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Your ref:

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Dear Sirs

CONSULTATIVE REPORT ON THE REVIEW OF THE IFRS FOUNDATION'S GOVERNANCE

ICAEW welcomes the opportunity to comment on your consultation *Consultative Report on the Review of the IFRS Foundation's Governance* published by the IFRS Foundation Monitoring Board in February 2011.

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

CONSULTATIVE REPORT ON THE REVIEW OF THE IFRS FOUNDATION'S GOVERNANCE

Memorandum of comment submitted in April 2011 by ICAEW, in response to the IFRS Foundation Monitoring Board's paper *Consultative Report on the Review of the IFRS Foundation's Governance* published in February 2011.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Review of the IFRS Foundation's Governance*, published by the IFRS Foundation Monitoring Board.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure that these skills are constantly developed, recognised and valued.

ICAEW AND IFRS

4. ICAEW believes strongly in the benefits to investors and business of truly international standards, and has been a persistent champion of the creation of a single set of high quality global accounting standards and their application by publicly traded and other companies around the world. In our view the *prima facie* case for moving to a single set of global accounting standards has been bolstered by recent economic events, which have clearly illustrated the interdependencies of capital markets worldwide, as recognised by recent G20 meetings. Differences between standards - even relatively small differences in detail - caused difficulty for regulators, investors and other users of reported financial information trying to understand global issues and to formulate an effective and internationally-coordinated response to the financial crisis.
5. ICAEW made a significant contribution to the successful adoption of IFRS by UK listed companies in 2005/2006, and our expertise in this area was reflected in our selection by the European Commission to deliver a comprehensive study in 2007 covering all aspects of first time application of IFRS by European Union member states. In 2008 ICAEW was commissioned by the United Nations to prepare a follow-up report on the UK experience of IFRS implementation. The reports can be found respectively at www.icaew.com/ecifrsstudy; and www.icaew.com/index.cfm/route/161454.
6. Our continuing support for the International Accounting Standards Board (IASB) and its standards is not offered lightly, or unconditionally. It is set firmly in the context of what we see as the fundamental aims of standard setting: the development of accounting standards that are high quality and neutral, providing the foundation for transparent and comparable financial statements that improve investor confidence in the reliability and transparency of published information. To that end we believe firmly that accounting standards should only be issued by an independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process and making decisions solely in the public interest, and more specifically to protect the interests of investors. We note - and welcome - the support of the G20 for these broad principles, and it is against these fundamentals that we have assessed the Monitoring Board's proposals. We have also taken the opportunity below to reiterate in more detail our views on independent standard setting.

MAJOR POINTS

REVIEWING IFRS FOUNDATION GOVERNANCE

7. ICAEW has been closely involved at each stage of the review of the constitutional arrangements of the IFRS Foundation. We have submitted comments to all the consultation papers on the Constitution issued since February 2004 and have been represented at each of the public hearings held in London since that time. Although we do not advocate significant change at this time, we regard the ongoing process of debate and reform as key to the success of the IASB and to wider acceptance of its legitimacy as a global standard setter. The importance of achieving an appropriate and widely-respected governance structure for the IFRS Foundation as the IASB increasingly assumes a global role of profound economic significance should not be underestimated. We thus welcome this review.

INDEPENDENT STANDARD SETTING

8. There appears to be wide acceptance internationally of the principle that accounting standards should only be issued by a properly constituted and independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process. However, there is less clarity over the meaning of 'independent' in this context. In our view, it means the ability to make decisions solely in the public interest, and more specifically to protect the interests of investors, without strong external pressure to reach particular conclusions not supported by the quality of the arguments deployed. Giving priority to investor protection is in the broader public interest because it helps to ensure both that resources are efficiently allocated among competing projects and that the cost of capital for business is kept as low as possible. In these ways, economic growth is promoted and so is the welfare of the community as a whole.
9. Accounting solutions should therefore be determined on their merits in achieving the objective of meeting investors' information needs, not according to political weight or to further other social or economic policy objectives. Where decisions are seen to be influenced unduly by pressure from governmental or regulatory organisations or the lobbying of particular interest groups, the result tends to be a lack of adequate due process or rigorous exposition of the issues involved. Pressure in 2008/2009 on both the IASB and FASB to eliminate differences in their financial instruments standards in 2008, without full due process, is a case in point. It damaged the credibility of the standard setting process and any further occurrences will cause long-term damage to the credibility and quality of financial reporting and to the confidence of investors in capital markets.
10. Regulators are of course an important stakeholder in the financial reporting process. However, they often have a distinct focus, not necessarily aligned with the information needs of investors - the primary users of annual financial statements under the IASB *Framework*. Regulators should in our view have no particular influence over the determination of the detailed requirements of accounting standards for general purpose financial reporting. Whilst it is desirable in principle for regulators to use GAAP financial information as their initial point of reference, they usually have the power to obtain any extra information needed to supplement or adjust the published financial statements. In some cases they may not have that power, but that does not mean financial reporting for investors should be reshaped to suit regulators' information needs. Financial stability and prudential supervision should always be delivered principally through prudential regulatory regimes. Any attempt in the light of the financial

crisis to align directly regulatory and financial reporting objectives runs the risk of deep and lasting damage to the capital markets.

11. We thus welcome the establishment of the Monitoring Board in the expectation that the Board will assist the Trustees and the members of the IASB, collectively and individually, to resist overt political pressure and lobbying in the standard setting process.

ASSESSMENT OF THE CURRENT PROPOSALS

12. Whilst we support the current three tier structure, we believe that existing governance arrangements could be strengthened through greater definition of the role of each tier. Accordingly, we welcome the Monitoring Board's review and a number of its recommendations. However, because it is important to maintain independent standard setting, we have grave concerns about certain of the proposals contained within this consultation. Those proposals do not appear to address properly the Monitoring Board's relationship with either the Trustees or the IASB in a way that safeguards the latter's technical independence and promotes the efficient working of the Trustees and the organisation as a whole. Indeed in some areas they appear rather to threaten that independence, as explained in the following two paragraphs, and seem to envisage responsibilities for the Monitoring Board that go beyond its very important role of 'monitoring' the work of the Trustees and IASB.

MONITORING BOARD INVOLVEMENT IN SELECTING THE IASB CHAIR

13. The Trustees must retain their existing autonomy over the selection of IASB Board members. In particular, we are not persuaded that any change is necessary to the current provisions for the appointment of the IASB Chair. We agree with the conclusion in paragraph 3-2-2 that the involvement of the Monitoring Board in the appointment of IASB members could appear to infringe the independence of the standard setter and risks eroding public confidence in the standard-setting body. These concerns are far greater when the selection of the IASB Chair is at stake. Although the Chair is additionally responsible for the accountability of the IASB more generally, this role is clearly central to the standard setting process and therefore any change to the Trustees' autonomy in relation to this appointment risk raising very significant questions about the Foundation's independence. This proposal should be dropped.

IASB AUTONOMY OVER ITS AGENDA

14. We are entirely unconvinced by the proposal in paragraph 3-2-1 that the Monitoring Board be given a mandate to place items onto the IASB agenda. This is an idea that flies in the face of commonsense and good governance principles. The primary purpose of the three tier governance structure is to safeguard the independence of the standard setter. Were the IASB to lose full autonomy over its agenda, this independence would be sorely tested. It would allow for the possibility that, at some future point, the Monitoring Board would become a conduit through which undue pressure from governmental or regulatory organisations could be brought to bear on the standard setting process. This proposal should not be pursued.

RESPONSES TO SPECIFIC QUESTIONS

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.

15. Quality must always be the primary criterion when selecting IASB Board members. Only by recruiting the best qualified and highest quality individuals can the IFRS Foundation hope to develop global accounting standards that are fit for purpose. Balance in terms of the geographical and professional backgrounds of IASB Board members is also a very important factor, but as paragraph 25 of the Constitution makes clear, 'professional competence and practical experience' must take precedence.
16. We are satisfied that recent appointments to the IASB Board have met the objective of maintaining the high calibre of the Board members, whilst taking due account of the need for diverse professional and geographical backgrounds. The search for suitable candidates should always be rigorous and conducted on an ongoing basis, and steps to improve the transparency of the process would be welcome, but we see no need at this time for any 'concrete efforts to deepen the pool of candidates for IASB membership'. This would be a distraction from more pressing regulatory objectives.
17. While we are generally content with the representation on the IASB Board, we question whether the insertion at the 2009 constitutional review of paragraph 26, rigidly defining geographical criteria, was the best solution. Paragraph 26 has already been amended once since its introduction and the current consultation questions those criteria again. It is unsurprising that such a rigid approach to setting geographical requirements has resulted in ongoing challenge and debate.

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.

18. We acknowledge that there may be a perceived conflict of interest, and that the responsibilities of the new position could usefully involve coordination and communication between the three tiers. It is therefore worth investigation, along with other potential courses of action, for example expanding the role and resources of the Chair of the Trustees, or appointing a Chief Operating Officer. However, whatever decision is taken, it is of critical importance that it is preceded by wide consultation over the allocation of responsibilities and powers to ensure that the position of the IASB Board and its Chair are not undermined, and would suggest the impact of any change on the technical independence, operational effectiveness and accountability of the organisation is reviewed after say two years.

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.

19. This seems to be one of a number of examples where the benefits of the proposed change appear likely to be minor, at best. We are unaware of any difficulties in practice arising from the current arrangements. In the current circumstances regarding funding,

it seems impractical to suggest clear segregation of duties when it is unclear what problem is arising in practice. We suggest that if governance at board and management level is dealt with properly, how staff are utilised (as long as it is efficiently) should not be a significant issue.

Question 4

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

20. An effective body of Trustees is of great importance to the success of the Foundation and we would welcome the Trustees taking a more high profile role both in promoting IFRS and in the oversight of the IASB. In principle we thus welcome measures to improve transparency in the operation of the Foundation, such as making public the Trustee nomination process or the steps taken to ensuring adequate funding is available. However, we are uncertain of what is intended by the suggestion in paragraph 2-3 that the Trustees 'improve their communication of and transparency into their oversight activities'. We not aware of any major failings at present and it is not clear what changes would bring significant improvement.
21. Paragraph 2-3-1 of the paper questions how a representative geographical distribution of Trustees can be maintained, noting that 'there can be no absolute membership composition that is evergreen'. This is a valid concern. Although quality should be the primary consideration in the appointment of Trustees, it is important that the board of Trustees as a whole continues to be regarded as broadly geographically balanced. The prescriptive approach adopted in the current constitution may not be helpful in this respect, and may simply result in continual pressure for amendments to the requirements regarding geographical composition. Of equal importance to geographical factors is the selection of high calibre candidates committed to actively engage with stakeholders in their region and to exercise effective oversight of the IASB whilst vigorously defending its technical independence.
22. At present a significant segment of both the IASB Board and the Trustees are North American. If the United States defers a decision on adoption of IFRS later this year, or makes only very cautious steps in that direction, there are likely to be calls to reduce or remove this representation. We would not necessarily agree with this view; the United States remains the largest economy in the world, and as such will continue to be a major constituency for international financial reporting standards even if it should choose not to mandate IFRS adoption for its domestic issuers. Any precipitate action should be avoided. We would certainly not agree that the IASB Board itself should be off limits to highly capable individuals just because they happen to carry a US passport.

Question 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.

23. We are not convinced that the measures described in paragraph 2-3-2, aimed at improving transparency around the nomination process for the Trustees, are necessary. The nomination process is already clearly stipulated in paragraphs 5 to 7 of the constitution, which we believe provide a good level of transparency. We doubt that

further steps need to be taken to 'support confidence of the stakeholders', or at least the great majority of stakeholders. Indeed, by opening up the nominations process there is a danger that it becomes exposed to undue external pressures, which would be unwelcome.

Question 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.

24. We agree that Monitoring Board membership should be composed primarily of representatives of capital market authorities as proxies for capital providers, the primary audience for the financial statements. However, we would not rule out the admission of other types of organisations if a sound and widely-supported case for this were made.
25. Care should be exercised when considering expansion of the membership of the Monitoring Board. It is neither practicable nor desirable to invite public authorities from every IFRS adopting country to join the Board, and a doubling in size risks a negative effect on its operational effectiveness. It is also unlikely to represent an enduring accommodation with those critical of its representativeness. Consequently, whilst we would support some initial increase in membership, perhaps through the creation of a number of new rotational places, we have strong reservations about establishing strict quotas and do not accept that the case has been made for such substantial change at this time.
26. We agree that rotating members should continue to be selected through IOSCO, which is an appropriately representative body for those capital markets that do not have direct representation on the Monitoring Board.

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.

27. Yes. We do not support any change in this area. We agree that decision making by consensus is appropriate and contributes to market certainty and stakeholder confidence.

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?

28. We do not support the establishment of an advisory body. This would add to the complexity of the current governance arrangements, which are already substantial, and might simply act to increase the influence of regulatory bodies over the standard setting process. As discussed above at paragraphs x t o x, we believe that this is neither necessary nor desirable. Financial stability and prudential supervision should always be delivered principally through prudential regulatory regimes.
29. For similar reasons, whilst we encourage a regular dialogue between the Monitoring Board and other stakeholder organisations – user groups as well as regulatory authorities - we would be wary of new arrangements for more ‘formalised’ dialogue, which might have similar results to the establishment of an advisory body.
30. We have no particular objections to a small increase in the number of observers where there is a sound case made for special treatment.

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

31. Yes. We believe that the standard setting process is appropriately structured to deliver high-quality standards. Regular and inclusive due process with constituents is a hallmark of an effective and credible standard setting process, and accordingly, we welcome the recent, significant improvements in due process arrangements and procedures. We believe that in general the IASB’s due process is now transparent, well publicised and engages a broad range of constituents in extensive and constructive dialogue.
32. It is also important in this context to recall the IASB’s objective for financial reporting, with its focus on capital providers as the primary user group. We support this focus. It avoids the obfuscation of reported financial information through attempts to meet in full the many disparate and potentially-conflicting information needs of other user groups. This allows financial reports to be produced which contain clear, transparent and comparable financial information, focused on investors but able to meet the primary information needs of a wide range of users. Tempting though it is to use the annual report as a vehicle for disclosures driven by other public policy imperatives, we do not believe that mandating such disclosures is consistent with the fundamental objective of financial statements and the annual report.

Question 10

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

33. We would welcome steps to improve the ‘visibility and public understanding’ of the Monitoring Board’s activities. However, the focus of stakeholders will be the discussions and activities of the Trustees and the IASB and there is a risk that regular communications from all three tiers of the governance structure will be confusing to stakeholders.

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.

34. There appears to be wide acceptance internationally of the principle that accounting standards should only be issued by a properly constituted and independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process. However, there is less clarity over the meaning of 'independent' in this context, and this proposal seems to illustrate this. In our view, it means the ability to make decisions solely in the public interest, and more specifically to protect the interests of investors, without strong external pressure to reach particular conclusions not supported by the quality of the arguments deployed. Accounting solutions should be determined on their merits in meeting the objective of satisfying investors' information needs, not according to political weight or to further other social or economic policy objectives. Where decisions are seen to be influenced unduly by pressure from governmental or regulatory organisations or the lobbying of particular interest groups, the result tends to be a lack of adequate due process or rigorous exposition of the technical or legal issues involved.
35. In view of these imperatives, we strongly disagree with this proposal. The purpose of the Monitoring Board, and indeed of the Foundation, should be above all else to ensure the independence of the IASB. This proposal may well have the opposite effect, and will at the least result in a perception that the independence of the IASB is conditional. It would also bring into question the role of the Trustees and the effectiveness of the relationship between the two bodies. The Monitoring Board has the ability already to discuss potential agenda items with the Chairman of the Trustees, and should also take the opportunity to participate in the forthcoming public consultation over the forward agenda of the IASB. This is particularly the case now that the IASB has acknowledged that it should consult on its agenda on a regular basis, thus giving its constituents a direct ability to comment. This was long overdue.

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?

36. We agree that it is of great importance that the Foundation is established on a firm financial footing. In our opinion the preferred source of financing would be through a levy on companies listed on capital markets of those jurisdictions adopting IFRS. Such a scheme could operate in a similar way to the mechanism in place for funding the UK's Financial Reporting Council; there a levy is collected via the market regulator which is in turn subsumed in the fees borne by companies listed on UK markets. Such a fee would be an annual levy and not linked in any way to individual transactions.
37. Whatever solution is adopted, the greatest care should be taken to ensure that influence over the governance of the IFRS Foundation is not linked to funding arrangements. There should be no perception that influence can be 'bought', and no dominance by one funder or group of funders.

Question 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.

38. We do not believe that any change is necessary to the current provisions for the appointment of the IASB Chair. We agree with the conclusion in paragraph 3-2-2 that the involvement of the Monitoring Board in the appointment of IASB members could appear to infringe the independence of the standard setter and risks eroding public confidence in the standard-setting body. These concerns are far greater when the selection of the IASB Chair is at stake. Although the Chair is additionally responsible for the accountability of the IASB more generally, this role is clearly central to the standard setting process and therefore any change to the Trustees' autonomy in relation to this appointment risk raising very significant questions about the Foundation's independence. This proposal should not be pursued.

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.

39. We agree that the Trustees should seek to achieve balance in both the geographical and professional backgrounds of IASB members, but the paramount selection criterion must be the quality of the individual candidates. Although this principle is still reflected in the Constitution, we are concerned that it is becoming increasingly subordinated. We were opposed to the insertion in 2009 of paragraph 26 to explicitly stipulate the geographical composition of the IASB and were similarly opposed to its extension in 2010. It is unsurprising that the establishment of such precise criteria for Board composition has resulted in an ongoing and largely unproductive debate over its representativeness.
40. We would in any case certainly not support any extension of the remit of the Monitoring Board to involvement in the selection of IASB Board members. Such a move would represent a grave threat to the independence of the standard setter. The responsibility for setting up an effective and transparent framework should lie solely with the Trustees.

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.

41. No. We are not convinced of the case for a permanent secretariat. Although we support the current three tier system, the value of replicating this segregation at the operational level is less clear. Such a division could prove expensive, quite cumbersome and may moreover impede the efficient working of the organisation. A board that properly focuses its activities on the very important role of monitoring the Trustees and IASB,

thereby underpinning the legitimacy of the Foundation, should be able to obtain sufficient staff and other resource to support its activities from existing sources.

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.

42. We regard the ongoing process of debate and reform as key to the success of the IASB and to wider acceptance of its legitimacy as a global standard setter. The importance of achieving an appropriate and widely-respected governance structure for the IFRS Foundation as the IASB increasingly assumes a global role of profound economic significance should not be underestimated. We thus agree with the notion of a periodic review and agree that it should be closely aligned with the timing of the Trustees' review.
43. At the same time, we would emphasise that constitutional change should only be made where the case for change is compelling and widely-supported by constituents.

Question 17

Do you have any other comments?

44. No.

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