



Financial Reporting Council

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Tamara Oyre
Assistant Corporate Secretary
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30 Cannon Street
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By e-mail to: constitutionreview@iasb.org

13th March 2009

Dear Tamara

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

The Financial Reporting Council (FRC) is the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting and governance.

The FRC is a strong and committed supporter of the IASC Foundation and the IASB and welcomes the opportunity to comment on the Constitution Review proposals set out in the December 2008 consultation document. Our responses to the questions posed in the consultation document are set out in the appendix to this letter.

Our primary comment is that the Trustees should use the Review to strengthen and provide greater focus to improving the quality of financial reporting through a globally accepted set of accounting standards. We believe this should be the primary objective of the organisation. In particular, we consider that convergence of national accounting standards and IFRS should not be an objective of the Foundation, but rather taken into account as one of the means by which a set of high quality, globally accepted standards could be enhanced.

If you would like to discuss any of the comments made above, then please contact Ian Wright on 020 7492 2330 or me on 020 7492 2390.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Paul Boyle'.

Paul V Boyle
Chief Executive
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Questions for consideration

Objectives of the organisation

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?

FRC Response:

The FRC has a number of comments on the organisation's primary objective.

First, we are concerned that the current wording of the Constitution does not make the distinction between the organisation's primary objective and its supporting objectives. We think it should. In our view the convergence of national accounting standards and IFRS referred to in Section 2(d) of the Constitution should not be an objective but rather considered as one of the means by which a set of high-quality globally accepted accounting standards could be enhanced. In addition, any decisions to converge national accounting standards with IFRS rest with the relevant national authorities, not the IASC Foundation. Accordingly, we are in favour of the Constitution only making reference to the primary objective of the organisation, which – as a consequence of the above – should refer not to a "single" set of standards, but rather a "globally accepted set of high quality, understandable and enforceable accounting standards...". It may be appropriate to refer to supporting objectives in the Constitution but these may more logically feature in the strategic planning process of the organisation.

Second, there needs to be an alignment between the primary objective of the organisation and the objective of financial reporting as set out in the IASB's conceptual framework. In particular, we note that the IASB has recognised that along with decision-usefulness, financial reporting also plays an important role in demonstrating stewardship of resources by management. This should be reflected in the primary objective of the organisation.

Third, we fully support the capital markets focus of the organisation's primary objective. The FRC is aware that the current credit crisis has led to calls for the objectives of converging accounting standards and prudential rules to be aligned. In our view, such calls need to be resisted, as they do not take into account that financial reporting and regulatory reporting are seeking to satisfy two different objectives. The purpose of financial reporting is to portray a neutral (unbiased) view of economic reality for investors and other users with a need for financial information. The purpose of prudential regulation is intentionally biased towards protecting depositors (and policyholders) ahead of shareholders.

Finally, we agree that it is appropriate to take into account the special needs of small and medium-sized entities and those of entities in emerging economies in the context of the organisation's primary objective.

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?

FRC Response:

We fully support the importance of principle-based standard-setting. The UK has a long tradition of emphasising principle-based rather than rules-based accounting standards. However, it is not clear to us that there is a general understanding in the global community of what the Trustees mean exactly by the term 'principle-based' and how it will manifest itself in the standard-setting process. In our view, these issues are more properly dealt in the process used by Trustees to monitor and review the IASB's compliance with the Constitution, rather than in the document itself.

For those reasons we would suggest that any proposed reference to a principles-based approach in the Constitution should be kept as simple as possible. The wording of Section 2(a) of the Constitution could be amended to refer to: "a globally accepted set of high quality, understandable and enforceable standards, based on clear principles, that..."

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 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.

FRC Response:

In the short-term, the FRC believes that the IASB's remit should continue to be focused on financial reporting by private sector companies. In the longer term, however, we believe that the reach of the IASB's financial reporting standards should extend to not-for-profit entities.

The financial reporting needs of the public sector are being covered by the International Public Sector Accounting Standards Board (IPSASB). In our view, the emphasis for the public sector should be on the IASB forging stronger links with the IPSASB. This point should be specifically acknowledged in the Constitution making it clear for the need for the two boards to work more closely together and clarifying their respective roles and responsibilities.

Given the ambitions the Trustees have for developing a globally accepted set of high quality standards we are concerned that the achievement of that ambition will be put at risk if the IASB extends its remit now to cover not-for-profit entities, given the urgency and importance of delivering on its current work programme. But the Constitution could be amended now to make clear where the responsibility for not-for-profit entities lies in the longer-term.

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?

FRC Response:

We have partly addressed the issue of closer collaboration (with IPSASB) in our response to Question 3.

We agree that the Constitution should be amended to allow for closer collaboration with other bodies, where there is a clear and demonstrable benefit to the achievement of the organisation's primary objective. In our view, this should include the International Auditing and Assurance Standards Board (IAASB), given that body's objective to serve the public interest by setting high quality audit and assurance standards. That said, we believe that the primary focus on collaboration should remain that with national accounting standard-setting bodies and other official bodies concerned with standard-setting, including those dealing with valuation and actuarial standards. Partnerships and other forms of collaboration can often be particularly resource intensive and have the potential to distract rather than support and augment existing arrangements. Accordingly, we suggest the Trustees proceed with caution in creating expectations about greater collaboration with other bodies.

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.

FRC Response:

We suggest that Section 3 should be modified to reflect more accurately the creation and role of the Monitoring Board (MB), as announced by the Trustees on 29 January 2009.

We also offer the following comments about Part One of the Review:

- (a) In due course, the FRC believes that the membership of the MB should be extended to official global organisations with a wider range of responsibilities, such as the Financial Stability Forum (FSF). Membership will also need to be reviewed if the remit of the organisation is extended to cover not-for-profit entities and the public sector; and
- (b) The Memorandum of Understanding with the MB to underscore the independence of the IASCF and the IASB is welcomed. While we believe it is important for the organisation to be accountable and transparent that should not mean that it is subject to political interference or is unduly influenced by any particular stakeholder – especially on technical matters.

Trustees

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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?

FRC Response:

In our view, the current distribution is appropriate. As a matter of good practice, we would suggest that the distribution of trustees be reviewed as part of each review of the Constitution to ensure it remains appropriate.

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.

FRC Response:

We generally agree with the duties and powers as they are set out in Sections 13 and 15.

However, the FRC does have concerns on the effectiveness of how these duties and powers are discharged. Given recent experience with the credit crisis, in our view, the Trustees should have played a more active oversight role in challenging the IASB on whether its priorities and the application of its resources (as evidenced by its agenda) remained appropriate. Looking at the latest version of the IASB's work plan (dated 25 January 2009), the agenda is extensive and implies too high a level of activity for constituents to handle effectively, with 3 Discussion Papers (DPs), 11 Exposure Drafts (EDs), 12 new/amended IFRS, and the final chapters on Phase A of the IASB-FASB joint conceptual framework project all scheduled to be issued by the end of 2009. In our view, the Trustees should be considering the impact of this volume of activity on constituents and whether they can cope with it.

More generally on the issue of effectiveness, the Constitution is silent on evaluating the performance of the organisation. In particular, we believe it would be useful for the Trustees to articulate how they will assess the effectiveness of the IASB. While it may not be appropriate to set this out in the Constitution it should at least be referenced in that document.

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. (For an update on the funding status, see <http://www.iasb.org/About+Us/About+the+IASC+Foundation/Funding.htm>). 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.

FRC Response:

The FRC commends the Trustees for progressing the funding arrangements for the organisation. The FRC has played its part by raising a UK contribution through a levy on publicly traded companies. We also recognise that the Trustees are yet to secure a stable system of funding from the United States and we agree that this remains an imperative.

International Accounting Standards Board

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.

FRC Response:

In our view, periodic – perhaps annual – consultation with stakeholders on the IASB's agenda would be useful in promoting greater understanding about how the Board goes about setting its priorities and allocating its technical resources. The IASB's 'Due Process Handbook' (paragraph 59), already 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, but this is not always the case. We think it should be. We also believe that the Board should consult more widely on its priorities as part of discharging its accountability and in demonstrating that its activities are in the public interest. In our view, this would improve the agenda-setting process without compromising the IASB's independence in determining its technical agenda.

We are concerned that, at times, there is some confusion about the relationship between the Board's accountability and its independence in setting and pursuing its technical agenda. Independence we understand to mean that the Board can address financial reporting issues without being beholden to the specific interests or concerns of any particular stakeholder or group. Accountability comes with that right to independence over its technical activities. That is, the Board is obliged to demonstrate that in discharging its obligations to serve the public interest it has done so in an independent and even-handed manner. In doing so, the Board should be subject to a high degree of accountability to ensure that its actions and the decisions it reaches on financial reporting standards are evidence-based and consistent with the objective of developing high quality standards.

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.

FRC Response:

We are generally supportive of the due process employed by IASB. In particular, we welcome the enhancements made by the Trustees to introduce feedback statements, effects analyses and post-implementation reviews, although there, as yet, few practical examples of the enhancements on which to judge the effectiveness of their introduction.

We do, however, believe that the due process could be applied more judiciously in supporting the assessment of the impact of developing financial reporting standards at each key milestone in the process. Staff from the UK Accounting Standards Board (ASB) are working with their counterparts in the IASB to develop a proposed framework for assessing

that impact. We believe this will serve to strengthen the evidence-based nature of the standard-setting process and provide a clearer link between the Board's due process and in demonstrating it has discharged its obligation to serve the public interest.

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?

FRC Response:

We support the notion of a separate 'fast track' procedure for dealing with changes to IFRSs in cases of great urgency, which should happen only in rare circumstances and where there is a clear justification. But while we agree that there may be a case to shorten the due process under these circumstances it should not be dispensed with entirely. To do so, we believe, would seriously undermine the Board's credibility and introduce greater risk of fatal flaws in the standard issued.

We do not have any specific comments on the elements that should form part of a fast track procedure except to say they should not deviate too greatly from the elements in the normal due process. We also note that the National Standard Setters in their November 2008 communiqué offered to assist the IASB in developing an effective due process to apply in these circumstances. National Standard Setters can play an important role in stimulating debate among national constituents, holding round tables on technical issues and acting as the focal point for comments – again supporting our contention that the fast track process should not depart significantly from what should happen under normal circumstances. We would strongly encourage the Trustees to take up that offer.

Standards Advisory Council

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?

FRC Response:

It is difficult for us to comment on the SAC given that the first meeting under the new Chair only took place in February 2009 and one of the issues it had on the agenda was to consider how it plans to fulfil its mandate. In principle, we have no concerns with the current operating procedures as set out in the discussion document. The more important aspect is how the SAC operates in practice.

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?

FRC Response:

The SAC's terms of reference appear to be appropriate and we think it is appropriate for the Trustees to monitor and review the effectiveness of the SAC periodically.

Other issues

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

FRC Response:

The FRC would like to raise the following issues which we believe are particularly relevant to the Trustee's Review:

- (a) The current Constitution states that "Members of the IASB shall be appoint for a term of up to five year, renewable once". We believe that the document should make it clear that renewal is not automatic; and
- (b) The IASB's due process in Section 31 should include a requirement for the IASB to either (i) identify any problems with a current IFRS and/or (ii) demonstrate the potential to significantly improve the quality of a standard before embarking on a project to revise or amend the standard. This is consistent with our comment in Question 10 that the IASB should assess impacts at each stage of the process.