

IASC FOUNDATION
TO THE TRUSTEES

c/o Tamara Oyre
Assistant Corporate Secretary
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constitutionreview@iasb.org

8 April 2009

Dear Ms Oyre,

IASCF Review of the Constitution: *Identifying Issues for Part 2 of the Review*

On behalf of the Supervisory Board of European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IASCF Review of the Constitution: *Identifying Issues for Part 2 of the Review*.

We see the periodic review of the IASCF Constitution as an important part of the IASCF's processes, and are pleased that the IASCF is asking, through this latest paper, for comments on the issues on which the review should focus. Our detailed comments are set out in the appendix, but we wish to highlight some key points:

- We believe that a change is necessary concerning the IASB's agenda process. We believe the current process needs to be more consultative. We also think it needs to be extended to major prioritisation and scoping decisions.
- Another change we think is necessary concerns decisions about re-exposure. We believe the IASB should be required to follow some sort of explicit process and explain the basis for its judgement that re-exposure is not necessary in cases where significant changes to ED's have been made. The role of the Trustees would then be to ensure that the process has been properly followed.
- Moreover, improvements are also required as to how the constitution and those processes are implemented. We make some specific comments on this in our letter.

Finally, we note that the world has recently faced an unprecedented financial crisis. Voices have questioned the possible role of accounting requirements in the development of this crisis. In due course, it will be very important for all stakeholders to draw conclusions from this experience. In particular, it is of fundamental importance that the process of standard-setting is reviewed in depth to identify whether some areas need to be improved in light of the experience. It may be too early to do this in the context of Part

2 of the review of the constitution, but in the coming months, and certainly before the next review of the constitution in five years, we would urge the IASCF to carry out this analysis.

We look forward to commenting on the IASCF's specific proposals in due course.

If you have any questions about this letter, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Göran Tidström', written in a cursive style.

Göran Tidström Chairman
EFRAG Supervisory Board

Appendix

EFRAG Supervisory Board's detailed comments on IASCF Review of the Constitution: *Identifying Issues for Part 2 of the Review*

QUESTIONS ASKED IN THE PAPER

Question 1 *The Constitution defines the organisation's primary objective in the following manner: "to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions."*

In fulfilling that objective, the organisation is "to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies".

Does the emphasis on helping 'participants in the world's capital markets and other users make economic decisions', with consideration of 'the special needs of small and medium-sized entities and emerging economies', remain appropriate?

- 1 In our view the primary objective of the IASB should continue to be to provide standards required by the world's capital markets. However, the IASB also has responsibilities to small- and medium-sized entities and emerging economies, and this reference serves as a reminder of those responsibilities and that a 'one size fits all' approach might not always be appropriate.
- 2 Having said that, we think it might be worth updating the wording to reflect the fact that the IASB is focusing on non-publicly accountable entities, rather than small and medium-sized entities as such.
- 3 We note that Section 2(d) of the Constitution states that convergence of national accounting standards is an objective. We think it might be preferable to delete convergence as a stated objective and instead view it as one of the means by which a single set of high-quality global accounting standards could be enhanced. This would serve to emphasise that convergence, whilst important, is not a goal that should be pursued at the expense of quality.
- 4 We would suggest that the Constitution be aligned with the new Conceptual Framework which has dual objectives: economic decision-making and stewardship. The Constitution should therefore also address stewardship in its objective since stewardship is a basic characteristic of accounting and financial reporting. Accountability of management is important for users and existing shareholders to take decisions about the ability of management to generate economic value. It has been the main reason for producing financial statements in Europe. For SME reporting, the objective of stewardship is even more important than the predictive value of reporting.

Question 2 *In the opinion of the Trustees, the commitment to drafting standards based upon clear principles remains vitally important and should be enshrined in the Constitution. Should the Constitution make specific reference to the emphasis on a principle-based approach?*

- 5 We are strongly of the view that the best financial reporting frameworks are principle-based, and can see this becoming a very important issue over the coming

years as the use of IFRS around the world increases even more. We support the inclusion of this emphasis in the Constitution on principle based standards.

- 6 Having said that, we recognise it is simplistic to think that there are only two possible approaches—principle-based or rule-based standards—and that much depends on the level of detail at which standards are written. For example, we have heard it argued that FASB standards are principle-based standards. Even if that is a fair comment, they generally include and are accompanied (in interpretations) by substantial amounts of application guidance that effectively constitute detailed rules. So, the issue is not straight-forward, but we nevertheless think a reference in the Constitution might help in keeping the IASB moving along in the right direction on this fundamental issue.
- 7 We believe the Trustees have a role to play in helping to ensure that IFRS continues to be written in a principle-based way and do not involve extensive amounts of application guidance and interpretations as more and more jurisdictions move onto IFRS.

Question 3 *The Constitution and the IASB's Framework place priority on developing financial reporting standards for listed companies. During the previous review of the Constitution some commentators recommended that the IASB develop financial reporting standards for not-for-profit entities and the public sector. The Trustees and the IASB have limited their focus primarily to financial reporting by private sector companies, partly because of the need to set clear priorities in the early years of the organisation. The Trustees would appreciate views on this point and indeed whether the IASB should extend its remit beyond the current focus of the organisation.*

- 8 We would not at this time support an extension of the IASB's remit to not-for-profit entities and/or the public sector. We recognise that sometimes looking at such entities and sectors can enrich one's understanding of issues that also arise for profit-oriented private sector entities, but it also has the potential to be a significant drain on the IASB's resources at a time when there are many important and urgent accounting issues that already need to be on the IASB's agenda. In our view the IASB's agenda is already too large.

Question 4 *There are other organisations that establish standards that are either based upon or have a close relationship with IFRSs. The IASC Foundation already recognises the need to have close collaboration with accounting standard-setting bodies. Should the Constitution be amended to allow for the possibility of closer collaboration with a wider range of organisations, whose objectives are compatible with the IASC Foundation's objectives? If so, should there be any defined limitations?*

- 9 We think the Constitution should allow for the possibility of closer collaboration with other organisations than standard setters. It is essential that the IASB has a close relationship with national standard setters, because those bodies can be the source of valuable input as well as important partners in the two-way communication process that is essential to a global standard-setter. It is also important for the IASB to maintain close contact with securities and other regulators and enforcement agencies. However we believe that there should also be room for close collaboration with other organisations closely linked to or otherwise interested in accounting standard-setting. We are such an organisation—although in practice we already work closely with the IASB—but we think there is no reason why the Constitution should prevent closer ties with bodies such as representative groups of actuaries and of valuers, as well as organisations such as the IMF.

- 10 There is no reason, in principle, why suitable collaborations with user organisations, auditors and preparers should also not be possible, so we would suggest some fairly generally expressed, principle-based wording that allows some flexibility to the IASCF and IASB to collaborate with bodies when that would further their objectives without endangering their independence and other processes.
- 11 Of course, such collaborations can be resource intensive and have the potential to distract rather than support and augment existing arrangements, so it is important that the Trustees and the IASB proceed with caution and seek to avoid creating expectations that are unrealistic.

Question 5 *The first part of the review of the Constitution proposed the establishment a formal link to a Monitoring Group. Under this arrangement, the governance of the organisation would still primarily rest with the Trustees. Although the first part of the review has not yet been completed, the Trustees would welcome views on whether the language of Section 3 should be modified to reflect more accurately the creation of the Monitoring Group and its proposed role.*

- 12 As we understand it, the Monitoring Board is not part of the IASCF and is therefore not subject to the IASCF's processes. On the other hand, it will play an important role in the governance of the IASCF—including approving the appointment of Trustees and perhaps requesting meetings with the Trustees and with the Chairman of the IASB—so it would seem odd to make no reference to it whatsoever. We think, therefore, that there should be a short reference to or description of the Monitoring Board in the Constitution, and we note that a description has now been included (in paragraphs 18 to 23) of the 1 February 2009 version of the Constitution. We think this description is sufficient.
- 13 We believe that in relation to financial stability accounting standards should continue to focus on the primary objective of meeting the needs of capital market users. Macro-economic objectives, including financial stability should be achieved by other means such as macro-economic policy and regulatory actions. Continued cooperation between the IASB and global regulatory networks such as IOSCO and FSF are important. We support the IASB in the efforts to maintain and enhance there relationships by participating actively in the FSF and IOSCO accounting related activities. We are strongly of the view that technical accounting standard setting should remain independent and not be politically influenced. Standard setting has become of greater interest to public policy makers and regulators as a result of wider international adoption of IFRS and the financial and economic crises.

Question 6 *The Trustees are appointed according to a largely fixed geographical distribution. Is such a fixed distribution appropriate, or does the current distribution need review?*

- 14 Our major concern in relation to the appointment of trustees was the system of self-appointment. Those concerns have, we believe, now been addressed. We strongly support maintaining some provisions in the Constitution that require a largely fixed geographical distribution of Trustees. We believe it is important that all parts of the world have a possibility to be represented on the Trustees.
- 15 Furthermore, we believe that the current geographical distribution of the Trustees does not need to be reviewed at the current time because, in our view, it achieves a broadly satisfactory balance between jurisdictions already adopting IFRS and other jurisdictions with an interest in adopting IFRS and it also achieves a broadly

satisfactory balance within each of those categories, bearing in mind factors such as the funding between provided from each of the areas. Having said that, we also believe that the current and prospective constituencies committed to IFRS should be represented by more Trustees than those constituencies not using or being committed to use IFRS.

Question 7 *Sections 13 and 15 set out the responsibilities of the Trustees. The intention of these provisions is to protect the independence of the standard-setting process while ensuring sufficient due process and consultation—the fundamental operating principle of the organisation. In addition to these constitutional provisions, the Trustees have taken steps to enhance their oversight function over the IASB and other IASC Foundation activities. The Trustees would welcome comments on Sections 13 and 15, and more generally on the effectiveness of their oversight activities.*

- 16 We are broadly satisfied with the Trustees' oversight responsibilities as set out in the Constitution. As a result, we do not think that major changes to those descriptions are needed to improve the governance of the IASCF and the IASB.
- 17 However, we do have some concerns about how—and the extent to which—the Trustees carry out those responsibilities. It seems to us that over the years the Trustees role has changed; initially the role was primarily to establish the IASB and help its standards to become truly global, while the focus is now more on oversight. We do not think the Trustees' activities have evolved sufficiently to reflect this change.
- 18 We mention some specific issues in the remainder of this letter, but we think that, given the recent experience with the financial crisis, the Trustees probably should have played a more active oversight role in challenging the IASB on whether its priorities and the application of its resources remained appropriate.
- 19 We would also like to highlight another concern that we believe should be considered as a part of the Trustees' oversight role. The IASB is currently intending to issue a vast amount of consultative material over a fairly short period of time. We question whether the IASB's constituents will be able to cope with all this material. If that proves to be the case, due process will not be effective and the standard-setting process will suffer as a result. We believe the Trustees should consider the potential impact of the IASB's proposed volume of activity when it is carrying out its oversight responsibilities.

Question 8 *The Trustees are responsible for ensuring the financing of the IASC Foundation and the IASB. Since the completion of the previous review of the Constitution, the Trustees have made progress towards the establishment of a broad-based funding system that helps to ensure the independence and sustainability of the standard-setting process. However, the Trustees have no authority to impose a funding system on users of IFRSs. The Trustees would welcome comments on the progress and the future of the organisation's financing.*

- 20 Independent financing is important for the IASCF and the IASB. Accountability and funding are also milestones of the SEC Roadmap. A secure and stable funding mechanism that permits the IASB to function independently is as important for Europe as for the US. Therefore, we believe that the IASCF should work towards a funding arrangement that is primarily non-voluntary, transparent and stable. Such an arrangement will help to ensure the independence of the IASB, both in perception and reality.

- 21 We welcome the EC Proposal for a Decision of the EP and Council on establishing a Community Programme to support specific activities in the field of financial services, financial reporting and auditing. These proposals cover inter alia IASCF and EFRAG. Having said this, the funding of the IASB and IASCF should be structured in such a way that it is sustainable so that the IASCF can commit to long term projects and that the funding process and structure do not jeopardise the independence of the standard setting process.

Question 9 *Commentators have raised issues related to the IASB's agenda-setting process. The Constitution gives the IASB 'full discretion in developing and pursuing its technical agenda'. The Trustees have regularly reaffirmed that position as an essential element of preserving the independence of the standard-setting process. However, they would welcome views on the IASB's agenda-setting process and would appreciate it if, in setting out views, respondents would discuss any potential impact on the IASB's independence.*

- 22 We have been uncomfortable with the existing agenda setting arrangements for some time. There are two issues that concern us: the degree of consultation that takes place currently, and the fact that decisions about the priority to be attached to agenda items and the scoping of those items are not subject to the same procedures as decisions about whether an item should be added or removed from the agenda.

Degree of consultation that takes place

- 23 It has long been EFRAG's view that the IASB should have full due process on its agenda process. We recognise that the IASB consults with the SAC and others before taking its agenda decisions, but we believe that, as the IASB's decisions affect all its constituents, it should give all its constituents the opportunity to express their views on the agenda. We also believe that such a change would ensure that the IASB is in much closer contact with its constituents when it takes agenda decisions, which ought to help ensure the agenda reflects the needs of constituents and cannot be criticised for focusing on technical weaknesses in standards that are not causing significant concerns in practice.
- 24 We therefore recommend that every year the IASB publish its proposed agenda for the coming year for comment and that, when it finalises its agenda in the light of the comments received, the IASB should be required to summarise the views expressed and explain the decisions it has taken. That published proposed agenda should include a full 'needs analysis', including an initial summary of the perceived costs and benefits, to demonstrate that there is a genuine need for the project.
- 25 We note in this context that, although the IASB's 'Due Process Handbook' (paragraph 59), states that the IASB consults the Standards Advisory Council (SAC) and standard-setters before approving the addition of an item onto the agenda and deciding on the priority of agenda items, that is not always done.

Agenda prioritisation

- 26 It is clear from experience over the years that the IASB agenda setting process is not just about deciding which projects to add or remove from the IASB's agenda, it is also about setting the priorities for those projects and determining their scope. For example:

- (a) Fundamental changes were made to the programme of future standards the IASB's constituents could expect in the short- and medium-term as a result of the decisions the IASB and FASB took in 2008 about the prioritisation and scope of the projects mentioned in the MoU, yet constituents had no opportunity to comment on those decisions. The same was true when the MoU was first entered into.
 - (b) Many of the IASB's constituents in Europe have been asking the IASB for some time now to undertake a project on common control transactions. Last year the IASB agreed to add the project to its agenda, but the project is currently "paused", so it might as well not be on the agenda. Similarly, a number of European constituents asked for a project to be undertaken on rate regulated activities. Such a project has been added to the agenda, but it is not yet clear how the project will be scoped; so it is not clear whether this is the project that Europe asked for.
- 27 Having said that, we recognise that the prioritisation of projects is a complicated issue in practice and involves consideration of a number of detailed factors including technical considerations (for example, linkage between projects) and operational considerations (for example, staffing). As a result, it is not feasible to expect every decision about priority and scoping to be subject to full due process. However, we see no reason why the IASB should not consult on major re-prioritisation and re-scoping programmes like the recent ones involving the MoU and on the priorities to be attached to and scope of major new projects.
- 28 Another issue that should be considered is the issue of convergence. Convergence has been important providing it leads to better high quality standards. However, convergence should not be the only factor driving the work plan and the related priorities in the future. A proper balance needs to be struck with the speed and nature of the changes, in particular where current standards are not perceived as being flawed. We note the freeze period of 2011 announced for the application of IFRS, but are concerned that this could lead to an acceleration of amendments to the standards before that date.

Should the IASB take the decisions about its agenda?

- 29 There are various ways of organising the agenda setting and prioritisation of a standard-setter. For example, the IASB could itself take the decisions as at present; or the decisions could be taken by the Trustees, by a combination of the two or in some other way. We know that constituents in certain jurisdictions seem to prefer someone other than the IASB to set the IASB's agenda, whilst those in certain other jurisdictions prefer the IASB to set its own agenda. Our position is that—as long as full due process is introduced and that process extends to cover prioritisation and scoping of projects—we would not argue for major changes in this area at the current time because we want to see how the revised agenda process works.
- 30 We do not think that the introduction of due process that encompasses agenda setting and the prioritisation and scoping of projects would in any way adversely impact the standard setter's independence. In fact, quite the opposite as, with proper feedback, the independence of the standard setter would be more apparent. In our view independence is about having the unrestrained ability, subject to

appropriate accountability mechanisms, to take the decisions that are believed to be appropriate on the content of standards, based on input gathered through due process.

Question 10 *The Constitution describes the principles and elements of required due process for the IASB. The IASB's procedures are set out in more detail in the IASB Due Process Handbook. If respondents do not believe the procedures laid out in the Constitution are sufficient, what should be added? If respondents believe that the procedures require too much time, what part of the existing procedures should be shortened or eliminated? The Trustees would also welcome comments on recent enhancements in the IASB's due process (such as post-implementation reviews, feedback statements, and effect analyses) and on the IASB Due Process Handbook*

- 31 We believe that the IASB's written due process procedures are generally very good. However, we think there is room to improve the way they are implemented. For example, there is very widespread concern about how due process is operating in practice and we think consideration needs to be given to what could be done to address this concern. The IASB's constituents clearly put a lot of effort and resources into writing comment letters responding to the IASB's proposal, yet many feel the comments are not taken into account when the final standards are issued.
- (a) Often the IASB Board members seem to argue that, because no new arguments have been raised, there is nothing further to consider. Yet the least the Board members need to consider are the weight they have given to the arguments and also the possibility that they have drawn the wrong conclusions from the arguments.
 - (b) If many constituents disagree with proposals that have been issued for comment, we think that sends an important message to the IASB, yet our impression is that that message is sometimes too easily dismissed. We would expect to see the Board proceed with caution in such circumstances. We have heard the views of a significant majority of respondents being dismissed on the grounds that they have not understood the proposals being made. It seems to us that in such circumstances the Board should acknowledge that it has not explained itself clearly enough and that re-exposure with better explanations is necessary.

We have no specific recommendations on this issue because we would not want to see a rule (such as if 90 percent of comment letters disagree a standard could not be issued without re-exposure) being introduced. We think what is probably most needed is greater oversight of this aspect of the IASB's work.

- 32 Similarly, our understanding is that many of those who participate in the IASB's public Roundtables and its working groups find the experience unsatisfactory. We recognise that an experience is never totally satisfactory if one's point of view is not accepted, but we think there is more to it than that. We suspect that, although due process is being followed in form, the feeling is that something is sometimes missing in terms of substance.
- 33 We would also like to see the Trustees encourage the IASB to fully implement the recent enhancements in the IASB's due process, particularly feedback statements and effect analyses. We think it is particularly important for the credibility of the standard-setting process that effect analyses are carried out and published much earlier in the process than at present. Moreover, it would be important that these

processes are formalised in paragraph 37 of the IASCF's constitution and in the IASB's Due Process Handbook.

Question 11 *Should a separate 'fast track' procedure be created for changes in IFRSs in cases of great urgency? What elements should be part of a 'fast track' procedure?*

- 34 We note that recently the IASB has been required to—or chosen to—issue material that has required a very quick response from constituents, either to comment on proposals or to implement before an effective date. Although this can cause real problems for EFRAG and in the EU, we nevertheless accept that it is important that a standard setter can react in a timely manner to urgent issues that are of extraordinary significance.
- 35 We have considered whether it might be appropriate for the IASB and IFRIC to institutionalise some form of fast-track procedure for use in such circumstances. The problem with fast-track procedures is that they can have the effect of preventing a significant proportion of the IASB's constituents from participating in its due process, either because they work on a consultative basis—and such consultations take time—or because of language difficulties. As such, rather than institutionalise some form of fast-track procedure, we believe it is better to continue to require the use of any form of fast-track procedure to be approved by the Trustees on a case by case basis.
- 36 Furthermore, our view is that the IASB should never forego due process completely. It is the due process that gives a private sector standard setter like the IASB its legitimacy, and great care is needed to ensure that that process is not compromised. In the very rare case where a fast track procedure is justified, there should still be at least 30 days for consultation at global level.

Question 12 *Are the current procedures and composition, in terms of numbers and professional backgrounds, of the Standards Advisory Council (SAC) satisfactory? Is the SAC able to accomplish its objectives as defined in Section 38?*

and

Question 13 *Attached to this discussion document are the terms of reference for the SAC, which describe the procedures in greater detail. Are there elements of the terms of reference that should be changed?*

- 37 We welcome the recent decision to modify the membership of the SAC, which we understand represents an operational change that does not prejudge the possibility for additional structural changes in the context of the current constitutional review.
- 38 As already mentioned above, we consider that the SAC should play a more prominent role in the IASB's agenda-setting process. In this context, the SAC should be formally consulted about **all** changes to the IASB's work programme, including issuing a written opinion following the annual consultation proposed in paragraph 21 above.
- 39 There is a need to reflect on the size of the SAC, which currently has over 40 members. The large membership of this body, while it ensures wide geographical and sectoral representation, may undermine the SAC's effectiveness. The possibility to streamline the membership after the current term of office of its

members expires on 31 December 2011 should be explored, while maintaining a balanced geographical and sectoral representation of key stakeholder groups.

Question 14 *Should the Trustees consider any other issues as part of this stage of their review of the Constitution?*

- 40 We are concerned about the current procedures that are followed when decisions are taken as to whether a standard or interpretation needs to be re-exposed. There have been cases in the past where the IASB has made very significant changes to the proposals published in an ED but not exposed those revised proposals for comment. Furthermore, it has seemed to us that sometimes the Board has based that decision on expediency. This is, in our view, never acceptable. Similarly, we think the IASB has also too easily concluded in the past that it will not learn anything more from re-exposure. In our view further consultation should be viewed as an opportunity, not a burden.
- 41 Therefore we propose that the Trustees consider developing a means of challenging the re-exposure/non re-exposure decisions of the IASB. We would not be in favour of laying down specific criteria that would trigger re-exposure—it will always be a matter of judgement—but the IASB should be required to follow some sort of explicit process and explain the basis for its judgement that re-exposure is not necessary in cases where significant changes have been made. The role of the Trustees would then be to ensure that the process has been properly followed.
- 42 It has been suggested to us that this would impinge on the IASB's independence, but we do not agree. It is a governance issue, not a decision about the technical content of the standards.
- 43 Some further points raised also by constituency are:
- As the business environment in which we operate today has grown increasingly complex, it is unavoidable that accounting standards also reflect in their requirements the increasing complexity of many business transactions, which in turn may result in more complex financial statements. The IASB should continue to ensure that its (proposed) standards are clear and comprehensible, as well as capable of being implemented and audited in a practical manner.
 - We believe that changes to the standards should be made only when they result in a more faithful representation of economic reality, in better presentation and/or increased transparency. A proper balance needs also to be struck between the goal of improving financial reporting and the ability of preparers, auditors and, importantly, users of accounts, to be able to produce, audit and interpret the resulting financial information in a meaningful way. When standards become too conceptually purist, rules-based and complex, the financial statements prepared on the basis of these standards are no longer understood by management and as a result no longer considered relevant for internal management purposes. The result of this would be that financial reporting would become a compliance exercise, rather than a tool for internal and external decision-making. This would be highly undesirable.
 - To avoid such a situation, it is important that standard-setters find the appropriate balance between the ideal academic solutions and practical standards that limit

complexity to the necessary minimum. The Trustees have an important role to play in setting guidance for criteria to be considered in the cost-benefit analysis before new standards projects are added to the agenda.

- The costs associated with educating preparers and users in application and understanding of existing and proposed accounting standards, as well as keeping such knowledge current are increasing dramatically. In addition there are the costs and risks associated with frequent substantial system changes resulting in many cases from changes in the application of accounting standards. Though standards may need to be improved and adapted in a fast changing environment, care should be taken to ensure that preparers and users can have confidence that there will be a certain amount of continuity of current standards. Adequate time should be allowed for the implementation of standards in Europe and elsewhere. More time should be allowed for adequate field testing of new proposed standards and major proposed changes to standards; this would enhance both the practicability and quality of the standards.