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Dear Mr. Zalm

Re.: Discussion Document – Review of the Constitution: Identifying Issues for Part 2 of the Review

We appreciate the opportunity to comment on the discussion document mentioned above and would like to submit our comments as follows:

General Matters: Pace of change, quality and complexity of standards

The financial crisis has revealed the necessity to remedy some weaknesses in the current standards which the Board has had to attend to, i.e. accounting for off-balance sheet vehicles, disclosures and reclassification of certain financial instruments and fair value measurements, especially in inactive markets. However, the pace of change can and should not continue. Instead, each standard must be robust so as to remain valid for an extended period and that subsequent changes should be kept to an absolute minimum. In our view, this is essential if the integrity of IFRSs is not to be undermined. In particular, it is a nuisance when a standard or an interpretation has to be amended again shortly after its publication as it has been the case recently or is intended for IFRS 7 and IFRIC 16. Another problem we would like to mention in this context is IFRS 3 (revised 2008): There have been subsequent consequential amendments twice already in connection with this revised standard. Firstly, the Board proposed amendments to the scope of IFRS 2 in the annual improvements project 2008. Secondly, the Board currently proposes amendments to IFRIC 9.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB CPA;
Manfred Hamann, RA

Another topic which concerns us is the way the convergence project of IFRS and US GAAP is promoted. In general, we support the aim of IASB and FASB to achieve convergence. However, it has to be kept in mind that convergence is not an end in itself but should result in global high quality standards. For example, in case of the Exposure Draft of Proposed Amendments to IAS 23 Borrowing Costs, in our opinion, the strengths and weaknesses of the two approaches under consideration (immediate expensing of borrowing costs to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset versus their capitalisation) have not been analysed in appropriate depth. The former IAS 23 already enabled entities with a second listing in the US to capitalise borrowing costs and therefore avoided a reconciliation pertaining to this issue. From this point of view, there was no necessity for more convergence. This is true all the more as some differences between US GAAP and IFRS remained. However, the deletion of the option was a burden for those entities that wanted to continue expensing borrowing costs. We believe that this is an example where an existing standard has been amended hastily with the excuse of convergence whereas in fact there was no need for a change.

The cost-factor should not be underestimated, nor the practicalities of application. These relate not only to those entities applying the standards, but also to their auditors and other interested parties. Among others, considerable resources may be required to train staff and update accounting systems. We would, therefore, like to suggest a further amendment to the objectives which would specify that development of robust standards is to remain a continuing priority, and specifically that consideration must be given to achieving an appropriate balance between the importance of individual changes and the resultant costs to all parties from their application. We would like to suggest that the Trustees ensure that the pace at which new standards are issued and existing standards revised is carefully monitored in order that reliability and comparability within financial reporting, and thus the reputation of the IFRSs, is not disadvantaged.

Furthermore, we are still concerned that the standards in all areas are becoming increasingly complex and difficult to understand. There is a danger that specific complexities may not be fully appreciated or understood and that this could lead to incorrect application. In this context also the increased use of fair value measurements has to be mentioned. Additionally, the still increasing complexity of language impairs the quality of implementation. This is true all the more as IFRS are international standards, which have to be translated into other languages.

Moreover, we believe that amendments and new standards respectively should not be implemented before a conceptually sound solution exists and thorough analyses and intensive discussions within the community have been conducted. This would prevent the Board adopting a piecemeal approach rather than implementing comprehensive solutions in one step. Especially, we are not supportive of the Board accelerating its projects with respect to the pending changes in the composition of the Board because there is a danger that this results in hasty decisions as well as artificial fragmentation of projects that actually are intrinsically tied to each other. Examples of piecemeal approaches are the projects on the Conceptual Framework, Financial Statement Presentation, Business Combinations and Post-Employment Benefits.

Objectives of the organisation

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?

In our view, 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' remains appropriate. However, we believe that it is not helpful to link the SME issue with emerging economies since, apart from educational issues, it is questionable whether they have many issues in common.

Moreover, we would like to accentuate the importance of high quality standards which are sufficiently clear and understandable. Clarity and understandability must be enhanced because otherwise, ambiguities inevitably result in diversity

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in practice and hinder consistent application. In addition, an improved quality of the standards will conduce to their auditability and enforceability.

We have identified the following standards which would have to be ameliorated in particular: IFRS 3 is not clear in how the fair value measurement of identifiable intangible assets acquired has to be carried out. In IAS 38 especially the distinction between the research and the development phase is ambiguous. With regard to further details on such weaknesses in IFRS we refer to the last Annual Activity Report of the German Financial Reporting Review Panel.

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?

We support the proposal to make specific reference to the emphasis on a principle-based approach in the Constitution.

As already mentioned in our comment letter to the IASCF on the Constitution Review dated 13 February 2004, we consider it important that the standards are, as far as possible, sensitive to the legal impediments and economical particularities of the jurisdictions in which they are to be applied. Therefore, we support principles-based standards promulgated by the IASB, as they provide the advantages of consistency and transparency in financial reporting whilst allowing for their application in a variety of situations and circumstances and at the same time prevent the need for undue regulatory intervention in the form of detailed rules that would have to be applied in every conceivable situation. Furthermore, principles-based standards are more suitable for the prevention of financial engineering around rules-based requirements and thus contribute to decision-useful financial statements.

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 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

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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 are of the opinion that the objectives of public sector financial statements and financial statements for not-for-profit entities depart from private sector financial statements. Especially, the objective of accountability is emphasised, as compared with the IASB's Framework. Furthermore, there are particularities which have to be considered and might result in special requirements, e.g. in the context of impairment of non-cash generating assets and cash basis accounting. Therefore, we believe that a separate standard setter will better be able to accommodate these distinctivenesses. In our view, the IPSAS Board preeminently meets these demands up to now. In addition, it might not be feasible, given the current workload of the IASB, to attend to these additional tasks without considerable extra resources. If the Board developed standards for not-for-profit entities and the public sector, there is a danger that it would detract from the Board's ability to achieve its objectives pertaining to its current focus which is primarily on financial reporting by private sector companies.

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?

We support collaboration with accounting standard-setting bodies and other organisations, whose objectives are compatible with the IASC Foundation's objectives where there is a need for it. However, we would appreciate the Trustees ensuring that no single national standard-setting body and organisation respectively might be able to dominate the due process of the IASB.

Governance of the organisation

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

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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 refer to our comment letter on Part I of the Review of the Constitution: Public Accountability and the Composition of the IASB, Proposals for Change dated 3 September 2008, whereby the governance of the IASCF should lie with the Trustees and the responsibilities of the Trustees remain unaltered (apart from those already proposed in the context of the establishment of the Monitoring Group). In particular, the annual review of the IASB's strategy and effectiveness, including consideration of its agenda, should continue to be the Trustees' responsibility.

We noticed the publication of the "Memorandum of Understanding to Strengthen the Institutional Framework of the International Accounting Standards Committee Foundation" (MoU) on 29 January 2009. Against this background, we believe that there is a need to include sufficiently clear arrangements in the Constitution on competences, responsibilities and the status of the new Monitoring Board in relation to the IASCF.

In our view, the Memorandum of Understanding exceeds the boundaries as set out in the sections of the Constitution on the creation of a Monitoring Board: According to section 19(a) the Monitoring Board is responsible for approving the appointment of Trustees. However, the Memorandum of Understanding stipulates in Article III.8.E. that, in addition, even the nominated Chair of the Trustees is subject to the approval of the Monitoring Board. This goes beyond the scope of the proposals as discussed in the context of Part I of the Review of the Constitution.

We would have appreciated the submission of the Memorandum of Understanding for public consultation and refer to our comment letter on Part I of the Review of the Constitution.

Trustees

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?

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We believe that a fixed distribution is appropriate in principle. However, we are not convinced that the Constitution's requirement to have six members from North America (para. 6) is really conducive. In our view, there is a danger that it could lead to a one-country dominance in the Trustee's composition. As several countries in Latin America are moving towards the adoption of IFRS, we suggest that the Constitution should refer to six Trustees appointed from the Americas instead. We refer to our comment letter on Part I of the Constitution Review dated 3 September 2008 mentioned above, where we submitted a similar proposal concerning the geographical distribution of the IASB members.

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.

As already mentioned in our comment letter to the IASCF on the Review of the Constitution dated 25 February 2005, we would prefer the deletion of paragraph 15(j), stating that the Trustees shall “foster and review the development of educational programmes and materials...”. In our view, this requirement might ultimately lead to the creation of a second interpretation body in addition to IFRIC. The oversight role of the IASC Foundation should ensure that such an additional interpretation body cannot be established.

A further issue that arises with respect to educational programmes relates to the influence of national legal issues on the application of IFRS in practice. For example, an understanding of contract law in a particular jurisdiction to determine the economic consequences of a particular sales contract is a prerequisite for the appropriate application of IFRS on revenue recognition in practice. Another example is the need to understand the intricacies of the tax system within a particular jurisdiction to determine the appropriate application of IFRS on the accounting treatment of taxes (especially with respect to deferred taxes). Educational programmes at an international level cannot address these kinds of issues.

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. (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.

We support the efforts of the Trustees towards the establishment of a broad-based funding system that helps ensure the independence and sustainability of the standard-setting process. We believe that these aims can be achieved by listing fees, for example.

International Accounting Standards Board

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.

In our view, the Constitution should continue to ensure the IASB 'full discretion in developing and pursuing its technical agenda'. As already mentioned in our comment letter to the IASCF on the Constitution Review dated 13 February 2004, the IASB work programme, its priorities and convergence aspects should be extensively debated and should include the involvement of all major stakeholders. We believe that the Constitution should warrant that no single stakeholder dominates the work programme and the priorities. Instead, all those countries who actually adopted IFRS and thereby acquired practical experiences should be in the position to exert decisive influence. This is true all the more as in the past the IASB's work programme has been overly influenced

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by the convergence project with the FASB. As already mentioned, we believe that this frequently leads to disadvantages for other constituents.

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.

Concerning the IASB's due process, we wish to point to the fact that situations have arisen where a clear majority of commentators expressed serious concerns about a proposed standard but their comments were rejected on the basis that they raise no new arguments and have already been considered by the IASB during the development of the proposed standard. Examples of such situations are the revisions to IFRS 3 and IAS 27 (choice of an economic entity model) and to IAS 23 (elimination of the expense option). The fact that arguments are raised by a substantial majority of commentators in all stages of the standard setting process, in itself, should oblige the Board to discuss the concerns again and to reconsider the impact assessment and needs analysis in order to assess whether all practical implications have been appropriately considered. Instead, the Board sometimes seems to follow convergence as an end in itself, which it definitely is not, by neglecting even technically convincing arguments supported by the majority of commentators. In this context, we welcome the introduction of feedback statements as they enhance transparency.

We are concerned that IASB's recent discussion papers tended to be more in the nature of position papers focusing on the Board's intended and predetermined way forward rather than discussing possible solutions and asking for input on the various options. Examples are the Discussion Papers on Insurance Contracts, Fair Value Measurements, Reducing Complexity in Reporting Financial Instruments, Revenue Recognition in Contracts with Customers and Financial Statement Presentation. We believe that discussion papers should address all important issues and possible ways forward in broader terms, enabling commentators to engage in a comprehensive and more conceptual debate of the issues.

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Because the analysis of discussion papers necessitates an intensive examination and multi-step consultations, we would appreciate the Board providing for a comment period of at least 6 months in future. In our opinion, a short comment period does not add to an effective due process. This is especially true when the paper is issued at the turn of the year, when many constituents are concerned with drawing up financial statements. As an international standard setter the IASB will appreciate that translation difficulties also need to be discussed in non-English speaking countries and that this will require additional time.

Pursuant to paragraph 31(f) of the Constitution, the Board need only consider undertaking field tests. According to the “comply or explain” requirement of paragraph 31(g) the Board would need to give reasons when it did not carry out field tests for a certain standard. However, we consider it highly desirable that field tests be made compulsory for those proposed standards and interpretations which are presumed to result in significant changes to accounting practice, or have been subject to controversial discussions during the standard setting process. In such cases the performance of field tests should not be at the discretion of the Board. This would help the board to pre-empt contentions that the Board's standards are too theoretical or “intellectually rigorous”. We would also advise transparency in respect of the process of selection of candidates to carry out field tests.

In some cases, we have concerns whether the procedures in respect of a re-exposure of standards and interpretations are appropriate. We refer to the proceeding chosen for IFRIC 18 Transfers of Assets from Customers, where there was no re-exposure despite of the fact that the IFRIC acknowledged that the changes made to D24 Customer Contributions were significant. Instead, the IFRIC posted the near-final draft of the Interpretation on the website for a longer than normal period. However, near-final drafts are available to IASB subscribers only, but not to all constituents. In our view, there is a lack of transparency in respect of the procedures applicable to a re-exposure of standards and interpretations.

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?

In general, a ‘fast track’ procedure is problematical because there is a danger that such a procedure might lead to an overly extensive usage, i.e. not only in

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cases of great urgency. Furthermore a 'fast track' procedure will increase the risk of error.

Nevertheless, in our view, there is a necessity for a 'fast track' procedure in certain circumstances, as for example the financial crisis. However, we suggest the following preconditions for its use:

- Existence of unique and exceptional circumstances;
- As far as possible, involvement of all major groups of constituents concerned in the course of the shortened due process;
- Approval by the Trustees and the SAC of (a) the existence of unique and exceptional circumstances as well as (b) the necessity for the use of the specific 'fast track' procedure that is proposed in the respective situation.

Standards Advisory Council

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?

With the exception of our answer to question 13 we are not aware of any issues that need to be solved in the context of the SAC.

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?

In order to strengthen the SAC we suggest making use of an operating procedure described in the terms of reference for the SAC more frequently: At the meeting of the SAC, there should be formal polls to demonstrate to the IASB the extent of support within the SAC for a particular point of view. If the IASB takes a different position, feedback should be given at the next meeting of the SAC on the reasons for the IASB's decision.

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Other issues

Question 14

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

We do not have any other comments.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Klaus-Peter Naumann
Chief Executive Officer

Norbert Breker
Technical Director
Accounting and Auditing