



Australian Government

**Australian Accounting
Standards Board**

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03)9617 7608

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Ms Tamara Oyre
Assistant Corporate Secretary
IASB Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom
Email: constitutionreview@iasb.org

Dear Ms Oyre

Discussion Paper Review of the Constitution: Identifying Issues for Part 2 of the Review

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the Discussion Paper.

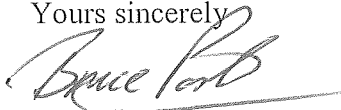
The AASB considers that the review of the Constitution is not only timely but necessary, in the light of recent events that have led some to question the independence of the IASB. The AASB thinks that the Trustees should take steps to strengthen the standard setting structure, particularly with respect to maintaining the IASB's independence and the perception of that independence, and its due process. The AASB is concerned that any perceived weaknesses in the standard setting structure might pose a threat to the plans of some countries, such as the US, to adopt IFRSs, and thereby undermine the aspiration for truly global standards. The credibility of the IASB is arguably more important than ever, particularly with the prospect of a US move towards IFRSs, which has implications for many Australian constituents, either directly (as foreign registrants) or indirectly (as subsidiaries of US parents).

IFRSs are made into AASB Standards in Australia – word-for-word in respect of for-profit entities, and with limited modifications in respect of not-for-profit entities. A review of the Constitution that results in a strengthening of the standard setting structure is likely to be helpful in this context.

Consistent with transaction-neutrality principles, the AASB would welcome, as a longer-term aspiration, a move by the IASB towards setting standards for not-for-profit and public sector entities, and is of the view that the Constitution should be amended to facilitate that change. As such, the AASB suggests using more sector neutral language in the Constitution and making amendments aimed at developing a closer working relationship between the IASB and the International Public Sector Accounting Standards Board (IPSASB) in a way that does not risk forestalling action that will lead to a better use of standard setting resources in the longer term.

Please refer to the attached for the AASB's responses to the specific questions in the Discussion Paper.

Yours sincerely

A handwritten signature in cursive script, appearing to read "Bruce Porter", with a long horizontal flourish extending to the right.

Bruce Porter
Acting Chairman

-attachment-

AASB Comments
Review of the Constitution: Identifying issues for Part 2 of the Review

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?

Yes, an emphasis on users of financial reporting and their economic decisions is appropriate. Furthermore, consideration of small and medium-sized entities and emerging economies is appropriate. However, given that the IASB has already commenced its consideration of small and medium-sized entities, and in light of the AASB's response to Question 3 in relation to not-for-profit and public sector entities, the AASB suggests that more neutral language should be used in place of 'participants in the world's capital markets'. The type of language currently used inappropriately implies a focus on setting standards primarily for debt and equity holders, with all other users being considered to be less important. The AASB suggests using 'resource providers' instead, which would encompass a broad range of stakeholders.

The AASB notes that the Trustees have used the phrase 'high quality, understandable and enforceable global accounting standards' in the objective, however, only the phrase 'high quality global accounting standards' is used in Sections 6 and 19. The use of 'high quality' and 'understandable' in the objective suggests that 'high quality' does not necessarily imply 'understandable'. To avoid this implication, the AASB suggests that consistent phraseology, including 'understandable' is used throughout the document. The AASB also considers that the objective of the SAC and the SAC terms of reference in general should use words consistent with those in the objective specified in the Constitution.

In relation to the use of the term 'enforceable' in the objective, given that enforcement is a jurisdictional issue and has anti-abuse connotations, the AASB suggests that the Trustees replace the term with 'operational' or 'effective'.

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?

Yes. The AASB supports a principles-based approach to standard setting and is of the view that making specific reference to that approach, as an aspiration, in the Constitution, together with expediting completion of the Conceptual Framework, would help to ensure that future standards are developed in a consistent manner. However, the AASB thinks that the Constitution could usefully clarify the meaning of such an approach. In this context, the Constitution should also acknowledge the vital role of professional judgement in applying principle-based standards. Furthermore, due consideration should be given to the impact an articulated principles-based approach will have on the role of the IFRIC.

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.

The AASB considers that the IASB should aim to develop standards for not-for-profit entities and public sector entities, in a transaction-neutral way (i.e. similar transactions accounted for in a similar way irrespective of the nature of the entity undertaking the transaction, unless there is a sector specific reason for treating them differently). This would serve the public interest by allowing for increased transparency and comparability between entities across different sectors and jurisdictions, particularly given the extent to which it is expected that governments will themselves be accessing capital markets in the future. It would also facilitate better use of limited standard setting resources, particularly if a transaction neutral approach is adopted. Furthermore, it would contribute to the development of higher quality and more understandable standards. This is because the IASB would give greater attention to the fundamental principles by considering the issues from a transaction-neutral perspective within both a for-profit and a not-for-profit context.

The AASB acknowledges that developing standards for not-for-profit entities and public sector entities may be more of a longer-term aspiration rather than a short-term goal for the IASB as it currently has other major projects on its agenda. However, the Constitution should be amended now to reflect the IASB's mandate to develop standards for those entities in the future. In the meantime, the IASB should consider writing standards with more neutral expression in preparation for an expanded role, and to facilitate their use by countries (such as Australia) that currently apply, to the extent feasible, the standards to not-for-profit entities and public sector entities.

The AASB also suggests that the IASB consider working in consultation with the International Public Sector Accounting Standards Board (IPSASB) on some or all of its current projects. This would help the IASB address any issues in the preliminary stages of projects and thereby ease the transition to specifically addressing the reporting for not-for-profit entities. This should be undertaken in a way that does not risk forestalling action that will lead to a better use of overall standard setting resources in the longer term.

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?

The AASB notes that the IASB's *Statement of Best Practice: Working Relationships between the IASB and other Accounting Standard-Setters* (February 2006) currently sets out the working relationships between the IASB and other accounting standard setters. Subject to the *Statement of Best Practice* being updated, the AASB suggests that the Constitution be amended to make specific reference to the *Statement of Best Practice*.

The Constitution should also be amended to allow for even closer collaboration with certain accounting standard setting organisations. These organisations have in some cases developed or are developing standards in areas not yet tackled by the IASB, for example, the IPSASB is progressing work on grantor accounting for service concessions. Collaborating with such organisations would benefit the IASB in some of its current projects, and would facilitate better use of limited standard setting resources, particularly if a transaction neutral approach is adopted.

The AASB considers that the Constitution should also allow for closer collaboration with a wider range of organisations. The AASB encourages the IASB to consult as widely as possible and believes that the Constitution should allow the IASB to collaborate with whichever constituents are appropriate in the circumstances. The organisations might include the International Federation of Accountants (IFAC) including the IPSASB, the National Standard Setters (NSS) Group, the International Organization of Securities Commissions (IOSCO), the International Valuation Standards Council (IVSC) and international user groups such as the International Monetary Fund (IMF), the World Bank, and the Corporate Reporting Users Forum (CRUF). However, with the exception of the reference to national standard setters already made in paragraph 28 and reference to IPSASB in the context of Question 3, it is not necessary to specifically name all such organisations in the Constitution.

Governance of the organisation

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 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.

The AASB considers that the language in section 3 should be modified to acknowledge the existence and the role of the Monitoring Group. The AASB notes that in January 2009 the Trustees of the IASB Foundation amended the Constitution, including establishing a link to a Monitoring Board of public authorities. The Monitoring Board will be responsible for approving Trustee appointments and reappointments, a role that would give the Monitoring Board the power to decide who governs the organisation. The Monitoring Board will also be responsible for reviewing the Trustees' performance with regard to fulfilling their duties as set out in the Constitution, a role that would give the Monitoring Board the power to influence how the Trustees govern the organisation. While the governance of the organisation would largely rest with the Trustees, as currently drafted, section 3 no longer accurately reflects the governance arrangements of the organisation now that the Monitoring Board has been created.

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?

The AASB thinks that the current geographical distribution is reasonable. However, the AASB thinks that it would be useful if the Constitution provided a clear explanation as to the purpose of having a geographic representative membership of the Trustees. This could be because it is intended to replicate the body of users and therefore resemble their blend of needs. Furthermore, the AASB notes that while a geographical balance is desirable to ensure that no one region dominates, selection criteria should be primarily based on independence, ability to act in the public interest and history of public service.

Given that the focus of the organisation may extend beyond developing financial reporting standards for listed companies in the future (see question 3), consideration should also be given to appointing Trustees with knowledge and experience in the not-for-profit and public sectors.

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 AASB is concerned that the absence of due process and consultation relating to the IAS 39 fair value reclassification amendments have weakened the position and perception of the IASB as an independent standard setter, both now and in the future. The AASB thinks that the duties of the Trustees should be specified and carried out in such a way that their oversight activities protect the independence of 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 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.

The AASB does not think that a voluntary funding system is sustainable, noting that the nature of funding has the potential to impact the perception of independence. Accordingly, the AASB encourages the Trustees to find an alternative permanent funding system. The AASB believes that the work of the IASC Foundation and the IASB is important and is confident that if high quality accounting standards continue to be produced into the future, the Trustees will be able to source funding for both organisations.

Ideally, the IASC Foundation will soon be able to allow not only the free use of IFRSs, but also the related materials to encourage IFRS adoption, although the AASB appreciates the funding implications that may arise. The AASB notes, and appreciates, that in January 2009 the Trustees agreed that the IASB's standards should become free of charge through the IASB's website.

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.

The AASB considers that any involvement of the Trustees in the IASB's agenda-setting process may jeopardise the independence (both real and perceived) of the IASB. The AASB therefore supports an independent agenda-setting process of the IASB, which distances the Trustees from the IASB's technical processes.

The AASB considers that the IASB's current agenda-setting process should be improved, particularly in relation to its transparency and the process for re-prioritising items.

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.

The AASB thinks that the due process of the IASB as set out in the Constitution and in the IASB Due Process Handbook is sufficient. The AASB also supports recent enhancements, including the post-implementation reviews, as they demonstrate that the IASB is committed to setting and maintaining high quality, understandable and enforceable global accounting standards.

The AASB also notes the due process aspects of the *Statement of Best Practice*, which emphasises the need to provide various jurisdictions with sufficient time to properly expose and process consultative documents among domestic constituents. This is important to ensure that the IASB receives the best feasible input from a wide constituency, which in turn helps to boost acceptance of IFRSs. The AASB is concerned that recent departures from normal due process, inadequate comment periods on important issues such as consolidations and the proposals for retrospective application of certain amendments have not satisfied this expectation.

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?

Yes, a separate fast track procedure should be created, but not at the expense of high quality, understandable and operational global accounting standards. Therefore, the AASB would

expect such a fast track procedure would be used in only rare and exceptional circumstances and would normally only be used to defer or cancel an existing requirement. The AASB would not expect it to apply to a change to an existing requirement or creation of a new requirement. As part of the fast track procedure, the IASB should follow the current due process with respect to developing and pursuing the agenda and it should also publish an exposure draft regardless of the circumstances. Anything other than a 90-day plus comment period should only rarely be contemplated when the situation demands and the topic is limited in scope. Due consideration should still be given to constituents' comments and the SAC should be consulted as outlined in the Constitution. In developing a fast track procedure, the IASB should bear in mind the legal frameworks operating in countries that have adopted IFRSs and the processes that they have to follow before an IFRS becomes fully operative, including legal processes and translation of standards in non-English speaking countries. Consideration should also be given to the practicalities of the timing of consultation, for example the holiday/summer season in the Southern Hemisphere. The AASB therefore suggests that the IASB consult with national standard setters in order to develop a fast track procedure that takes into account such matters.

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 AASB understands that the SAC is now operating under new protocols, which looks encouraging for a more effective SAC in the future. The AASB notes that if the SAC is able to operate more effectively, there would be less need for other bodies to be created such as an Expert Advisory Panel and a Financial Crisis Expert Group.

While the SAC currently has a large number of members, which may reduce the Council's efficiency, the AASB considers that this is necessary to achieve a sufficiently broad spread of representation to achieve the Council's objectives.

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?

The AASB does not suggest any fundamental changes to the SAC's terms of reference.

The AASB would however like to suggest some editorial amendments with respect to section 6 as follows:

- 6 *In the interests of retaining an active and engaged membership, the membership of those individuals who do not attend in person three consecutive meetings will be asked to stand down from the SAC lapse.*

The AASB also thinks section 18 is ambiguous where it states “This subcommittee reports to the SAC, which in turn presents its views to the IASB.” The Trustees should clarify whether ‘its’ refers to the SAC’s views or the views of the subcommittee.

Other issues

14. Should the Trustees consider any other issues as part of this stage of their review of the Constitution?
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The AASB suggests that the Trustees give consideration to the IFRS ‘branding’ issue. The AASB believes that it is important for the IFRS brand to be protected so that only those countries that adopt IFRS in full can claim IFRS compliance.

The AASB has no other issues that it wishes to raise with the Trustees as part of their review.