

IFRS Foundation
30 Cannon Street
London
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27 November 2015

Dear Sirs

Request for Views *Trustees' Review of Structure and Effectiveness: Issues for the Review*

This letter sets out the comments of the UK Financial Reporting Council (FRC) on the above Request for Views.

This is an important time for the IFRS Foundation to review its strategic direction and assess the effectiveness of its strategy as the IASB is in the process of issuing its revised *Conceptual Framework* and finalising other key projects and therefore will enter a new phase of work; a new strategic period. Accordingly, we have answered the questions in the Request for Views document and have also made a number of broad observations below to help in the determination of that strategy and in the assessment of the effectiveness of its delivery. In our view both are key roles of the IFRS Foundation.

Monitoring Board

We agree with the current three-tier structure of the governance of the IFRS Foundation. We understand that the composition of the Monitoring Board is under review and consider it is important for its composition to change to reflect both the balance of global financial activity and the adoption of (or commitment to adopt) IFRS.

Role of the Trustees

We consider that the Trustees should provide more direct oversight of the strategic direction of the IASB's standard-setting and exercise greater oversight of the output of the IASB rather than their current focus which is limited to adherence to due process requirements.

There is a continuing view that the IASB's standards are too theoretically-based and that the cost-benefit analysis and effects analysis are insufficiently robust. It is important that standards are developed and assessed with recognition of the context that financial reporting affects economic decision-making and financial stability. They must be practical and understandable by those that implement them ("preparers") and meet the needs of users in the jurisdictions that adopt them. Our Chairman, Sir Win Bischoff, highlighted this view when he spoke to the Trustees in July last year.

The FRC believes that the Trustees should, following consultation and in light of the Foundation's Mission Statement, set the strategic direction of the IASB's standard-setting agenda, hold the IASB to account for following this strategy and assess the performance of the IASB as a whole, by reference to adherence to both the words and the spirit of the Foundation's due process requirements and by reference to the quality and timeliness of its outputs.

We consider that the Trustees' breadth of experience and knowledge of commerce, economics and current issues should be used to ensure that the IASB's agenda remains focused on areas where there is a genuine need for improvement; that standards are practical and operational; and standards are written with cognisance of their potential commercial and macro-economic implications.

The Trustees should increase their scrutiny of the cost-benefit analysis that the IASB performs when developing new standards to ensure that the costs on business as well as the perceived benefits are properly taken into account. This would help address the perception of technical purity overriding commercial reality.

That the IASB is undertaking an agenda consultation in parallel with the Trustees' strategic consultation, is indicative of our concerns that the IASB's work is not carried out within an agreed strategy and given effective strategic direction by the Trustees. We would expect those charged with governance of an organisation, i.e. the Trustees, to agree a strategic direction before more operational level matters, such as the short- to medium-term priorities for standard-setting, are agreed.

The strategic direction should include consideration of how economic growth might be better supported. For example, in the UK and the EU there is a focus on minimising regulatory change and on effective embedding of recent change. The Trustees need to consider the pace of development of standards and the level of detail the standards should include, to ensure that the IASB remains focused on a principles-based approach.

Geographic distribution of Trustees

We believe that the geographic distribution of the Trustees should focus, though not exclusively, on those jurisdictions that apply IFRS or are committed to their adoption. Trustees should build closer relationships with stakeholders in their jurisdictions to ensure standards meet the needs of those stakeholders and, in effect, be representatives of their jurisdiction. The powers to set standards that have been entrusted to the IASB must be properly exercised and it should be the role of the Trustees to ensure this is done on behalf of their jurisdictions. Therefore we do not agree with the increase in the number of "at large" Trustees.

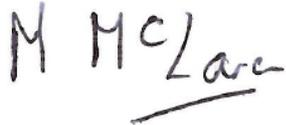
Funding

Finally, we support the goal of the IFRS Foundation being publicly funded with the funding being shared amongst jurisdictions on the basis of GDP. It is positive that the IFRS Foundation is working to increase the number of accounting firms contributing to the funding as this reduces the potential threat, perceived or otherwise, to its independence from a small number of larger firms. Securing a commitment to funding for a specified period from the expanded group of firms would also help address such potential threats.

Our responses to the questions in the Request for Views are included in the Appendix to this letter.

If you would like to discuss these comments, please contact me or Anthony Appleton on 020 7492 2432. We will also be in touch shortly to suggest a meeting of our Chairmen to discuss these and other matters.

Yours sincerely

A handwritten signature in black ink that reads "M McLaren". The signature is written in a cursive style, with the first letter of each word being capitalized and larger than the others. A horizontal line is drawn under the name "McLaren".

Melanie McLaren
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Appendix: Questions on the IFRS Foundation Trustees' Review of Structure and Effectiveness

Question 1—Scope: should the IASB develop Standards for other entities?

Considering the consequences referred to above, what are your views on whether the IASB should extend its remit beyond the current focus of the organisation to develop Standards; in particular for entities in the private, not-for-profit sector?

Public sector and not-for-profit entities

- A1 The FRC agrees that the IFRS Foundation should not take on responsibility for developing accounting standards for the public sector and that the IASB should continue its current liaison arrangements with the International Public Sector Accounting Standards Board (IPSASB).
- A2 Whilst we recognise there is strong demand for international not-for-profit accounting standards we do not believe the IASB has sufficient resources and expertise to undertake such work without detrimentally affecting its work on setting standards for private sector for-profit entities. Consequently, the FRC does not believe that the scope of the IFRS Foundation's mandate should be expanded to encompass private sector not-for-profit entities.
- A3 However, many of the issues that arise in accounting for private sector not-for-profit entities relate to non-exchange transactions. Work to address the accounting for such transactions by private sector for-profit entities (such as government grants and taxation) may also benefit private sector not-for-profit entity accounting.

Reporting by SMEs

- A4 The FRC welcomes the IFRS Foundation's proposal that it should take forward any further work on financial reporting for SMEs as a part of the European Commission's work on developing a Capital Markets Union (CMU)^{1,2}.
- A5 We have recently undertaken a project to consider the quality of reporting by such companies (including those on the AIM growth market as well as those listed on the Main Market of the London Stock Exchange)³. As part of the project we considered whether the reporting regime, and in particular the requirement to report under IFRS, is appropriate for AIM quoted companies and smaller listed companies or whether there is any appetite for a less complex accounting framework such as UK GAAP.

¹ The European Commission published its Action Plan on Building a Capital Markets Union (COM(2015)468) in September 2015. We note that the Action Plan includes a commitment to explore, together with the IASB, the possibility of developing a voluntary tailor-made accounting solution for companies trading on SME Growth Markets. This document is available at: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

² Our response to the initial European Commission consultation is available at: <https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-response-to-Green-Paper-Building-a-Capital-Ma.pdf>

³ *Improving the Quality of Reporting by Smaller Listed and AIM Quoted Companies—Discussion paper on the FRC's findings and proposals*, June 2015. This document is available at: <https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Improving-the-Quality-of-Reporting-b-File.pdf>

- A6 The overwhelming response we received is that IFRS recognition and measurement criteria provide the appropriate framework for all listed companies as it ensures consistency and comparability. However the volume of disclosures currently required might be reviewed, as some disclosure are of little interest to investors. We consider that the Capital Markets Union initiative provides an opportunity to develop a differentiated disclosure framework for smaller listed companies, similar to the approach adopted in UK GAAP.

Question 2—Scope: wider corporate reporting
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Do you agree with the proposal that the IASB should play an active role in developments in wider corporate reporting through the co-operation outlined above?

- A7 The FRC agrees that the IFRS Foundation and the IASB should continue their cooperative work with other organisations such as, but not limited to, the International Integrated Reporting Council (IIRC). Whilst financial reporting, and the financial statements in particular, should remain the IASB's primary focus, involvement in broader corporate reporting dialogue will ensure IFRS retain their relevance and, in the preparation of financial statements, their primacy.
- A8 When considering the IASB's agenda, the FRC encourages the Trustees to ensure that the IASB continues to develop its thinking on the placement of items (e.g. whether amounts can be included in the financial statements by reference to other components of the wider financial report, similar to the approach permitted in respect of risks associated with financial instruments) and on the reporting of non-IFRS information (including alternative performance measures (APMs)).
- A9 APMs have a role to play as they allow entities to fully explain their financial performance in the financial statements in a manner that properly reflects their business model and objectives that is meaningful to investors; APMs are often necessary to bridge the gap between the narrative reporting of performance and that in the financial statements. Therefore, any project on the use of APMs should also consider the reasons entities consider their presentation necessary and identify lessons to be drawn for performance reporting generally.

Relevance of IFRS in structured digital reporting: IFRS Taxonomy

Question 3

Do you agree with the Foundation's strategy with regard to the IFRS Taxonomy?

Question 4

How can the IASB best support regulators in their efforts to improve digital access to general purpose financial reports to investors and other users?
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Question 3

- A10 The FRC does not agree that the IFRS Taxonomy should be integrated into the process of setting standards. There is a risk that proposed changes to the IFRS Taxonomy unintentionally interpret the standards or imply a greater degree of prescription than is intended, due to its rigid structure and focus on quantitative disclosures. This may detract from the aim of developing principles-based standards that focus on the

objectives of disclosure. Furthermore, it is difficult to assess proposed changes to the IFRS Taxonomy when reviewing them in isolation from the rest of the IFRS Taxonomy.

- A11 In our view, it would be more helpful for proposed changes to the IFRS Taxonomy to be consulted on in an agreed amendment cycle, incorporating changes to several standards, rather than with each proposed change to a standard. Based on our experience of developing taxonomies, we believe that this would create a more stable platform and enable a more holistic and efficient process for reviewing proposed changes to the IFRS Taxonomy. It would be easier to assess whether proposed changes to the IFRS Taxonomy are at an appropriate level of detail and whether various updates are consistent. It would also be considerably more cost-beneficial for preparers.
- A12 We consider the Board should provide oversight of the Taxonomy to ensure its development does not, in practice, constitute interpretation of standards nor undermine the philosophy of principles-based standard-setting.

Question 4

- A13 The FRC considers that the work that is being undertaken to build profiles of current requirements in each jurisdiction for filing and distribution of IFRS financial statements (including electronic filing requirements) will be helpful to regulators and other to understand what is happening in other jurisdictions relating to the digital access to general purpose financial reports by investors and others. We encourage the IFRS Foundation to publish their findings. The findings of our Financial Reporting Lab on current digital reporting practices may provide some helpful insight to be built upon.

Question 5—Relevance of IFRS in the face of wider developments in technology

Do you have any views or comments on whether there are any other steps the IASB should take to ensure that it factors into its thinking changes in technology in ways in which it can maintain the relevance of IFRS?

- A14 The FRC agrees with the IFRS Foundation's plans to establish a network of experts to help monitor and assess changing technology and how the IASB should respond to those changes and to undertake research on technological changes and how the IFRS Taxonomy should respond to those changes. We consider that both these initiatives will help maintain the relevance of IFRS.
- A15 Developments in information technology have the potential to change how entities communicate with investors and other stakeholders; such changes are already apparent. Accounting standards were first developed in a time when periodic reporting was the primary source of information on a company, its performance and financial position. As new communication channels are opened that provide more timely and granular information, the primacy of such periodic reporting may be challenged or, at the very least, the role it plays may need to evolve. We consider it important that the IFRS Foundation consider the impact of such changes on the relevance, nature and content of IFRS over the medium- and long-term. The next phase of our Financial Reporting Lab project will be considering such issues and may be of assistance to the IFRS Foundation's considerations.

Primary Strategic Goal 3: Consistency of application and implementation
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Question 6

What are your views on what the Foundation is doing to encourage the consistent application of IFRS? Considering resourcing and other limitations, do you think that there is anything more that the Foundation could and should be doing in this area?

- A16 The FRC recognises that the IASB faces a difficult challenge in balancing principles-based standard setting with achieving consistent application and reduced diversity. Whilst we agree with the comment in paragraph 64 that inconsistent application may “damage the brand” of IFRSs, so can constant change and a proliferation of narrow-scope amendments and Interpretations. Such change undermines the credibility of the standards, creates additional burden on preparers and may lead to confusion.
- A17 Therefore, the FRC encourages the IASB to ensure that the amendments are only made where there is strong evidence of significant, widespread diversity in practice that is not a result of the legitimate application of principles and the use of professional judgement to present more meaningfully relevant financial information.
- A18 Under a principles-based approach that has been applied rigorously, differing accounting outcomes should be expected and accepted, when:
- a. the requirements of a standard dictate that the application of professional judgement is needed, such as the assessment of the probability of a contingency crystallising;
 - b. standards are silent on an issue so professional judgement is required to determine an appropriate accounting policy;
 - c. standards permit flexibility, such as in presentation of primary statements, and professional judgement is applied to facilitate clear communication between an entity and its investors and other users of its financial statements; and
 - d. differences in the exercise of professional judgement arise due to different cultural and legal backgrounds.
- A19 The Trustees should ensure that the Board and the IFRS Interpretations Committee continue to be mindful of these logical and desirable outcomes of principles-based standard-setting.
- A20 The FRC considers that cooperation with securities regulators is positive as it assists in understanding each other’s viewpoint (i.e. the tension between the IASB’s principles-based standard-setting and the regulators desire for consistency and, in some cases, uniformity), as well as identifying those areas where IASB intervention is justified.
- A21 Diversity can also be addressed in other ways such as the development of education material. We also encourage the further use of Transition Resource Groups for major new standards as these allow public discussion of issues that will aid in reaching a common international understanding of the requirements and minimise implementation issues.

- A22 Clearly there are situations where diversity is so significant that the IASB must intervene by amending current or introducing new requirements in standards. Similarly, where there is evidence, such as that arising from a post-implementation review, that significant issues have arisen, timely changes to standards may be required. However, such diversity will sometimes be best minimised by the issuance, in the first instance, of high quality, clear and understandable standards. As discussed below the role of the Trustees should include oversight of output as well as due process requirements. Additionally, more extensive use of field testing and external reviews will aid the development of high quality standards.
- A23 We encourage the Trustees to ensure the IASB continues to fulfil its commitment to amend its agenda on the basis of evidence that active projects will either fill a significant gap in existing accounting literature or result in a significant improvement in the transparency of financial reporting for particular transactions. The IASB needs to remain aware of the risks associated with constant change arising, for example, from carrying out too many narrow-scope amendments projects. The FRC has a set of published criteria⁴ used to determine whether a standard or amendment thereto is needed, which ensures there is a high hurdle in place before any change is proposed.

Question 7—Governance

Do you have any suggestions as to how the functioning of the three-tier structure of the governance of the Foundation might be improved?
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- A24 The FRC supports the current three-tier structure of the governance of the IFRS Foundation. However, we believe its functioning could be improved by strengthening the oversight of the output of the IASB and the IFRS Interpretations Committee, as set out below. Whilst we refer below to only the IASB, the points apply equally to the Trustees oversight of the work of the IFRS Interpretations Committee.
- A25 We understand that the composition of the Monitoring Board is under review and consider it is important for the composition of the Monitoring Board to change, when appropriate, to reflect both the balance of global financial activity and the adoption of (or commitment to adopt) IFRS.
- A26 There is a continuing view that the IASB's standards are too theoretically-based and that the cost-benefit analysis and effects analysis is insufficiently robust. It is important that standards are developed and assessed in the context that financial reporting affects economic decision-making and financial stability; that they are practical and understandable by preparers; and that they meet the needs of users in the jurisdictions that adopt them. Our Chairman, Sir Win Bischoff, highlighted this view when he spoke to the Trustees in July last year. The Trustees should assess the performance of the IASB as a whole both pre- and post-issuance of a standard. Accordingly, a review of the process of development of a standard once issued should help the IASB avoid having the same issues arise with future standards. For example, will the levels of costs being incurred in implementing, and uncertainty surrounding the final text of IFRS 15 *Revenue from Contracts with Customers* be repeated when entities start to implement the new leases standard?

⁴ Principles for the development of Codes, Standards and Guidance (January 2014). This document is available at: <https://frc.org.uk/FRC-Documents/FRC/About-the-FRC/Principles-for-the-development-of-Codes.pdf>

- A27 Paragraph 25 of the Request for Views notes that the Trustees have a duty under the Constitution to consider the IASB's agenda, but cannot determine it. However, the FRC believes the experience of the Trustees should be used to contribute to the agenda-setting process including setting the strategic direction of the IASB's agenda.
- A28 That the IASB is undertaking an agenda consultation in parallel with the Trustees' strategic consultation, is indicative of our concerns that the IASB's work is not carried out within an agreed strategy and given effective strategic direction by the Trustees. We would expect those charged with governance of an organisation, i.e. the Trustees, to agree a strategic direction before more operational level matters, such as the short- to medium-term priorities for standard-setting, are agreed. However, we welcome the opportunity to comment on the IASB's agenda, but consider it should be done in light of stakeholder views on the future strategic direction of standard-setting.
- A29 The strategic direction should include consideration of how economic growth might be better supported. For example, in the UK and the EU there is a focus on minimising regulatory change and on effective embedding of recent changes. The Trustees need to consider the pace of development of standards and the level of detail the standards should include, to ensure that the IASB remains focused on a principles-based approach.
- A30 The Trustees bring with them a breadth of experience and knowledge of commerce, economics and current issues that could be brought to bear to ensure:
- the IASB agenda remains focused on areas where there is a genuine need for improvement;
 - the IASB issues standards that are practical and operational; and
 - standards are written with cognisance of their potential commercial and macro-economic implications.
- A31 The Trustees should increase their scrutiny of the cost-benefit analysis that the IASB does when developing new standards to ensure that the costs on business as well as the perceived benefits are properly taken into account. This would help address the perception of technical purity overriding commercial reality.
- A32 One of the duties of the Trustees is to appoint the members of the IASB and establish their contracts of service and **performance criteria** (emphasis added). However, there does not appear to be an equivalent duty for the Trustees to review the performance of the IASB as a whole and the quality of its output. Therefore, we encourage the Trustees to undertake regular effectiveness reviews of the IASB. These reviews should focus on whether the IASB has undertaken its due process in the spirit in which it is intended when responding to stakeholder concerns, rather than focusing solely on whether the IASB has adhered to the due process requirements.
- A33 The performance of the IASB as a whole should be assessed by the Trustees by reference to the strategic direction they provide and the recently issued Mission Statement. Furthermore, the input of the Trustees, given their experience and backgrounds, will greatly enhance the success of the standard-setting process to result in IFRSs that bring transparency, strengthen accountability and contribute to economic efficiency, as called for in the Mission Statement. It is surprising that the Request for Views does not more thoroughly explore how the Mission will be achieved.

A34 In our answer to question 8 below, we set out that the role of the Trustees is to ensure that the IASB properly exercises the standard-setting powers entrusted to it by those jurisdictions which apply or are committed to adopting IFRS. In summary, the FRC believes that the Trustees should:

- a. following consultation and in light of the Foundation’s Mission Statement, set the strategic direction of the IASB’s standard-setting agenda with reference to stakeholders concerns on IFRS as a whole;
- b. hold the IASB to account for following this strategy; and
- c. assess the performance of the IASB as a whole by reference to adherence to both the words and the spirit of the due process requirements and by reference to the quality and timeliness of its outputs.

A35 If compliance with our recommendations would require changes to the Constitution then these should be made. Our recommendations may be perceived as substantially undermining the independence of the IASB, but we do not believe that this is the case. We are not advocating that the Trustees make technical decisions or “hold the pen” when standards are written, only that they exercise proper oversight of the IASB’s output alongside the current oversight of due process requirements.

Trustees
<p>Question 8</p> <p>What are your views on the overall geographical distribution of Trustees and how it might be determined? Do you agree with the proposal to increase the number of ‘at large’ Trustee appointments from two to five?</p>
<p>Question 9</p> <p>What are your views on the current specification regarding the provision of an appropriate balance of professional backgrounds? Do you believe that any change is necessary and, if so, what would you suggest and why?</p>
<p>Question 10</p> <p>Do you agree with the proposal to change the focus and frequency of reviews of strategy and effectiveness, as set out above?</p>

Question 8

A36 Jurisdictions applying IFRS or committed to their adoption have entrusted the IASB with significant standard-setting powers that can have a profound effect on capital markets and the essential communication between entities and their investors and other stakeholders. The role of the Trustees should be to ensure these powers are properly exercised, that due process is followed and that the resulting standards meet the needs of stakeholders, including preparers, in those jurisdictions.

A37 We believe that there should be stronger ties between individual Trustees and the jurisdictions they represent. These ties should include liaising with regional stakeholder groups to understand their views and local implementation issues, and to ensure these are taken into consideration in the standard-setting process. Such relationships and the resulting dialogue would also benefit the Foundation in its objectives of wider and more consistent application of IFRS.

A38 To achieve this some changes to the geographical distribution of Trustees may be necessary to ensure there is sufficient, though not absolute, focus on those jurisdictions that apply IFRS or are committed to the adoption of IFRS.

A39 Consistently with the above, the FRC disagrees with the proposal to increase the number of “at large” Trustee appointments from two members to five.

Question 9

A40 The FRC considers that the current specification relating to the balance of professional backgrounds, set out in Section 7 of the Constitution is appropriate. We welcome the Trustees’ commitment to encouraging greater representation by investors and their continued efforts to improve gender balance amongst Trustees.

Question 10

A41 The FRC agrees with the proposal to amend the Constitution to change the focus and frequency of reviews of strategy and effectiveness for the reasons given in paragraph 86. However, the FRC considers that the Trustees’ duties should be amended to strengthen their oversight of the IASB as discussed in our response to Question 7 above.

IASB
Question 11 Do you agree with the proposals to reduce the size of the IASB as set out in the <i>Constitution</i> from 16 members to 13 and the revised geographical distribution?
Question 12 Do you agree with the proposal to delete Section 27 and to amend the wording of Section 25 of the <i>Constitution</i> on the balance of backgrounds on the IASB?
Question 13 Do you agree with the proposal to amend Section 31 of the <i>Constitution</i> on the terms of reappointment of IASB members as outlined above?

Question 11

A42 The FRC agrees with the proposal to reduce the constitutional size of the IASB from 16 members (with only 14 currently appointed) to 13 members if the Trustees are confident this would not hinder the Board’s ability to perform its work, including extensive direct outreach, in a timely manner.

A43 We note that this will be achieved by reducing the representation of the three largest geographical areas. However, we believe there should be less emphasis on the geographical distribution of IASB members because they are appointed for their technical expertise, as explained in paragraph 92:

“...IASB members are not appointed as representatives of any geographical region. The main qualifications for membership of the IASB remain professional competence and practical experience...”

Question 12

- A44 Section 25 of the Constitution states that “The main qualifications for membership of the IASB shall be professional competence and practical experience”. The FRC agrees with this statement and notes this will be retained.
- A45 Therefore the proposed changes appear to remove reference to “an appropriate mix of *recent* practical experience” [italics added] and to add reference to “market and/or financial regulators”.
- A46 We disagree with the first of these changes because we consider it important that the Board can bring recent experience of financial reporting to bear in its deliberations. This is not to say that every new member should have been involved in financial reporting immediately prior to his/her appointment, but that an appropriate mix is maintained.
- A47 On the latter change, we note that the IASB already includes members with regulatory experience so agree with their inclusion as relevant professional experience. However, we do not think this should lead to any increase in their representation compared to today. We also believe those with a standard-setting background should also be considered.
- A48 We welcome the Trustee’s commitment to addressing the current gender imbalance in the Board.

Question 13

- A49 The FRC agrees with the proposal to amend Section 31 of the Constitution to introduce some flexibility to the length of the second term of IASB members to be up to five years rather than being limited to three years.

Question 14—Financing

Do you have any comments on the Foundation’s funding model as outlined above? Do you have any suggestions as to how the functioning of the funding model might be strengthened, taking into consideration the limitations on funding?

- A50 The FRC supports the Trustees’ continuing strategy to ensure that the IFRS Foundation has a broad and sustainable funding structure to provide long-term stability based on national financing schemes and that funding be shared amongst jurisdictions on the basis of GDP.
- A51 It is positive that the IFRS Foundation is working to increase the number of accounting firms contributing to the funding as this reduces the potential threat, perceived or otherwise, to its independence from a small number of larger firms. Securing a commitment to funding for a specified period, from the expanded group of firms, would also help address such potential threats.

Question 15—Other issues

Should the Trustees consider any other issues as part of this review of the structure and effectiveness of the Foundation? If so, what?

A52 Please refer to our covering letter.