Setting the global standard for investment professionals

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IFRS Foundation
30 Canon Street
London United Kingdom

CFA Institute[1], in consultation with its Corporate Disclosure Policy Council ("CDPC")[2], appreciates the opportunity to comment on the *IFRS Foundation Status of Trustees' (Trustees) Strategy Review (Strategy Review).*

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

General Comments

IFRS Foundation Review & Monitoring Board Consultative Review Necessary But Should Have Been Completed Jointly

CFA Institute appreciates the opportunity to express its views regarding the Trustees' strategy review. The Trustees' desire to seek the advice of the stakeholder community is in keeping with the spirit of transparency and demonstrates an understanding of international stakeholder community interest in the ongoing review. CFA Institute, as an organization is comprised of analysts and professional investors who are primary users of financial statements, has interest in the governance of the IFRS Foundation and to that end we have written comment letters regarding the Constitution reviews[3] and provided public testimony[4]. These reviews, in addition to the current Strategy Review conducted by the Trustees' ensure

[1] With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

[3] CFA Institute comments letters related to:
- *International Accounting Standards Committee Foundation: Part 2 of the Constitution Review Proposals for Enhanced Public Accountability* (November 30, 2009).
- *International Accounting Standards Committee: Review of Governance and Structure of the IASB and the IASC Foundation* (September 30, 2008).

[4] CFA Institute statement before the *IASC Foundation Constitution Review Roundtable on the Governance of the IASB and the IASC Foundation* (June 18, 2008).

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that there is transparency into the process as well as provide a means for the various stakeholders to express their views.

While we agree with the need to conduct the IFRS Foundation Strategy Review, there is substantial overlap with Monitoring Board Consultative Review and we believe the issues could have been addressed jointly – particularly in light of the volume of consultations being requested by the IASB and FASB as a part of the 2006 Memorandum of Understanding.

Support for Single-Set of High-Quality Standards But Investors Believe Structural Improvements Required
CFA Institute has consistently supported the goal of a single-set of high-quality, understandable and enforceable financial reporting standards that would facilitate the comparison of investments in different countries. CFA Institute has supported IFRS as a means of creating this single-set of high-quality financial reporting standards due to its organizational mission and global stakeholder involvement. CFA Institute believes that the IASB and its global stakeholders must be prepared to make a number of structural improvements to its organization if the IFRS Foundation and the IASB expect investors to support IFRS as the single-set of high-quality financial reporting standards of choice. The areas that the Trustees' have identified as four areas of examination (mission, governance, process, and financing) are key strategic areas to focus on to ensure the long-term success of IFRS as the financial reporting standard of choice.

Response to Specific Questions

Mission: How should the organization best define the public interest to which it is committed?

Question 1. The current Constitution states, "These standards [IFRSs] should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions." Should this objective be subject to revision?

We believe that the stated objective in the development of IFRS standards should continue to place primacy on the informational needs of investors given that financial statements are the principal source of financial information regarding an investee and most investors have no authority to require additional financial information. As presently worded, the Constitution's definition of who financial reporting standards are developed for is too vague since, in addition to investors, it includes: "*other participants in the world's capital markets and other users of financial information make economic decisions*." As presently articulated, nearly every constituency who may happen to choose to use financial reports can claim that IFRS are developed for its benefit.

The Constitution's objective should be reworded to clarify that the investor is the primary user. While we recognize there are other stakeholders who rely on high-quality financial reporting standards, other users such as governments and regulators have the ability to use their public interest mandate and regulatory authority to obtain financial information in the form they deem appropriate to accomplish their legally defined mandate[5]. In such circumstances, the primary financial statements produced for the benefit of the investors could serve as a starting point and then be further augmented as may be necessary to fit the needs of other interested stakeholders. Also, in September 2009 the Monitoring Board issued its statement on principles and refers to "the primary objective of financial reporting as being to provide information on an entity's financial performance in a way that is useful for decision-making for present

[5] We note that suppliers, customers, and employees also use financial statements and do not have the ability to obtain information in another form. We believe that their needs are also best served when the investor is the primary focus of financial reporting standards.

and future investors". We believe that this could be used to amend the Constitution and to bring it in alignment with the Monitoring Board.

Question 2. The financial crisis has raised questions among policymakers and other stakeholders regarding the interaction between financial reporting standards and other public policy concerns, particularly financial stability requirements. To what extent can and should the two perspectives be reconciled?

The financial crisis has put the adequacy of financial reporting standards in the spotlight and raised questions among policymakers and other stakeholders regarding the interaction between these standards and other public policy concerns, particularly financial stability requirements. The on-going debate regarding balancing public policy concerns with the primary purpose of financial reporting has, in our view, undermined the independent functioning of the IASB. One example of political interference, evidenced by the actions of the IASB in October 2008 regarding amendments to IAS 39 to permit reclassification of some financial instruments out of the fair value through profit and loss category to the available-for-sale category, illustrates the conflict between these two objectives.

Investors understand and appreciate the importance of financial stability and capital adequacy; however, they believe that financial reporting that provides decision-useful information for investors should not be subjugated to the needs of regulators. Transparency in financial reporting to investors should not be diminished to serve the objectives of prudential regulators who have the ability to require financial data tailored to meet their needs. While some suggest that less transparency will result in greater financial stability, they provide no evidence for that assertion and fail to consider that financial markets attach a risk premium to preparers' cost of capital for such lack of transparency.

We believe that financial reporting standards should be designed to provide decision-useful information, which by its nature should reflect economic events. An agenda such as financial stability or other regulatory considerations should be pursued through alternative and separate information gathering processes afforded to regulators and others by their public interest mandates.

Governance: How should the organization best balance independence with accountability?

Question 3. The current governance of the IFRS Foundation is organised into three major tiers: the Monitoring Board, IFRS Foundation Trustees, and the IASB (and IFRS Foundation Secretariat). Does this three-tier structure remain appropriate?

In principle, we agree with that the three tier structure is appropriate to establish a system of oversight that should promote the independent functioning of the IASB.

<u>Monitoring Board</u>
Since the IFRS Foundation Trustees, whose principal purpose is to oversee the IASB, has no formal relationship to the global capital markets, we believe the Monitoring Board should be concerned with investor protection, market integrity and capital formation.

<u>IFRS Foundation Trustees</u>
We agree that the Trustees' principal charge of overseeing the effective and independent functioning of the IASB is appropriate. Through this mandate we believe that their function should be restricted to those activities espoused in the IFRS Foundation Constitution[6]. We believe that Trustee duties such as appointing members of the IASB; reviewing the strategy of the IFRS Foundation and the IASB;

[6] IFRS Foundation Constitution, March 1, 2010.

reviewing the IASB's effectiveness including consideration, but not determination, of the IASB's agenda; and assuming responsibility for establishing and maintaining appropriate financing arrangements; are appropriate responsibilities to ensure that the IASB is independent in its standards setting. We believe, however, that IASB members, particularly the IASB Chairman, should not be exposed to political pressure. The Trustees should address such matters leaving the IASB members to address accounting related issues in accordance with the organization's due process.

<u>Investor Representation</u>
In the past we have called for more investor representation on all three of these bodies. We understand that limiting the composition of the Monitoring Board to regulators attempts to replicate the relationship between local/national securities regulators and the not-for-profit organizations which oversee the accounting standard setting bodies in these respective localities/nations. However, we believe that an investor viewpoint on the Monitoring Board would be useful in helping the Board understand how financial reporting affects capital markets. Absent such representation, we believe that the Monitoring Board should be comprised of regulators who have investor protection – not prudential regulation – as their primary mandate. We also believe that the Monitoring Board should have a formal program to reach out to investors and seek their input and discuss its actions in providing investor protection as they oversee the IFRS Foundation and the IASB.

We continue to stress that investor involvement and representation on the IFRS Foundation Trustees and the IASB from across the world is essential to the development of accounting standards which provide decision-useful information. We believe that until there is substantially greater investor representation on these boards, users will have limited confidence in the standard setting process and the ability of these bodies to serve their interests. Our experience suggests that preparers, auditors, and other constituencies from which Trustees and Board Members are drawn often do not understand how financial reports are used. **Investors believe that given they are the ultimate consumers of financial reporting information that they should play a major role in the creation of such standards rather than having a minor interest as is currently the case.** Investors continually monitor markets, track economic developments and assess what information is needed to make informed investment decisions. Those who invest their wealth, or that of their clients, are constantly apprised of new developments including the appropriateness of available financial information. This means that investors can be an early-warning system for deficiencies in financial reporting and the need for new or revised accounting standards. For this to occur investors should be better represented on the IFRS Foundation Trustees and the IASB so that they are able to directly contribute to the deliberations of the bodies as they are being held rather than through indirect involvement with advisory committees. Also, direct membership would enhance the investor confidence in the quality of the standards and the comprehensiveness of financial reporting.

Question 4. Some stakeholders have raised concerns about the lack of formal political endorsement of the Monitoring Board arrangement and about continued insufficient public accountability associated with a private-sector Trustee body being the primary governance body. Are further steps required to bolster the legitimacy of the governance arrangements including in the areas of representation of and linkages to public authorities?

It is our view that it is the role of the Monitoring Board and the Trustees to handle all matters related to political endorsements, political influence and other such matters with public authorities. It should not be the responsibility of the IASB since such activity could jeopardize its independent functioning.

The Monitoring Board and the Trustees should, however, be allowed to perform their functions without undue political influence and we believe that formal political endorsement of the Monitoring Board may be incompatible with the independent functioning of the IASB. We are concerned that there may be some governments, abetted by some influential preparers, who may want to control the standard setting process through influencing the Trustees or the Monitoring Board.

To ensure that undue influence does not occur, we believe that the responsibilities, functions, activities and accountability mechanisms of the Monitoring Board should be established and well articulated. Further, to improve transparency, the Monitoring Board and the Trustees should issue an annual report outlining their objectives and key activities. In addition, they should illustrate how they have improved financing, served investors' interests and demonstrate their efforts to immunize the IASB from political pressures.

Process: How should the organization best ensure that its standards are high quality, meet the requirements of a well functioning capital market and are implemented consistently across the world?

Question 5. Is the standard-setting process currently in place structured in such a way to ensure the quality of the standards and appropriate priorities for the IASB work programme?

The standard setting process has come under significant strain as both the IASB and the FASB work to complete the technical projects under the 2006 Memorandum of Understanding between the IASB and FASB (2006 MoU). The recent reprioritization of items in the 2006 MoU which now focuses on completing four projects (i.e., financial instruments, revenue recognition, leases and insurance) exemplifies the pressure on the resources of the Boards as the June 30, 2011 deadline approaches. For example, the financial statement presentation project was delayed until after June 30, 2011 which was a disappointment to investors who assigned a high priority to this project (i.e. much higher than insurance, for example). Earlier prioritization could have resulted in better use of stakeholder time and the quality of the deliberations.

We believe that stakeholder input, specifically and critically investor input is essential and should have greater influence on the agenda of the global standard setters. Increased investor representation on the IASB and the IFRS Foundation would foster quality standards and appropriate priorities. To be clear, we are suggesting that investors should be represented in a more meaningful way with a vote rather than merely in an ad hoc advisory capacity.

This standard setting process must also be independent yet responsive to stakeholder input, transparent in its process and accountable in appearance and in fact. As we have noted elsewhere herein there have been instances where political and regulatory interests have clearly influenced the outcome of standard setting. For the standard setting process to result in high-quality standards for investors, those interests should be removed.

We are also very concerned by the perceived "front running" of standards, or first adopter inertia, which is evident in the financial instruments project. Standards should not be adopted based upon who finishes the standard first. The lack of coordination on this important and controversial 2006 MoU project has diminished the credibility of the convergence process.

As we have noted elsewhere herein, redirecting the political pressure from the IASB to the Trustees and Monitoring Board would improve the perception of independence in accounting standard setting. IASB members' interaction with political bodies and regulators reinforces the perception of political interference and lack of independence.

We are also concerned by an increasing trend whereby accounting standards appear to be put out not only for public comment to enhance the quality of the standards but to seek a "vote" on their popularity. The number of comment letters – irrespective of the thoughtfulness or thoroughness of their input and/or analysis – is considered by some to be the determining factor in the decision-making process of the standard setters rather than whether it will increase the decision-usefulness of information for investors. Because of the disaggregated nature of investors, and their unfamiliarity with the technical parlance of the accounting profession, investor comment letters will always be outnumbered by preparer and other stakeholders. As such, this apparent trend toward "voting" will further leave investors underserved in the accounting standard setting process. We believe it is the responsibility of the standard setters to better educate, communicate and market their standards and to engage the interest and input of investors.

Finally, we are concerned that the IASB and FASB may be under pressure to circumvent or fast track due process to meet arbitrary deadlines, which may compromise the quality of the final standards. The revenue recognition standard, in particular, is of concern to investors in this regard. It has been our long-held belief that rather than progressing to a date, that accounting standards must be of high-quality as well as understandable and enforceable and that such quality should be measured from an investor perspective. The push to complete a standard by June 30, 2011 because IASB membership will change makes investors concerned regarding the final form of these projects.

Question 6. Will the IASB need to pay greater attention to issues related to the consistent application and implementation issues as the standards are adopted and implemented on a global basis?

There are several pillars upon which successful global acceptance of IFRS will be built; 1) uniformity of incorporation/adoption of IFRS in the reporting regime of the respective country moving to IFRS, 2) consistent implementation/application of IFRS by companies within and between such jurisdictions and 3) adequate and consistent enforcement within and across jurisdictions following IFRS. Each of these key components plays an important part in the final outcome. We believe the IASB's mandate should include consideration of all of these factors. The IASB must focus greater attention on the consistency of adoption and implementation of IFRS and on the enforcement of the IFRS standards because failing to do so diminishes the IFRS brand and the ultimate purpose of a single-set of high-quality standards – that being comparability.

While the IASB and IFRS Foundation do not have the authority or ability to mandate consistency in adoption, implemention, and enforcement, it is essential that they embrace their obligation to work toward this objective as not doing so will ultimately diminish the usefulness of their product. The central point is that IFRS as promulgated by the IASB is a "brand" in need of protection to ensure consistent application among entities across the globe. Without sufficient oversight of how these standards are applied they may be rendered less effective and comparable among entities in and among jurisdictions. For this reason, we believe that not only the IASB, but also the Monitoring Board and the Trustees will need to pay greater attention to issues related to the consistent application, implementation and enforcement of the standards as they are adopted around the globe.

At the December 2010 AICPA National Conference on Current SEC and PCAOB Developments participants heard SEC staff indicate that in the execution of their steps to complete the IFRS Work Plan, they had observed diversity in application and implementation of IFRS between companies and countries following IFRS. Yet IASB staff speaking at the same conference continued to indicate that 100+ countries have or will be adopting IFRS as promulgated by the IASB. The IASB staff comments do not reconcile to the SEC staff comments or to the experience of investors. Failure to address this issue diminishes the credibility of the IASB and IFRS as a global standard.

While we understand that principles-based standards create the possibility that the standards may be inconsistently applied in different regulatory environments, auditing regimes and cultures, major differences would not be beneficial to investors. It is important for investors to have transparency surrounding divergence of application within the principles-based standards of IFRS. This is especially important in the U.S. context as many U.S. investors do not believe that shifting to IFRS would be worth the effort if financial reports remain non-comparable across borders and through time because of divergent interpretations and judgements made by management and auditors. The IASB should bring to light, in required footnote disclosures, any material differences in application that are accepted by local authorities of different jurisdictions.

Financing: How should the organization best ensure forms of financing that permit it to operate effectively and efficiently?

Question 7. Is there a way, possibly as part of a governance reform, to ensure more automaticity of financing?

We continue to believe that the Monitoring Board and the Trustees should seek to obtain an entirely independent and sustainable source of funding for the IASB. The source of funding is critical to maintaining the independence of the IASB. A system of voluntary contributions, regardless of how diversified such contributions might be, cannot ultimately ensure the independence of the IASB and its standard-setting function from the influence of special interests.

That said, we think that the Trustees and Monitoring Board should work with their local jurisdictions whereby countries seeking to: use the IFRS brand; obtain seats on the IFRS Foundation; participate in the Monitoring Board; or have citizens appointed to the IASB, must contribute to a mandatory funding mechanism. As with other brands, IFRS should not be able to be utilized without commanding a licensing fee.

Closing Remarks

We thank the Trustees for the opportunity to express our views on the Strategy of the IFRS Foundation. If you, other members of the Trustees or your staff have questions or seek further elaboration of our views, please contact either Matthew M. Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org, or Sandra J. Peters by phone at +1.212.754.8350, or by e-mail at sandra.peters@cfainstitute.org.

Sincerely,

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