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Submitted by e-mail to constitutionreview@iasb.org

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

Grant Thornton International is pleased to comment on the IASC Foundation's Consultation Document *Review of the Constitution: Identifying Issues for Part 2 of the Review* (Part 2 of the Constitution Review).

We welcome the opportunity to comment at this relatively early stage of Part 2 of the Constitution Review. In the following paragraphs we offer some broad themes that we believe should be considered by the IASC Foundation (the Foundation) in developing more detailed proposals. Our responses to the specific questions raised by the Trustees are set out in the Appendix to this letter.

Preparing the organisation for the future

In our view the most important goals for Part 2 of the Constitution Review should be to strengthen the IASB's mandate as a global standard-setter and to equip the organisation to fulfil that role over the next several years.

As noted in our letter dated 16 September 2008 on Part 1 of the Review, we believe the International Accounting Standards Board (IASB) and the Foundation have made remarkable progress in securing greater acceptance of IFRS. This success indicates to us that the current organization and its operating processes have served their purpose well and are not fundamentally flawed. Nonetheless, we believe that the Foundation and the IASB now face challenging circumstances and that continued success cannot be taken for granted. We expand on this comment in the following paragraphs.

Acceptance of IFRS requires the organization to sustain and build on the support it has enjoyed across a broad range of constituents. We perceive that, notwithstanding strong support for the idea of global standards, the organization has faced growing criticism from important stakeholders in recent times. This criticism may be a result of the current financial crisis which is 'stress-testing' IFRS to a far greater extent than at any previous time. We also recognize that standard-setting is often controversial and that robust debate on future developments is normal. However, we believe there are grounds to be concerned over the trend in the organization's standing that are not fully attributable to those factors. We therefore suggest that the Trustees should assess the current situation carefully and broadly.

More specifically, we suggest that the Trustees might consider whether the IASB needs to adopt a more 'consensus-building' approach in its engagement with stakeholders, and whether its style of communication is sometimes unduly combative or defensive. In addition, although we understand that technical matters are the preserve of the IASB, we believe the Trustees should consider whether IFRS is developing in a manner that best meets the needs of stakeholders. This comment is motivated by our perception of growing criticisms of the complexity of IFRS, and a possible tendency in setting standards to place greater emphasis on conceptual purity than on practical relevance.

More widespread use of IFRS also brings increased responsibility. Many more countries will adopt IFRS in the next few years. Moreover, the adoption of IFRS in the US market is now contemplated at some point (although by no means guaranteed). It is therefore appropriate to regard the IASB as a genuinely global standard-setter and to equip the organisation accordingly. We encourage the Trustees to look ahead for (say) five years and consider how the organisation's resources and operations will need to develop and what should be put in place to facilitate that development. This review should consider not only the governance of the organisation but also operational matters (such as resources, expertise, the need for a greater IASB regional presence). Funding is also a pervasive and critically important matter.

Impact of the global financial crisis

The global financial crisis has focused considerable attention on the role of accounting standards, the impact of fair value accounting and the appropriate mandate for standard-setters. We believe that the IASB is responding diligently to requests from governmental and regulatory organisations (including the G20 and the European Commission) to consider improvements to its standards in the context of the financial situation. We welcome the engagement of the Trustees in this process.

In developing proposals for the Constitution Review the Trustees will no doubt consider the impact of the financial crisis and the effectiveness of the IASB's response to the demands placed upon it. We have the following general comments and observations which we suggest the Trustees should keep in mind in formulating their detailed proposals:

- In our view the Constitutional objective should remain focused on 'high quality, transparent and comparable information ... to help participants in the world's capital markets and other users make economic decisions'. We recognize that some commentators may call for this objective to be modified to encompass macro-economic policy objectives such as financial stability and bank solvency. We suggest that such calls should be treated with caution. We do however encourage the Trustees and the IASB to continue to engage with global regulatory organisations such as the Financial Stability Forum and Basel Committee on Banking Supervision (along with governments and securities regulators). At a standard-setting level we also believe that opportunities exist to make improvements that will serve the needs of investors (and other users) and those of regulators and supervisors (for example, the IASB might consider making an improvement to address a 'regulatory' concern if the change is neutral in terms of the usefulness of financial reports to investors and other users). However, we believe that an explicit 'financial stability' objective will obfuscate (and possibly conflict with) the objective of general purpose financial reporting. We also have concerns both with the practicality and with the legitimacy of the Foundation and IASB assuming responsibility for macro-economic policy goals.

- We believe that recent experience has emphasised more than ever the importance of adequate due process. The current financial situation has led to calls for fast-track changes to IFRSs and we acknowledge that a rapid response is occasionally necessary. However, we have observed that the October 2008 amendments to IAS 39 (on reclassifications of financial assets) led to a disproportionate number of application problems and also to further changes to clarify the original intent. This experience has also given rise to questions over the IASB's independence. Accordingly, while some other issues related to the current financial crisis may require an accelerated response, we believe that all changes must be subject to proper due process.
- Recent experience has also highlighted the importance of achieving converged solutions (between IFRS and US Generally Accepted Accounting Principles) in areas that have become more significant and sensitive in the financial crisis. The challenges and limitations of a convergence agenda have also been illustrated (a true 'level playing field' is almost impossible to achieve while different systems prevail). We are therefore pleased to note that the IASB has been working closely with the Financial Accounting Standards Board (FASB) in developing its response.

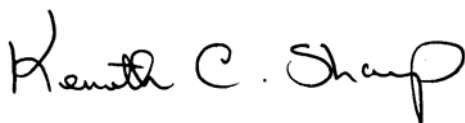
Outcome of Part 1 of the Review

We congratulate the Trustees on concluding Part 1 of the Review and welcome the creation of the new Monitoring Board. We believe that the new Monitoring Board, with an appropriate link to the IASC Foundation, should make a significant enhancement to the public accountability of the Foundation and (in turn) of the IASB.

We believe that the creation of the Monitoring Board is also likely to focus increased attention on the Trustees' broader responsibility to ensure that the work of the IASB serves and balances the interests of all its stakeholders. In this context (and as noted in our 16 September 2008 letter) we suggest that particular attention should be paid to the effectiveness of the Trustees' and IASB's engagement with investor bodies. We therefore welcome the creation of a standing investor subgroup of the Standards Advisory Committee and urge the Trustees to ensure that it is fully operational as soon as possible. Our 16 September 2008 letter also suggested that the Trustees should consider establishing an investor advisory group to provide input to the Trustees on discharging their governance responsibilities. We believe that this suggestion continues to be relevant and hope that the Trustees will give it careful consideration in concluding Part 2 of the Review.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,



Kenneth C Sharp
Global Leader - Assurance Services
Grant Thornton International

Responses to questions for consideration

Objectives of the organisation

Q1 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?

Yes, in our view this objective remains appropriate.

We also believe that the information in general purpose financial statements should aim to meet the needs of a wide range of users. This view is explained in more detail in our letter to the IASB and FASB responding to the Preliminary Views Document *Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information* (dated 3 November 2006). That letter also explains our belief that the current reference to "economic decisions" encompasses decisions concerning management's stewardship (or accountability) responsibility and should continue to do so.

Q2 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?

Grant Thornton International supports the IASB's efforts to move towards more principle-based standards. We wrote to the IASB Chairman in July 2007 to explain our views on the subject in some detail.

However, we are not convinced at this time that stakeholders have a shared, common understanding of the meaning of 'principle-based' in this context (or how the term should be put into practice in developing accounting standards). Moreover, to make reference to a particular style of accounting standard in the Constitution pre-supposes that the style in question represents the best or only way of meeting the organisational objective referred to in Question 1.

For these reasons we advise against making specific reference to the emphasis on a principle-based approach in the Constitution (at least until a widespread consensus on the meaning of the term is more evident).

Q3 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 should 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.

We note that, while the Constitution refers to the world's capital markets, the organization is also "to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies" (paragraph 2(c) of the current Constitution). We believe that this is an important part of the existing objective.

We also recognize the critical importance of the not-for-profit and public sectors. We believe there is a strong case for the development of internationally-recognised financial reporting standards for those sectors. Nonetheless, we question whether the IASB presently has the resources to assume this responsibility (including Board members with the appropriate background). Moreover, the International Public Sector Accounting Standards Board develops Standards for the public sector and is in our view the appropriate body to do so.

In addition we suggest that the IASB has an extremely heavy workload in order to meet its commitments under the Memorandum of Understanding with the FASB and also to address issues arising out of the global financial crisis. We would therefore advise against expanding the IASB's remit still further at present.

Q4 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?

We note that, at an operational level, the IASB already works closely with a number of National Standard-Setters and with the European Financial Reporting Advisory Group. We certainly believe that the IASB should continue to maintain and enhance those working relationships. These collaborations help to expand the Board's outreach, provide access to different sources of ideas and expertise and assist the IASB in managing its resources.

Although we favour increased collaboration, we have no strong view as to whether the Constitution should be amended to facilitate or require this. We are not aware of any references in the current Constitution that place inappropriate constraints on increased collaboration.

We do believe that it is essential that the IASB ultimately takes the decisions on the contents of IFRSs. Moreover, although other organizations should (and do) undertake very valuable activities such as research, development of proposals and consultation, we believe that any proposed new IFRSs must also undergo adequate due process under the auspices of the IASB. In other words, we believe that it would be inappropriate to outsource decision-making or due process.

Governance of the organisation

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.

We note that a Monitoring Board has now been announced. We welcome this step (consistent with our comments in our letter of 16 September 2008). We believe the language of Section 3 should be modified to reflect the Monitoring Board's existence and its link to the Foundation.

Trustees

Q6 The Trustees are appointed according to a largely fixed geographical distribution. Is such a fixed distribution appropriate, or does the current distribution need review?

We believe that the primary criterion for the appointment of Trustees should be an individual's ability to contribute effectively to the organization's objectives and to fulfill the duties set out in paragraph 13 of the Constitution.

Subject to that comment, we believe that it is important to maintain a geographic balance (for reasons of liaison, diversity and legitimacy). We also note that the Constitution currently allows for four of the Trustees to be from any area and therefore incorporates some flexibility.

As regards the current formulation in paragraph 7 of the Constitution, we suggest that the distribution should be reconsidered in the light of the decisions taken recently on composition of the IASB. In particular, we suggest that paragraph 7 should be amended to specify representation from Africa and from South America.

Q7 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.

We welcome the steps taken or announced by the Trustees to enhance the effectiveness of their oversight, in particular:

- establishing a due process oversight committee
- additional procedures to monitor the effectiveness of IASB Board members
- engagement in reviewing the IASB's response to the global financial crisis.

Q8 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.

We believe that establishment of a robust, broad-based funding system that helps to ensure the independence and sustainability of the standard-setting process is critically important. It is a necessary step in establishing the legitimacy of the Foundation and the IASB in countries around the world. We therefore welcome the progress reported by the Trustees in January 2009.

We believe that the funding criteria established by the Trustees are best achieved by national or regional payment systems or levies. We therefore welcome the Trustees' ongoing commitment to assist in developing such systems.

Q9 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.

The agenda-setting process and setting of work priorities is a critical aspect of the development of IFRS and, accordingly, is of great interest to constituents. There is also a perception that the IASB's agenda is prioritised largely by reference to the MoU with the FASB which has caused concern among some constituents.

We acknowledge that certain steps have been taken to improve the agenda-setting process including:

- consultation via the 'IFRIC Update' publication on proposed IFRIC agenda decisions
- inclusion in some IASB due process document of questions on whether specific projects should be pursued
- a new structure of the SAC, which advises the IASB on its agenda and work plan.

Nonetheless, we believe that further progress needs to be made to enhance the transparency of the agenda-setting process and establish channels through which stakeholders can provide input and reactions. Moreover, we believe that the Trustees should reconsider whether they should assume greater responsibility for the agenda-setting process including powers to instruct the IASB to include or exclude specific projects. We do not view this as incompatible with maintaining the IASB's independence, provided that all technical decisions (including decisions on issuing any pronouncement or amendment) are reserved for that body.

Q10 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*.

In general we believe that the IASB's procedures as described in the *IASB Due Process Handbook* are sufficient. We recognize that extensive due process is time-consuming, but suggest that shortening the process (for example by reducing comment periods or eliminating steps) is inadvisable.

We also welcome the recent enhancements referred to in the question. We emphasize in particular the importance of demonstrating to stakeholders that their views have been considered and acted upon where appropriate. We therefore welcome the introduction of the feedback statement¹ on issuing important new pronouncements and hope that this aspect of the Board's due process will be developed further.

Whilst recognizing the challenges of performing a robust analysis of costs and benefits, we encourage the Trustees and the IASB to continue to develop this aspect of the due process procedures.

Q11 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?

We note that a fast-track process was used to issue the amendments to IAS 39 dealing with reclassifications of financial assets in October 2008 (amended further in November 2008). We offer no comment on whether a fast-track process was justified in that particular case, but note that those amendments have led to a disproportionate number of application problems (and have indeed created the need for the IASB to make more changes to clarify their original intentions). In our view this serves to emphasise the importance of adequate due process and the risks associated with urgent amendments.

We acknowledge that future situations may arise that call for an urgent response. Nonetheless we believe such situations should be very rare. Accordingly, although we see some advantages in having a protocol for a fast-track procedure, on balance we would prefer that any short-cuts in due process are implemented on an exception basis rather than being enshrined in the Constitution.

Standards Advisory Council

Q12 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?

We note that the Foundation has recently implemented a new structure for the SAC (of which our organization is a member). We believe that the new structure is a positive development and recommend that it is given an opportunity to bed down before re-considering these matters.

Q13 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?

We believe the SAC's current terms of reference are appropriate. Having said that, we may make suggestions for improvements when we have gained more experience of participating in SAC meetings and deliberations under the new SAC structure.

Other issues

Q14 Should the Trustees consider any other issues as part of this stage of their review of the Constitution?

We offer the following suggestions acknowledging that the Trustees might view them as matters for the IASB (in the context of its conceptual framework project and/or standards-level projects).

- *Complexity* - we perceive that many of the Foundation's and IASB's constituents are becoming increasingly concerned at the length and complexity of financial statements prepared in accordance with IFRS. We note that one or two of the IASB's current projects are aimed explicitly at reducing complexity. This is welcome but we believe there is a case for a separate exercise taking a broader view of complexity in financial reporting and the volume of disclosure included in financial reports.
- *Stewardship and the objectives of financial reporting* - we note that the IASB is currently developing a replacement for its current Conceptual Framework document that will include a revised objective of financial reporting. This objective and the objectives of the IASC Foundation are of course inter-linked - for example the Framework and the Constitution both refer to the user group and to 'economic decisions'. We therefore take this opportunity to reiterate our view (as expressed to the IASB and FASB in our letter of 3 November 2006) that 'stewardship' and 'accountability' should remain an objective of financial reporting and not a by-product of a resource allocation objective.