

25th June 2004

Andrea Pryde
IASB
30 Cannon Street
London EC4M 6XH

Dear Ms Pryde

STRENGTHENING THE IASB'S DELIBERATIVE PROCESSES

The global organisation of Ernst & Young is pleased to respond to the IASB's invitation to comment on the above consultative paper.

In our letters dated 11 February 2004 and 23 June 2004 to Mr T Seidenstein and Mr P A Volcker, respectively, regarding the IASC Foundation's review of its constitution, we drew particular attention to the need to expand and reinforce the IASB procedures set out in the Constitution and *Preface to International Financial Reporting Standards* in order to ensure due process in the development of IFRS's and to increase the transparency of the Board's operations. We are pleased to note that several of the specific process improvements we recommended are addressed in the Board's paper.

Although the improvements set out in the Board's paper should help to enhance public confidence in the Board's procedures, we believe that in order to allay the legitimate concerns of its constituents the IASB must set out the specific criteria it expects to apply in determining the particular deliberative processes it expects to follow in each project. We would expect these criteria to be included in the handbook of policies and procedures related to its due process that the Board intends to publish.

We note the comment in the consultative paper that the IASB must balance steps to enhance its deliberative processes with the need for timely decision-making. However, in our view the need for timeliness in decision-making cannot justify shortcomings in due process. If necessary, projects must be delayed to allow full and open due process to take place. In this regard, we note the references to time constraints related to the IASB's March 2004 deadline for having a stable platform of standards in place. The widespread perception that the Board's processes have not been sufficiently rigorous, open-minded or transparent might have been avoided had the Board prioritised its agenda and work programme differently, for example, by avoiding the temptation to change standards in order to achieve convergence with US GAAP (as in the case of IFRS 5) and by recognising early on the need to address major concerns expressed by preparers about its proposals (as in the case of IAS 39).

Scope of activities in respect of which deliberative process should be strengthened

We agree with the Board's analysis that particular attention should be paid by the Board to the accessibility and transparency of the IASB's deliberative process, to the IASB's responsiveness to constituents' comments and to the extent of consultation before releasing proposals and standards. However, in our view it is essential that, as well as addressing the nature and extent

of the IASB's deliberative process, the IASB also addresses the scope of its activities in respect of which deliberative process needs to be strengthened.

In particular, the IASB should take steps to involve all its key constituents in the development of its agenda and work programme. As we stated in our letter of 11 February 2004, the Board has allowed its agenda to lengthen without proper prioritisation, as a result of which it has tried to do too much too quickly, without full consideration of the practical implications and economic impact of its proposals. Accounting theory and convergence with US GAAP have been given priority over practical aspects such as the coherence of standards effective at any point in time, the change management implications of the standards the Board has developed, and the auditability and understandability of financial statements prepared on the basis of those standards.

In our view, the IASB should issue for comment a draft three- to five-year work programme, explaining the rationale for, and relative importance of, the elements of the programme in the context of the IASB's overall priorities. This would result in greater clarity about the relationship between the Board's objectives of developing high quality standards and of achieving convergence between US GAAP and IFRS.

A further matter not addressed in the consultative paper is the length of the exposure period. In order to allow sufficient time for exposure drafts to be translated and for constituents to develop their comments, longer comment periods should be set for proposals that involve significant change to current accounting practice or are especially complex.

Accessibility and transparency of the IASB's deliberative process

Access to IASB discussions

We support the IASB's proposals to improve access to its meetings by broadcasting them over the Internet and archiving the broadcasts.

Availability of IASB documents

We acknowledge that the IASB has expanded the observer notes it provides for its meetings. Nevertheless it is still very difficult for outsiders to follow the Board's discussions without access to the Board papers and we can see no reason why Board papers should not be made available at least to observers during the meeting.

Publication of comment letters

We support the IASB's decision to make comment letters freely available on its website as soon as they are received.

The IASB's responsiveness to constituents' comments

Response to comment letters

We support the IASB's decision to publish on its website a summary of the Board's position on the major points raised in comment letters.

Publication on the IASB's website of latest proposals for new standards

We support the IASB's decision to publish agreed amendments to exposure drafts and near-final drafts of forthcoming exposure drafts and standards.

We are not clear how the IASB's decision to use existing advisory groups or an appropriate expert group to discuss near-final drafts of exposure drafts and standards will differ from the current practice of having near-final drafts of exposure drafts and standards reviewed by an expert group. If the difference is that there will be an active and collective interchange between the review group and the IASB as a whole, rather than between individual reviewers and the IASB staff, we are supportive of the change. However, we believe that advisory groups should be established at the outset of each project and their advice sought throughout the project. The Board needs to be aware of the practical implications of its thinking long before an exposure draft or standard has nearly been finalised.

The extent of consultation before releasing proposals and standards

We acknowledge that the Board has made some use of each of the principal consultation mechanisms over the past three years. However, in our view insufficient use has been made of several of these mechanisms, such as public hearings, while greater use should have been made of advisory groups from the early stages of projects, and greater time devoted to field testing.

Use of steering committees/working parties/advisory groups

We strongly support the use of advisory groups for every IASB project. Advisory groups bring in-depth knowledge and practical experience in the relevant area and should be set up at the outset of and involved throughout a project. We agree with the observation in the IASB's paper that the IASB will need to examine further ways to ensure that the membership of advisory groups best reflects the diversity and breadth of interests involved in a particular area. Although advisory groups will reflect the opinions and prejudices of their members, the IASB must adopt an open-minded attitude in dealing with advisory groups.

Public hearings and field testing

There is widespread and growing concern about the complexity and practicability of the standards developed by the IASB and about the understandability of financial statements based on the standards. In our view, field testing is essential in every project in order to achieve a balance between conceptual integrity on the one hand and practicality and understandability on the other. The extent of the field testing will depend on the significance of the changes in accounting that are under consideration.

We accept that public hearings and round tables should be reserved for projects in which significant accounting changes might be proposed, and believe that such hearings and round tables should be held before the exposure period, at a stage when the hearing can be based on clearly articulated discussion papers that outline key directions and conclusions that the exposure draft will propose.

However, there have been a number of such IASB projects on which no public hearings have been held and we believe that the IASB should make a far stronger commitment to both public hearings and meaningful field tests. The statement in the consultative paper that 'it is likely that public hearings and especially field visits will become a more common feature of [the IASB's] work' does not express an appropriate level of commitment to these two essential elements of a transparent due process.

Discussion Papers

In our view there should be a presumption that the IASB will issue a discussion paper on every topic that is expected to result in an exposure draft. We agree that this would be a major shift

from existing international practice but note that the *Preface to International Financial Reporting Standards* includes 'publishing for public comment a discussion document' as one of the steps that are 'normally' involved in due process for projects.

Re-exposure of proposals

We acknowledge that determining the need to re-expose an issue is a matter of judgment, based on the criteria discussed in paragraphs 29 to 31 of the consultative paper. However, the paper does not give any indication that the Board has ever faced difficulty in making this judgment and puts forward no suggestions as to how this aspect of the IASB's deliberative processes could be strengthened.

In our view, there have been cases in which very significant changes have been made to exposure drafts that have not been discussed with constituents before the change was embodied in the final standard. This has been the case, for example, with IFRS 2, IAS 31 (which was not included in the Improvements Project but has nevertheless been changed significantly) and the fundamental change in the IAS 39 impairment criteria from 'significant and prolonged' to 'significant or prolonged'.

The consultation paper discusses re-exposure but does not reach specific conclusions about the terms for re-exposure. In our letter of 23 June, we expressed the view that the IASB's voting arrangements should be changed so that a standard would not be approved if more than one third of the Board did not vote in favour of approval, ie, unless the standard is approved by two-thirds of the Board. We believe that a lower threshold is appropriate for decisions to re-expose. Accordingly, in our view it would be appropriate to require re-exposure when more than one third of the Board believes that the exposure draft has been changed significantly enough to justify re-exposure.

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Should you wish to discuss any aspect of this letter, please contact David Lindsell on 020 7951 4463.

Yours faithfully

Ernst & Young