

Memorandum

To: Monitoring Board members

From: Gerrit Zalm

Date: June 26, 2009

Re: Second Part of the IASC Foundation Constitution Review

The Trustees are in the process of conducting the second part of their five-yearly Constitution Review. (The first part of the Constitution Review established the link to the Monitoring Board, expanded the IASB to 16 members and provide guidelines regarding the geographical distribution of IASB members.)

The Trustees wish to discuss a few issues that have arisen with the Monitoring Board. These include the IASB's agenda-setting process, the possibility of a "fast-track" due process, and the role and the effectiveness of the Standards Advisory Council.

Background and timing of the Second Part of the Constitution Review

The Trustees began the second part of their review of the Constitution at their meeting in October 2008 in Beijing. In December 2008, the Trustees published a consultation document, *Review of the Constitution: Identifying Issues for Part 2 of the Review* as the first step of the second part of the review. The Trustees received 68 responses, including from Monitoring Board members and participants. For your information, those Monitoring Board comment letters are attached.

In Amsterdam, the Trustees will develop proposals that take account of the input received and will then publish another document for public comment. This will most likely occur in early August, and the discussion document will have a three month comment period. The Trustees have also announced that in September and October they will hold three round tables—one in London, one in New York, and one in Tokyo.

The Trustees' current plan is to conclude the review at their January 2010 meeting.

Major issues identified

While commentators (including Monitoring Board members) identified a number of issues for consideration, three issues warrant particular attention at our meeting:

- the process of the IASB agenda-setting
- the possibility of a "fast-track" due process, and
- the role and the effectiveness of the IASB

The agenda-setting process

The IASB's agenda-setting process has always attracted significant attention from commentators. For this reason, in the discussion document, the Trustees asked:

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.

The IASB already has significant procedures related to its agenda-setting process. An excerpt summarizing the agenda-setting process is attached as an appendix to this paper.

Furthermore, IASC Foundation governance documents, including the Constitution and the Monitoring Board Memorandum of Understanding, provide opportunities for formal input. The Trustees "review annually the strategy of the IASC Foundation and the IASB and its effectiveness, including consideration, but not determination, of the IASB's agenda." (Section 15c)

The Standards Advisory Council also has a formal role in providing input. While the Constitution states that the IASB should "have full discretion in developing and pursuing the technical agenda of the IASB and over project assignments on technical matters," the SAC has a Constitutional responsibility for "giving advice to the IASB on agenda decisions and priorities in the IASB's work."

Finally, the Monitoring Board MoU states:

- A. The IASCF Monitoring Board may refer accounting issues to, and will confer regarding these issues with, the Trustees and the IASB Chair.
 - i The Trustees will work with IASB to ensure these issues are addressed in a timely manner.
 - ii If the IASB determines that consideration of the issue(s) identified by the IASCF Monitoring Board is not advisable or that the issue(s) cannot be resolved within the time frame suggested by the Monitoring Board, the Trustees should:
 - 1. call on the IASB to undertake all reasonable efforts to consider issue(s) in a manner that is consistent with the public interest, taking into account the protection of investors.
 - 2. call on the IASB to explain its position through the Trustees regarding the IASB's position on the issue(s); and
 - 3. promptly notify the IASCF Monitoring Board of the IASB's position.

It is significant that in response to the question almost all commentators reaffirmed the need for the IASB to maintain its independence to set IFRS standards without interference, if it is to be capable of setting high quality international accounting standards.

At the same time, the comment process on the Constitution Review discussion document revealed concerns regarding the substance of the IASB's agenda and also the process of agenda-setting. In terms of the Constitutional review process, the focus should be on the latter, but one possible view is that substantive concerns are symptoms of perceived problems.

In this regard, some commentators called for more transparency regarding the agenda-setting process and for explanations and justifications for their prioritisation of the agenda. In suggesting approaches to the issue, some (including the European Commission) have called for the IASB to have public consultations on its agenda and priorities on an annual basis or when new issues arise in addition to the current formal process already utilized.

Others have suggested that the SAC could play a role in helping the Trustees evaluate the IASB's performance regarding its agenda-setting and priorities.

Some commentators, mainly commentator outside Europe, urged against the Trustees interfering with the agenda-setting process or the IASB's independence.

The likely view of the Trustees, though subject to discussion, is that the ultimate determination regarding the agenda and the IASB's must rest with the IASB. At the same time, the IASB could utilize its annual review of agenda priorities with the SAC to enhance transparency and to provide public input. The IASB prepares a document for the SAC for such a discussion, and the existing SAC suggested that the public could have an opportunity to comment on the document in advance of the IASB-SAC discussion.

There is some concern about creating a formal and potentially lengthy public comment period on an annual basis. Adding additional formal consultation steps may risk the ability to respond to issues in a timely manner and be viewed as bureaucratic.

The possibility of a "fast-track" due process

The Trustees asked:

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?

Respondents generally do not favour a fast track procedure, but recognise that one may be required for pragmatic reasons. Commentators say that if a fast track procedure is introduced, it would only be acceptable provided a minimum of 30 days' consultation is compulsory and the specific circumstances that will trigger the fast track procedures are clarified and understood by all. Indeed, such a 30 day comment period is already permitted under existing procedures.

The preliminary view is that there should be some form of public consultation in every circumstance. At the same time, the current provisions allowing a 30-day accelerated process were generally sufficient. In exceptional circumstances and for issues of limited scope, the Trustees, who can alter the Constitution, could enable a shorter period of consultation. These occasions, where major unforeseen developments arise, would be rare.

The Trustees should only permit a shorter period of consultation after a formal request of the IASB and should make the decision at a public meeting (either by phone or in person).

The SAC's operations and effectiveness

The effectiveness of the SAC has been repeatedly raised as issues by commentators. To a great extent, the newly constituted SAC is a direct response to the concerns raised. Because of the relative newness of this SAC, it is difficult to assess whether the Trustees have been effective in addressing the concerns.

Indeed, many commentators to the discussion paper noted that exact point. Accordingly, many said that they would reserve their position until a later date.

It should be noted that many commentators commended the IASC Foundation for strengthening and improving this valuable stakeholder consultation forum. Those from the investor community expressed their appreciation for the creation of an investor sub-group in the SAC to allow for better engagement with the investor community.

On the whole, most commentators were of the opinion that the current terms of reference and professional background requirements for the SAC are acceptable and achieve the SAC's objectives and that it is appropriate for the Trustees to continue to monitor and review the SAC's effectiveness. However, (without the basis of the experience of the new body, one or two commentators felt that the SAC is not functioning as intended and that, as a consequence, a considerable number of professional accountants and practitioners should be added to the presently constituted SAC.

Some European commentators tied their concerns with the governance and due process of the organisation to the role of the SAC, and therefore suggested that the SAC should play a greater role in the governance of the organisation. One commentator said that the SAC should be modified to act as an extended arm of the Trustees to improve governance and due process. Related to this were the following recommendations:

- That the SAC should play an enhanced role in providing relevant consultation and feedback to the IASB when setting its agenda and the IASB should provide feedback to the SAC.
- The IASC Foundation should make greater use of formal polls to indicate the extent of support for the IASB's proposals.
- The Trustees were urged to take account of the key issues raised at the SAC and bear this in mind when scrutinising the effectiveness of the IASB and its responses to stakeholders.
- The SAC should be required to draw up the IASB work programme rather than just monitor it.

Other European commentators made the following comments:

- To remain efficient no more than 30 should be on SAC. As such the currently constituted SAC is too large;
- The SAC has too few meetings;
- The SAC requires more guidelines concerning meetings and needs clarity as to how the IASB integrates the suggestions made by SAC or why.
- The SAC agenda should be prepared by a restricted committee so that it focuses on a limited number of strategic issues. Supplementary educative sessions could be organised for those SAC members who wish to attend and preparatory documents should be prepared in advance.
- The SAC should be granted a minimum level of independent resources.

There is a sense among the Trustees that it would be premature to make significant reforms of the SAC currently. The new SAC seems to have started well, and despite its size has provided constructive input to the IASB, particularly in formulating its financial crisis response.

At the same time, the Trustees are providing greater staff resources to the SAC and should monitor the body's effectiveness.

Stage 1: Setting the agenda

19 The IASB, by developing high quality accounting standards, seeks to address a demand for better quality information that is of value to all users of financial statements. Users include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. Better quality information will also be of value to preparers of financial statements.

20 Although not all of the information needs of these users can be met by financial statements, there are common needs for all users. As investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users. The IASB therefore evaluates the merits of adding a potential item to its agenda mainly by reference to the needs of investors.

21 When deciding whether a proposed agenda item will address users' needs the IASB considers:

- (a) the relevance to users of the information and the reliability of information that could be provided
- (b) existing guidance available
- (c) the possibility of increasing convergence
- (d) the quality of the standard to be developed
- (e) resource constraints.

For further discussion see paragraphs 52–58.

22 To help the IASB in considering its future agenda, its staff is asked to identify, review and raise issues that might warrant the IASB's attention. New issues may also arise from a change in the IASB's conceptual framework. In addition, the IASB raises and discusses potential agenda items in the light of comments from other standard-setters and other interested parties, the SAC and the IFRIC, and staff research and other recommendations.

23 The IASB receives requests from constituents to interpret, review or amend existing publications. The staff consider all such requests, summarise major or common issues raised, and present them to the IASB from time to time as candidates for when the IASB is next considering its agenda (see paragraphs 60 and 61).

24 The IASB's discussion of potential projects and its decisions to adopt new projects take place in public IASB meetings. Before reaching such decisions the IASB consults the SAC and accounting standard-setting bodies on proposed agenda items and setting priorities. In making decisions regarding its agenda priorities, the IASB also considers factors related to its convergence initiatives with accounting standard-setters. The IASB's approval to add agenda items, as well as its decisions on their priority, is by a simple majority vote at an IASB meeting.

25 When the IASB considers potential agenda items, it may decide that some issues require additional research before it can take a decision on whether to add the item to its active agenda. Such issues may be addressed as research projects on the IASB's research agenda. A research project normally requires extensive background information that other standard-setters or similar organisations with sufficient expertise, time and staff resources could provide.

26 Research projects are normally carried out by other standard-setters under the supervision of, and in collaboration with, the IASB. In the light of the result of the research project (normally a discussion paper, see paragraph 32), the IASB may decide, in its public meetings, to move an issue from the research project to its active agenda.