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IFRS Foundation

Report of the Trustees' Strategy Review 2011

IFRSs as the Global Standards: Setting a Strategy for the Foundation's Second Decade

IFRS™

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Report of the IFRS Foundation Trustees' Strategy Review 2011

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1. Summary

In the ten years since its founding, the IFRS Foundation, through its independent standard-setting body, the International Accounting Standards Board (IASB), has succeeded in establishing International Financial Reporting Standards (IFRSs) as the accepted set of financial reporting standards in more than 100 countries. In countries where IFRSs are not the locally accepted standard, adoption of IFRSs is under active consideration. As the organisation's second decade begins, the goal of a single high quality globally accepted set of accounting standards is now within reach. The next 18 months will be critical in determining whether this goal is achieved.

As a result of their second five-yearly review of the Constitution, and because of the critical nature of the coming months, the Trustees launched a comprehensive review of the IFRS Foundation's strategy. This paper sets out a strategy and vision for the IFRS Foundation and the IASB as they evolve into the global accounting standard-setter.

In this paper, the Trustees set out a series of recommendations for the organisation's second decade. These recommendations address four areas: (1) the IFRS Foundation's mission, specifically the public interest served by the Foundation's work; (2) governance; (3) the process and procedures used by the Foundation and the IASB; and (4) the organisation's financing.

In making the recommendations contained in the strategy review paper, the Trustees have put forward proposals that affect the different components of the IFRS Foundation. These include actions for (1) the Trustees specifically as the non-executive body responsible for the oversight of the entire range of the IFRS Foundation's activities; (2) the Foundation in general (which includes the standard-setting function, an education programme, publication and content-related services, IFRS XBRL development, and general operations); and (3) the operations, procedures and strategy of the IASB, but not its technical activities. Consistently with their constitutional responsibilities, the Trustees set out in this document a vision related to all three organisational components and identify where specific action is required, where appropriate. The Trustees do not comment on the technical content of IFRSs or possible technical items for the IASB's agenda.

The Trustees acknowledge that they are making these recommendations at a time when a number of major economies have made the decision to adopt, or are considering the adoption of, IFRSs for their domestic economies (including Japan and the United States). For the purpose of the review, the Trustees assume that commitments, in some form, on the adoption of global standards are made. Failure to make such commitments would lead to the reconsideration of some elements of this strategy review document and could lead to modifications in the suggested geographical distribution of the membership of the IFRS Foundation Trustees and the IASB.

In making these recommendations, the Trustees also note that the IFRS Foundation Monitoring Board has undertaken its own review of the Foundation's governance arrangements. The Monitoring Board's review focuses primarily on institutional aspects of governance, particularly the composition and the respective roles and responsibilities of the Monitoring Board, Trustees and the IASB. While addressing the issue of governance (in a manner consistent with the Monitoring Board's proposals), this paper addresses broader issues of the IFRS Foundation's mission and operations, the Trustees' activities, the IASB's due process, and financing.

A summary of the principles and recommendations follow:

A. Mission: defining the public interest to which the IFRS Foundation is committed

Purpose of financial reporting standards

A1 **In carrying out the IFRS Foundation's mission as its standard-setting body, the IASB should develop financial reporting standards that provide a faithful portrayal of an entity's financial position and performance in its financial statements. Those standards should serve investors and other market participants in making informed resource allocation and other economic decisions. The confidence of all users of financial statements in the transparency and integrity of these statements is critically important for the effective functioning of capital markets, efficient capital allocation, global financial stability and sound economic growth.**

Adoption of IFRSs

A2 **As the body tasked with achieving a single set of improved and globally accepted high quality accounting standards, the IFRS Foundation must remain committed to the long-term goal of the global adoption of IFRSs as developed by the IASB, in their entirety and without modification. Convergence may be an appropriate short-term strategy for a particular jurisdiction and may facilitate adoption over a transitional period. Convergence, however, is not a substitute for adoption. Adoption mechanisms may differ among countries and may require an appropriate period of time to implement but, whatever the mechanism, it should enable and require relevant entities to state that their financial statements are in full compliance with IFRSs as issued by the IASB.**

A3 **With co-operation from national and international market and audit regulators, accounting standard-setters, regional bodies involved with accounting standard-setting and accountancy bodies, the IFRS Foundation should seek full disclosure where adoption of IFRSs is incomplete or where there is divergence from the full set of IFRSs as issued by the IASB. The Foundation should seek a mechanism to highlight instances where jurisdictions are asserting compliance with IFRSs without adopting IFRSs fully.**

Scope of standards and IFRS activities

A4 **In the short term, the primary focus of the IFRS Foundation and the IASB should remain on developing standards for for-profit corporate entities (ie publicly traded entities, other publicly accountable entities and SMEs). Taking into account the necessary resource requirements, the Foundation and the IASB will consider developing standards for other entities and other purposes at a later date.**

Consistency of application and implementation

A5 **In pursuing its mission, the IFRS Foundation has a vested interest in helping to ensure the consistent application of IFRSs internationally. The Foundation should pursue that objective in the following ways:**

- **The IASB, as the standard-setter, should issue standards that are clear, understandable and enforceable.**
- **The IASB will provide guidance on its standards that is consistent with a principle-based approach to standard-setting. Application guidance and examples should be provided when it is necessary to understand and implement the principles in a consistent manner.**

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- **The IASB will work with a network of securities regulators, audit regulators, standard-setters, regional bodies involved with accounting standard-setting, accounting bodies and other stakeholders to identify where divergence in practice occurs across borders. Where divergence in practice could be resolved through an improvement in the standard or an Interpretation, the IASB or the IFRS Interpretations Committee will act accordingly.**
- **The IFRS Foundation, through its education and content services, should undertake activities aimed at promoting consistent application.**
- **The IASB, in partnership with relevant authorities, will identify jurisdictions where IFRSs are being modified and, in these circumstances, encourage transparent reporting of such divergences at the jurisdictional level.**
- **The IFRS Foundation will seek the assistance of the relevant public authorities to achieve this objective.**

B. Governance: independent and publicly accountable

B1 **The independence of the IASB in its standard-setting decision-making process, within a framework of public accountability, must be maintained. A primary role of the Trustees is to advocate for, and to preserve, the independence of, the standard-setting process.**

B2 **The current three-tier structure (Monitoring Board, Trustees and IASB) is appropriate for the organisation's mission. Within that governance structure, the Monitoring Board, the IFRS Foundation and the IASB should enhance their interaction and procedures where appropriate to reinforce the principles of transparency, public accountability and independence. In doing so, the roles and responsibilities of each element of the organisation's governance should be clearly defined.**

B3 **Consistently with point B2, the Trustees should further clarify how they discharge their oversight responsibilities.**

B4 **Elements of the governance structure should provide regular public reports to demonstrate their effectiveness.**

C. Process: ensuring that its standards are of a high quality, meet the requirements of a well-functioning capital market and are implemented consistently across the world

C1 **A thorough and transparent due process is essential to developing high quality, globally accepted accounting standards. The IASB's due process should continue to be reviewed and regularly enhanced, benefiting from regular benchmarking against other organisations and from stakeholder advice.**

C2 **The framework for the Trustees in their oversight of the IASB's due process should be clarified. The Trustees' Due Process Oversight Committee, with appropriate and independent staff resource, should review and discuss due process compliance regularly throughout the standard-setting process and at the end of the process before a standard is finalised. The Committee should report regularly on these activities to the Trustees and in its annual report. The Committee should develop a procedure for handling instances of potential non-compliance.**

C3 **Building on the existing due process framework and in an effort to improve the usability of financial information, the IASB should undertake:**

- **Clear demonstration of how priorities on its agenda are set: in the agenda-setting process and after the required public consultation, the IASB should provide full feedback to the public, including a demonstration of how the input of the IFRS Advisory Council was taken into account. This will foster confidence in the IASB's agenda-setting process and reinforce support for its independence.**
- **Agreed methodology for field visits/tests and effect analyses: the IASB should work with relevant parties to develop an agreed methodology for field visits/tests and effect analyses (more often referred to as cost-benefit analyses or impact assessments).**
- **Consideration of the impact of standard-setting decisions on XBRL: while XBRL considerations should not dictate the substance of the standard-setting process, the Trustees recognise the growing use of XBRL requirements. The IFRS XBRL taxonomy is growing in importance and deserves encouragement. Consequently, in drafting new standards, the IASB should take into account the need for language that is easily translatable into foreign languages and into a consistent XBRL taxonomy.**
- **Consideration of the impact of standard-setting decisions on the translation of IFRSs: the IASB should be conscious that many end users require translations of the English-language IFRSs.**

C4 **To support the IFRS Foundation's interest in consistent application of IFRSs and to comply with the IASB's standard-setting mandate, the Foundation and the IASB should undertake the following actions:**

- **Using an agreed methodology, undertake post-implementation reviews to help identify implementation issues.**
- **Establish formal co-operation arrangements with securities regulators, audit regulators and national standard-setters to receive feedback on how IFRSs are being implemented and to encourage actions aimed at addressing divergence.**
- **Refine the scope of the IFRS Interpretations Committee's activities to ensure consistency of Interpretations, without undermining the commitment of a principle-based approach to standard-setting.**

C5 **The IFRS Foundation and the IASB should encourage the maintenance of a network of national accounting standard-setting bodies and regional bodies involved with accounting standard-setting as an integral part of the global standard-setting process. In addition to performing functions within their mandates, national accounting standard-setting bodies and regional bodies involved with accounting standard-setting should continue to undertake research, provide guidance on the IASB's priorities, encourage stakeholder input from their own jurisdiction into the IASB's due process and identify emerging issues.**

C6 **To provide leadership in thinking in the field of financial reporting, the IASB should establish, or facilitate the establishment of, a dedicated research capacity.**

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D. Financing: ensuring the organisation is financed in a manner that permits it to operate effectively, efficiently and independently

D1 **The funding system must maintain the independence of the standard-setting process, while providing organisational accountability.**

D2 **The existing base of financing should be expanded to enable the IFRS Foundation to serve the global community better and to fulfil the strategy described above. Specifically, the Trustees should propose that funding should be on a long-term basis (at least three to five years), be publicly sponsored, be flexible to permit the use of differing mechanisms and to adjust to budgetary needs, be shared among jurisdictions on the basis of an agreed formula (that would be consistent with the principle of proportionality) and provide sufficient organisational accountability.**

* * *

In the report that follows, the Trustees first provide broader context for the strategy review and the challenges facing the IFRS Foundation. The Trustees then provide a fuller explanation of each of the recommendations above.

2. Background: the first decade (2001—2010): success and tensions

Much of the success of the IFRS Foundation to date is a result of three factors:

1 the IASB's strength as an organisation and the quality of IFRSs;

2 the European Union's decision to designate the IASB as its standard-setting body, which served as a catalyst for the adoption of IFRSs elsewhere internationally; and

3 the willingness of the United States to engage in convergence, to accept IFRSs for non-US companies and to consider possible adoption for US companies.

The new Foundation was established in 2000 as a non-governmental and independent body, blessed by, but not formally connected to, public institutions. The Foundation inherited a constitution that established its governance arrangements. The Constitution declared that the new IASB would be focused on creating standards aimed at investor protection. An independent and professional IASB, not beholden to national or special parochial interests, endowed the standards with credibility.

The European Union (EU) soon became the catalyst for IFRS adoption worldwide, making IFRSs an alternative to US GAAP for raising international capital. In 2002 the EU decided to adopt IFRSs for its publicly traded companies as part of the effort to create a common European capital market. Since 2005, the European decision has spurred the advance of IFRSs across Asia-Oceania, Africa and the Americas.

Lastly, beginning with the 2002 Norwalk Agreement, an intensive and joint convergence programme has been a dominant feature of the IASB's agenda. Importantly, the convergence process has led to improvements to the inherited standards, has reduced differences with US GAAP, and has led to the removal of the reconciliation requirement by the US Securities and Exchange Commission (SEC). The G20 has formally identified the need for a single set of global standards. The United States is in the process of considering the adoption of IFRSs. SEC pronouncements indicate that the SEC expects to make a determination shortly on the use of IFRSs. Other major economies (including China, India and Japan) are in the process of converging with IFRSs or are considering whether to implement IFRSs as their chosen accounting standards.

While these factors have spurred the organisation's success, a number of challenges remain for the organisation:

- **convergence and adoption:** in an effort to facilitate adoption of its standards, the IASB has devoted considerable energy to convergence. But convergence alone will not produce a single set of global standards. A number of countries still need to make decisions to adopt IFRSs for domestic use.
- **quality and implementation of the standards:** two tensions have arisen in this area. First, the IASB must continue to demonstrate the quality and relevance of its standards to ensure global acceptance, including a need to reflect the lessons learned from the financial crisis. Second, even as the standards are being adopted universally, there is a risk that practices related to implementation and adoption will diverge.
- **governance and accountability:** as adoption of IFRSs has extended to more and more countries, public authorities around the world have paid increasing attention to the accountability and governance of the institution. While the IASB's independence has been a source of strength, it is widely understood that those arrangements may need to evolve further in order to enhance the IFRS Foundation's public accountability.

3. The IFRS Foundation's mission: serving the public interest through financial reporting standards

The IFRS Foundation's Constitution states that the objectives of the Foundation are:

(a) to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards 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.

(b) to promote the use and rigorous application of those standards.

(c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the needs of a range of sizes and types of entities in diverse economic settings.

(d) to promote and facilitate adoption of International Financial Reporting Standards (IFRSs), being the standards and Interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

The Constitution makes a direct reference to the 'public interest' without providing a specific definition of the public interest. To address the challenges outlined above, the Trustees believe that it is important to define what the public interest means in relation to the IFRS Foundation's activities. In reviewing the Foundation's mission, the Trustees have identified the following areas of public interest:

- the purpose of financial reporting standards and standard-setting activities;
- global adoption of IFRSs;
- the scope of the IASB's work; and
- the Foundation's role in helping to ensure the consistent application of IFRSs.

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Purpose of financial reporting standards and standard-setting activities

The Constitution implies a strong investor perspective, while indicating that there are other users of financial information. The financial crisis has raised questions regarding the interaction between financial reporting standards aimed primarily at investors for capital allocation decisions and other reporting requirements for, and their impact upon, other public policy objectives (eg prudential regulation, sustainability, anti-corruption measures and others). The question is how, and to what extent, these perspectives can be reconciled. While these tensions are not new, the financial crisis has served to bring them to the surface again. In order to meet the challenges of the next decade, the Trustees believe that it is important to define how the IASB intends to address these tensions.

The Trustees believe that tensions among the varying objectives are overstated, and that the various public policy objectives are all served by transparency in financial reporting. At the same time, the Trustees believe that a clear statement of the Foundation's commitment to providers of capital as the primary, but not exclusive, users of financial information is essential. Consequently, the Trustees have set out the following principle, which is consistent with the IASB's *Conceptual Framework*, to guide the IFRS Foundation and the IASB's work in their second decade:

A1 **In carrying out the IFRS Foundation's mission as its standard-setting body, the IASB should develop financial reporting standards that provide a faithful portrayal of an entity's financial position and performance in its financial statements. Those standards should serve investors and other market participants in making informed resource allocation and other economic decisions. The confidence of all users of financial statements in the transparency and integrity of these statements is critically important for the effective functioning of capital markets, efficient capital allocation, global financial stability and sound economic growth.**

Indeed, in setting out the above principle, the Trustees are reaffirming the current constitutional focus on the development of financial reporting standards aimed at making informed resource allocation decisions. The Trustees also believe that the text of paragraph A1 is consistent with the language in the IASB *Conceptual Framework*, including maintaining the principle of stewardship.

At the same time, the Trustees believe that transparency in financial reporting is an essential component of addressing the varying public policy perspectives. These perspectives can often be reconciled transparently within a single set of accounting standards. As the global standard-setter and without sacrificing the objective above, the IASB accounts for these perspectives appropriately in the development of high quality accounting standards.

The Trustees believe that the IASB can best account for differing perspectives, including the needs of a range of sizes and types of entities in diverse economic settings, through effective stakeholder engagement with a broad range of parties as part of the IASB's due process. Such a due process is essential to understanding diverse needs and the impact of standards (including their potential cost) and to minimising the need to have multiple reporting requirements. For example, when it comes to issues concerning the interaction of financial reporting and prudential concerns, the IASB should seek to build upon its 'enhanced technical dialogue'

established with prudential supervisors and other stakeholders. One possibility would be to formalise existing informal arrangements in a manner that includes regular and joint meetings with specifically designated organisations (such as IOSCO, the Basel Committee on Banking Supervision, the Financial Stability Board, the IMF and the IAIS).*

At the same time, the Trustees recognise that general purpose financial reporting cannot, by itself, fulfil all public policy objectives that require financial information. In fulfilling its mission, the IASB should emphasise the needs of investors and other financial market participants in their resource allocation decisions. The IASB should work with regulators and other stakeholders, to the maximum extent possible, to enable other authorities to require the display of financial information outside the general purpose financial reports in a way that meets other public policy objectives without compromising transparency.

Global adoption of IFRSs

The IFRS Foundation Constitution states that the organisation's primary objective is to develop 'a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles'. The Trustees remain committed to the belief that a single set of standards is in the best interests of the global economy, and that any divergence from a single set of standards, once transition to IFRSs is complete, can undermine confidence in financial reporting.

A2 **As the body tasked with achieving a single set of improved and globally accepted high quality accounting standards, the IFRS Foundation must remain committed to the long-term goal of the global adoption of IFRSs as developed by the IASB, in their entirety and without modification. Convergence may be an appropriate short-term strategy for a particular jurisdiction and may facilitate adoption over a transitional period. Convergence, however, is not a substitute for adoption. Adoption mechanisms may differ among countries and may require an appropriate period of time to implement but, whatever the mechanism, it should enable and require relevant entities to state that their financial statements are in full compliance with IFRSs as issued by the IASB.**

A3 **With co-operation from national and international market and audit regulators, accounting standard-setters, regional bodies involved with accounting standard-setting, and accountancy bodies, the IFRS Foundation should seek full disclosure where adoption of IFRSs is incomplete or where there is divergence from the full set of IFRSs as issued by the IASB. The Foundation should seek a mechanism to highlight instances where jurisdictions are asserting compliance with IFRSs without adopting IFRSs fully.**

As described above, companies in more than 100 countries use or are in the process of adopting IFRSs as developed by the IASB. Other countries are in the process of considering the adoption of IFRSs for domestic companies. A number of countries are still focused on bringing about convergence of national standards with IFRSs.

The Trustees recognise that countries will need to establish their own mechanisms for bringing IFRSs formally into national law and are unlikely to cede sovereignty in this area. Regardless of the mechanics of IFRS adoption, the end result should be the same—full adoption of IFRSs as issued by the IASB. Countries may also require some transitional period when in

* In addition to the existing enhanced technical dialogue, the IASB meets these groups regularly, most often on a bilateral basis. In a number of jurisdictions, a range of regulatory authorities, including standard-setters (as appropriate), meet regularly. Such a system could be set up on an international basis.

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the process of fully implementing IFRSs. National authorities will need to assess these transitional requirements against their national circumstances. However, even recognising that transitional periods will vary, the Trustees strongly support the need to maintain the long-term goal of full adoption of IFRSs.

There is a natural temptation for countries (and stakeholders within those countries) to argue against full adoption of IFRSs, to call for convergence of national standards and IFRSs rather than adoption, or to introduce national exceptions to IFRS rules. The temptation to pursue convergence rather than adoption should be resisted. Full adoption of IFRSs must be the end goal.

Convergence will not, by definition, lead to a common set of global standards, because convergence is not identical to adoption. Convergence has been, is, and will likely remain a useful process to facilitate adoption by narrowing differences. Convergence, however, will not produce identical results because each set of standards has a different starting point and convergence will not address all of the details. Having once achieved convergence, standards could well diverge again.

Furthermore, in a world where standards have only been made to converge but are not identical, issues of mutual recognition are raised. Countries will seek acceptance of their 'equivalent' but different standards for access to capital markets. The benefits of IFRS adoption, particularly in relation to comparability for investors, are partially lost in favouring convergence rather than adoption.

Countries choosing to adopt IFRSs should also avoid creating national or regional variants of IFRSs. Understandably, different interest groups will cite special circumstances as justification for national and regional exceptions. However, national and regional exceptions have a cost, and these long-term costs should be weighed against the perceived immediate benefits.

The Trustees should seek the assistance of relevant public authorities in identifying divergence from full IFRSs. The goal should be twofold. First, disclosure should be made where adoption of IFRSs is incomplete or there is divergence from the full set of IFRSs as issued by the IASB. Second, there should be a mechanism to highlight instances where jurisdictions are asserting compliance with IFRSs without adopting IFRSs fully. By engaging relevant parties the IFRS Foundation and IASB will work towards developing such a mechanism in the coming year.

The scope of the IASB's work

The IASB has focused its work on developing standards for private sector (ie non-governmental) for-profit entities. At the same time, there is a demand for internationally consistent standards for the public sector and not-for-profit sectors. Furthermore, stakeholder groups are increasingly asking the IASB to consider issues not directly related to financial reporting for the purposes of making capital allocation decisions (one such example is sustainability reporting).

A4 **In the short term, the primary focus of the IFRS Foundation and the IASB should remain on developing standards for for-profit corporate entities (ie publicly traded entities, other public interest entities, SMEs). Taking into account the necessary resource requirements, the Foundation and the IASB will consider developing standards for other entities and for other purposes at a later date.**

The Trustees strongly support the need for transparent financial reporting requirements for not-for-profit and public sector bodies. The Trustees also understand the strong public policy interest of other stakeholders in the financial reporting process. Indeed, the Trustees believe that they should consider the expansion of the organisation's mandate at some point in the future.

At the same time, in reaching conclusion A4, the Trustees took into consideration the unsettled status of IFRS global adoption and the limited resources facing the IFRS Foundation. The time horizon for full global adoption of IFRSs is likely to require work over the next several years. At present, there is a need to provide stability to the organisation and the financial reporting environment.

Recognising the importance of financial reporting to other sectors and that its mandate may be broadened in the future, the IASB should develop standards in such a way as not to encourage 'regulatory arbitrage' by enabling entities to opt out of the IFRS regime by changing their category (ie from those covered by IFRSs to those not required to use IFRSs) in order to evade transparency requirements.

The Trustees will actively consider other areas related to financial reporting (eg not-for-profit, public sector, sustainability and others) as the system stabilises and as resources permit. The Trustees believe that the next Constitution Review commencing in less than three years' time will provide a timely opportunity to consider any expansion of scope.

The Trustees note that other standard-setting organisations produce standards on matters outside the current scope of the IASB's work. The IFRS Foundation should continue its co-operation, as appropriate, with these organisations. In addition, also as appropriate, the IASB should agree to memoranda of understanding with these standard-setting organisations to formalise co-operation.

Consistent application of IFRSs

The IFRS Constitution states that the IFRS Foundation should 'promote the use and rigorous application of those standards [IFRSs]'. This constitutional provision is an explicit acknowledgement that the success of IFRSs (and the objective of global standards) requires consistency and faithfulness in the application of IFRSs.

In this regard, the Trustees have concluded that:

A5 **In pursuing its mission, the IFRS Foundation has a vested interest in helping to ensure the consistent application of IFRSs internationally. The Foundation should pursue that objective in the following ways:**

- **The IASB, as the standard-setter, should issue standards that are clear, understandable and enforceable.**
- **The IASB will provide guidance on its standards that is consistent with a principle-based approach to standard-setting. Application guidance and examples should be provided when it is necessary to understand and implement the principles in a consistent manner.**
- **The IASB will work with a network of securities regulators, audit regulators, standard-setters, regional bodies involved with accounting standard-setting, accounting bodies and other stakeholders to identify where divergence in practice occurs across borders. Where divergence in practice could be resolved through an improvement in the standard or an Interpretation, the IASB or the IFRS Interpretations Committee will act accordingly.**

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- **The IFRS Foundation, through its education and content services, should undertake activities aimed at promoting consistent application.**
- **The IASB, in partnership with relevant authorities, will identify jurisdictions where IFRSs are being modified and, in these circumstances, encourage transparent reporting of such divergences at the jurisdictional level.**
- **The IFRS Foundation will seek the assistance of the relevant public authorities to achieve this objective.**

Among the tools available to the IFRS Foundation in its efforts to ensure consistent application are:

- **The IASB's standard-setting process,** to ensure that standards are clear and, if they are not, to amend them.
- **The IFRS Interpretations Committee,** to identify emerging areas of divergence across borders before they become entrenched practice, to refer issues to the IASB when standards require improvement, and to issue Interpretations within a principle-based environment. In the second decade, the Interpretations Committee will probably play a more active role, in close co-ordination with the IASB.
- **The IFRS XBRL taxonomy,** to maintain a high quality IFRS XBRL taxonomy to help ensure comparability of financial data for end users.
- **IASB education and IFRS Foundation content service activities,** to undertake and serve as a catalyst for educational activities and information that will improve the consistency of application.

The Trustees also note the limitations of the IFRS Foundation in this field. Consistency of application depends upon enforcement and regulatory activities, rigorous audits and sound corporate financial reporting and governance, which are areas that are outside the mandate of the Foundation.

Lastly, the Trustees believe that transparency regarding IFRS adoption practices will encourage convergence of adoption practices and enforcement activities and discourage deviations. The IFRS Foundation does not have the mandate or the resources to monitor adoption practices, but a number of international and national institutions have significant experience in this area. The Foundation will therefore work with other organisations, including securities regulators, standard-setters and international financial institutions, to monitor the consistency of the application of IFRSs.

4. Enhancing governance arrangements to strengthen public accountability and independence

The IFRS Foundation is a unique example of international co-operation in the financial arena. Unlike other bodies that establish international rules, the IASB is composed of full-time professionals who do not serve as representatives of particular jurisdictions and interests. The IFRS Foundation's Constitution establishes an independent standard-setting process, subject to extensive due process requirements, but protected from special and parochial interests. This independence has been a fundamental strength of the IFRS Foundation and the IASB, and gives credibility to the standards.

Independence is a prized asset for the IFRS Foundation, but independence comes with the requirement of public accountability. A form of public accountability was provided from the outset insofar as the binding character of IFRSs depended on their validation by local authorities. Subsequently, following two formal reviews of the Constitution, the Trustees have enhanced their oversight function, increased the transparency of their operations and made a number of institutional reforms to expand representation. In 2009 a Monitoring Board was created and a Memorandum of Understanding linking it to the Trustees provided a formal public component to the governance structure for the first time. The creation of the Monitoring Board and the emergence of publicly sanctioned financing regimes for the IFRS Foundation anchored the organisation more formally with those responsible for serving the public interest.

The IFRS Foundation now has a three-tier system of governance: the Monitoring Board acting on behalf of public authorities, the Trustees as overseers, and the IASB, with the IFRS Foundation secretariat, as the standard-setting body. There is a sense that within the three-tier structure a further evolution is required to assure public trust as IFRSs become the global standard.

The Monitoring Board has agreed to further enhancements to elements of the three-tier governance structure. Consistently with their own independent responsibilities the Trustees have agreed on principles and actions on Trustee, IASB, and IFRS Foundation activities that are relevant to issues of independence and public accountability.

The Trustees acknowledge that broad participation from a range of professional and geographical backgrounds in the IFRS Foundation and IASB structures is also an important aspect of governance and public accountability concerns. As stated above, for the purposes of the strategy review, the Trustees are assuming that major jurisdictions considering the adoption of IFRSs for domestic purposes in the coming 18 months will make a positive commitment on a time frame for adopting IFRSs within their own jurisdictions. The Trustees believe that in the long term the governance and membership of the IASB and of the IFRS Foundation Trustees are likely to reflect the global coverage of IFRS adoption.

The Trustees propose that:

B1 **The independence of the IASB in its standard-setting decision-making process, within a framework of public accountability, must be maintained. A primary role of the Trustees is to advocate for, and to preserve the independence of, the standard-setting process.**

B2 **The existing three-tier structure (Monitoring Board, Trustees and IASB) is appropriate for the organisation's mission. Within that governance structure, the Monitoring Board, the IFRS Foundation and the IASB should enhance their interaction and procedures where appropriate to reinforce the principles of transparency, public accountability and independence. In doing so, the roles and responsibilities of each element of the organisation's governance should be clearly defined.**

The Trustees believe that the three-tier structure, established through the creation of the Monitoring Board in 2009, is serving the organisation well and balances the needs of public accountability and the independence of the standard-setting process. Under these arrangements, the independence of the IASB's standard-setting process is protected and is overseen through an active and internationally diverse group of Trustees.

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Public accountability is assured through a formal reporting line from the IFRS Foundation Trustees to the Monitoring Board. Specifically, the responsibilities of the Monitoring Board, as the public capital market authorities, are:

1 to participate in the Trustee nominations process and to approve Trustee nominees;

2 to review the adequacy and appropriateness of Trustee arrangements for financing the IASB;

3 to review the Trustees' oversight of the IASB's standard-setting process, in particular with respect to its due process arrangements;

4 to confer with the Trustees regarding their responsibilities, particularly in relation to the regulatory, legal and policy developments that are pertinent to the IFRS Foundation's oversight of the IASB; and

5 through the IFRS Foundation Trustees, to refer for consideration by the IASB matters of broad public interest related to financial reporting. The IASB has an obligation to explain their decision following such a referral.

The Trustees support the conclusions in the Monitoring Board's governance review aimed at further enhancements of the three-tier structure

B3 Consistently with point B2, the Trustees should further clarify how they discharge their oversight responsibilities.

The Trustees support the continuation of this basic construct and believe that it has supported the primary objective of maintaining the IASB's independence, within the context of public accountability. However, many commentators have sought a more visible and clearer role for the Trustees. The Trustees are also recommending steps aimed at the clarification of their oversight responsibility and their relationship with the Monitoring Board.

In terms of enhancements in the Trustees' oversight role, the Trustees are recommending the following actions:

- The Trustees will undertake activities that highlight the importance of the independence of the standard-setting process, including meeting with relevant public authorities and stakeholder groups in public and private settings.
- The Trustees will enhance the role of their Due Process Oversight Committee to ensure that the Committee periodically reviews the status of the IASB's due process on major projects against an agreed framework that is regularly benchmarked against best practice.
- The Due Process Oversight Committee will intensify its interactions with the IFRS Advisory Council and the IFRS Interpretations Committee as a means for receiving feedback that is better informed on the functioning of the IASB.
- The Trustees will develop a defined staff resource to support the management of their due process oversight responsibilities. This dedicated resource will better enable the Trustees to carry out their oversight of the IASB's due process and remove any perceived conflict of interest for staff in serving both the Trustees and the IASB.

The Trustees support further steps that would enhance the relationship with the Monitoring Board, including the following measures:

- The Trustees will enhance their discussions with the Monitoring Board on matters related to strategic priorities.

- Consistently with the Monitoring Board's proposals, the Trustees will work with the Monitoring Board in the development of enhanced procedures and clearer criteria for the nomination of Trustee candidates.

B4 **Elements of the governance structure should provide regular public reports to demonstrate their effectiveness.**

The Trustees believe that increased transparency and public reporting regarding the work of the Monitoring Board and the Trustees will improve the legitimacy of the organisation. In this regard, the Trustees have reached the following conclusions:

- The Trustees support the Monitoring Board's recommendations regarding increased communications related to the Monitoring Board's activities.
- As part of their regular reports to the Monitoring Board, the Trustees will describe how they are discharging their oversight responsibilities.
- The Trustees should regularly report on their oversight activities, in order to make their activities more visible to the general public.

5. Strengthening the process and procedures of the IFRS Foundation and the IASB

The standard-setting process is highly structured and has at its core the principles of multi-staged stakeholder consultation and transparency. This due process is described in full in the IASB's *Due Process Handbook*. The IASB meets and makes decisions in public. Issues are added to the IASB's work agenda only after consultation with the IFRS Advisory Council and the Trustees. The IASB also consults other groups, such as national accounting standard-setters, on its agenda and work programme. The IASB must publish exposure drafts (and often preliminary discussion papers) with the opportunity for public comment before reaching final conclusions. On major projects, the IASB establishes working (or advisory) groups reflecting the different stakeholders.

By making all of the decisions in the public domain and by sharing IASB documents on the IASB's website, the IASB has established a process that is recognised as one of the most transparent among international organisations. At the same time, the process is not without its critics.

Critics have often argued that the IASB does not account adequately for the views expressed by stakeholders and nor does it sufficiently explain how it reconciles differing viewpoints, both in the setting of its agenda and strategy and in the resolution of technical issues, and on the effects of the standards. The Trustees and the IASB have taken a number of steps to address these concerns. First, the IASB makes greater use of working groups, publishes feedback statements and effect analyses, and has greatly expanded its outreach efforts. Second, the Trustees have expanded their oversight function and have reformed the IFRS Advisory Council to reflect better the views of stakeholder groups. Third, the recently revised Constitution requires a three-yearly public consultation on the IASB's work programme.

In the areas of working procedures and process, the Trustees are recommending the following principles, guidelines, and steps to ensure that the IFRS Foundation and the IASB fulfil their commitment to best practice:

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Due process and benchmarking

C1 **A thorough and transparent due process is essential to developing high quality, globally accepted accounting standards. The IASB's due process should continue to be reviewed and regularly enhanced, benefiting from regular benchmarking against other organisations and from stakeholder advice.**

The IFRS Foundation and the IASB will maintain a transparent due process. There should be a commitment to continued improvement in the due process, based upon regular and systematic benchmarking against other standard-setting and regulatory organisations. Such a benchmarking exercise is currently under way. Furthermore, as is current practice, the Trustees will consult stakeholders on proposed changes to the IASB's *Due Process Handbook*.

Trustee oversight of the IASB's due process

In 2006 the Trustees established their Due Process Oversight Committee to play a more active and visible role in the oversight of the IASB's due process. This Committee meets the IASB regularly to monitor its compliance with due process procedures, to review complaints regarding the IASB's due process and to assess other areas of concern related to the IASB's due process activities. Nevertheless, stakeholders regularly express concern regarding the effectiveness of the Trustees' oversight over the IASB's procedures.

C2 **The framework for the Trustees in their oversight of the IASB's due process should be clarified. The Trustees' Due Process Oversight Committee, with appropriate and independent staff resource, should review and discuss due process compliance regularly throughout the standard-setting process, and at the end of the process, before a standard is finalised. The Committee should report regularly on these activities to the Trustees and in its annual report. The Committee should develop a procedure for handling instances of potential non-compliance.**

The Trustees believe that stakeholders' confidence in the standard-setting process will improve if the regular interaction between the Trustees' Due Process Oversight Committee and the IASB includes a focused, regular and systematic review of the due process of current projects. While this occurs already, the Committee is enhancing its interaction with the IASB and is working to develop a Committee protocol to govern its oversight work. This protocol will serve as a basis for the IASB to manage its due process commitment and to provide evidence of compliance to the Due Process Oversight Committee. The Committee intends to publish this protocol for public comment.

This protocol is intended to provide a framework for continuous oversight of the IASB's work throughout all stages of a project's development. The protocol aims to provide definable and transparent steps to assess the effectiveness of the oversight function.

As part of its work, the Due Process Oversight Committee will meet regularly with the IASB and periodically with the IFRS Advisory Council to help ensure the effectiveness of the due process. The Due Process Oversight Committee will also meet periodically with the IFRS Interpretations Committee to review the effectiveness of the interpretations process.

At the same time, the Trustees recognise the need to balance enhanced due process oversight against the continuing need for efficiency in the standard-setting process.

Stakeholder feedback and enhancements in the agenda-setting and standard-setting processes

C3 **Building on the existing due process framework and in an effort to improve the usability of financial information, the IASB should undertake:**

- **Clear demonstration of how priorities on its agenda are set: in the agenda-setting process and after the required public consultation, the IASB should provide full feedback to the public, including a demonstration of how the input of the IFRS Advisory Council was taken into account. This will foster confidence in the IASB's agenda-setting process and reinforce support for its independence.**
- **Agreed methodology for field visits/tests and effect analyses: the IASB should work with relevant parties to develop an agreed methodology for field visits/tests and effect analyses (more often referred to as cost-benefit analyses or impact assessments).**
- **Consideration of the impact of standard-setting decisions on XBRL: while XBRL considerations should not dictate the substance of the standard-setting process, the Trustees recognise the growing use of XBRL requirements. The IFRS XBRL taxonomy is growing in importance and deserves encouragement. Consequently, in drafting new standards, the IASB should take into account the need for language that is easily translatable into foreign languages and into a consistent XBRL taxonomy.**
- **Consideration of the impact of standard-setting decisions on the translation of IFRSs and XBRL: the IASB should be conscious that many end users require translations of the English-language IFRSs.**

Agenda-setting: the Trustees recently introduced a requirement to have three-yearly public consultations on the IASB's agenda and priorities. The first such review is occurring now. In undertaking the public consultation, the IASB should actively engage the IFRS Advisory Council and other stakeholders. The Trustees believe that engaging stakeholders in the development of agenda priorities will enable the IASB to address the most pressing financial reporting issues. Furthermore, it will strengthen public confidence in the standard-setting process.

As part of the agenda-setting process and following the public consultation, the IASB should provide a feedback statement explaining how it accounted for the views of the Trustees, the IFRS Advisory Council, the Monitoring Board and stakeholders. As with other elements of the IASB's due process, the IASB will review progress on its agenda-setting process with the Trustees' Due Process Oversight Committee.

Field visits/tests and effect analyses: field visits/tests and effect analyses (or impact assessments) are now considered best practice in the establishment of regulations. They are now regular parts of the IASB's due process (field visits and tests as part of a 'comply or explain' approach and effect analyses as a requirement for major projects). Nevertheless, there is a sense among stakeholders that the IASB should further clarify the role of these elements of the IASB's due process.

The Trustees believe that the organisation could benefit from receiving guidance in developing an agreed methodology for field testing and effect analyses. Consequently, the Trustees are recommending the establishment of a working group from the international community, chaired by the IASB, to develop an agreed methodology for field testing and effect analyses.

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Consideration of XBRL issues and quality control over the XBRL taxonomy development process: the IFRS Foundation is already actively engaged in the development of an IFRS XBRL taxonomy. Until now, the XBRL taxonomy process has occurred after the development of standards by the IASB. In this manner, the development of the XBRL taxonomy is similar to a translation of IFRSs from English into another language. There is no formal link between the technical aspect of standard-setting and its potential impact on XBRL-driven data.

While XBRL considerations should not dictate the substance of the standard-setting process, the Trustees recognise the growing use of XBRL requirements. For this reason, the Trustees believe that the IASB has a strong interest in the development of the IFRS XBRL taxonomy. The Trustees are therefore recommending that the IFRS taxonomy development team that is already in place should come under the direct supervision of the technical directors at the IASB. This would be analogous to the situation at the US national standard-setter, the Financial Accounting Standards Board (FASB). This reporting structure would ensure some level of IASB involvement in the quality assurance process and interaction between IASB project managers and the XBRL team at the staff level during the standards development stage.

In addition, the Trustees are committed to providing an IFRS XBRL taxonomy that serves investors and other users of financial information. In this light, the XBRL team should develop an agreed methodology to develop a relevant number of extensions to the existing base taxonomy in order to reflect common IFRS practice.

Actions aimed at consistency of IFRS implementation

The Trustees have earlier emphasised that the IFRS Foundation has a vested interest in helping to ensure the consistent application of IFRSs internationally. The Trustees have borne that interest in mind through their approach on XBRL, education activities and publication. But in addition there are procedural steps that can support consistent application.

C4 **To support the IFRS Foundation's interest in consistent application of IFRSs and to comply with the IASB's standard-setting mandate, the Foundation and the IASB should undertake the following actions:**

- **Using an agreed methodology, undertake post-implementation reviews to help identify implementation issues.**
- **Establish formalised co-operation arrangements with securities regulators, audit regulators and national standard-setters to receive feedback on how IFRSs are being implemented and to encourage actions aimed at addressing divergence.**
- **Review and possibly enhance the scope of the IFRS Interpretations Committee's activities to ensure consistency of Interpretations, without undermining the commitment of a principle-based approach to standard-setting**

Post-implementation reviews: the IASB can play an important role through its post-implementation review and, using the IFRS Interpretations Committee, through the interpretations process. The IASB is required to undertake post-implementation reviews of new IFRSs, as well as major amendments to IFRSs and major Interpretations after at least two full years of implementation, to be completed within three years of the pronouncement's effective date. These reviews were designed to be limited to important issues that had been identified as contentious during the development of the pronouncement and would include any unexpected costs or implementation problems encountered.

The IASB is now about to consider the first standards subject to such a review. The IASB is developing a clear and transparent methodology for undertaking these reviews.

Co-operation with securities regulators, audit regulators, national accounting bodies and national standard-setters: securities regulators, audit regulators, national accounting bodies and national standard-setters are best positioned to identify inconsistency in the application of IFRSs. The IASB should use existing or new formal networks with securities regulators, audit regulators and national standard-setters to identify issues and then develop an action plan with these parties.

IFRS Interpretations Committee: the IFRS Interpretations Committee should help to ensure consistency in Interpretations, without undermining the commitment to a principle-based approach to standard-setting. The Trustees expect the IFRS Interpretations Committee to play a more active role in its second decade. The Committee will probably play this role by:

- Identifying emerging areas of divergence across borders, before they become entrenched practice, by consulting auditors, audit regulators and securities regulators.
- Having timely public discussions and resolution of requests for an Interpretation or improvement.
- Developing authoritative guidance to clarify accounting principles and their application to a (narrow) range of circumstances.
- Communicating persuasive explanations and reasons for not issuing further authoritative guidance than is already contained in the standards.
- Correcting and clarifying the wording of IFRSs for matters that are relatively minor and that do not justify a separate IASB project.
- Reaching out to all stakeholders to explain the interpretation and implementation processes (conferences, standard-setter engagements, fact books, podcasts) and regularly reassessing the operational efficiency and effectiveness of the Committee in conjunction with the Trustees' Due Process Oversight Committee.

Importance of national and other accounting standard-setters

C5 **The IFRS Foundation and the IASB should encourage the maintenance of a network of national accounting standard-setting bodies and regional bodies involved with accounting standard-setting as an integral part of the global standard-setting process. In addition to performing functions within their mandates, national accounting standard-setting bodies and regional bodies involved with accounting standard-setting should continue to undertake research, provide guidance on the IASB's priorities, encourage stakeholder input from their own jurisdiction into the IASB's due process and identify emerging issues.**

The IFRS Foundation and the IASB should encourage the maintenance of a network of national accounting standard-setting bodies and regional bodies involved with accounting standard-setting (reflecting the relevance of regional organisations in the endorsement of IFRSs and the growing development of regional groupings of standard-setters) as an integral part of the global standard-setting process. These bodies that are concerned with standard-setting have important, specified and independent roles within their own national and regional context. They should also continue to undertake research activities with the IASB, provide guidance on the IASB's priorities, encourage stakeholder input from their own jurisdiction into the IASB's due process and identify emerging issues. The IASB should seek to enlist national and other accounting standard-setters in the identification and disclosure of deviations of national standards from IFRSs.

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Dedicated research capacity

C6 **To provide leadership in thinking in the field of financial reporting, the IASB should establish, or should facilitate the establishment of, a dedicated research capacity.**

The IFRS technical staff have no dedicated resource for accounting research to understand how existing standards are operating, to analyse trends of financial reporting and to identify future issues. This is the consequence of limitations on financial resources and the focus on completing the present work programme. The Trustees recommend establishing, or facilitating the establishment of, a research capacity that could draw upon some combination of internal and external intellectual resources, including a more active engagement of the academic community. The Trustees would necessarily seek dedicated, separate financing to support such a research capacity. The Chairman and the Vice-Chairman of the IASB should present a proposal by the end of 2012 on implementing this conclusion, which assumes funding will be available.

6. Financing: ensuring that the IFRS Foundation has a broad and sustainable source of funding

At the outset, the Foundation was financed through voluntary contributions by some 200 organisations. Occasionally, this partial dependence on voluntary contributions raised two concerns by a few observers. One was a possible lack of objectivity because of the temptation to provide special consideration in the standard-setting process to important financial supporters. Conversely, there were suggestions that supporters, dissatisfied with the outcome of a rigorous standard-setting process, might withdraw funding and disrupt the IASB's work. While neither of these concerns materialised in practice, there was a sense that dependence on voluntary contributions from largely private sources was inappropriate for an organisation acting in the public interest and could deprive the organisation of necessary resources in the future.

Since 2006 the Trustees have sought to establish national financing regimes, proportionate to a country's relative GDP, which would establish a levy on companies or provide an element of publicly supported financing. Now the great majority of the Foundation's finances are based on such regimes, and this approach has been particularly successful in Asia-Oceania and Europe. However, voluntary systems remain in place in some jurisdictions; some countries contribute less than their fair share or not at all; budget deficits are currently projected if new financing is not found; and the Trustees do not have the authority to mandate financing.

The Trustees believe that further progress on financing is essential to safeguard the IFRS Foundation's position as the world's independent accounting standard-setter.

D1 **The funding system must maintain the independence of the standard-setting process, while providing organisational accountability.**

D2 **The existing base of financing should be expanded to enable the IFRS Foundation to serve the global community better and to fulfil the strategy described above. Specifically, the Trustees should propose that funding should be on a long-term basis (at least three to five years), be publicly sponsored, be flexible to permit the use of differing mechanisms and to adjust to budgetary needs, be shared among jurisdictions on the basis of an agreed formula (that would be consistent with the principle of proportionality), and to provide sufficient organisational accountability.**

The 2011 budget for the IFRS Foundation (for all activities) is £26 million. This budget is relatively small compared with those of other international organisations with global reach and influence. Furthermore, the budgetary increases since the advent of the IASB in 2001 have failed to keep pace with the growing demands placed on the organisation.

To 'adjust' for the global spread and to implement the strategy contained in this report, the Trustees believe that the budget may need to grow to approximately £40–45 million (at current sterling amounts, ie excluding future inflation) annually over a period of time. This would still be a relatively small amount when compared with other international financial institutions. Furthermore, it would mark significant savings when compared with the sum of resource requirements for all national accounting standard-setting before global adoption of IFRSs.

Achieving that new funding target will require a robust financing system that builds upon, and significantly advances, efforts already under way.

The Trustees recognise that individual sovereign jurisdictions will have different methodologies for providing the necessary financing. In addition, because the IFRS Foundation would receive publicly supported financing, requirements for organisational accountability regarding resource expenditures will grow. To address these two issues consistently with principle D1 in the IFRS Foundation's mission, the Trustees seek a global funding system that has the following features:

- It will provide a long-term commitment. Funding should not be dependent on annual appropriations and not contingent on fulfilling any conditions that would compromise the independence of the standard-setting process.
- It should have public sponsorship (either direct or implicit governmental or regulatory support). This 'public' element will remove any perception of undue interference by private sector interest groups through the financing process.
- It should be flexible so as to take into account (1) agreed increases in the budget and (2) that national jurisdictions are likely to arrange the financing regimes to suit their legal frameworks and cultural background. However, the Trustees could indicate that a sensible formula would be a levy on users and beneficiaries of IFRSs (ie listed companies, investment companies). There should be a designated institution with which the IFRS Foundation should liaise in each funding jurisdiction.
- It should be allocated proportionally so that the funding is shared by the major economies of the world (including, but not exclusively, the G20) on a proportionate basis, using GDP as the primary determining measure. Targets could be adjusted to reflect levels of economic development. Each country or jurisdiction should meet its designated target in a manner consistent with the principles above and should indicate which agency should serve as the interlocutor with the IASB.
- It should provide public accountability in the budget process. The Trustees should publish annually how they seek to use the funds raised by national and international financing mechanisms. The final approval of the annual budget should include a review of the budget with the IFRS Foundation Monitoring Board.

In achieving the financing objectives, the Trustees are committed to working with the Monitoring Board to ensure that their collective responsibility to support the IASB is fulfilled.

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