Centre for Financial Market Integrity
CFA INSTITUTE

30th November 2009

Mr. Gerrit Zalm
Chairman of the Trustees
International Accounting Standard Committee Foundation
30 Cannon Street
EC4M 6XH
United Kingdom

Re: Comment Letter – *IASC Foundation, Part 2 of the Constitution Review, Proposals for Enhanced Public Accountability*

Dear Mr. Zalm,

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),[1] in consultation with its Corporate Disclosure Policy Council (CDPC)[2], appreciates the opportunity to comment on the *International Accounting Standards Committee (IASC) Foundation, Part 2 of the Constitution Review, Proposals for Enhanced Public Accountability* (Consultation).

The CFA Institute Centre represents the views of its worldwide members, including portfolio managers, investment analysts, and advisors. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protection. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the *CFA Institute Code of Ethics and Standards of Professional Conduct.*

EXECUTIVE SUMMARY

In our response, we reiterate what we see as primary issues. Namely these include:

- greater investor representation at the IASC Foundation,
- further clarification on the scope of the Monitoring Board (MB) activities and its engagement with investors, and
- ensuring the secure and diversified funding of the International Accounting Standards Board (IASB).

[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, Brussels and London, CFA Institute is a global, not-for-profit professional association of more than 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The Council is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the Council provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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In our specific comments, we articulate our opposition to the introduction of an emergency fast-track due process provision beyond the current minimum of 30 days and the reduction of maximum term of IASB members. We also articulate our support for:

- the decision not to enshrine 'principle-based' standards in the Constitution;
- the measure taken to ensure greater consultation by the IASB in its agenda setting, while ensuring it remains independent when determining its agenda.
- the proposals to include trustees from Africa and South America,
- the proposals to have a three year Constitution review, change the name of the IASCF and IASB and utilize the term 'financial reporting standards' as opposed to 'accounting standards'.

GENERAL COMMENTS

Even though the second round of the Consultation does not request input on investor representation, the role and composition of the MB and the sufficient and diversified funding of the IASB, we believe it is important to reiterate our views on these topics.

Investor Representation

An important issue that remains unaddressed by the Constitution is the limited investor representation at the International Accounting Standards Committee Foundation (Foundation) Trustees level**.** In an earlier comment letter[3] we stressed that increased investor representation would enhance the effectiveness of the Trustees and contribute to public confidence in their oversight of the IASB. The limited direct input of individuals with an investor background impairs the ability of the Foundation to meet its primary objective, which is to provide decision-useful information to present and potential capital providers or investors of an entity. Therefore, we strongly encourage the Foundation to appoint appropriate investor (See Appendix I for definition of "investor") representatives to the Trustees. This further strengthens the effectiveness and oversight of the standard setting process.

Monitoring Board

We are cognizant of the fact that the MB is established and functional, but we are concerned by the absence of clear engagement from the European Commission thus far. In our previous letter, we raised concerns about regulatory bias and the lack of investor representation, in the MB's composition. This remains an issue especially since there is no guarantee that the interests of regulators will always be universally aligned with those of investors. Investors believe that the goal of financial reporting is to provide information that reports the financial position and operating results of reporting companies as faithfully as possible. Regulators sometimes focus on economic or political factors and may prefer reporting standards that obscure the economics of reporting companies.

Another key concern is the scope of activities of the MB and the need for sufficient safeguards to ensure that it does not exercise undue influence on the standard setting process. Hence, clarification in the Constitution is needed to define the MB's responsibility for governance and oversight of the IASB and the role of the Trustees. However, our overall concerns about the composition and scope of activity of the MB remain and we believe more concrete and further steps need to be taken to address these concerns.

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[3] CFA Institute Comment letter on IASCF Constitution Review, 23rd September 2008

In the interim, given that there is no formal means for investors to communicate with the MB, we strongly urge the MB to schedule regular public meetings with investors to take into consideration their views. Such meetings would enhance transparency and instill confidence among investors in the due process.

Diversified Funding and Independence
We continue to believe that the Trustees must seek and obtain an entirely independent and sustainable source of funding for the IASB. This will ensure independence of the IASB and its standard-setting function from the influence of special interests.

SPECIFIC COMMENTS

Below is our response to some of the key issues raised in the Consultation.

Inclusion of Principles-Based Approach in the Constitution
We understand that the promise of principles-based standards has been a key element of seeking the acceptance of International Financial Reporting Standards (IFRS). At the headline level, the emphasis on a principles-based approach has connotations of reducing volume complexity and this bears some appeal. Hence, it is understandable that IFRS has sought to differentiate itself on this basis. However, we support the exclusion of any reference to or emphasis on a principles-based approach in the Constitution, for the following reasons.

- A critical examination of individual standards shows that the dichotomy between principles versus rules-based standards is often simplistic and misleading. For instance, an analysis of the path of the evolution of the accounting standards in the development of existing IFRS and/or preceding national generally accepted accounting standards shows how the pendulum can easily swing from a principles to a rules emphasis due to implementation difficulties, audit challenges and the desire by investors for increased information transparency and greater comparability.

- There is no consistent definition, and therefore understanding, of the requirements of principles-based standards. An example of the difficulty in defining principles-based standards is highlighted in a paper[4] that reviews the manner in which the term is applied by the United States Securities and Exchange Commission (SEC). An SEC report[5] identifies characteristics[6] that a standard has to meet if it is to be principles-based, however, it is not clear which of these characteristics are necessary or sufficient to meet the principles-based criteria and even when this term is applied, the criteria of doing so has not been explicit.

- There is a potential conflict between the goal of providing decision-useful information and principles-based information. For example, this has been evident in the level of compliance and quality of risk disclosure requirements arising from International Financial Reporting Standard 7 (IFRS 7): *Financial Instruments: Disclosures*, yet there could be reluctance by the IASB to

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[4] Dennis. I, 2008 ' A Conceptual Enquiry into the Concept of Principles-Based Accounting Standard', British Accounting Review, 40, Pg 260-271
[5] SEC - Study Pursuant to Section 108(d) of the Sarbanes Oxley Act of 2002, 2003
[6] The mentioned SEC report includes a concise statement of substantive accounting principle that incorporates the principles-based accounting objective. These include a) few, if any exceptions or internal inconsistencies b) provides an appropriate amount of implementation guidance c) is devoid of bright line tests and d) is consistent with and derived from, a coherent conceptual framework.

enhance these disclosures on the premise that the standard is principles-based. The lack of a robust enforcement mechanism for IFRS exacerbates this problem.

- The long-term benefits of principles-based standards remain unsubstantiated, partly due to the difficulties in definition as described.

For all the reasons noted above, the term "principles-based" should not be part of the Constitution. As opposed to enshrining this notion in the Constitution, we propose that there should be a better articulation and clarification of the nature of IFRS standards. Such an articulation should ensure the alignment between principles-based standards and the provision of decision-useful information.

Emergency/Fast-Track Procedures

We understand that situations, such as the ongoing credit crisis, may arise where the IASB faces enormous external pressure to undertake expedited accounting rule changes. However, it should be remembered that financial reporting information is primarily meant to faithfully represent the economic performance over multiple periods and it should never be seen as a tool of short-term regulatory policy interventions. The latter view creates, in our opinion, false emergencies that degrade financial reporting standards. In other words, accounting standards should not be seen as a means of arresting economic deterioration, as this is a futile policy choice as illustrated by recent events.

Even in circumstances that are deemed to be of an emergency nature, we strongly advocate for a minimum, yet effective, level of due process. Based on past experience, we are strongly opposed to formally establishing a fast-track process, and we do not believe any standard should be enacted within a due process period shorter than the current provision which provides for a minimum of 30 days. This minimum period permits stakeholders to review the proposed standards, consider their impact, and prepare an informed response.

The accounting standard changes[7] that have occurred during recent months due to political pressure being exerted on both the IASB and Financial Accounting Standards Board (FASB) illustrate the risks of "fast-track" standards. Clearly there have been undesirable consequences of accelerated due process. Importantly, compressed due process time-frames significantly heighten the risk of flawed decision outcomes by the IASB which may lead to insufficient transparency contributing to poor investment decisions and surprise investor losses. Additionally, fast-tracking standards, imposes burdensome and unrealistic translation, digestion, and feedback requirements on investors and preparers across multiple jurisdictions and increases the likelihood of misunderstandings of the new standards by the stakeholders. Furthermore, it most likely necessitates future, multiple and disruptive changes and increased implementation guidance.

[7] IASB October 2008 reclassification rules changes and FASB March/April FSP amendments.

Agenda-Setting
We strongly support the independence of the IASB in setting its agenda of activities and the subsequent evaluation and promulgation of standards. The IASB is an agent of multiple principals, with a primacy to investors and other capital providers as the end users of financial reporting information. The independence of the IASB is a public good given that it is the only way of safeguarding the capacity to act in the interest of all its stakeholders.

Nevertheless, in exercising its independence the IASB must act in the interests of investors and in a fashion that is consistent with its mission to provide a single set of high-quality standards. As rightly noted in the Consultation, concerns about agenda-setting are most likely symptoms of concerns about whether the IASB is actually responsive towards stakeholder inputs or even transparent about its agenda setting outcomes.

Therefore, we strongly support any improvements in the consultative process, including consultation with the IASB Standards Advisory Council (SAC) and Trustees on agenda items. This will ensure that the IASB is responsive and accountable in appearance and in fact.

Beyond these identified measures, we encourage the IASB to significantly refine its overall processes of engagement with stakeholders and especially in relation to investors. This includes the improved and broad based solicitation of investor views and creating greater transparency about the linkage between investor usefulness and standard-setting decision outcomes. We emphasize here that it is not only a matter of procedures and formal arrangements, but also, and perhaps more importantly, of a responsive mindset while ensuring the IASB independence. This can help build the trust that stakeholders have in the IASB's capacity to act in their interest and possibly stave-off some of the undue pressures.

Term of IASB Members
The current requirement is that IASB members serve a maximum of two five year terms. The Consultation proposes to restrict IASB member terms to a five year term that is renewable to a three year term with the exception of the chair who can serve two five year terms. We recognise the need for IASB members to bring to the table the benefits of their practical background. However, on balance, we do not support shortening the maximum term of IASB member terms by two years. We are concerned that this will increase the likelihood that, at an aggregate level, the IASB will be made up of less experienced members and this could impact on the pace and quality of completion of key projects. We believe that IASB members are likely to be most effective in their second term due to greater experience and if a member's term is renewed, shortening the term simply limits the benefit of their experience.

Trustee Diversification to Include Representatives from Africa and South America
Current requirements allow for six Trustees from the Asia/Oceania region, six from Europe and six from North America and four appointed from any area, subject to maintaining geographical balance. The proposal is to amend the latter criteria and have one each from Africa and South America and two appointed from any area, subject to maintaining geographical balance.

We support the proposal to diversify geographical representation. We believe that an all inclusive regional representation will provide a platform for full due process and reception of views in the setting of standards. However, we believe the targets for geographical diversity should be re-assessed no less than every five years to ensure the targets adequately and fairly represent a broad base of international interests. We believe that representation should take into account the size of financial markets and the use of IFRS in different geographies, and both will change over time.

Other Proposals
We are supportive of the proposals to implement a three year Constitution review and change the name of the respective organizations to the IFRS Trustees and IFRS Board. The change from “accounting” to “financial reporting” in both the literature and organisation titles is consistent with the notion of information being primarily generated for external communication purposes.

CLOSING REMARKS

If you, other board members or your staff have questions or seek further elaboration of our views, please contact either Vincent T. Papa, CFA, by phone at +44.207.531.0763, or by e-mail at vincent.papa@cfainstitute.org.

Sincerely,

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Sandra J. Peters, CPA, CFA
Head, Financial Reporting Policy Group
CFA Centre For Financial Market Integrity</td><td>/s/ Gerald I. White
Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council</td></tr>
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cc: Corporate Disclosure Policy Council

APPENDIX I

Definition of Investor

The “investor” referenced in our letter should be an individual who has achieved, through education, examination and experience, a level of professional competency. For example, a candidate could include an investment professional with a decade or more of buy-side or sell-side experience who is the holder of a relevant professional designation (such as a CPA or Chartered Financial Analyst® (CFA®)) and/or who has an MBA with a concentration in accounting or finance. An extremely important aspect to the “investor” definition is the ability to bring to accounting standard setting decisions an emphasis on the usefulness of financial statement data for investment decisions, including the need for comparability, consistency, and transparency. Preparers and auditors of financial statements may not understand how those statements are used, and usually have a preference for flexibility and confidentiality (preparers) and auditability (auditors). In essence, an investor is an individual whose career advancement and compensation are tied directly to their success or failure at making significant investment decisions.

As in any profession, “investors” come in a variety of flavors – frequently starting in assistant analyst support positions, moving up to full analyst responsibilities where their recommendations are actively used in investment decisions, advancing further to management roles (i.e., overseeing the activities of other investment professionals), and finally achieving executive positions within their companies or institutions. It is important for the International Accounting Standards Committee Foundation (IASCF) to recognize that as an individual makes that last transition, their role as an “investor” may undergo a significant change. The orientation of the Chief Executive Officer or other management level officer of a mutual fund, bank, or brokerage firm is likely to be much more closely associated with the priorities of preparers, since they are themselves responsible for preparing such public financial statements, and less linked to the needs and desires of analysts who are using these statements. While it is extremely important for the IASCF to receive input from such individuals, it is likely that financial statement users in non-management ranks and their immediate supervisors (such as directors of research) may provide more representative input as “investors.”