

## **PROPOSALS FOR THE ENHANCEMENT OF THE ROLE AND WORKING PROCESS OF EFRAG**

### **1. BACKGROUND OF THE CONSULTATION**

EFRAG (The European Financial Reporting Advisory Group) is a private institution that was set up in 2001 by organisations active in the financial reporting area (“the Founding Fathers”)<sup>1</sup> principally for the purpose of:

- Providing pro-active advice to IASB (the International Accounting Standards Board);
- Advising the European Commission on the acceptability of International Financial Reporting Standards (IFRS) for endorsement for use in Europe in the consolidated accounts of all listed companies;
- Advising the European Commission on any resulting changes to be made to the accounting directives and related topics.

In early 2003 EFRAG had started a process of reviewing its own role and working methods following its first years of operation. Soon afterwards the European Commission found itself involved in controversy about IAS 39 on Financial Instruments where it was felt by the banking and insurance industries in particular that European concerns needed more fully to be taken into consideration in the international accounting standard setting process. In addition there has been criticism in Europe on the complexities and/or general direction of certain standards. Accordingly it was suggested that ways should be found to enhance the role and working process of EFRAG. Shortly after the ECOFIN meeting in July 2003, the Commission invited interested parties and EFRAG invited its founding fathers to put forward proposals to this end. The proposals in the attached note are the result of this process.

The enhancement of the role of EFRAG should also be seen in the light of the Constitutional Review<sup>2</sup> of the IASB that is underway and in which a more substantial role for Europe and EFRAG will be sought.

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<sup>1</sup> UNICE (Union des Confédérations de l'Industrie et des Employeurs d'Europe), FEE (Fédération des Experts Comptables Européens), EBF (European Banking Federation), ESBG (European Savings Banks Group), GEBC (European Association of Cooperative Banks), CEA (Comité Européen des Assurances), EFFAS (European Federation of Financial Analysts Societies), FESE (Federation of European Securities Exchanges), UEAPME (European Association of Craft, Small and Medium-sized Enterprises) and EFAA (European Federation of Accountants and Auditors for SMEs)

<sup>2</sup> “Identifying Issues for the IASB Foundation Constitution Review – An Invitation to Comment” (November 2003)

Since EFRAG has a public interest function in providing advice to the European Commission on endorsement of IFRS, EFRAG has decided to conduct an open consultation process prior to reporting to the European Commission as input to the progress report to the ECOFIN meeting due to be held in late January 2004.

Comments are invited and should be provided no later than **January 12, 2004**. They should be sent to the Secretary General (Preferably by e-mail to [Paul.rutteman@efrag.org](mailto:Paul.rutteman@efrag.org)) at EFRAG, 41 Avenue des Arts, B-1040, Brussels. Unless otherwise indicated, comments will be regarded as on the public record.

A public hearing will be held in Brussels on **January 8, 2004**. Anyone wishing to put forward views at the public hearing is asked to contact the Secretary General in advance of the meeting.

The EFRAG Supervisory Board will take into account all views expressed in making its decision on the structure and strategy to be adopted. It is intended that decisions taken will be implemented as soon as possible.

## **2. INTRODUCTION**

The objective of EFRAG is to develop and express the European position on matters related to international financial reporting standard setting. It should work in much the same way as a "liaison standard-setter" towards IASB. That does not imply that EFRAG should set standards of its own for Europe (Founding Fathers are in favour of global financial reporting standards). EFRAG should have the central role in a network of all stakeholders including the European Commission and National Standard Setters with the objective of ensuring that European views are properly expressed.

To fulfil its role EFRAG should devote resources to improving the dialogue with European stakeholders, including National Standard Setters, the European Commission and the IASB. This is necessary to strengthen its image and public visibility.

## **3. CHANGE IN CORPORATE GOVERNANCE OF EFRAG: *The tasks of the Supervisory Board of EFRAG to be extended beyond a Trustee function to setting strategic orientations and objectives for EFRAG***

The tasks of the Supervisory Board have so far been the following:

- Appointment of members and chairman of the TEG,
- Advising on the work program of the TEG,
- Monitoring TEG and its work,
- Approval of budget,
- Organizing funding.

It is suggested that, in addition to the above-mentioned tasks, the Supervisory Board should review broad strategic issues affecting accounting standards and promote EFRAG and its work. The Supervisory Board should, however, be prevented from becoming involved in the decision-making of EFRAG TEG. The role of the Supervisory Board would include discussions and strategic orientations on objectives with political and conceptual dimensions such as:

- Definition of key criteria and principles for assessment of the acceptability of IASB proposals for the EU, including proactive work on the conceptual framework of IASB;
- Relevance of measurement attributes for entities below a certain size;
- Assessment of the economic impact of new standards at an early stage.

This would mean, in addition to a Trustee function, an additional and more proactive role of the Supervisory Board than was envisaged on the foundation of EFRAG. Consequently, the Supervisory Board should develop its working procedures. In particular in order to give input to the work of the TEG, the Supervisory Board should discuss at an early stage strategic, long term issues, new projects of the IASB, their impact on business and the European Economy. The Board should inform the TEG of its discussions

In order to fulfil this extended role, the Supervisory Board should be reduced in size down to no more than approximately 15 members appointed by the General Assembly on the basis of proposals made by Founding Fathers. The frequency of meetings should be increased to 4 ordinary meetings per year.

**4. CHANGE IN THE CONSULTING PROCESS OF EFRAG: *EFRAG, when expressing views on major issues will need to analyze their strategic political and/or economic implications with the input of other stakeholders. To obtain input on these aspects, EFRAG will set up an Advisory Forum***

There is a need to strengthen the consultation process of EFRAG to ensure that views in Europe on critical and/or emerging topical issues be sought and expressed, even ahead of specific proposals from the IASB in the form of Exposure Drafts. There is indeed common support for a broader debate within Europe on the concepts that underlie IFRS, as well as on the strategic political and/or economic impact IFRS might have, including focus on sectors or country specific issues.

To achieve the adequate broad consultation, EFRAG's TEG and Supervisory Board should be able to obtain interactive input from an Advisory Forum of high level representatives of key stakeholders (such as preparers, users, regulators and auditors). The membership would be variable depending on the subject discussed with a hard core of permanent membership.

The Forum would be a non-permanent structure convened (by the Supervisory Board or) on an ad-hoc basis and whose composition will be decided by the Supervisory Board of EFRAG. Meetings would be made in quality and frequency appropriate to ensure that a proper consultation process takes place.

TEG would undoubtedly benefit from the input of the Advisory Forum that is intended to have a consultative role only. The TEG views would continue to be formed independently. Working with the Advisory Forum is one of the proactive elements of EFRAG's work that could be undertaken in the form of discussion papers in order not to conflict directly with EFRAG's other role in the endorsement process.

TEG alone would be entrusted with expressing the views of EFRAG on financial reporting issues, both when commenting on IASB proposals and in giving advice to the European Commission as part of the endorsement process. The right of the Supervisory Board to make a statement of its own in the case of negative advice is therefore to be abolished.

**5. CHANGE IN THE DECISION PROCESS OF EFRAG TEG: *Decisions made by EFRAG should rely on a simple majority and dissenting views should be documented and published***

The EFRAG TEG's mandate covers both proactive work and endorsement advice to the Commission. Standards of quality that should characterize the TEG's work are independence, technical quality, widespread and open debate and efficient due process.

EFRAG TEG's proactive contribution to IASB covers:

- Proposals by EFRAG for consideration by IASB;
- Comments on the work program of IASB;
- Comments on discussion papers and exposure drafts for IFRS, IFRIC pronouncements and other IASB statements.

No major change is needed in terms of tasks or of membership criteria and appointment process. It is in the decision process that improvements need to be made.

Up to now, EFRAG TEG was unable to offer a negative advice to the European Commission unless at least two thirds of its members voted against the IASB or IFRIC proposal. In practice no dissenting view were published, either in commenting on IASB exposure drafts or in giving advice to the Commission, although this possibility was foreseen in the joint proposals establishing EFRAG back in 2001 as well as in the statutes.

The changes suggested in the TEG decision process are:

- The decision rules should be changed to simple majority decisions;
- Dissenting views of experts will be presented with the following conditions:
  - Dissenting views should concern substantial elements of the whole comment letter and/or standard and not secondary parts of it. Accordingly, only views that are so strong that the dissenting members cannot accept the comment letter and/or standard should be included in the final EFRAG comment letter;
  - Dissenting views need to be justified by indicating what the members disagree with and, to the extent possible, providing technical alternatives and justifying why these provide better information for users.

**6. CHANGE IN THE COOPERATION WITH THE NATIONAL STANDARD SETTERS: *The Consultative Forum of Standard Setters should lead to active cooperation between EFRAG and the EU National Standard Setters***

An extensive consultative process with National Standard Setters has always been seen as key to EFRAG's work and credibility.

EFRAG has therefore established the Consultative Forum of Standard Setters (CFSS). This forum has been set up to develop a proper dialogue between EFRAG and National Standard Setters on the work program of EFRAG and on major projects. In the future better and closer links must be established with all EU National Standard Setters.

The coordination with National Standard Setters should be conducted in order to:

- Exchange views in advance of discussion with IASB or in proactive work;
- Exchange views in response to IASB's discussion papers and exposure drafts;
- Share feedback from communication with industry and with users of financial information;
- Set up working groups to consider forthcoming standards that are complex or where specific technical expertise may be required;
- Coordinate research between EFRAG and National Standard Setters through joint projects selected from an agreed priority list;
- Publish discussion papers on topical or emerging issues as early input to IASB projects;
- Benefit from a wider and diverse European experience as gathered by National Standard Setters;
- Share information about emerging interpretation problems and implementation experience;
- Obtain secondment of staff by National Standard Setters to EFRAG on a project or period basis.

A majority of TEG members are coming from, or have a background as members of National Standard Setters. Active chairmen of National Standard Setters have in the initial phase of EFRAG been excluded as potential candidates for the TEG. Since EFRAG and National Standard Setters will have a common mission in influencing IFRS and their implementation in Europe such initial limitations made by the then current nominations committee could now be removed. In the event that one or more chairmen are nominated, the nominating committee has to assure that a proper balance is kept between expertise, influence and independence when recommending appointments to the Supervisory Board.

## **7. DEVELOPMENT OF EFRAG WORKING RELATIONSHIP WITH IASB AND INCREASE IN OVERALL VISIBILITY AND TRANSPARENCY**

The efficiency of the work of EFRAG depends on how it is perceived and treated by the IASB. Founding Fathers strongly believe that EFRAG should be recognized by IASB as the body that expresses European positions on matters related to its standard setting and that EFRAG should be given a status commensurate therewith. This implies that EFRAG be recognized and treated in the same way as the seven liaison standard setters.

Founding Fathers believe that a full time and paid chairman and an increase of TEG members involvement from 20 to 30% of their time is desirable in order to achieve the right level of coordination with all stakeholders and in particular with the IASB, European Commission, EFRAG Supervisory Board and Advisory Forum, Consultative Forum of National Standard Setters.

Furthermore it is proposed that TEG meetings should be open to the public. The TEG should also have the possibility to work with ad hoc committees on topics that require specific technical expertise (a due process would need to be installed for the appointment of members of such committees).

**8. EVOLUTION OF THE RELATIONSHIP WITH THE EUROPEAN COMMISSION: *The European Commission should formally acknowledge EFRAG as the Technical Expert Group set out in the Regulation***

EFRAG has been set up as an organization to influence the development of IFRS in a coordinated European pro-active way and to support the European Commission in all phases of the implementation and endorsement of IFRS within the European Union. EFRAG was not directly referred to in the Regulation, though reference is indirectly made to it. In addition it was given a major role in the endorsement process of IFRS. As a consequence the European Commission has an observer seat in the EFRAG TEG and the EFRAG Supervisory Board.

The Commission should formally acknowledge EFRAG as **the** Technical Expert Group as set out in the Regulation and urge the IASB to grant EFRAG the same recognition as a liaison standard setter. EFRAG and the Commission should update the present memorandum of understanding and agree a protocol setting out the undertakings of EFRAG towards the EC.

In order to enhance the credibility of EFRAG, as part of the nominating process of TEG members, the Supervisory Board of EFRAG could seek some form of blessing organised in coordination with the Commission.

**9. INCREASE IN FUNDING: *The improvements sought to proactive work, efficiency and visibility require that EFRAG resources be extended***

The current level of EFRAG funding is EUR 1 million in cash and some EUR 2 million in time value of TEG members and other unpaid support. To achieve the above improvements, the total available resources need to grow to a minimum of 5 millions Euros, of which at least a part of the increase should be contributed in cash. These additional resources would cover:

- The need for a full-time paid chairman, in order to lead the consultation and coordination process needed with the Advisory Forum, IASB, the European Commission and the National Standard Setters;
- The need for additional staff resources, in order to conduct proactive work in addition to the necessary follow-up of the IASB and IFRIC agendas.

Various potential sources of funding have been identified, that are accessible either in the very short-term or in the longer term:

- The secondment of staff from National Standard Setters and the accounting firms,
- Cash contribution by the European Commission,
- Levy on listed companies in Europe.

These potential sources of funding need to be further explored; some of which might require legal and regulatory measures.

Under the present structure TEG members are not remunerated by EFRAG nor are their travel expenses reimbursed, hence the contribution in kind referred to above.

December 5, 2003

On behalf of the Supervisory Board of EFRAG

Göran Tidström  
Chairman

## QUESTIONS RAISED

**Question 1:** EFRAG proposes that the Supervisory Board of EFRAG should be involved in setting strategic orientations and objectives for EFRAG, in addition to the Trustee's role adopted previously (see paragraph 3).

- (a) Do you agree? If not, why?
- (b) Do you agree that the Supervisory Board should not have the right to make a statement of its own in case of negative advice?

**Question 2:** EFRAG proposes that the consultation process of EFRAG with all stakeholders be broadened in order to better analyze and consider any strategic political and/or economic impact of IFRS by the establishment of an Advisory Forum (see paragraph 4).

- (a) Do you agree that the consultation process be broadened? If not, why not?
- (b) Do you consider that the creation of the Advisory Forum is the right way to achieve such an objective? If not, what alternative would you suggest?

**Question 3:** EFRAG proposes that the decision process of EFRAG TEG (Technical Expert Group) be modified, by the adoption of a simple majority rule and the publication of dissenting views (see paragraph 5).

- (a) Do you agree that the decision process needs to be modified? If not, why?
- (b) Do you agree with the proposals? If not, what would you suggest?

**Question 4:** EFRAG proposes that the coordination with National Standard Setters be strengthened (see paragraph 6).

- (a) Do you agree that a strong coordination with National Standard Setters is needed?
- (b) Do you agree with what EFRAG and National Standard Setters should achieve through active coordination?
- (c) Are there other areas in which close coordination can be beneficial to EFRAG?

**Question 5:** EFRAG proposes that the European Commission more formally acknowledges EFRAG as **the** Technical Expert Group set out in the IAS Regulation (see paragraph 8).

- (a) Do you agree?

**Question 6:** EFRAG has identified the need for additional resources in order to achieve its objectives (see paragraph 9).

- (a) Do you agree that a full time and paid chairman is desirable?
- (b) Do you have suggestions as to the sources of funding that EFRAG should rely on?
- (c) Do you believe that the proposed additional resources are adequate? If not, what is needed?