



## **International Federation of Accountants**

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Members of the Constitution Committee

### **Review of the Constitution: Public Accountability and the Composition of the IASB – Proposals for Change**

1. The International Federation of Accountants (IFAC) welcomes this opportunity to comment on the Constitution Committee's proposals to address matters relating to public accountability and the composition of the International Accounting Standards Board (IASB). The proposals are of particular interest to IFAC, as:
  - The accounting profession played an important role in the establishment of the International Accounting Standards Committee and has a continuing interest in the development of International Financial Reporting Standards (IFRS);
  - Through its membership, currently 157 professional accountancy bodies in 123 countries, IFAC represents more than 2.5 million accountants in public practice, industry and commerce, government and education, who – through their various roles, including those of preparers and auditors of financial statements – implement IFRS; and
  - IFAC has committed itself to the achievement of global convergence to IFRS. Statement of Membership Obligations (SMO) 7, "International Financial Reporting Standards," requires the membership of IFAC to support the work of the IASB by notifying their members of every IFRS, and to use their best endeavors:
    - To incorporate the requirements of IFRS in their national accounting requirements or, where the responsibility for the development of national accounting standards lies with third parties, to persuade those responsible for developing those requirements that general purpose financial statements should comply with IFRS, or with local accounting standards that are converged with IFRS, and disclose the fact of such compliance; and
    - To assist with the implementation of IFRS, or national accounting standards that incorporate IFRS.

## **Matters of Principle**

### **CONSULTATION WITH STAKEHOLDERS**

2. Loss of confidence in financial reporting, the trend towards global convergence in financial reporting, and the incorporation of international standards in law in many jurisdictions have resulted in governments and regulators developing a stronger and more direct interest in the activities of international standard setting bodies. In this context, it will be important that all those affected by IFRS will have a timely and sufficient opportunity to participate in the review of the IASC Foundation's Constitution. IFAC therefore encourages the Constitution Committee to work closely with international regulators and public and oversight authorities,<sup>1</sup> and organizations representing the accountancy profession (including IFAC) in reviewing the Constitution. In addition, many jurisdictions that have adopted IFRS are in developing economies. In this regard, the Committee may consider consulting with bodies such as the IOSCO Emerging Markets Committee and the IFAC Developing Nations Committee.
3. However, the Trustees' desire to establish a Monitoring Group before the end of 2008 has led the Constitution Committee to develop the initial proposals with no or limited consultation. These proposals were made public on May 30, 2008. Although stakeholders had some opportunity to comment at the roundtables that followed the release of the initial proposals, their comments did not appear to have a significant effect on the Proposals for Change (made public on July 21, 2008). This is not surprising given the short period between the release of the initial proposals and the Proposals for Change.
4. In addition, the consultation period for the Proposals for Change was unusually short and during the weeks of summer recess in the Northern hemisphere when many stakeholders might not have been available.
5. The rationale for such a hasty process is not clear. It might have been justified had there been an urgent need to amend the Constitution; however, there is no evidence of a need for such urgency. Given the importance of the Constitution, IFAC expects that its review will be conducted in a manner that allows for timely and sufficient consultation.

### **ORGANIZATION OF THE CONSTITUTION REVIEW**

6. Paragraph A4 of the Proposals for Change explains that the Trustees are seeking to balance the immediate priority to address issues related to public accountability and the need to have a thorough and inclusive process on other elements of the Constitution. IFAC is particularly concerned about the organization of the review of the Constitution. It is of the view that issues related to public accountability require a thorough and inclusive process, even more so than any other elements of the Constitution. As governance, management, standard setting and public interest oversight are interrelated, important elements thereof should not be considered in isolation.

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<sup>1</sup> Such as the Basel Committee on Banking Supervision, the European Commission (EC), the Financial Stability Forum (FSF), the International Association of Insurance Supervisors (IAIS), the International Organizations of Securities Commissions (IOSCO) and the World Bank.

7. IFAC considers that a clear split of governance and management responsibilities from public interest oversight responsibilities will increase the confidence of stakeholders that the activities of the Trustees and the IASB are properly responsive to the public interest.
8. In designing a public interest oversight system, the Constitution Committee is encouraged to take account of three critical aspects:
  - First, the overriding objective should be to ensure that the institutional arrangements would be and would be seen to be properly responsive to the public interest.
  - Second, a key objective should be to strengthen the legitimacy of the standard setting process, increase public confidence in the standard setting structure and process and, ultimately, strengthen financial reporting.
  - Third, it is important to maintain the technical competence of the standard setting process, while ensuring a sufficiently strong element of public interest oversight to achieve the first two objectives.
9. Based on the above, IFAC strongly recommends that the Constitution Committee conduct a single comprehensive review of the Constitution, taking account of changes in the financial reporting environment and recognizing the interrelationship between governance, management, standard setting and public interest oversight. Such a review should provide for timely and sufficient consultation of stakeholders.

#### **Responses to Questions**

10. IFAC's responses to the Questions in the Proposals for Change are set out below. They are based on the assumption that the Constitution Committee will not change its approach to reviewing the Constitution, as recommended in paragraph 9 above.

#### **MONITORING GROUP**

*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?*

11. IFAC is of the view that any proposal to enhance oversight of the standard setting activities of the IASC Foundation is in the public interest and a step in the right direction. However, due to the two-part approach to reviewing the Constitution, it is not clear how the proposed Monitoring Group will fit into the overall public interest oversight system. Also see response to Q3.

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

12. The rationale for selecting the organizations in paragraph 20 of the Proposals for Change is not clear. For example, it is not clear why organizations such as the Basel Committee on Banking Supervision and the IAIS are not included in the list of initial members of the Monitoring Group.

13. It will be important for the members of the Monitoring Group to represent adequately the range of participants in financial reporting. The initial members of the Monitoring Group appear to focus on capital market participants. The interests of SMEs and private entities do not appear to be represented, contrary to the stated objective of the IASC Foundation "... to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies ..." (paragraph 9(c) of the Proposals for Change).
14. IFAC therefore recommends that the Constitution Committee, in consultation with the stakeholders, further deliberate the initial membership of the Monitoring Group. In addition, the Committee is encouraged to consider:
  - (a) Whether it is necessary to be prescriptive as to who should represent the initial members. For example, paragraph 21 of the proposed revised Constitution could refer in all instances to "the responsible member of ...," as is the case for the EC. This will enable the organization to appoint "the best person for the job."
  - (b) Whether the Constitution should provide for the Trustees and the Monitoring Group to meet at least twice annually and more frequently as appropriate. IFAC is of the view that frequent meetings are desirable, and is therefore concerned that the currently proposed annual meeting (paragraph 19(c) of the proposed revised Constitution) may become the default.

*Q3 The Trustees will remain the body primarily responsible for the governance of the organization and the oversight of the IASB. Their responsibility to a Monitoring Group will enable regulatory and other authorities responsible for the adoption of IFRS to review the Trustees' fulfillment 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?*

15. The proposal will result in multiple layers of public interest oversight. It is more likely that the interest of the public will be addressed if there are fewer layers of oversight. It could thus be asked whether the Monitoring Group should have oversight of the Trustees and the Trustees have oversight of the IASB; or whether all public interest oversight responsibilities should be within a single body, such as the Monitoring Group.
16. Paragraph 16 of the Proposals for Change explains that the terms of reference of the relationship between the Monitoring Group and the Trustees would be encapsulated in a Memorandum of Understanding, which would be developed after the membership of the group is agreed and would be made public when completed. The Trustees recommend that the Memorandum of Understanding is subject to public consultation before its completion. IFAC strongly supports this recommendation.
17. The Proposals for Change do not contain any indication of the proposed content of the Memorandum of Understanding or the charter that will set out the Monitoring Group's organization, and operating and decision-making procedures. IFAC is of the view that the Memorandum of Understanding is central to the proposed arrangement and should therefore not be developed subsequent to agreeing the membership of the Monitoring Group. IFAC recommends that the establishment of the Monitoring Group is not finalized until completion

of the Memorandum of Understanding and the charter. It seems unwise to grant authority to a group whose mandate is as yet so ill-defined.

18. It is also recommended that the Memorandum of Understanding address matters such as:

- Responsibility for providing input on the agenda priorities of the IASB.
- Responsibility for affirming that due process has been followed in the development of a standard, including that comments on the exposure draft of the proposed standard have been given proper consideration.

*Q4 Given the proposed creation of a Monitoring Group, would there be a continued need for the Trustee Appointments Advisory Group<sup>2</sup> in the selection of Trustees? If so, what should be the role and composition of the Trustees Appointments Advisory Group?*

19. IFAC is of the view that Trustee Appointments Advisory Group is redundant in the context of paragraph 7 of the current Constitution, which provides for the selection of Trustees after consultation with national and international organisations of auditors (including the International Federation of Accountants), preparers, users and academics,” and oversight of the process by the Monitoring Group.

#### COMPOSITION OF THE IASB

*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?*

20. Legitimacy is achieved in part through representation in the standard setting process. A key element of representation relates to geographic or regional representation. A second element of representation derives from the notion that those who agree to abide by the standards have the greatest stake in the efficacy of those standards, as well as the strongest incentive to set appropriate and proportionate standards. IFAC therefore agrees with the proposal to expand the IASB to 16 members. The main qualifications for membership of the IASB should remain professional competence and practical experience, as stated in paragraph 19 of the current Constitution.

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

21. Based on paragraph 20, IFAC agrees with the proposal related to the IASB’s geographical diversity.

22. Paragraph 26 of the proposed revised Constitution, which deals with the composition of the IASB, notes that “... there shall *normally* be ...” IFAC recommends that the word “normally” be deleted as paragraph 26(f), referring to “two members appointed from any area, subject to maintaining overall geographical balance,” provides sufficient flexibility with regard to the composition of the IASB.

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<sup>2</sup> The Trustee Appointments Advisory Group is a high level and broadly representative advisory group to help the Trustees in discharging their responsibility for nominating and appointing highly qualified and interested individuals as Trustees. The Advisory Group was created to increase consultation between the Trustees and official international and regional organizations with an interest in accounting standard-setting.

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

23. IFAC is of the view that part-time membership is an important way in which the IASB could access practical experience. IFAC therefore agrees with the proposal to provide flexibility on the matter of part-time membership, but recommends that the Constitution provide for the appointment of no fewer than two part-time members. It is not necessary to limit the maximum number of part-time members.

*Other Matters for Consideration by the Constitution Committee*

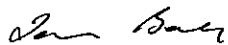
24. IFAC recommends that the Constitution Committee also consider the following:

- Whether the IASB could benefit from a limited number of observers with privilege of the floor. The observers, from organizations with significant public interest in the development of IFRS, may provide useful input in the development of IFRS.
- Whether the composition of the IASB should explicitly provide for SME representation, seeing that the objectives of the IASB Foundation includes "... to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies ..." (paragraph 9(c) of the Proposals for Change). Perhaps this role could be fulfilled by one of the part-time members.
- Whether individuals who perform audits of financial statements, rather than individuals who prepare financial statements or advise on the application of IFRS, should be represented on working groups of the IASB. Although individuals from audit firms may serve on these groups, they are often responsible for advising on the application of IFRS rather than the auditing of financial statements prepared in accordance with IFRS. Respondents to the 2007 IAASB Strategy Review consultations and representatives from the IAASB Consultative Advisory Group have encouraged the IAASB to establish formal liaison with the IASB to ensure that auditing considerations are part of the input to the development of IFRS.
- Paragraph 36 of the proposed revised Constitution, which deals with voting majorities, does not mention the conceptual framework. IFAC is of the view that voting on the framework ought to be subject to the same rules as voting on IFRS.

In conclusion, IFAC strongly recommends that the Constitution Committee conduct a single comprehensive review of the Constitution, taking account of the interrelationship between governance, management, standard setting and oversight. Such a review should provide for timely and sufficient consultation of stakeholders.

Please do not hesitate to contact me should you wish to discuss any of the matters raised in this submission.

Sincerely,

A handwritten signature in cursive script, appearing to read "Ian Ball".

Ian Ball  
Chief Executive