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Dear Mr Zalm

**Review of the IASC Foundation Constitution:
Public Accountability and the Composition of the IASB - Proposals for Change**

Deloitte Touche Tohmatsu is pleased to provide comments to the IASC Foundation Trustees on their proposals for changes to the IASC Foundation Constitution to enhance the public accountability of the IASC Foundation and for changes to the composition of the International Accounting Standards Board issued in July 2008.

We acknowledge that the IASCF Trustees are facing difficult challenges, not just in terms of the operation of the IASC Foundation and the IASB, but also demonstrating to each of its constituent groups that the structure is fair and unbiased. Recent developments have demonstrated an increasing urgency to these matters. In the light of such challenges, we believe the Trustees have put forward reasonable proposals for change which reflect many of the geopolitical realities of the expectations for change. As such, we support the Trustees' intentions in making their proposals.

While we appreciate that the IASCF Trustees' attention in these proposals is enhancing the governance and public accountability of the IASC Foundation and the IASB, we wish to reiterate our view that an adequate independent funding regime is a critical component of ensuring the success of any such enhancement. We encourage the Trustees to resolve this issue as quickly as possible, potentially in consultation with members of the proposed monitoring group.

We believe that in a number of areas the need for urgent action has meant that the Trustees may not have developed fully the detailed operations of the revised structure, or at least have not articulated these clearly in the proposals. Consequently, they are potentially ambiguous. Our general comments on each of the proposals are summarised below.

We support the creation of a monitoring group as a way of creating a direct link between the IASC Foundation and very senior levels of official institutions with a legitimate interest in accounting standard-setting and transparency in financial reporting. However, the role of the monitoring group should be more clearly defined than it is in the discussion document. We would prefer to see the monitoring group's role expressed explicitly as a responsibility to monitor the IASC Foundation Trustees' oversight of the Foundation and the International Accounting Standards Board and related standard-setting activities.

We agree that the monitoring group should approve appointments of Trustees to the IASC Foundation; however, we recommend that the IASCF Constitution should separate the search for and selection of those individuals from their appointment. We see this approach as more consistent with 'monitoring' the Trustees' oversight of the IASC Foundation than the proposals in the Discussion Document.

We agree that the monitoring group's primary purpose should be to monitor the Trustees' governance of the IASC Foundation and that this oversight should involve meetings with the Trustees, sub-committees of the Trustees, the Chairman of the Trustees and other senior figures in the organisation. However, we recommend greater clarity be given about the purpose of such meetings, because some might see such access as potentially compromising the independence of the standard-setting functions of the IASB.

We believe that the IASC Foundation Trustees have the opportunity to strengthen the IASB's independence and legitimacy. We encourage the Trustees to review carefully the role of the monitoring group to ensure that any opportunities for effective oversight of the Foundation and IASB are optimised.

With respect to the proposals affecting the IASB directly, we are not inclined to support increasing the size of the IASB from 14 to 16 members, but are willing to support such an increase to accommodate more part-time members. We do not believe that the Trustees have presented a convincing case to increase the size of the IASB and are concerned that the current size of 14 members is at the extreme upper end of operational efficiency. Nor do we support the introduction of any geographical formulation, quotas or other such limits. We support most strongly the unambiguous principle in the Constitution, paragraph 20, as it is currently formulated and do not believe an adequate case has been made for the changes as the best way of achieving this principle.

We support the flexibility in the Constitution on the matter of part-time membership of the IASB. We think that there should always be at least one part-time member. In our experience, the practical knowledge brought to a professional standard-setter by those who work in business is invaluable.

Finally, we regret that the Trustees' proposals were exposed with such a comparatively short comment period, especially given the undertaking at the March 2008 Trustees' meeting that these proposals would be issued with a 90-day comment period.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely

A handwritten signature in black ink, appearing to be 'AP', with a long horizontal stroke extending to the left.

Alain Pons
Global Audit Leader

Appendix

Responses to the Questions posed in the Invitation to Comment

Q1 Do you support the creation of a link to a Monitoring Group in order to create a direct link of public accountability to official institutions?

We support the creation of a monitoring group as a way of creating a direct link between the IASC Foundation and very senior members of official institutions with a legitimate interest in accounting standard-setting and transparency in financial reporting. The creation of such a group is a necessary component for ensuring broad acceptance of IFRS worldwide.

We see the creation of a monitoring group as a mechanism for providing a further degree of assurance that the already reasonably robust oversight procedures employed by the Trustees are operating efficiently and effectively and in the global public interest of all IASB constituents.

However, we have some concerns, elaborated in our responses to subsequent questions, about the terms of reference for and the operations of the monitoring group. Agreeing to the creation of a monitoring group without knowing exactly what its powers or terms of reference are to be, and where within (or out-with) the governance system of the IASC Foundation it is to fit would represent a 'leap of faith' on behalf of the IFRS community.

The Trustees' proposals are ambiguous and internally inconsistent as regards the status of the monitoring group. It is stated that the monitoring group would not be appointed by the Trustees, and that it would constitute an "independent group" (background materials, paragraph 16), i.e., it would not be part of the governance of the IASC Foundation. Yet, a significant amount of the proposed changes to the Constitution seem to imply that the monitoring group would be part of the governance structure of the IASC Foundation; and another in which it is not. We provide some of the examples of this contradiction in our response to Question 2b.

Q2 The proposals contemplate a Monitoring Group comprising representatives of seven public authorities and international organisations with a link to public authorities. While recognising that the Monitoring Group is an autonomous body, the Trustees would welcome comments regarding the Monitoring Group's membership and whether other organisations accountable to public authorities and with an interest in the functioning of capital and other financial markets should be considered for membership.

a) Size and membership

With the exception that it approves appointments to the IASC Foundation's Trustees, the monitoring group should not be a decision-making body. Its primary purpose is stated to be the monitoring of the IASCF Trustees' oversight responsibilities detailed in the IASCF Constitution, in particular those in Sections 13 and 15. As such, we see no overriding requirement for the monitoring group to be restricted to a given size, except that it should be able to operate efficiently. Rather, its membership should reflect its purpose: to provide a link between the IASC Foundation and very senior members of international organisations with a link to public authorities with a legitimate interest in accounting standard-setting and transparency in financial reporting.

We find the proposed composition of the monitoring group difficult to understand from a principles point of view. Some of the members are directly responsible for the regulation of financial reporting standards; others regulate securities markets; some do both and some do neither. The background in the proposals does not state the guiding principles governing the proposed monitoring group. We think that there should be clear guiding principles (criteria) for membership of the monitoring group and encourage the Trustees to establish them. Without clearly articulated criteria for membership, we are unable to reach a conclusion on the proposed membership of the monitoring group and we cannot see how the Trustees can do so either. Such guiding principles will be needed in the future because, as markets and economies develop, the monitoring group will inevitably need to be re-balanced.

In our view, the principles should include that membership of the monitoring group should represent very senior members of international organisations with a link to public authorities with a legitimate interest in accounting standard-setting and transparency in financial reporting (including such organisations as the Basel Committee on Banking Supervision and the Financial Stability Forum); and that such membership may not be delegated.

b) Relationship with the IASC Foundation

The proposals with respect to the monitoring group and its relationship with the IASC Foundation are confusing and, to some extent, contradictory. Paragraph 13 of the background materials states that 'a Monitoring Group would be created.' Paragraph 14 states that the 'Monitoring Group would establish a group outside the IASC Foundation's organisational framework [and] would establish its own charter and operational procedures.' Finally, paragraph 16 reiterates that the monitoring group would be 'an independent group'. If that is the case, we fail to understand the purpose of the proposed Constitution paragraphs 18-23, because these paragraphs seem to go beyond setting out 'a formal recognition of the Monitoring Group within the IASC Foundation's Constitution and...the basis for establishing a link between the Trustees and the Monitoring Group' (background materials, paragraph 14). Indeed, the proposed Constitution amendments, particularly proposed paragraph 19, seem to be the fundamental provisions of a 'charter' or terms of reference of the monitoring group.

Furthermore, by enshrining the membership of this 'independent group' in the IASC Foundation's Constitution (proposed Constitution paragraph 21), the Trustees imply that they do have a say in the composition of the monitoring group (otherwise it would not need to mention the membership in the IASC Foundation's Constitution); yet proposed Constitution paragraph 22 states that the 'Monitoring Group shall reconsider its composition from time to time...'. Presumably, if the monitoring group decided that, as a result of such a review a change in composition was necessary, the IASC Foundation would be obliged to amend the IASC Foundation Constitution, even though it could not influence the composition of the monitoring group (because that group is independent of the IASC Foundation). This lack of clarity as to the relationship between the IASC Foundation and the proposed monitoring group will only create uncertainty among constituents.

We would prefer to limit the changes to the Constitution to an acknowledgement of the existence and role of the monitoring group and leave operational aspects to documents outside the Constitution. This would enable the monitoring group and the IASC Foundation to make changes more quickly in the light of experience, without invoking an amendment of the IASC Foundation's Constitution.

Q3 The Trustees will remain the body primarily responsible for the governance of the organisation and the oversight of the IASB. Their responsibility to a Monitoring Group will enable regulatory and other authorities responsible for the adoption of IFRSs to review the Trustees' fulfilment of their constitutional duties. Does the formulation of the Monitoring Group's mandate and the Trustees' reporting responsibilities, as described in the proposed Section 19, appropriately provide that link, while maintaining the operational independence of the IASC Foundation and the IASB?

We have several reservations about parts of the IASCF Trustees' proposals in this area. We do not agree that 'operational independence' is the issue at stake; the issue at stake is the independence of the standard-setting activities of the IASB. In our view, as explained below, parts of the proposed changes to the IASCF Constitution could compromise that independence.

a) Proposed Constitution paragraphs 5 and 19(a)

We agree that the monitoring group be given the right to approve appointments of Trustees to the IASC Foundation. However, we think that the IASCF Constitution should separate the responsibilities to search for and select those individuals from their appointment. As explained further in our response to Question 4, we see great benefit from the involvement of the Trustee Appointments Advisory Group in these matters. As such, we would wish to see the Constitution, paragraph 5, set out the following principles:

- a) The Trustees shall be responsible for the search and the recommendation of candidates to fill Trustee vacancies, however arising. In making such recommendations, the Trustees shall be bound by the criteria set out in Sections 6 and 7 and in particular shall undertake mutual consultation with international organisations as set out in Section 7. This activity shall involve the Trustee Appointments Advisory Group to ensure that the requirements of the Constitution are met. The monitoring group may participate in this process by proposing candidates, but any such candidates shall be assessed on equal terms as those proposed from other sources.
- b) The monitoring group shall be responsible for approving the Trustees' recommendations for appointment or reappointment to the IASC Foundation. In approving such recommendations, the monitoring group shall ensure that the Trustees have administered the nomination and selection process in accordance with the IASCF Constitution, in particular the criteria set out in paragraphs 6 and 7; and have exercised reasonable due diligence in assessing candidates and making recommendations for appointment.

We see this approach as being more consistent with 'monitoring' the Trustees' oversight of the IASC Foundation than the ambiguous description in proposed in the Discussion Document. Indeed, we question whether, beyond monitoring the process and approving appointment to the IASCF Trustees, any additional comment needs to be made about the monitoring group's involvement in this area.

b) Proposed Constitution paragraph 19(b)

We see this as the guiding principle of the monitoring group and support this proposal. In addition, we agree that the Trustees should report on their oversight activities on an annual basis. We

believe that this report should be included in the IASC Foundation's annual report (consistently with the inclusion of the report on Trustees' oversight activities currently).

c) Proposed Constitution paragraph 19(c)

Part of this sub-paragraph causes us concern and we do not support its inclusion in the IASCF Constitution in its current form.

We agree that the monitoring group's primary purpose is to monitor the Trustees' governance of the IASC Foundation and that it is entirely appropriate that this involve meetings with the Trustees, sub-committees of the Trustees or with the Chairman of the Trustees alone as necessary. We agree that those meetings may address any aspect of the IASC Foundation's operations and issues relating to governance, funding and oversight of the IASB.

However, we are more concerned about the proposal that the monitoring group should have direct access to the IASB Chairman to discuss any 'any area of work' of the IASB and the 'proposed resolution of issues that the Monitoring Group has referred for timely consideration by the...IASB'. If access to the IASB Chairman is intended to provide linkage with official institutions to discuss the IASB's standard-setting activities generally, then we support the proposal. For example, we understand that the monitoring group might wish to raise global systemic issues with the IASB Chairman, as part of the IASB's agenda-setting process. We think this would be appropriate. However, if such access is used as a means to challenge the technical decisions reached by the IASB, we would not support the proposal.

Consequently, we recommend that the IASC Foundation Trustees clarify proposed paragraph 19(c) to describe clearly the terms of contacts between the monitoring group and the IASB Chairman. Without adequate safeguards, access by the monitoring group to the IASB Chairman could be seen as interference in the independence of the standard-setting functions of the IASB. We note that nowhere in the Discussion Document do the Trustees highlight, explain or seek to defend this proposal.

Q4 Given the proposed creation of a Monitoring Group, would there be a continued need for the Trustee Appointments Advisory Group in the selection of Trustees? If so, what should be the role and composition of the Trustees Appointments Advisory Group?

We think that the creation of the monitoring group, does not necessarily remove the need for the Trustees Appointments Advisory Group. We would encourage the IASCF Trustees to retain the TAAG as it provides a forum in which nominations from other sources may be received and considered before any recommendations for appointment are made to the monitoring group.

The role of the TAAG should continue to be as it is now—again the clearly articulated principle that the TAAG assists the Trustees “in discharging their responsibility for nominating and appointing highly qualified and interested individuals as Trustees” have worked well and have much to recommend them. The membership should include those areas which have a legitimate interest in accounting standard-setting, and could help in identifying candidates for the Trustees but which are not entities with ‘public accountability’. Such entities could also help to fill the lacuna in the monitoring group for a proper representation of developing economies.

Additional comments related to the Monitoring Group proposal.

Proposed Constitution paragraph 18

The proposed Constitution paragraph 18 states that a “Memorandum of Understanding will be agreed between the Monitoring Group and the Trustees describing the interaction of the Monitoring Group and the Trustees. This Memorandum will be made available to the public.” Paragraph 16 of the background materials states that the Trustees ‘would recommend’ public consultation on the Memorandum of Understanding before its completion. We believe public consultation should occur, given the concern many constituents have regarding the interaction between the monitoring group and the IASC Foundation. Such public consultation should provide for a realistic comment period, consistent with the IASB’s due process requirements. We recommend that this consultation takes place before the Trustees agree to any amendments to the IASCF Constitution with respect to the monitoring group.

On a related matter, paragraph 15 of the background materials state that the monitoring group ‘would establish its own charter’. Again, we urge the Trustees to ensure that any charter is subjected to public consultation before the IASCF Constitution is amended.

Q5 Do you support the principle behind expanding the IASB's membership to 16 members in order to ensure its diversity, its ability to consult, liaise and communicate properly across the world, and its legitimacy?

We are not inclined to support increasing the size of the IASB from 14 to 16 members, but are prepared to support such an increase to accommodate more part-time members. We think that the IASC Foundation Trustees are attempting to respond to two linked but distinct criticisms of the IASB and trying to fix them together.

The principal role of the IASB is to write International Financial Reporting Standards. However, communication with constituents is also important. If they wished to accommodate all the demands for contact with constituents, the IASB would have to expand significantly. We do not think this is the optimum solution. We suggest an alternative approach to communicating with constituents later in this section.

The second issue the Trustees are attempting to address is the balance of the IASB, something that is equally important. In our view, the Board should have a balance of both professional background and geography, a balance already implied by the IASC Foundation Constitution, paragraph 20. Rather than seek to require geographic distribution of IASB members, we would encourage the Trustees to focus on identifying the most qualified individuals from all parts of the world with diverse backgrounds including public accounting; preparers; professional users; and academics. We would urge the Trustees to amend the Constitution to require that two or three IASB members have a "majority [perhaps 'substantial majority'] of their career as a financial analyst, lending decision maker, portfolio manager or other similar user of financial statements".

We do not believe that the Trustees have presented a convincing case to increase the size of the IASB from 14 to 16 members. In 1999, the IASC's Strategy Working Party's final report apologised for recommending a board of 14:

While some might believe that a smaller sized Board would be preferable in terms of certain aspects of operating efficiency, the Working Party has come to this number because of the need to have enough people to work closely with national standard setters and the need for involvement of individuals with diverse experience. [Paragraph 36]

A Board of 14 is already large and several commentators at the 19 June 2008 public roundtables on the IASCF Constitution and at the June 2008 Standards Advisory Council meeting expressed real concerns that the current size of 14 members was near the extreme upper end of operational efficiency. We share those concerns, but are prepared to support an increase to 16 members in order to accommodate more part-time members.

We disagree with the Trustees' reasons stated in paragraph 25 of the Discussion Document that additional members are required to ensure its diversity, its ability to consult, liaise and communicate properly across the world, and its legitimacy. The Trustees have provided no real evidence that current Board of 13 members has had problems consulting, liaising, or communicating with its constituents. In our view, the IASB's programme of consultation, liaison and communication with their constituents is already comprehensive.

More importantly, we are not convinced that size ensures legitimacy. Legitimacy is ensured by the quality of the Board members—measured by how well they serve the public interest. The quality

of the Board members stems from the unimpeachable character of the appointment process undertaken by the Trustees and that the resulting Board members are, and are seen to be, people who embody the characteristics described in the Annex to the IASCF Constitution. Finally, legitimacy for constituents means that they:

- believe in and respect the fairness and openness of the process
- believe in and respect the underlying principles on which the IASB builds its standards, and
- agree to the IASB's final authority with respect to International Financial Reporting Standards.

Underpinning this understanding of legitimacy is that the IASB's due process must ensure opportunity for broad public consultation. IASB must publicly explain and justify its conclusions in light of the comments it received on its proposals and demonstrate that they serve the global public interest. Those responsible for governance of the IASB must ensure that the process is working.

We also disagree with the assertion of the Trustees that they "do not believe that expanding the IASB's membership will impair the IASB's ability to make decisions in a timely fashion, but will benefit the IASB in its ability to consult interested parties throughout the world." We believe that in such large executive groups, sub-groups inevitably form, undermining the collective decision-making of the Board. Such a result is in no one's best interests.

An alternative approach to communicating with constituents

We suggest an alternative approach to the Trustees' concerns about the IASB's consultation, liaison and communication activities. This would involve the IASCF Trustees appointing *non-voting* Board members specifically charged with such activities. They would be able to represent the IASB's views to constituents as well as transmitting the views of constituents back to the full Board in an objective manner. They would fulfil a vital role of listening to individual constituents and groups of constituents, ensuring that their concerns are understood and communicated faithfully to the IASB in and outside of Board meetings. They would also be charged with reporting back to these constituents on what actions the IASB intends to take. This plenipotentiary role is untried in standard-setting; but then so much of what the IASB has achieved since 2001 was achieved in untried circumstances. We urge the IASCF Foundation Trustees to consider this alternative approach.

Q6 Do you agree with the geographical formulation suggested by the Trustees?

No. Even if the size of the IASB is increased, we oppose the introduction of any geographical formulation, quotas or other such limits. A fixed geographical requirement could create more problems than it is intended to solve. Again, we support most strongly the clear, unambiguous principle in the Constitution, paragraph 20, as it is currently formulated:

The selection of members of the IASB shall not be based on geographical criteria, but the Trustees shall ensure that the IASB is not dominated by any particular constituency or geographical interest.

In doing so, we also support most strongly the 'Criteria for IASB Members' set out in the Annex to the Constitution, which criteria we would not seek to change.

If the Trustees are confident that 'they could identify qualified candidates...in line with the constitutional emphasis on professional competence, practical experience and diversity of professional backgrounds' (background materials, paragraph 27), they should have no need for quotas, and should be able to 're-balance' the IASB as term-limited members retire and are replaced between 2009 and 2011.

What is required is that the monitoring group should be tasked specifically to monitor the balance of the IASB membership in the light of the principle above—both background and geography—especially when it is out of balance, as it inevitably will be from time to time, and be required to report on this oversight on an annual basis, explaining how the balance has been achieved or, how it will be achieved if the IASB is out of balance. The Constitution should give the Trustees and the monitoring group flexibility about how the requirements in paragraph 20 are made operational.

Q7 The Trustees are suggesting that the Constitution should provide flexibility on the matter of part-time membership. Do you support that proposal?

Yes, although we would prefer that the Constitution requires that there be at least one part-time member. In our experience, the practical knowledge brought to a professional standard-setter by those who work in business and academe is invaluable. In addition, their ability to act with objectivity has rarely (if ever) been an issue, even though such members have other employment responsibilities.

Other comments on proposals related to the IASB

We would encourage the IASCF Trustees to explore reducing the terms of IASB members to three years, but to increase the number of possible renewals to two. In our view, this could assist the Trustees to recruit new members, in particular part-time members, who currently may be reluctant to commit to a five to ten year appointment, but would still bring valuable skills and experience to the IASB.