Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
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Berlin, 12 September 2016

Dear Mr Chairman, dear Michel,

Re: Exposure Draft *Trustees' Review of Structure and Effectiveness: Proposed Amendments to the IFRS Foundation* Constitution

On behalf of the Accounting Standards Committee of Germany (ASCG) we are responding to the Exposure Draft *Trustees' Review of Structure and Effectiveness: Proposed Amendments to the IFRS Foundation* Constitution (ED) of July 2016. We welcome the opportunity to share our suggestions and observations on the consultation document.

Whilst we agree with the majority of the proposals in the ED, we are particularly concerned about Proposal 5 dealing with the size of the IASB. Although we acknowledge that the feedback on the Request for Views was mixed, we continue to believe that a decrease in the number of Board members is neither warranted nor appropriate. Please find our detailed remarks to this and the other proposals in Appendix A to this cover letter.

Although the Trustees are not formally seeking feedback on any other issue, we wish to raise two further areas where we believe consideration is warranted. The first issue picks up on Question 6 of the Request for Views document where the Trustees have decided not to propose any changes to the Constitution; the second is on the IFRS Interpretations Committee. You will find our comments and recommendations in Appendix B.

If you would like to discuss any aspect of our comments further, please do not hesitate to contact us.

Yours sincerely,

Ralf Thomas
(Chairman of the Administrative Board)

Andreas Barckow
(President)

CC: Werner Brandt
Trustee, IFRS Foundation

Appendix A – Responses to the questions of the Exposure Draft

Proposal 1: Geographical distribution of the Trustees – draft proposed change to Section 6 of the *Constitution*

The ASCG's Administrative Board acknowledges and agrees with the Trustees' proposal to collate the seats of North and South America into 'the Americas' and to allocate six seats to the combined area.

Further, we understand that the Trustees wish to remain flexible to a changing world by turning the seventh seat into an at-large appointment. In line with our response to question 8 of the preceding Request for Views document, we would have preferred had the Trustees re-allocated that seat to Europe, thereby acknowledging that Europe is still the largest economic area with the highest number of IFRS reporting entities. That being said, we do not object to the seat being allocated to the at-large category in order to maintain an even spread over the core three regions (i.e. the Americas, Europe, and Asia/Oceania). By allocating the seat to the at-large group, though, the end of paragraph (e) now reads confusing: *"three Trustees appointed from any area, <u>subject to maintaining overall geographical balance</u>"*. We are unsure as to how strict "maintaining overall geographical balance" would be interpreted, as a strict reading would either lead to spreading the three seats evenly over the core three regions (in which case there would be no need to have the at-large category in the first place), or by allocating the seats to Africa completely. According to paragraph 15 of the ED, the Trustees will develop guidelines to specify the basis within which at-large appointments would be made. We suggest aligning the wording of paragraphs 12(e) and 15 to avoid any misperception of the Trustees' intent.

Proposal 2 — the professional background of the Trustees – Section 7 of the *Constitution*

We agree with the proposal.

Proposal 3 — the remuneration of the Trustees – Section 11 of the *Constitution*

We agree with the proposal.

Proposal 4 — focus and frequency of reviews of structure and effectiveness of the IFRS Foundation – Section 17 of the *Constitution*

We agree with the proposal.

Proposal 5 — the size of the Board – Section 24 of the *Constitution*

In line with our response to question 11 of the preceding Request for Views document, the ASCG's Administrative Board continues to disagree with the proposal to reduce the size of the IASB from 16 to 13, as we do not find the arguments presented compelling. On the contrary, we believe that engaging in outreach and liaising with key stakeholders across (an increasing number of) jurisdictions becomes even more important at times when the IASB will be relying heavily on input for its 'Better Communication' strategy and the research projects selected. We believe that a reduction in the number of Board members sends the wrong signal to a growing global constituency. Further, we reiterate our concern that a reduction of the IASB's size would, in essence, increase the burden for each of the remaining Board members to a degree that we are concerned about the quality of the Board's output. Hence, we fail to see how Board members could carry out their responsibilities more effectively, as is envisaged by the Trustees.

If, nonetheless, the Trustees were to push ahead with the proposal, we suggest clarifying the circumstances that may lead the Trustees to the conclusion that appointment of a fourteenth Board member was appropriate. Whilst we concur that the Trustees might retain a certain degree of flexibility, we feel that the current wording *"the Trustees shall have the discretion to appoint a fourteenth member <u>if they deem it appropriate</u>"* does sound inappropriately vague and subjective and makes the Foundation prone to governance concerns being raised.

Proposal 6 — professional background of the Board – Sections 25 and 27 of the *Constitution*

We do not agree with the Trustees' view that a reference to 'recent practical experience' might imply an unduly restrictive limitation on professional backgrounds of Board members. Moreover, we disagree with substituting 'recent <u>practical</u> experience' with 'recent relevant <u>professional</u> experience', as the two are describing different things: As we see it, the latter is a necessary precondition for anyone to be considered for membership on a technical Board. The three aspects 'recent', 'relevant', and 'professional experience' make clear that not all Board members need to be accountants by training and/or profession, but they need to be experienced in the field of or close to financial reporting (hence the 'relevant') – as a preparer, auditor, user, regulator, or other. The former phrase is then the sufficient condition in that the Board members to be appointed must demonstrate that they have indeed worked in practice until recently, as they simply cannot bring the latest thinking and expertise to the Board table otherwise. It is *both*, the 'relevant professional experience/background', *and* the 'practical' that make an individual a suitable Board candidate. Hence, we urge the Trustees to reconsider their proposal.

As far as the second proposal in paragraph 32 is concerned, we reiterate our concern in that the standard-setting process should not be framed by regulatory viewpoints or concerns. As said in our comment letter on the RfV, regulators can (and should) inform the IASB of any abuse they become aware of. However, that can surely be accomplished without having regulators directly involved in the development of standards at the Board table. Whilst we do not object to amending the paragraph as suggested, we flag that out of the current number of 12 Board members there are already four IASB members with a regulatory background; hence, we would not be sympathetic to increasing that number any further. Rather, we believe that the current imbalance as regards professional backgrounds on the Board should be rectified with the next rounds of appointments (especially as regards users and auditors).

Proposal 7 — geographical distribution of the Board – Section 26 of the *Constitution*

The ASCG's Administrative Board acknowledges and agrees with the Trustees' proposal to combine North and South America into "the Americas" and to allocate four Board seats to the combined area.

In line with our response to Proposal 1 of the ED, we are not sure how to read the end of paragraph (e): *"at times when the Board comprises fourteen members, one member appointed from any area, <u>subject to maintaining overall geographical balance</u>"*. Here, a strict reading would imply that the seat could only be attributed to Africa as the criterion for geographical balancing could not be met otherwise. We suggest clarifying the wording to avoid any misperception of the Trustees' intent.

There is a cross-cutting aspect that relates to Proposal 5 (that we were in disagreement with, see above) that we believe should be given consideration by the Trustees: So far, the Trustees are foreseeing four geographical areas, namely the (revised) Americas, Europe, Asia-Pacific, and Africa. If the Trustees were to go ahead with the proposed reduction of Board down to 13 members, the envisaged spread of 4:4:4:1 for the Americas, Europe, Asia-Pacific, and Africa would, in essence, mean that neither Chair nor Vice Chair would be considered and counted for as at-large any longer but attributed to particular regions. Given their leadership role, we would prefer if at least the Chairman (if not both Chair and Vice Chair) would retain a neutral geographic background and represent "the accounting world *at-large*".

Proposal 8 — terms of reappointment of the Board – Section 31 of the *Constitution*

We agree with the Trustees that reappointment should not be perceived automatic but should be subject to certain procedures developed by the Trustees. We note, however, that these procedures are not (yet) known to the public, so in order to be fully transparent we suggest the Foundation publish the procedural guidelines they intend to apply.

On the second change proposed, we do not object to the Trustees' proposal, even if it now turns a Board member's second term beyond three years into an exception – acknowledging that it is more in line with emphasizing 'recent practical experience' (see Proposal 6 above). Similarly to our response on the first proposal, we suggest that the Trustees make public the procedures that have been developed and that are referred to, so that it is transparent to everyone on which grounds someone may be appointed for a second term that is longer than the general three years.

Proposal 9 — voting requirements for the Board – Section 36 of the *Constitution*

Whilst the ASCG's Administrative Board agrees with adjusting the threshold necessary for Board approval, we are concerned by putting in absolute numbers rather than ratios. To demonstrate: Up until June 2016, the Board had 14 Board members, requiring nine Board members to vote in favour of a proposal. By the end of October 2016, the Board will only have eleven Board members, requiring eight Board members to vote in favour of a proposal. The change from 9/14 to 8/11 represents almost a move towards requiring a super majority (64% to 73%). Even though we acknowledge that the change will only be temporary, similar situations could arise in future if a Board member decides to step down before the regular end of his term. In order to avoid changing majority requirements over time, we propose fixing the voting ratio necessary for approval rather than the absolute number of Board members.

Proposal 10 — meetings of the IFRS Advisory Council – Section 46 of the *Constitution*

We understand that the IFRS Advisory Council is meant to be the Foundation's key advisor on strategic issues whereas the Accounting Standards Advisory Forum serves in a technical capacity. In that regard, we are concerned that decreasing the Council's number of meetings from three to two could send an unintended signal to the outside world. The reference to an equally reduced number of Trustee meetings does not, by itself, sound compelling as we do believe that the strategic challenges existing today will not vanish over time (ensuring consistent application, financial reporting outside of the private for-profit sector, other strands of corporate reporting, trends in digital reporting, to name but a few).

Whilst we acknowledge that the wording of the amended paragraph still retains the "shall normally meet at least" so that additional meetings can be arranged for, we wonder what precisely triggered the change. Given that the Council is the only advisory body mentioned in the Constitution, and given that the number of participants on the Council is much bigger and a far broader reflection of jurisdictions and professional backgrounds than any other grouping the IASB is regularly in contact with, we would have thought that there is no better 'eyes and ears' capacity for both the IASB and the Trustees to be informed in a timely fashion about upcoming changes around the globe (and potentially outside of those jurisdictions the IASB is speaking to more frequently anyway). We therefore suggest the Trustees reconsider their proposal.

Appendix B – Additional issues not raised in the Exposure Draft

1 – The role of the Trustees

The ASCG's Administrative Board commented extensively on Question 6 in the Request for Views document. In that question, the Trustees sought suggestions as to what the Foundation could do in order to enhance consistent application of IFRSs. Very much to our regret, the Trustees have not taken any of our points on board when considering potential enhancements to the Constitution. We continue to believe that, in order to maintain and strengthen the acceptance of the organisation and its product, the Trustees need to get involved more with the technical output of the IASB. As said in our comment letter, we do not foresee the Trustees becoming active or intervening in the development of the standards themselves. Rather, it is the relationship management vis-à-vis jurisdictions that have adopted or are in the process of adopting IFRSs that we believe needs revisiting. In this regard we quote from our letter sent on the RfV:

> *"We believe that the Trustees' mission of working in the public interest encompasses at least two quite diverse groups, namely investors and those jurisdictions that make the use of IFRSs compulsory or optional in their region. We are not completely convinced that the IASB is the tier to serve the former and the Monitoring Board the tier to deal with the latter constituency. When jurisdictions are adopting IFRSs for use in their country or region, they are delegating legislative power to the Foundation, at least to a certain degree. We feel that it is understandable that jurisdictions have a keen interest in ensuring that the technical body they have delegated the standard-setting activity to addresses the needs they see in their respective constituency, and we fully appreciate that the IASB has a difficult task of serving 140+ different jurisdictions at the same time. However, we believe that it is ultimately the Trustees who need to ensure that the jurisdictions and their needs are duly considered and appropriately dealt with (appropriateness to be judged from the jurisdiction's perspective)."*

2 – The IFRS Interpretations Committee

The Trustees did not solicit any specific comments about the organisation, the mandate, and the processes of the Interpretations Committee, neither in the Request for Views nor in the Exposure Draft. Our IFRS Technical Committee is regularly monitoring the work and output of the Interpretations Committee and noted an increase in rejections that were grounded in either a parallel IASB (research) project and/or a scope too large for it to take on an issue.

The ASCG's Administrative Committee believes that the Trustees ought to reconsider (and potentially revise) the Interpretations Committee's mandate. If an issue is being submitted to the Committee and the Committee acknowledges the validity of the issue, absent extreme cases, there is hardly any compelling reason not to take the issue to the active agenda. The IFRS Foundation claims sole proprietorship for IFRSs, both as regards the development of the standards, and their interpretation. Whilst we fully acknowledge the mandate of the organisation for its product, we equally believe that this comes with an obligation to deliver robust and unambiguous requirements. If, following the publication of a standard, diversity in practice emerges and that diversity causes an entity, auditor, regulator or any other party to lodge an issue with the Interpretations Committee, the 'null' option to do nothing and leave the issue hanging is not an acceptable option: Not only does the diversity run counter the IFRS Foundation's stated mission for consistent application of

IFRSs; even worse, it leads to uncertainty and risks amongst its stakeholders as to the 'correct' accounting that only the Foundation itself could take away.

Whilst we accept that there are thorny issues that cannot be dealt with quickly and holistically at the same time, we believe that the Foundation needs to do everything in its hands to ensure markets maintain their faith in the product. As this is of mutual importance to both the Foundation and the jurisdictions that have adopted IFRSs, we could envisage National Standard Setters stepping in and using their knowledge and resources to help the Foundation find interim solutions that provide market participants with assurance and certainty as to acceptable accounting outcomes. The ASCG stands ready to assist in that regard and we are more than happy to help the Foundation seek possible solutions and processes.