

**COMMISSION SERVICES WORKING PAPER ON GOVERNANCE DEVELOPMENTS IN THE
INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB)
AND
IN THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE FOUNDATION (IASCF)**

3RD REPORT

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1. INTRODUCTION

This is the Commission services's third report about governance developments in the International Accounting Standards Committee Foundation (IASCF) and in the International Accounting Standards Board (IASB). Previous reports were published in December 2006 and July 2007. These reports are the Commission services's response to the declaration adopted by the ECOFIN Council on 11 July 2006, which *inter alia* invited the Commission to monitor and regularly report about developments in the governance of the IASCF and the IASB.

On 10 July 2007, the ECOFIN Council examined the Commission services's second report and on that basis issued conclusions noting that improvements have been made to the IASB/IASCF governance structure, while also highlighting several areas where further progress is required. In particular, the Council called for:

- measures to strengthen the IASB's accountability and transparency towards stakeholders, notably by informing EU authorities regularly and at an early stage about their intention to issue new standards, as well as by giving a more prominent role to the Standards Advisory Committee (SAC);
- steps to enhance the IASB's due process, including by rigorous ex-ante impact analysis and ex-post review of standards and interpretations;
- ensuring geographically balanced representation and bringing additional expertise into the IASCF structures.

The ECOFIN Council expressed its general satisfaction with the IASCF's efforts to provide a stable and secure funding system, while calling for further progress to broaden the international base of contributors and ensure an equitable contribution from all regions of the world. The Council called for modalities to evaluate the effectiveness and stability of the new funding system to be agreed.

This third report focuses on the key themes highlighted in the last report and in the ECOFIN conclusions of 10 July 2007. It covers developments until the end of January 2008. During this period, the IASCF Trustees held three meetings, on 2-3 July 2007, on 30 October – 1 November 2007 and on 29-30 January 2008.

The Commission services recall that during the period since the publication of its second report, the European Parliament's Committee on Economic and Monetary Affairs, under the responsibility of rapporteur Mr. Alexander Radwan MEP, has continued work on the report on International Financial Reporting Standards and the governance of the IASB. This report is scheduled to be adopted by the European Parliament in March 2008.

2. GOVERNANCE STRUCTURE

2.1. Accountability and oversight role of the IASCF Trustees

As part of their strategy to enhance the IASCF's governance announced on November 2007, the Trustees recognised the need to establish a public oversight body. This would approve Trustee appointments, as well as to review the Trustees' role in organising the Foundation's funding arrangements. In line with the joint statement issued on 7

November 2007 by the authorities responsible for capital market regulation (see annex 1), it should also have the possibility to review the Trustees' oversight role over the activities of the IASB, including the latter's funding, agenda-setting and due process. The terms of reference for the oversight body will be subject to further consultations between the Commission, its international counterparts and the IASCF Trustees.

The Commission services welcome the Trustees' announcement, which broadly meets the corresponding expectation expressed in the abovementioned joint statement. The oversight body should have strong powers to guarantee the transparency and objectivity of the Trustee selection process, as well as to take the ultimate decision on the appointment of Trustees.

The new arrangements should also allow the new oversight body to review the IASB's work programme, agenda-setting and due process to ensure that it meets the expectations of democratically-accountable public authorities. This would complement the arrangements approved by the Trustees in April and July 2007 to enhance their own oversight of the IASB's work programme, without calling into question the Trustees' primary responsibility for oversight of the IASB nor undermining the latter's independence.

The Commission services consider that authorities responsible for capital market regulation in jurisdictions that apply IFRS should have a leading role to determine the membership of such an oversight body. Members of the public oversight body must have sufficient authority to effectively hold Trustees to account, while respecting the independence of the Foundation and without undermining the Trustees primary responsibility for the oversight of the IASB.

Moreover, in view of the fact that the term of office of 8 out of 19 Trustees expires on 31 December 2008, the Commission services consider that the new appointment process should become applicable before the end of 2008. This would also allow testing the new procedures, and adjustments to be made in the light of experience, before the Foundation's constitutional review process is completed.

2.2. Role of the Standards Advisory Committee (SAC)

In the previous report, the Commission services referred to the ongoing review of the SAC's efficiency and highlighted the importance it attaches to the SAC's role to provide advice on the working agenda of the IASB and to give direction on the development of ongoing projects. The ECOFIN Council's conclusions of 10 July 2007 similarly called upon the IASCF to swiftly proceed with the review of the SAC's working methods and to give it more prominence.

The Commission services note that the review of the SAC's efficiency has not yet been completed and calls upon the SAC Chairman and upon the Trustees to prioritise this task. The key issues identified in the Commission services' 2nd report remain relevant.

3. DUE PROCESS WITH STAKEHOLDERS

3.1. Impact assessment and feedback statements

During their meeting of 2-3 July 2007, Trustees gave further consideration to the need to develop an overall framework for impact assessment/cost-benefit analysis. Following the

IASB's decision to publish feedback statements for new standards and interpretations, the Trustees also decided that the Trustee Due Process Oversight Committee (formerly the Procedures Committee) would review impact assessments and feedback statements to ensure that they meet the objectives of enhanced transparency towards IASB stakeholders.

In January 2008, the IASB published a project summary and feedback statement for the *Business Combinations – Phase II* project (amendments to IFRS 3 *Business Combinations* and to IAS 27 *Consolidated and Separate Financial Statements*).¹

The Commission services are encouraged by the efforts made by the IASB to enhance its due process and invite the Board and the Trustees to further develop the framework for impact assessment. Ideally, *ex ante* impact assessments of new standards and interpretations should be carried out as early as possible in the development of these documents. This would allow stakeholders to evaluate the rationale and likely effects (including cost-benefit ratio) for new standards and interpretations, and to comment thereon during the IASB/IFRIC's consultation process. The quality of impact assessments could be enhanced by providing for *ex ante* review of draft impact assessments, such as by a board consisting of independent experts. This would complement the *ex post* oversight of due process carried out by the Trustee Due Process Oversight Committee.

3.2. Ex post review

During their meeting on 2-3 July 2007, Trustees agreed that new IFRS, major amendments to IFRS and major interpretations should be subject to an *ex post* review after at least two full years of implementation. These reviews would assess any unexpected costs or implementation problems encountered. The first documents to be reviewed by the IASB will be IFRS 8 *Operating Segments*, IFRIC 12 *Service Concession Arrangements*, and the two standards covered by the *Business Combinations – Phase II* project. The Commission services welcome the Board's decision to carry-out *ex post* reviews of newly adopted standards and consider that all major standards and interpretations adopted in the past should be regularly reviewed for continued relevance.

4. FUNDING

In April 2007, the IASCF published its draft budget for 2008. This foresees a total budget of £16 million (about €21.3 million at current exchange rates). By early 2008, the IASCF Trustees had obtained funding commitments in excess of £12 million. This indicates that the draft budget for 2008 should be largely funded.² However, certain aspects of the IASCF's funding system remain of concern:

¹ http://www.iasb.org/NR/rdonlyres/FB09D3C0-D7CA-478C-881C-704495F8A6CC/0/Business_Combinations_JN2008.pdf

² The IASCF has two major sources of revenue, i.e. contributions from stakeholders and revenues from publications and related activities. In 2006 (the last year for which audited financial statements are available), contributions were £10.4 million (79.2% of total revenue) and net revenues from publications and related activities were £2.1 million (16.3%). Assuming a similar share of contributions in total revenue for 2008, the IASCF needs to raise about £12.8 million (about €17.1

- while the Trustees have successfully broadened the IASCF's geographic funding base, contributions from some key jurisdictions currently do not match their weight in the global economy and capital markets. Moreover, not all jurisdictions applying IFRS have agreed to contribute funding to the IASB.
- Similarly, while the number of organisations contributing to the IASCF's funding has grown from less than 200 organisations in 2005 to several thousands in 2008, the Foundation remains dependant on the major international audit networks for a significant part of its funding. Funding from some jurisdictions is also dominated by a specific stakeholder group, e.g. large financial institutions. This may give rise to continued concerns about the IASB's independence from key stakeholder groups.

Overall, the EU's share of voluntary contributions is slightly below its weight in the global economy.³ To date, national funding schemes, for example via levies on companies with listed securities, or privately-arranged, broad-based voluntary funding schemes have been established in 10 Member States⁴ (in some cases still subject to final confirmation). In parallel with its efforts to strengthen the IASCF's governance structures and due process, the Commission services will continue to work with public and private stakeholders to ensure that the EU is in a position to make a stable and equitable contribution to the Foundation's funding.

The Commission services welcome the fact that the new funding system will achieve a substantial diversification of the IASCF's funding sources. At the same time, it considers that further efforts should be made to ensure that all stakeholder groups and jurisdictions contribute in a balanced and equitable manner to the Foundation's funding.

5. ADEQUATE REPRESENTATION OF STAKEHOLDERS

5.1. Trustees

Since the publication of the Commission services's 2nd report, several Trustee appointments have taken place. The Commission services note the appointment of Mr. Zalm, former Deputy Prime Minister and Minister of Finance of The Netherlands, to the position of Chairman of the IASCF Trustees with effect from 1 January 2008. In parallel with Mr. Zalm's appointment, Mr. Bertrand Collomb stepped down as Vice Chairman of the Trustees, in which role he was replaced by Mr. Philip Laskawy. Mr. Jeffrey Lucy, former Chairman of the Australian Securities and Investment Commission and incoming Chairman of the Australian Financial Reporting Council, joined the Board of Trustees on 1 January 2008. As a result of these changes, there are currently 19 Trustees: 5 from

million) from contributions, with the remainder being funded mainly via revenue from publications and related activities.

³ It should also be borne in mind that the EU's contributions to the 2008 budget have been boosted by the favourable exchange rate of the Euro vs. sterling.

⁴ Austria, Denmark, Finland, France, Germany, Italy, Luxembourg, The Netherlands, Sweden and The United Kingdom.

North America, 7 – including the Chairman of Trustees – from Europe (of which 6 from the EU), 6 from Asia/Oceania and 1 from South Africa.⁵

5.2. Board

The Commission services's 2nd report noted that three vacancies on the IASB arose on 30 June 2007, two for full-time members and one for a part-time member. Two of these vacancies were filled in July 2007 through the following appointments:

- Mr. Stephen Cooper was appointed to the IASB as a part-time member. Mr Cooper is Managing Director and head of valuation and accounting research at UBS;
- Zhang Wei-Guo joined the IASB as a full time member. Dr. Zhang previously worked as Chief Accountant and Director General of the Department of International Affairs at the China Securities Regulatory Commission (CSRC).

The IASB has advertised the third vacancy.

The Commission services note these appointments and recognise the importance of broadening the geographical representativeness of Board members. The appointment of Dr. Zhang is a step in this direction, especially in view of the growing importance of Chinese capital markets.

5.3. IFRIC

The Commission services's 2nd report noted the Trustees' proposal to expand the membership of IFRIC from 12 to 14 members. The Trustees approved this change at their meeting on 30 October and 1 November 2007. Following the publication of the necessary amendments to the IASCF Constitution, the Trustees published vacancy notices on 2 January 2008. The two new IFRIC members will serve for a term that will expire on 30 June 2011.

6. CONCLUSION AND OUTLOOK

During the period since the publication of the Commission services's 2nd report, the IASCF and IASB have made important announcements that, if fully and effectively implemented, will enhance the accountability of the IASCF/IASB to their stakeholders and enhance the transparency of their activities.

Most significantly, there is now broad-based agreement to establish a formal public oversight structure for the IASCF. This will also lead to a reform of the appointment process for Trustees, thus abolishing the self-appointment mechanism by granting an external, independent oversight body the power to decide upon the appointment of Trustees.

The Commission services welcome the decisions taken by the IASCF to strengthen the IASB's due process, in particular by carrying out *ex ante* impact assessments and *ex post* reviews of new standards and interpretations, as well as by publishing feedback statements. The Commission services are encouraged by the project summary and

⁵ <http://www.iasb.org/About+Us/About+Trustees/Trustee+distribution.htm>

feedback statement published for the *Business Combinations – Phase II* project and encourage the Trustees and the Board to pursue their work in this area, in particular by ensuring that impact assessments are carried out earlier in the development of standards and interpretations.

The IASCF has achieved progress towards establishing a new funding system, which should allow the Foundation to meet its funding requirements for 2008. The IASCF Trustees should pursue their efforts to develop an effective funding arrangement that is broadly-based, equitable and ensures the long-term stability of funding.

A number of EU Member States have established national funding mechanisms to support the IASCF while in others funding is being raised through broad-based voluntary mechanisms. However, not all Member States have committed funding, while some existing commitments remain subject to final confirmation. In parallel with efforts to strengthen the IASCF's governance structures and due process, the Commission services will continue to work with Member States and other stakeholders to ensure that the EU is in a position to make a stable and equitable contribution to the Foundation's funding.

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MEMO/07/451

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**AUTHORITIES RESPONSIBLE FOR CAPITAL MARKET REGULATION
WORK TO ENHANCE THE GOVERNANCE OF THE IASC FOUNDATION**

Combined statement of the European Commission, the Financial Services Agency of Japan, the International Organization of Securities Commissions (IOSCO) and the US Securities and Exchange Commission proposing changes to strengthen the institutional framework of the International Accounting Standards Committee (IASC) Foundation and encourage the Foundation's related efforts, while emphasizing the continued importance of an independent standard-setting process.

European Internal Market and Services Commissioner Charlie McCreevy, Financial Services Agency of Japan Commissioner Takafumi Sato, IOSCO Executive Committee Chairperson Jane Diplock and US Securities and Exchange Commission Chairman Christopher Cox explained:

"International Financial Reporting Standards (IFRS) are becoming more widely used throughout the world. We have a common interest of ensuring continuing user confidence in the institutions responsible for the development of global accounting standards. A natural step in the institutional development of the IASB and the IASC Foundation would be to establish a means of accountability to those governmental authorities charged with protecting investors and regulating capital markets. We will work together to achieve these objectives."

This positive development is a reflection of both the work accomplished to date by the Trustees and the International Accounting Standards Board (IASB), the body responsible for promulgating IFRS, and the desirability of the creation of a single, high-quality set of accounting standards for international use. At the same time, the increased use of IFRS has raised interest in establishing formal ties between important securities regulatory stakeholders and the IASC Foundation.

The IASB, which is overseen by the IASC Foundation Trustees, is an independent standard setter committed to developing, in the public interest, a single set of high quality, understandable, and enforceable global accounting standards. The IASC Foundation Trustees have scheduled a review of the Foundation's Constitution to begin in 2008. The authorities responsible for capital market regulation propose to utilize the opportunity of the Constitution Review to put forward, in collaboration with the IASC Foundation, certain changes to strengthen the Foundation's governance framework, while emphasizing the continued importance of an independent standard-setting process.

Central to this effort is the establishment of a new monitoring body within the governance structure of the IASC Foundation to reinforce the existing public interest oversight function of the IASC Foundation Trustees. The creation of such a monitoring body would serve to complement the Trustees in its representation of the interest of the global investor community, thereby enhancing public confidence in IFRS.

One key objective is to have the monitoring body meet regularly with IASC Foundation Trustees to discuss, review and comment on the IASB's work program. We expect the IASC Foundation and IASB Chairmen will also engage with relevant public authorities. The monitoring body would, together with the IASC Foundation Trustees and in consultation with the trustee appointments advisory group, participate in the selection of Trustees. The monitoring body would also be responsible for the final approval of Trustee nominees and would have the opportunity to review the Trustees' procedures for overseeing the standard-setting process and ensuring the IASB's proper funding.

We also welcome procedural reform and oversight enhancements underway since the completion of the last IASC Foundation Constitution Review in 2005. The IASB has committed to continued development of a framework for impact assessments/cost benefit analyses and feedback statements on new accounting standards. The monitoring body will work with the Trustees to strengthen these efforts, including identifying resources, for the purpose of continued improvement of impact assessments/cost benefit analyses, and with a view to developing objective procedures for assessing their impact.