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

Dear Ms Oyre,

We appreciate the opportunity to comment on the discussion document *Review of the Constitution – Identifying Issues for Part 2 of the Review*.

The constitutional review is an extraordinarily important project in the context of ensuring worldwide acceptance of the international standard-setting organisation on a sustained basis. Current discussions about the possible shortcomings of international accounting standards to have emerged in the financial crisis show that long-standing problems of IASB governance, responsibility and accountability have not yet been satisfactorily resolved. We therefore warmly welcome and strongly support the efforts of the International Accounting Standards Committee Foundation (IASCF) to enhance the IASB's responsibility and accountability and to improve governance structures within the IASCF.

Our comments on the questions posed in the discussion document are as follows:

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?

We consider the provision of decision-useful information for investors and other market participants to be the key objective of IFRS accounting. The current phrasing *to help participants in the world’s capital markets and other users make economic decisions* is therefore appropriate, in our view, and should be retained.

We would like to suggest expanding the definition of the organisation’s primary objective to include an explicit reference to a cost-benefit criterion. Implementing new standards normally requires extensive adjustments and reprogramming of IT systems as well as substantial time and staff resources. With this in mind, greater consideration should be given to cost-benefit factors when setting or revising standards.

By contrast, the reference to considering the special needs of SMEs should be re-evaluated. If the primary objective is to provide information for participants in the world’s capital markets, it follows that IFRS are designed first and foremost for large, internationally active listed companies. We see no pressing need at present to broaden or modify this objective. Against this backdrop, it serves no useful purpose in our view to include a special mention of SME interests in the Constitution. We would therefore recommend dropping the reference to the needs of SMEs.

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?

In recent years IFRS have increasingly tended to specify highly detailed rules targeting individual sets of circumstances, thus marking a shift towards the rules-based approach of US GAAP. We see this trend as cause for considerable concern. An excess of detail runs the risk of obscuring the really relevant information and making it far more difficult to achieve the actual objective of financial reporting – namely to provide an accurate insight into the

economic situation of an entity. The tendency towards rules-based accounting has resulted in standards being changed in rapid succession, frequently without any apparent reason. The result is increasing legal uncertainty for preparers and a need to make constant adjustments which are not matched by added value for users.

The proposal to make specific reference in the IASCF Constitution to the importance of a principles-based approach is therefore warmly welcomed. An explicit commitment to principles-based standards would, in our opinion, help to halt and reverse the undesirable trend towards a rules-based accounting regime.

We would also welcome the inclusion in the Constitution of an express commitment to drafting practicable and workable standards. The quality of accounting standards cannot be judged solely on the basis of a theoretical “fair and true” concept. The acceptance and recognition of IFRS depend just as much on the ability to apply the standards in practice.

- 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.**

As things stand, we see no need to extend the IASB’s remit to include the development of standards for use by not-for-profit or public-sector entities. Nor do we believe that the resources are available to do so at present. The focus of the IASB should remain on the objective of IFRS, namely to provide decision-useful information for capital market participants, and its standards should continue primarily to cover listed entities, i.e. companies whose debt and/or equity instruments are traded in a regulated market.

In the short and medium term, the IASB should first concentrate its efforts on the numerous projects and issues thrown up by the current financial crisis. This includes fulfilling the requirements and tasks set at the G20 summit.

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 consider it vitally important for the IASB to collaborate and cooperate closely with other standard-setting bodies. The current turmoil makes it more important than ever for accounting issues to be viewed not in isolation but in the context of their interaction and possible interdependence with other regulatory measures. Such cooperation and coordination with other organisations are not ruled out by the Constitution in its present form and, indeed, already take place. It is therefore debatable whether there is any real need to change the Constitution in this regard. Should such an amendment be made, however, we believe it will be essential to clarify that full responsibility for setting accounting standards and issuing additional guidance remains with the IASB.

Governance of the organisation

5. The first part of the review of the Constitution proposed the establishment of 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 welcomed the proposed establishment of an independent Monitoring Group outside the IASCF. We agree, on the one hand, that responsibility for the Foundation's governance should continue to rest primarily with the Trustees. Nevertheless, the extent to which the Monitoring Group succeeds in introducing the principle of public accountability at the IASB will depend on the group's authority and clout. We see no need to amend Section 3 at this stage. We would, however, recommend reviewing the Monitoring Group's role and effectiveness after a certain period of time, such as one or two years, and, depending on the results, making any necessary changes then.

Trustees

- 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?**

We see no need at present to change the geographical distribution key for the composition of the Trustees. It is true that Trustees are appointed primarily on the basis of the qualitative criteria set out in para 6 of the Constitution (firm commitment to the IASCF and the IASB, sensitivity to the challenges associated with adopting and applying international standards, etc.). We nevertheless consider a fixed geographic distribution not unimportant in ensuring adequate representation of the world's major economic regions. This also plays a role with regard to balanced funding arrangements.

- 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.**

The process of setting the agenda and prioritising the work programme of the IASB needs to be much more transparent, in our view. One possible option would be regular public consultation on the IASB's annual agenda and long-term strategic direction (cf. reply to question 9). In this case, a duty to ensure an open and transparent agenda-setting process should be added to the responsibilities of the Trustees (para 15(c) of the Constitution).

- 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.

Establishing and maintaining appropriate funding arrangements is one of the major responsibilities of the Trustees (para 13(a) of the Constitution). Up to now, the IASB has largely been financed by voluntary contributions and donations from companies, financial institutions, accounting firms and central banks. This raises independence and sustainability concerns. We therefore welcome the efforts of the Trustees to seek a new, permanent and stable system of funding the IASB. We agree with the envisaged four basic principles of future funding arrangements (broad-based, compelling, open-ended, country-specific). In our view, it would be worth considering a fee-based model. Possible options include voluntary fees or the introduction of mandatory fees linked to listings on a stock exchange. It should be borne in mind, however, that the power to charge mandatory fees does not lie with the Trustees, but with legislators in the various jurisdictions involved. Any plans to charge mandatory payments should therefore be supported and facilitated by the Monitoring Group.

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.**

We see a pressing need to make the agenda-setting process at the IASB more transparent (cf. reply to question 7). One possibility would be to hold a public consultation on the IASB's agenda and strategic priorities. The consultation paper published on 10 March 2009 by the Financial Crisis Advisory Group (FCAG) on future work in connection with the financial crisis is a welcome step in the right direction.

At the very least, the IASB should explain the rationale behind its agenda and priorities and give its reasons for starting or postponing certain projects.

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*.

In our view, the due process procedures currently set out in the Constitution and *IASB Due Process Handbook* are sufficient, in principle, to ensure that the standard-setting process is transparent and orderly. We have warmly welcomed the recent improvements to due process, along with the introduction of various new elements such as ad-hoc working groups, feedback statements, field tests and post-implementation reviews. These measures have the potential to significantly enhance the quality and practicability of IFRS.

The key point, however, is that the procedures enshrined in the Constitution and Handbook must also be translated into practice. We therefore consider it crucially important for the Trustees to be diligent in exercising the oversight function laid out in para 15(g) of the Constitution and thus ensure compliance with all due process procedures. The future review by the Monitoring Group of the Trustees' performance of their oversight function will also help to further practical implementation of the Constitution's provisions.

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?

All changes to standards should be made in compliance with due process. Due process should be followed even in cases of extreme urgency, albeit in a possibly shortened form. As has become abundantly apparent in the last few months, critical situations sometimes call for very swift action. The Constitution should therefore permit the use of a fast-track procedure for urgent changes. The prerequisites for application of the fast-track procedure should be set out in the Constitution while the *IASB Due Process Handbook* should spell out the details of its application, such as shortened consultation periods or the skipping of certain steps of the regular due process procedure.

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?**

The task of the SAC is primarily to advise the IASB on its strategic direction, agenda and priorities. The SAC also monitors and communicates the views and concerns of other organisations and groups with respect to the work of the IASB. We consider this function highly important. As things stand, we see no need to change the composition of the SAC. We would nevertheless recommend reviewing the interaction between the various advisory bodies within the IASCF and the new Monitoring Group after an appropriate period of time, e.g. one year.

- 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?**

Please see our reply to question 12.

Other issues

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

No further comments.

Yours sincerely,


Dirk Jäger


Silvia Schütte