



Investors Technical Advisory Committee

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Via Email

March 31, 2009

Ms. Tamara Oyre
Assistant Corporate Secretary
IASC Foundation
Email: constitutionreview@iasb.org

*Re: Discussion Document: Review of the Constitution,
Identifying Issues for Part 2 of the Review*

Dear Ms. Oyre:

The Investors Technical Advisory Committee (“ITAC”)¹ appreciates the opportunity to provide its views on the International Accounting Standards Committee Foundation’s (“IASCF” or “Foundation”) December 2008 Discussion Document, *Review of the Constitution, Identifying Issues for Part 2 of the Review* (“Discussion Document”).²

General comments

ITAC supports the IASCF’s review of the governance structure and operating procedures of the Foundation and the International Accounting Standards Board (“IASB”). Those matters are vitally important for ITAC and other investors and market participants that support the goal of convergence to a single set of high-quality financial reporting standards

¹ This letter represents the views of the Investors Technical Advisory Committee (“ITAC”) and does not necessarily represent the views of its individual members, the organizations in which they are employed, or the views of the Financial Accounting Standards Board (“FASB”) or its staff. For more information about the ITAC, including a list of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/.

² International Accounting Standards Committee Foundation, *Review of the Constitution, Identifying Issues for Part 2 of the Review* (Dec. 2008), http://www.iasb.org/NR/rdonlyres/4E80F1BE-8BC5-48F8-8EEC-46B2123D7481/0/Constitution_Review_PartII_Consultation.pdf [hereinafter *Discussion Document*].

through the joint efforts of the IASB and the Financial Accounting Standards Board (“FASB”).³

As we indicated in our September 2008 letter in response to the initial part of the review of the IASCF Constitution (“September Letter”):

As investors, we believe that at least three general areas of inquiry are relevant when considering the appropriate governance structure and operating procedures of an **independent private sector** accounting standard setter such as the IASB. First, we believe the structure and procedures should “safeguard[] the independence of the standard-setting process.”

Having a standard setter that is independent in appearance and in fact enhances the credibility of the standard setting process and lessens the ability of special interest groups to manipulate the process to favor their own short-term interests to the detriment of the interests of investors and the capital market system. Moreover, independence promotes the long-term sustainability of global standards and ensures continual buy-in and participation by all parties.

Second, we believe that the structure and procedures of the accounting standard setter should focus primarily on the needs of investors, and should be commensurably aligned. On this point, we generally agree with the recommendation of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission which stated:

³ See, e.g., Letter from Jack Ciesielski, ITAC, to Ms. Florence E. Harmon, Acting Secretary, Securities and Exchange Commission 1-2 (Jan. 30, 2009), http://www.fasb.org/investors_technical_advisory_committee/itac_01-30-09.pdf [hereinafter January Letter].

Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor representatives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting. . . . [A]dditional investor representation would facilitate increased consideration of investor perspectives in the standards-setting process.

Finally, we believe the structure and procedures of the accounting standard setter must provide for a secure, stable, and mandatory funding source for the standard setter. As we outlined in a recent letter to the Financial Accounting Foundation (“FAF”) regarding the [funding of the] Governmental Accounting Standards Board:

We believe the GASB, like any accounting standard setter, must be adequately funded to provide high quality and timely standards. We also believe that the key criterion for evaluating the appropriateness of a funding source for the GASB or any other accounting standard setter is whether the source enhances rather than detracts from the independence of the standard setter.⁴

⁴ Letter from Jeff Mahoney, Co-Chair, ITAC, to Tamara Oyre, Assistant Corporate Secretary, IASC Foundation 2 (Sept. 26, 2008), <http://www.iasb.org/NR/rdonlyres/BE64C3F2-193D-4DF1-B5EF-1365374A5131/0/62.pdf> (footnotes omitted) [hereinafter September Letter].

Since the issuance of the September Letter, the need for dramatic improvements to the existing governance structure and operating procedures of the Foundation and the IASB, particularly in the area of enhancing the independence of the IASB and its focus on serving the needs of investors, has become ever-evident. As we commented in our January 2009 letter to the United States Securities and Exchange Commission (“SEC”) in response to their proposed *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by US Issuers* (“January Letter”):

We have profound doubts about the ability of the IASB to function independently and in the best interests of investors in its current form. Those doubts have been confirmed by the October capitulation of the IASB when the European Union politicians, at the behest of the banking and insurance lobby, coerced the IASB into amending its accounting standards on the classification of financial instruments without any public due process, including without any solicitation or consideration of investor input.⁵

Consistent with those doubts and our other general comments, the following are our responses to the specific questions raised in the Discussion Document.

Questions for consideration

- 1. The Constitution defines the organization’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.

⁵ January Letter, *supra* note 3, at 4 (footnote omitted).

In fulfilling that objective, the organization 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?

As indicated in our general comments, and consistent with the conclusions of the Final Report of the Advisory Committee on Improvements to Financial Reporting to the SEC,⁶ we believe that the primary objectives of the IASCF as described in its Constitution should be revised to explicitly focus on serving the needs of the primary consumers of financial reports. We, therefore, would revise the above language as follows:

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 investors in the world’s capital markets and other users make economic decisions.

...

to take account of, as appropriate, the special needs of investors in small and medium-sized entities and investors in emerging economies.

We fully agree with those critics of the IASCF who have concluded that “[b]y missing the opportunity of clear empowerment of users in

⁶ Financial Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission 57 (Aug. 1, 2008), <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>.

IFRS governance, the trustees risk finding themselves torn between conflicting objectives.”⁷

With respect to the “special needs” of investors in small and medium-sized entities or investors in emerging economies, we would not support different recognition and measurement standards for those entities. We believe that the recognition and measurement requirements for economic transactions should generally be comparable across entities and geographies. We, however, would not object to disclosure standards for those entities that are responsive to the special needs of their investors.

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 principles-based approach?

Although we support the need for clear principles in accounting standards,⁸ we do not support enshrining the term “principles-based approach” in the Constitution. As we explained in the January Letter:

International financial reporting standards are often described as more “principles-based” than their US GAAP equivalent. We harbor reservations about whether or not standards of a “principles-based” design will always produce robust, investor-useful reporting. We question the benefit of a move to a set of standards that, in its current state, provides minimal guidance while possibly broadening some accounting treatments as an accommodation of other countries’ accounting regimes, regulatory environments and cultures.⁹

⁷ See, e.g., Nicolas Veron, *Fuzzy Oversight Will Not Solve Standards Issue*, Fin. Times, Feb. 5, 2009, at 16, available at <http://www.ft.com/cms/s/0/25420800-f2e1-11dd-abe6-0000779fd2ac.html>.

⁸ See, e.g., Letter from Mike Gyure, Member, ITAC, to Mr. Robert Herz, Chairman, FASB 4 (Dec. 11, 2007), http://www.fasb.org/investors_technical_advisory_committee/ITACDisclosureProposal.pdf.

⁹ January Letter, *supra* note 3, at 10.

Notwithstanding the aforementioned, we reiterate our belief that accounting standards should be based on clear principles.

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 organization.**

We generally would not support the IASB extending its remit to include the development of globally consistent standards for non-profits and public sector enterprises for the following reasons. First, it is our understanding that the existing accounting standards for non-profits and public sector enterprises are significantly different from existing IASB standards.

Second, the primary users of non-profits and public sector enterprises' financial reports are different than the primary users of the financial reports of private sector enterprises. Finally, and most importantly, the IASB does not have the resources to take on any additional standard setting responsibilities at this time.

As we stated in the January Letter:

[A]s a result of the strained finances available to the IASB, the Board currently must place heavy reliance on contributed human resources from the major auditing firms in order to complete its standard setting agenda for the benefit of investors. This arrangement does not contribute to the trust and confidence that investors must be able to place

in the independence of the IASB or the usefulness to investors of the resulting standards.¹⁰

4. **There are other organizations 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 the possibility of closer collaboration with a wider range of organizations whose objectives are compatible with the IASC Foundation's objectives? If so, should there be any defined limitation?**

As indicated in response to question 1, the Constitution should be amended to require closer collaboration, greater input, and greater consideration of the views of investors—the primary consumers of financial reports. Significant investor representation on the Foundation and the IASB is critical to facilitating increased consideration of the views of investors in the standard setting process.

We would not object to the Foundation developing a close relationship with other organizations that promote the same objectives as the IASCF. Establishing closer collaboration with investor organizations, however, should be the Foundation's first priority.

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 organization 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.**

As indicated in our September Letter, we “do not object to the creation of a link to the Monitoring Group.”¹¹ If properly structured and operated the Monitoring Group could achieve its stated purpose of complementing and enhancing confidence in the governance of the

¹⁰ January Letter, *supra* note 3, at 5.

¹¹ September Letter, *supra* note 4, at 4.

IASCF and IASB,¹² while still safeguarding the independence of the standard setting process.¹³ In our view, however, the Monitoring Group will likely be unable to fulfill this important role if (1) the meetings are not conducted in the public with adequate notice, and (2) if investors do not have direct and *significant* representation on the group.

On the second point, the September Letter explains:

We understand that the Monitoring Group is intended to address a specific perceived deficiency of participation from public authorities, but that perceived deficiency is not, in our view, a legitimate basis for denying representation from the primary customers of financial reports. Any perceived deficiency of participation from public authorities is far surpassed by the perceived deficiency of participation from investors in and outside of the U.S. As one example, a recent analysis of International Financial Reporting Standards by French institutional investors concluded:

The **governance process** . . . and more generally . . . the overall structure of international standard setting including the IASC Foundation . . . is often criticised for the scant attention paid to the viewpoints of users of financial statements.¹⁴

¹² One important role that the Monitoring Group should perform is a review of IASB standards within a reasonable period of time after their issuance and implementation for the purpose of determining whether the standards have achieved the goal of providing high quality information to investors.

¹³ *See id.*

¹⁴ *Id.* at 5 (footnotes omitted).

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 do not believe that a fixed geographical distribution or quota system for IASCF Trustees is appropriate. We recognize that geographical diversity is important to the selection of Trustees. We, however, believe that the geographical quota system detracts from what, in our view, are the following far more important selection requirements.

First, that the Trustees include significant representation from the investor community. Second, that the Trustees demonstrate a commitment to actively supporting the improvement of financial accounting and reporting for the benefit of investors. Third, that the Trustees demonstrate a commitment to actively supporting and defending the independence of the IASB.¹⁵

Finally, we are concerned that the geographical quota system may also create “representative” Trustees composed of individuals that are more likely to perceive their roles as promoters of the narrow public interests of the region they represent, rather than promoters of improving financial accounting and reporting that best serves the needs of global investors.¹⁶

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 organization. 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.

¹⁵ *Cf. id.* at 8-10 (Opposing a geographical formulation for IASB members).

¹⁶ *Id.* at 8.

We believe it is important that the Trustees enhance their oversight function of the IASB to the extent that their oversight activities enhance the independence of the IASB and the confidence and trust investors place in the IASB's product. We, however, strongly object to the Trustees having involvement in the IASB's agenda setting process as suggested by Section 15(c) of the Constitution.¹⁷

Without a significant change in the selection criteria and composition of the Trustees, as described in response to question 6, we believe that expressly providing the Trustees a role in the IASB's agenda setting process will only result in even greater special interest group influence over the standard setting process to the detriment of investors and the capital markets.¹⁸

As indicated in our general comments, the "October capitulation" has severely shaken our confidence in the IASCF Trustees, particularly those who approved the suspension of public due process in that instance. It has also severely shaken our confidence in the IASB members, particularly those fourteen members, who voted in favor of the amendment knowing (or who should have known) that the resulting change in accounting was not an improvement to financial reporting from the perspective of most investors.¹⁹

As indicated, one means towards regaining investor confidence is to significantly increase investor representation on the Foundation and on the IASB.

- 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**

¹⁷ Cf. *id.* at 5 (opposing the Trustees of the Financial Accounting Foundation having a role in the FASB's agenda setting process).

¹⁸ Cf. *id.* at 8 (opposing providing the FASB Chair with decision-making authority to set the FASB technical agenda).

¹⁹ See, e.g., Glen Kessler, *Accounting Standards Wilt under Pressure*, Wash. Post, Dec. 27, 2008, at A01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/26/AR2008122601715.html>.

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 organization's financing.

We remain concerned with the IASCF's financing. We agree with those experts who have concluded that "economic . . . independence is an important guiding principle in institutionalizing a standard setting body that is responsive to the needs of investors and capital markets."²⁰

We note that per review of the IASB's website it appears that the first, second, third, and fourth largest single contributors to the IASB's "long-term funding" are Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers.²¹ The combined voluntary contributions of those "big four" accounting firms amounts to approximately thirty percent of the IASB's entire funding.²²

As explained in the January Letter:

We also remain unconvinced that a funding mechanism has been devised yet which will satisfy the criteria set forth in Section 109 of the SOX and provide sufficient resources to support a high-quality independent global accounting standard setter. More specifically, Section 109 of SOX requires an accounting standard-setter designated by the SEC to be independently funded. At this time, the IASB is not independently funded, and we are not aware of any clear evidence of progress in that area. Indeed, as a result of the strained

²⁰ Luzi Hail et al., *Global Accounting Convergence and the Potential Adoption of IFRS by the United States: An Analysis of Economic and Policy Factors* 78 (Feb. 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1357331.

²¹ See International Accounting Standards Board, *Long-term funding commitments* 3 (last visited Mar. 23, 2009), <http://www.iasb.org/About+Us/About+the+IASC+Foundation/Long-term+funding+commitments.htm>.

²² See *id.* at 1-3.

finances available to the IASB, the Board currently must place heavy reliance on contributed human resources of the major auditing firms in order to complete its standard setting agenda for the benefit of investors. This arrangement does not contribute to the trust and confidence that investors must be able to place in the independence of the IASB or the usefulness to investors of the resulting standards.²³

Although we agree that some progress toward the establishment of a broad-based mandatory funding system has been made by the IASCF, that progress is not sufficient to remove the appearance of a lack of independence as a result of the material amounts of voluntary contributions from companies, who use the IASB standards to prepare financial reports and, significantly, the large accounting firms who audit to the IASB standards.²⁴

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.**

As indicated in response to question 7, we agree with the IASCF Trustees that providing the IASB with full discretion in developing and pursuing its technical agenda is an essential element of preserving the independence of the standard-setting process. Allowing the Trustees or other potentially less independent groups to have the authority to, for example, remove a project from the IASB's technical

²³ January Letter, *supra* note 3, at 5.

²⁴ Cf. S. Rep. No. 107-205, at 13 (June 26, 2002), http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_reports&docid=f:sr205.107 (Congress concluding based on hearing witness testimony that a guaranteed, rather than voluntary, source of funding was necessary to protect the independence of the FASB and the Public Company Accounting Oversight Board from the auditing profession and their clients).

agenda, particularly if the project was supported by most members of the IASB or most investors, would likely impair the independence of accounting standard setting to the detriment of investors and the capital markets.²⁵

- 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*.**

As indicated in our general comments, we believe that the procedures of the IASB should focus primarily on the needs of investors. We, therefore, believe that the Constitution's description of the principles and elements of the IASB's required due process and the related procedures included in the *IASB Due Process Handbook* should be revised to make explicit that, at each and every stage within the IASB's due process investor perspectives are given pre-eminence with no exceptions.

- 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?**

As indicated in the January Letter, we have profound doubts about independence of the IASB as a result of its "October capitulation."²⁶ We acknowledge that there may be some limited "cases of great urgency" in which it may be appropriate for the IASB to pursue a "'fast track'" procedure. Unlike the October capitulation, however, any fast track procedure should *never* be permitted: (1) to completely

²⁵ Cf. February Letter, *supra* note 10, at 8 (opposing providing the FASB Chair with decision-making authority to set the FASB technical agenda).

²⁶ January Letter, *supra* note 3, at 4.

eliminate the solicitation and consideration of investor input; and (2) to be used to promulgate an accounting standard that, from the perspective of most investors, is clearly not an improvement to financial accounting and reporting.

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?

Consistent with our general comments, we compliment the IASCF for their recent efforts to increase the investor representation on the SAC, including inviting the ITAC to participate on the SAC. Even as reconstituted, however, it appears that of the forty-one organizations represented on the current SAC, there are no more than six other organizations that could possibly be considered representatives of investors.²⁷

We encourage the IASCF to correct this gross imbalance as soon as practicable. In that regard, we stand ready to offer our assistance in identifying other qualified investor organizations and individuals to participate on the SAC.

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?

We have no proposed changes to the elements of the terms of reference for the SAC at this time, with the exception of increasing the investor representation on the SAC as discussed in response to question 12.

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

We respectfully request that the Trustees carefully review and consider the contents of this letter, the September Letter, and other

²⁷ IAS Plus International Accounting Standards: IASB Standards Advisory Council (last visited Mar. 23, 2009), <http://www.iasplus.com/restruct/advisory.htm#sacmembers>.

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input from investors. We believe that the Trustees must take the decisive actions necessary to begin the process of regaining investor trust and confidence in the IASCF and the IASB.

We appreciate the opportunity to comment on the Discussion Document. As always, we would be happy to respond if you have any questions or need any additional information.

Sincerely,

Investors Technical Advisory Committee

By:

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney
Co-Chair

cc: Terri S. Polley, President, Financial Accounting Foundation