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To:

IFRS Foundation Monitoring Board
c/o Financial Services Agency of Japan
Attn. Mr Takashi Nagaoka & Mr Makoto Sonoda

12 April 2011

Re.: Consultative Report on the Review of the IFRS Foundation's Governance

I appreciate the opportunity to comment on the Monitoring Board's Consultative Report on the Review of the IFRS Foundation's Governance[1].

I am a resident scholar at Bruegel, a European think tank which started operations in Brussels in 2005, and a visiting scholar at the Peterson Institute for International Economics, based in Washington DC. I am also a member of the CFA Institute's Corporate Disclosure Policy Council, of the International Corporate Governance Network's Accounting and Auditing Practices Committee, and of the French Accounting Standards Authority's Advisory Council. This letter represents my personal views and not those of any of the above mentioned organizations. Accounting standard-setting is a topic on which I have conducted research almost continuously in the past decade, first in France and then in an international context[2]. I believe that my work commitments and activities do not introduce any commercial or special-interest bias to my views nor do they impair the integrity of my research[3].

This letter follows comments I had contributed to the Foundation's Trustees in the context of their own Strategy Review[4] earlier this year; also to the Trustees in both phases of the Foundation's latest Constitution Review[5]; and to the US Securities and Exchange Commission's consultation on its proposed "roadmap" in 2009[6].

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[1] Consultative Report available on http://www.iosco.org/monitoring_board/pdf/Review_of_the_IFRS_Foundation_Governance_Report.pdf

[2] See in particular "La Mondialisation en partie double : La Bataille des normes comptables" (with Philippe Crouzet), En Temps Réel, Paris, March 2002, English version published in September 2004; *Smoke & Mirrors, Inc.: Accounting for Capitalism* (with Matthieu Autret and Alfred Galichon), Cornell University Press, July 2006; and *The Global Accounting Experiment*, Bruegel Blueprint Series, April 2007

[3] A comprehensive list of these commitments and activities is available on www.bruegel.org

[4] Response available on http://www.ifrs.org/NR/rdonlyres/86161C46-D78A-46FB-9BC5-23C67139FF02/0/NicolasVeron.pdf

[5] Published by Bruegel, respectively, as "Empower Users of Financial Information as the IASC Foundation's Stakeholders", July 2008; and "IFRS Sustainability Requires Further Governance Reform", December 2009, both available on www.bruegel.org (Policy Contribution series)

[6] Published by Bruegel as "A US Strategy for IFRS Adoption", Policy Contribution 2009/06, April 2009, available on www.bruegel.org

General Comments

Accountability challenge

The core challenge of the IFRS Foundation's governance is to make it credibly accountable to the base of stakeholders whose needs it is primarily meant to serve, namely the global investment community. The IFRS Foundation's Constitution and even more so the IASB Conceptual Framework are quite unambiguous about this stakeholder orientation. So are the preamble of the Monitoring Board's Charter as signed by all its current members (first recital: "Whereas, the primary objective of general purpose financial reporting is to provide financial information about the issuer to capital providers"), as well as its statement of 22 September 2009 on Principles for Accounting Standards and Standard Setting[7].

The global investment community is very fragmented and has not organized itself into any broadly representative body, in spite of valuable contributions from organizations such as the CFA Institute or the International Corporate Governance Network. This problem of collective action makes it challenging to create a well-functioning governance framework for the IFRS Foundation.

In its first eight years of existence (2001-09), the IFRS Foundation (then named IASC Foundation) has been governed by a group of Trustees who were initially appointed by an ad hoc committee and then independently decided on their own reappointments and replacements. In early 2009 this framework was profoundly altered by the creation of the Monitoring Board, whose governance is set by its own Charter though without autonomous legal personality, as a separate body from the IFRS Foundation, and the agreement of a Memorandum of Understanding under which the Foundation's Trustees grant the Monitoring Board broad and explicit power over their own appointments and reappointments. This transfer of power implies that the role of the Monitoring Board goes actually well beyond mere monitoring – its name is a misnomer – and that it has become the IFRS Foundation's de facto highest body, even though it is not formally part of the Foundation[8].

The previous situation, in which the Trustees were essentially self-appointed, was unsatisfactory from an accountability perspective and recognized as such by most stakeholders. However, the post-2009 arrangement is not satisfactory either, for two main reasons. First, the Monitoring Board cannot be expected to consistently represent the global investment community, whose needs the IFRS Foundation is meant to serve, because of the diverse perspectives, mandates and governance patterns of its members. This assessment is amply backed by past experience. Second, the Monitoring Board, through its crucial power to appoint and reappoint the Trustees, has de facto control over the Foundation (at least on a medium-term basis) without being actually part of its institutional framework. Such "backseat driving" can be expected to result in a harmful muddling of responsibilities, with the probable effect of further disempowerment of the Trustees without compensating it by creating appropriate accountability channels for the Monitoring Board itself.

Two options for improvement

This situation can be improved in two possible ways. The first, in my opinion preferable option would be to recognize the central role of the Monitoring Board in the Foundation's governance, bring it into the fold of the Foundation itself, and make it more convincingly representative of the global investment community. In this option, the governance of the Monitoring Board itself would be set by the

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[7] Monitoring Board Charter and September 2009 statement available on http://www.iosco.org/monitoring_board/

[8] The Foundation's revised Constitution has a section about the Monitoring Board (Articles 18-21); however, the Monitoring Board is not bound by the Constitution.

Foundation's modified Constitution, and its Charter and Memorandum of Understanding with the Trustees would no longer exist. To be consistent with the commitment to serve the information needs of the global investment community, the membership of the Monitoring Board should be simultaneously enlarged to a number of investor representatives, which I believe should be at least as many as the representatives of public authorities within the Monitoring Board. How to select these investor representatives would be a thorny, but in my opinion not intractable issue.

The other, less radical option would be to refocus the role of the Monitoring Board on monitoring, by ending its right of veto over Trustee appointments and reappointments and thus reducing the current confusion of responsibility and accountability. However, this should not be simply a return to the pre-2009 situation, and additional accountability of the Trustees to the global investment community should be introduced. One possibility would be to complement the current Monitoring Board with a parallel body composed of investor representatives and to require both bodies to express public opinions on proposed Trustee appointments as part of the Trustee appointment and reappointment process.

Just as important, the Foundation's funding framework requires reform that would make it better aligned with the aim of keeping the Foundation accountable to the global investment community. This should involve a re-examination of the principle that funding should be "non-voluntary", which is practically incompatible with the aim to make the Foundation independent from national political interests.

These fundamental issues of accountability should be clarified as a priority for the Monitoring Board's reform efforts. I am fully aware of the political difficulty of such an endeavor – but what is at stake is the mid-term sustainability of IFRS standard-setting with global authority, a crucial component of current policy commitments to efficient, globally connected capital markets. Thus, I believe that the Monitoring Board should consider bold options to fix what remains at this point a profoundly imbalanced, and potentially dysfunctional, governance framework.

Responses to the Monitoring Board's Questions

In the text below, the sections in italics reproduce the questions listed in the Monitoring Board's Consultative Report.

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.

The IFRS Foundation has published a set of detailed criteria for the selection of IASB members, as an Annex to its Constitution document. However, it has not always been seen as complying with these criteria. Specifically, by recently appointing of Mr Hans Hoogervorst as Chairman of the IASB, the Trustees have chosen an individual of high reputation but whose prior accounting experience is limited, in apparent non-compliance with the first criterion set out in the Annex under which "All members of the IASB (…) should have demonstrated a high level of knowledge and technical competence in financial accounting and reporting." I insist that this remark is not meant as criticism of the decision to appoint Mr Hoogervorst, but rather of the value of adding criteria while the existing ones are arguably already too rigid to be expected to be fully complied with.

Specifically, I would favor relaxing the geographical criteria set out in the Constitution's current Article 26, and replace them with a general requirement that the composition of the Board should not be materially imbalanced when measured against the realities of contemporary capital markets.

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.

I would support the deletion of the words "who shall also be the Chief Executive of the IFRS Foundation" in the Constitution's Article 30, and the introduction of separate provision for the appointment of the Foundation's CEO by the Trustees replacing the current Article 47, thus allowing for the appointment of a separate CEO if the Trustees so decide.

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.

I would support the physical separation of the two organizations by moving the main office location of the Foundation's staff (as opposed to the IASB's staff) to either the Americas or Asia (in a country widely seen as strongly committed to the rule of law), thus making the Foundation less London-centric and a better reflection of the global diversity of its stakeholders than is currently the case. This proposal is also practical given the current small size of the Foundation's staff (see also response to Question 15).

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

In addition to the comments provided in the above General Comments, I would favor making the position of Chair of the Trustees a full-time (or at least half-time) job, thus allowing for actual leadership and commitment that in general has not been sufficiently noticeable in the past half-decade or so.

5. 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? 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.

There is an inherent limit to the extent of the possible transparency of recruitment processes, short of making them subject to actual elections by a broad base of voters, which I do not recommend at this stage of the development of the IFRS Foundation. Thus, I do not see a case or scope for additional transparency. As argued in the General Comments I also believe that the involvement of the Monitoring Board should be reduced by no longer giving it a veto over Trustee appointments, unless the Monitoring Board is itself fully brought into the scope of the Foundation's Constitution and is made in effect a body of the Foundation.

As for recruitment criteria, I would favor adding a provision in Article 6 of the Constitution that each new Trustee's professional background should give credence to his/her commitment to high-quality standards that serve the needs of capital providers. I would also favor deleting the unnecessary and distortive provision in Article 7 that "Normally, two of the Trustees shall be senior partners of prominent international accounting firms".

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

As set out in the above General Comments I see two broad options for the improvement of the Monitoring Board's position and role. In the first, in my view preferable option, the Monitoring Board should be transformed into a body of the Foundation that should credibly represent the global investment community whose needs the Foundation is meant to serve. In the second, less radical option, the Monitoring Board should see its formal power to appoint the Trustees scaled down so as to enhance the possibility that the Trustees would see themselves as accountable and committed primarily to the global investment community.

In both such options, as well as in the assumption of status quo in the form and role of the Monitoring Board (an option I do not recommend), the choice of public authorities as members of the Monitoring Board should be confined to those that, in view of their mandate and governance framework, have the most credible alignment of priorities with the global investment community as regards financial reporting standard-setting, in their respective jurisdictions. This criterion should be preferred to the formal responsibility "for setting the form and content of financial reporting", whose importance is set to decline in those jurisdictions that have already made the firm decision to adopt IFRS. In the three jurisdictions that currently enjoy a permanent representation in the Monitoring Board, the above suggested criterion would arguably lead to the inclusion as members of, respectively, the US Securities and Exchange Commission, the Japanese Financial Services Agency, and the European Securities and Markets Authority.

As for the geographical coverage, objective criteria for representation in the Monitoring Board would be preferable to discretionary powers for IOSCO. One option would be to weight jurisdictions by their share of the aggregate market value of listed companies' free float, based on the location of such companies' operational headquarters. Under this criterion I would expect, subject to more precise calculation, that 11 jurisdictions have consistently occupied the first ranks in the past few years and together represent more than nine-tenths of the global total: Australia, Brazil, Canada, China, the European Union, Hong Kong, India, Japan, Russia, Switzerland, and the United States. The membership of the Monitoring Board (again, as far as public authorities are concerned) could thus be based on this list. Alternatively, the inclusion of GDP as part of the weighting of jurisdictions could be considered. The criterion of free float is imperfect, particularly as it directly relies to issuers rather than to the investor community, but it is comparably easy to define and understand, and directly related to the use and usefulness of financial reporting standards, which is why I recommend its use for lack of a better alternative.

As the Monitoring Board should primarily serve the needs of the investor community rather than issuers, I do not see a case for making inclusion of a public authority in the Monitoring Board directly dependent of whether the corresponding jurisdiction mandates or permits the use of IFRS for local issuers.

I am not sure that rotating memberships are necessary or even desirable in this context, but would recommend a revision of the membership at regular intervals (say, every five years) together with a principle that the number of jurisdictions represented should not exceed a reasonable total, say twelve, in order for the Monitoring Board not to become too unwieldy. One implication would be that jurisdictions could have to leave the Monitoring Board if their relative share in global free float drops, assuming the above proposed weighting criterion is adopted. Thus, rotation would mirror the transformations of the global financial landscape.

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.

If the Monitoring Board's role was essentially consultative, as it would become in the event of suppression of its veto right over Trustee appointments, then consensus could arguably be kept as a decision-making principle.

However, if the Monitoring Board has direct decision-making power in respect to the Foundation, as is currently the case and as would also be the case if it were to integrally become a body of the Foundation, then the consensus rule is likely to lead to harmful deadlock, in the current configuration and even more so if Monitoring Board membership is extended to additional jurisdictions and/or enlarged to investor representatives.

In such case, I would advocate a qualified majority voting principle using the same weighting as in my suggestions in response to the previous question – e.g., share of the aggregate market value of listed companies' free float in the global total. The majority threshold could be set at different levels (say, from simple majority to four-fifths) depending of the type of decision considered.

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?

I am unsure of the usefulness and role of observers in the Monitoring Board and would rather favor a commitment by the Monitoring Board to consult with relevant global bodies with a clear and broad role in supporting economic and financial policymaking at global level, including the Financial Stability Board and the International Monetary Fund and depending of the nature of the decision(s) to be made.

As IFRS are unambiguously meant not to be sector-specific, there is no compelling case for giving a privileged position to sectoral regulators, be they of banks or insurance companies or telecom firms or electric utilities, in the general framework of the Monitoring Board. The obvious importance of financial sector accounting justifies a frequent dialogue between the IASB and the Basel Committee, but not a formal representation of bank supervisors as such in the Monitoring Board.

I am also skeptical about the establishment of a new advisory body, as this would further complicate the already fairly complex set of bodies surrounding IFRS standard-setting.

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 a specialized organization that primarily serves the needs of a specific base of stakeholders, first and foremost the global investment community, the IFRS Foundation cannot and should be expected to give all possible public policy objectives the same level of priority.

This is echoed by the fact that most jurisdictions that have adopted IFRS have included safeguard clauses in their endorsement mechanisms, such as the provision in EU Regulation 1606-2002 (Article 3.2) that IFRS can only be adopted if they "are conducive to the European public good". Such clauses should be used with utmost restraint but are appropriate to ensure that individual jurisdictions can opt out of standards they judge to be incompatible with vital public interests.

Specifically, the primary responsibility for assessing the financial stability consequences of accounting standards, a matter that generally involves a significant dimension of judgment and for which there is little globally agreed analytical base, should be kept at the level of individual jurisdictions rather than granted to the IASB or IFRS Foundation.

As for involvement of relevant stakeholders, the priority for the IFRS Foundation should be to increase and strengthen the involvement of investors at all levels of its governance and operations.

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

The response obviously depends of the future form and role of the Monitoring Board as envisaged in other questions of this consultation. A good starting point would be to align the name of the body with its actual role. As earlier argued, the fact that the Monitoring Board controls the process of Trustee appointments / reappointments implies that its role goes well beyond mere monitoring. To the extent that such remains the case, a change of name would enhance the public understanding of its function and activities.

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.

As the Consultative Report rightly notes (page 19), "the oversight role of both the Monitoring Board and Trustees must be designed to promote – and never undermine, either substantively or in appearance – the independence of the IASB and its standard-setting process." In this context, granting the Monitoring Board an explicit ability to place an item on the IASB's agenda does not appear advisable. More generally, I do not see a strong case for formally enhancing the Monitoring Board's involvement in the IASB agenda-setting.

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 mentioned in the above General Comments, my assessment is that the Trustees' current principles for the Foundation's funding are flawed, and do not work well in practice. In particular, it seems to me that the consequences of the principle that funding should be non-voluntary have not been sufficiently thought through and that this principle should be re-examined, as it is bound to lead to excessive dependence of the Foundation from national / jurisdictional political interests. This is a key item of the debate on IFRS Foundation reform.

13. 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. 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.

As previously argued, I believe the current powers of the Monitoring Board over Trustee appointments are too extensive as long as the Monitoring Board is not transformed into a body of the IFRS Foundation. As long as this remains the case I would strongly recommend against an extension of such powers to the appointment or vetting of the IASB Chair, including establishing a set of publicly disclosed criteria.

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.

In line with previous comments, I do not see the case for making this a formal responsibility of the Monitoring Board as long as it exists outside of the IFRS Foundation.

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.

I agree that establishing a small permanent secretariat would be beneficial to the operation of the Monitoring Board and to its role of oversight of the IFRS Foundation. It would have a number of consequences though, including possibly the need to establish the Monitoring Board as a separate legal entity.

In relation to my response to question 3, I would favor locating the staff of the Foundation in Asia and the secretariat of the Monitoring Board in the Americas, or conversely, to reflect the global stakeholder base of IFRS standard-setting, and taking into account the fact that it would be impractical to move the bulk of IASB staff from London.

The funding of the permanent secretariat should come from the members of the Monitoring Board and not from other stakeholders, particularly as long as the Monitoring Board exists as a separate entity from the IFRS Foundation.

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.

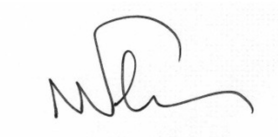
To the extent that the governance of the IFRS Foundation has not reached a stable balance, and I don't consider such a balance to have been reached at this point, more frequent reviews may be warranted.

This need is actually illustrated by the sequence of the last few years, with partial changes brought to the IFRS Foundation’s Constitution in 2005, 2007, 2009 and 2010.

<u>17. Do you have any other comments?</u>

I have no further comments in response to the Monitoring Board’s Consultative Report. I look forward to the next steps of this important public debate and remain at your service for any follow-up contributions.

Yours sincerely,



Nicolas Véron
Washington DC, 12 April 2011

Cc.: Monitoring Board’s Working Group on the Review of the IFRS Foundation’s Governance