRS Foundation – cannot afford to take any other approach, and needs to value differences and use them as strategic business assets in achieving its objectives.

The Constitution of the IFRS Foundation (the Constitution) sets out the desired allocation of geographical backgrounds for IASB members. This allocation has not yet been achieved, although we recognize that the terms of several Board members will come to an end between now and the target date of mid-2012, which provides scope to meet the targets within the designated timeframe. Given that targets for geographic diversity have already been established, under the current Constitution it appears that limited scope exists to broaden the diversity of Board membership.

It is our view that the geographical allocation specified in the Constitution will not result in a sufficiently diverse composition for the IASB. Whilst we understand the rationale for the Board composition to reflect, in broad terms, the current global configuration of major capital markets, we are not convinced that this will achieve the breadth of geographical representation that is needed for the Board to have credibility as a genuinely global body. Specific concerns we have with the current allocation, and how it is being implemented/interpreted, include the following:

- 50% of members are to be drawn from North America and Europe – in our view this is too high.
- North America should not be interpreted as being synonymous with the USA.
- Brazil, India and China are not the only rapidly-growing developing countries.
- It is very difficult to achieve genuine representation for Asia under the current allocation.
- At the time of writing, the Middle East is not represented on the Board at all.
- One seat for Africa is insufficient; and South Africa is not representative of the African Continent as a whole.
- In evaluating candidates for Board membership, consideration should be given to where individuals' professional experience has been garnered, as well as their nationality, as this will color the perspectives they bring to the table.

Accordingly, in this respect we do not share the Monitoring Board's view that the current framework "...deserves some time for assessment...". In order to achieve the degree of geographical diversity sought, the geographical allocation proposed by the Trustees should be reassessed, and this reassessment should also consider whether a further increase in the size of the Board is warranted to allow for broader geographic representation.

The case for further diversity of professional backgrounds is less clear. Given the nature of the Board's outputs, Board members need to have in-depth technical accounting and financial reporting expertise, as well as a thorough understanding of the operation of financial markets, and the characteristics of, and valuation techniques for complex financial instruments. The degree of specialist expertise required necessarily limits the range of professional backgrounds from which candidates for Board membership can realistically be drawn. The organization should aim to recruit from the broadest possible pool within this limited range of professional backgrounds, but we are not of the view that a more specific allocation of professional background of candidates should be required.

Question 2:

Do you agree with the proposal to separate the roles of the IASB Chair and the CEO of the IFRS Foundation, and if so would you have suggestions on how to formalize this? Please provide reasons for your agreement/disagreement.

We agree in principle with the proposal to separate the roles of the IASB Chair and the CEO of the IFRS Foundation, mainly on practical grounds: as the Monitoring Board notes, both functions constitute full-time roles in themselves, and it is becoming increasingly impractical to expect one individual to fulfill them effectively. (We are less convinced of the seriousness of the actual or perceived conflict of interest that might arise from one individual being responsible for both functions.)

Separating the two roles would require an amendment to the Constitution, which explicitly states that the IASB Chair shall also be the CEO of the IFRS Foundation. We suggest that the Trustees proceed with such an amendment, after which a hiring process for the CEO may be initiated.

Question 3:

Do you agree that clearer division of responsibility between staff dedicated to the IASB operations and staff dedicated to the Foundation's administrative and oversight functions should be considered, and if so would you have suggestions on how to formalize this? Please provide reasons for your agreement/disagreement.

We agree that a clearer division of responsibilities along the lines suggested should be considered, consistent with the separation of the roles of the IASB Chair. We would propose that in implementing this proposal there be no sharing of staff roles – i.e., staff should be dedicated either to IASB operations or to the Foundation's administrative and oversight functions, but not to both.

Question 4:

Please provide comments on any aspects of Trustee composition or appointments that you believe the Monitoring Board should consider.

We provide our detailed comments with regard to the composition and appointment of Trustees under Question 5 below. We have one additional observation in connection with the Monitoring Board's proposal for a regular review of the distribution of Trustees' regions and professions.

The Constitution sets out broadly similar requirements for the geographic composition of the Trustees and the IASB. Insofar as the Trustees are concerned, we support the Monitoring Board's proposal for a regular review of geographic composition, perhaps as part of the 5-yearly Constitution reviews. However, a similar proposal is not made with regard to the Trustees' monitoring of the composition of the IASB – rather, under item 2-2-1 of the paper, the Monitoring Board urges the Trustees to undertake concrete efforts to deepen the pool of candidates for IASB membership from diverse geographic (and professional) backgrounds. This is a less onerous standard, especially in light of the qualifying clause that applies to IASB composition (“The work of the IASB shall not be invalidated by its failure at any time to have a full complement of members according to the above geographical allocation, although the Trustees shall use their best endeavours to achieve the geographical allocation.”)

We suggest that the Monitoring Board strengthens its recommendations in this area, specifically by requiring the Trustees to conduct a regular review of the geographic and professional composition of the IASB, in the same way as the Monitoring Board proposes to do for the Trustees.

Question 5:

(1) Do you agree with the proposal to provide increased transparency into the process for Trustee nominations? Please provide reasons for your agreement/disagreement.

To what extent should the Monitoring Board be involved in the nomination process?

(2) Do you agree that further clarification of criteria for the Trustees' candidacy would help support confidence of the stakeholders? Please provide reasons for your agreement/disagreement.

We agree that it would be useful to document and publish the formal procedures for the nomination of Trustees, including clear criteria for candidacy. Currently the only publicly-available material on the subject of the appointment of Trustees is the four paragraphs in the Constitution, which are couched in very general terms.

The criteria for an individual's candidacy as a Trustee are as follows:

- Must show a firm commitment to the IFRS Foundation and the IASB as a high quality global standard-setter
- Must be financially knowledgeable.
- Must be able to meet the time commitment.
- Must have an understanding of, and be sensitive to, the challenges associated with the adoption and application of high quality global accounting standards developed for use in the world's capital markets and by other users.

As a group, the Trustees shall:

- Broadly reflect the world's capital markets and diversity of geographical and professional backgrounds.
- Provide an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and officials serving the public interest.

Normally, two of the Trustees shall be senior partners of prominent international accounting firms.

The criteria for individuals' candidacy do not establish a challenging benchmark, and hence do not narrow the field of potential candidates to any great extent. Similarly, the desirable group attributes offer little insight into how the different perspectives that individual Trustees will bring are expected to contribute to the functioning of a highly effective group. Moreover, we do not believe that it is necessarily in the public interest for two of the Trustee positions to be reserved for senior partners of prominent international firms (or for representatives of any particular type or size of organization).

The IFRS Foundation is committed to transparency in all aspects of its operations, and stakeholders can reasonably expect to be provided with information about the basis on which members of the governing body are appointed, both in terms of the desirable attributes of Trustees – as a collective and as individuals – and the nomination and appointment procedures, to the extent that this is consistent with privacy considerations.

The question about the extent to which the Monitoring Board should be involved in the nominations process is somewhat surprising. The appointment of Trustees is one of the Monitoring Board's core functions, and it should be closely involved in all aspects of the process.

Question 6:

(1) Should the membership of the Monitoring Board continue to be confined to capital markets authorities responsible for setting the form and content of financial reporting in respective jurisdictions?

(2) Do you agree with the proposal to expand the Monitoring Board's membership by adding a mix of permanent members ([four]) representing primarily major emerging markets and rotating members ([two]) from all other markets? Please provide reasons for your agreement/disagreement. How should the major markets be selected? Should a jurisdiction's application of IFRSs and financial contribution to standard-setting play a role?

(3) Do you agree that rotating members should be selected through IOSCO? Please provide reasons for your agreement/disagreement.

We comment in detail under Questions 8 and 9 below on whether membership of the Monitoring Board should continue to be confined to capital markets authorities.

We agree with the expansion of the Monitoring Board's membership of capital markets authorities to include additional relevant authorities with the same kind of responsibilities with respect to financial reporting as the current members, along the lines suggested. We welcome in particular the focus on major emerging markets. Our reason for agreeing with this is that the current Monitoring Board membership is unrepresentative, and does not recognize or reflect the evolution of global capital markets in recent years. Accordingly, we support the inclusion of representatives from the major emerging markets. A jurisdiction's application of IFRS should play a role in determining eligibility for membership, but it should not be a condition: representatives from jurisdictions that do not adopt IFRS can make equally substantive contributions as those that do adopt, and may also bring fresh perspectives to the deliberations of the Monitoring Board.

We do not believe that a jurisdiction's financial contribution to the IFRS Foundation should be a determinant of its eligibility for membership of the Monitoring Board. Doing so would create an unfortunate perception that jurisdictions were able to buy seats on the Monitoring Board.

We do not have a strong view on whether or not rotating members should be selected through IOSCO.

Question 7:

Do you agree that the Monitoring Board should continue to make its decisions by consensus? Please provide reasons for your agreement/disagreement. Are there any types of decisions taken by the Monitoring Board for which voting other than by consensus (for example, by qualified majority) may be appropriate? If so please describe why and suggest an appropriate voting mechanism.

We see no reason why the Monitoring Board should not continue to make its decisions by consensus.

Question 8:

To ensure increased involvement of public authorities and other international organizations in Monitoring Board activities, do you support the Monitoring Board (a) expanding the number of Monitoring Board observers, (b) holding more formalized dialogue, or (c) establishing an advisory body, and on what basis? What should be the criteria for selecting participants?

In our view, the basis on which the Monitoring Board continues to restrict its membership to capital market regulators is debatable. It is argued that:

- The Monitoring Board appoints and oversees the activities of the Trustees.
- The Trustees oversee the activities of the IASB, which issues IFRS.
- IFRS “are primarily designed to provide accurate information to users of capital markets”.
- Securities regulators are responsible within each jurisdiction to ensure that appropriate accounting standards are used for financial reporting.

Therefore the Monitoring Board should comprise only securities regulators.

However, the Constitution states that: “These standards [IFRSs] 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.” (Emphasis added.) By limiting membership of the Monitoring Board to securities regulators, the interests of other (i.e., non-investor) participants in the world’s capital markets and other users of financial information are not being addressed. Moreover, oversight of the Trustees is at one step removed from direct oversight of the standard-setting activities of the IASB, which tends to further weaken the argument that only securities regulators have the necessary institutional mandate to perform the oversight function.

As noted below, we do not believe that the perspectives of the various constituencies with an interest in financial reporting and financial reporting standards should necessarily be at odds with each other. All users of financial statements have an interest in information that is both relevant and represents faithfully the economic substance of the underlying transactions. Differences arise between user groups in terms of the relative emphases placed on different components of financial statements.

We recognize, however, that investors are the primary users of general purpose financial reports and therefore securities regulators have the primary interest in financial reporting standard-setting, by virtue of their role in setting financial reporting requirements in their home jurisdictions. Whilst we believe that other constituents have a valuable contribution to make, the Monitoring Board was established to serve as a mechanism for formal interaction between capital markets authorities and the IFRS Foundation. Broadening its membership to incorporate prudential authorities would inevitably change the perspective of the Monitoring Board, and potentially inhibit the dialogue between the Foundation and securities regulators.

In our view, therefore, there is a legitimate argument for expanding the number of observers at the Monitoring Board to include other groups of prudential authorities and other international organizations¹. In other words, our preference is for Option (a) in Question 8.

Question 9:

Do you believe that the current arrangements for the standard-setting process adequately ensure the appropriate involvement of all relevant stakeholders and that all relevant public policy objectives are taken into account? Please provide reasons for your agreement/disagreement.

As outlined in our response to the preceding question, we believe that the governance arrangements for the standard-setting process neither adequately ensure the appropriate involvement of all relevant stakeholders, nor take into account all relevant public policy objectives. Limiting the membership of the Monitoring Board to securities regulators means that the perspectives of banking supervisors and others concerned more broadly with financial stability issues are absent. In the wake of the financial crisis, we believe that an integrated approach to macro-prudential and capital market regulation is called for, since it is clear that no single regulatory group has all the answers to the complex problems that confront us.

Moreover – and of particular concern to the World Bank – there is inadequate voice for developing countries under the current arrangements. Whilst IFRS are primarily targeted at corporations listed on the major capital markets, we believe that the longer-term success of the standards will be determined by the extent to which they are adopted on a global basis, and in particular in the developing world. We therefore welcome the proposal to open the membership of the Monitoring Board to Brazil, India and China. But the interests and views of other developing countries – both middle-income and lower-income – are also important in this context, and we think some way should be found to accommodate them.

Adoption of IFRS in the SME sector, in both developed and developing countries, will be a critical success factor for the Foundation. The IASB is especially concerned with SME issues and has allocated Board and staff resource specifically to work on them: which means that as part of their oversight function, the Trustees will also need to have an awareness of the issues that impact adoption of IFRS in the SME sector. However, by limiting its membership to securities regulators, there is a risk that SME sector issues and concerns may not receive a proper airing at the Monitoring Board.

¹ For example, the IAIS, the IMF and the World Bank.

Question 10:

What are the appropriate means and venues for the Monitoring Board to enhance the visibility and public understanding of its activities?

We agree that the Monitoring Board's current outreach efforts are not fully effective in promoting public understanding of its activities. Media and communications strategy planning is a specialized area; we suggest that the Monitoring Board commissions some consulting advice from appropriately qualified professionals, to identify target audiences and plan the most effective means of communicating to them its activities.

Question 11:

Do you believe that the current arrangements for Monitoring Board involvement in the IASB's agenda-setting are appropriate, or should the Monitoring Board have an explicit ability to place an item on the agenda, or would you consider other alternatives that would enhance the Monitoring Board involvement in the IASB agenda setting? Please provide reasons.

We believe that the current arrangements for Monitoring Board involvement in the IASB's agenda-setting are appropriate. The Monitoring Board should not have an explicit ability to place an item on the agenda as this would, in our view, impair the independence of the IASB. Agenda-setting is a central element of the standard-setting process, and the IASB has in place rigorous due process arrangements for the setting of its agenda. We believe that Article III. B of the Memorandum of Understanding between the Monitoring Board and the Trustees already provides ample scope for the Monitoring Board to make its views on accounting issues known to the Trustees and the IASB Chair, and to refer any such matters to them for consideration.

Question 12:

Do you have concrete suggestions on how the Monitoring Board or the Trustees could encourage a move towards a more stable and independent funding model?

As with communications strategy, fundraising is a specialized area, and the Trustees should commission expert advice to guide its efforts in this area. In our response to the Trustees on their strategy document, we recommended that they initiate a dialogue with the FSB, as a proxy for the G20, to explore ways to establish a sustainable, long-term funding model for the Foundation.

Question 13:

(1) Do you believe that the Monitoring Board should have a more prominent role in the selection of the IASB Chair? Do you agree with the proposal that the role include involvement in establishing a set of publicly disclosed criteria for the Chair, and assessment of a short list of candidates against those criteria? Please provide reasons.

(2) Do you believe that the Monitoring Board should be given any further, specific role in the selection of the IASB Chair? In particular, should the Monitoring Board approve the Trustees' final selection? Please provide reasons.

The Monitoring Board notes in the paper that: “A properly functioning governance model requires clear delineation of the respective oversight responsibilities of the Monitoring Board and those of the Trustees.” We believe that the Monitoring Board’s proposals with regard to its role in the appointment of the IASB Chair cut across this important overarching principle, by extending the Monitoring Board’s role beyond oversight into direct involvement in operational matters, in a way that would undermine the proper role of the Trustees.

We agree that some dialogue between the Monitoring Board and the Trustees with regard to the criteria for the Chair may be appropriate. The criteria for the appointment must be informed by, and consistent with the strategy for the IASB, and since the latter subject is a matter on which the Trustees and the Monitoring Board will confer from time to time in the context of their oversight roles, there may be some value in such a discussion prior to initiating an appointment process. Such a dialogue is consistent with section 19(a) of the Constitution, under which the Monitoring Board shall “review and provide advice to the Trustees on their fulfillment of the(ir) responsibilities...”

That being said, we do not believe it would be appropriate for the Monitoring Board to play any further role in the appointment of the IASB Chair, whether it be assessing a short list of candidates against the appointment criteria, or approving the Trustees final selection. These are both roles that fall squarely within the purview of the Trustees, under the Constitution.

The Monitoring Board does not propose to play any direct role in the appointment of IASB members (apart from the Chair), since it has concluded that “(s)uch a role may appear to infringe upon independence and erode public confidence in the standard-setting body...” It is by no means clear to us why this same argument does not apply, with even greater weight, in the case of the appointment of the Chair.

Question 14:

Do you agree that the Monitoring Board’s responsibilities should explicitly include consultation with the Trustees as they further develop the framework to ensure proper balance in the composition of the IASB? Please provide reasons for your agreement/disagreement.

We agree with this proposal. We have commented in greater detail in response to previous questions on the desirability of the Trustees’ further refining the framework to ensure proper balance in the composition of the IASB. In doing so, it would be consistent with the defined respective roles of the Trustees and the Monitoring Board for there to be joint consultations on this issue.

Question 15:

Do you agree with the proposal to consider establishing a permanent secretariat for the Monitoring Board to support its increasing roles in overseeing the governance of the standard-setter? Would you support this proposal even if it would require additional financial contributions from stakeholders? Please provide reasons.

We agree with the proposal to consider establishing a permanent secretariat for the Monitoring Board. The current arrangement, under which secretariat support is provided by the rotating Chair of the Monitoring Board, is problematic in a number of respects:

- Member bodies of the Monitoring Board may not be adequately resourced to provide secretariat support.
- Unless the designated staff work full-time on Monitoring Board activities, there is a risk that the secretariat work will be regarded as a lower priority than the staff’s “core” work program.
- Since the position of Chair of the Monitoring Board rotates periodically, the secretariat support must also rotate. There is a risk that the associated discontinuity in staff support will be disruptive to the work program.
- The lack of a permanent secretariat may be perceived by stakeholders as indicating a casual and informal approach by the Monitoring Board to what is an important function.

We would also support the creation of a permanent secretariat shared by the Monitoring Board and the Monitoring Group responsible for overseeing the governance of IFAC. We believe there would be synergies by combining the two functions, and would enable a critical mass of staff to be assembled, which would not necessarily be possible with the creation of two separate secretariats.

Question 16:

Do you agree with the need for regular reviews, and the interval of five years as a benchmark? Should the reviews be aligned with the timing of the Foundation's mandated Constitution reviews? Please provide reasons for your agreement/disagreement.

We agree with the need for regular reviews of the governance structure. A five-year interval seems appropriate, and the reviews should also be aligned with the Foundation's mandated Constitution reviews.