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Dear Mr Zalm

**Review of the IASCF Constitution:
Identifying Issues for Part 2 of the Review**

Deloitte Touche Tohmatsu is pleased to provide comments to the IASC Foundation Trustees on their discussion document *Review of the Constitution: Identifying Issues for Part 2 of the Review* issued in December 2008.

In our view, the IASCF Constitution should identify the principles of governance and oversight of the IASCF and the IASB. It should be relatively short and allow the various components of the IASCF a necessary degree of operational flexibility. This operational flexibility has allowed the IASB to react quickly to crises (e.g., that in October 2008). Were the Constitution to be overly detailed, this ability to act with agility might be compromised.

However, we have identified areas within the Constitution where we see the need for change: to align the IASCF Constitution and the IASB *Framework*; to require that IFRS be based on clear principles; and to clarify certain aspects of the IASCF's governance.

Many of our comments encourage the IASB and the Trustees to enhance the documentation of operational aspects of their activities. Within the constitutional framework, the IASB and the IFRIC have voluntarily documented their operational practices in their respective Due Process Handbooks, to which they adhere generally and the SAC developed its own 'Terms of Reference and Operating Procedures'. We believe that the IASB should amend its *Due Process Handbook* to give constituents an opportunity to comment on the IASB's agenda and relative priorities; to be required to conduct field tests when a proposal would change current practice in an untested way;

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and to require more rigorous reconsideration of a principle in light of substantial unorchestrated opposition.

Many of the criticisms being levelled at the IASCF and the Trustees in particular stem from a lack of transparency and understanding around what they do and how they do it. We encourage the Trustees to prepare a document that explains their operating procedures and how they exercise their oversight functions.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ken Wild', written over a horizontal line.

Ken Wild
Global IFRS Leader

Appendix 1

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?

We believe that the objective remains appropriate, but that the Trustees should take the opportunity to align the objectives of the organisation as expressed in the Constitution as far as possible with the objective of general purpose financial reporting as it is expressed in the IASB's proposed *Framework*. Although any change to the IASCF Constitution should use the words in the final version of Chapter 1 of the *Framework*, using the words in the May 2008 Exposure Draft of *An Improved Conceptual Framework for Financial Reporting* the Objective would be:

to develop, in the public interest, a single set of high quality, understandable and enforceable global financial reporting ~~accounting~~ standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help present and potential equity investors, lenders, creditors and other participants in the world's capital markets ~~and other users make economic decisions~~ in their capacity as capital providers.

And that, in discharging this responsibility, the IASB should

take account of, as appropriate, the special needs of private entities [or however the IASB refers to the 'SME project' in the final Standard] ~~small and medium-sized entities~~ and emerging economies.

In suggesting these changes, we wish to emphasise that the world's capital markets include public and private capital markets; both of which seem to have similar (although not identical) information requirements. That is, the user of the financial statements may be different between public and private capital markets, but the objective of financial reporting remains the same: to provide high-quality, transparent and comparable financial information about the reporting entity that is useful to present and potential equity investors, lenders, creditors and other capital market participants in making economic decisions in their capacity as capital providers.

The disclosure requirements in public capital markets are usually thought to be more extensive than for private ones, but this is an issue already being addressed by the IASB in its IFRS for non-publicly accountable entities project.

Is 'emerging economies' the correct term?

We believe that there is some misunderstanding of the term 'emerging economies'. Sometimes, the term is used (e.g., the FTSE Emerging Markets Index and the Morgan Stanley Emerging Markets Index) to refer to large second-tier economies such as Argentina, Brazil, Chile, China, India,

Russia, South Africa and Taiwan. We question whether economies of this size are those contemplated in objective 2(c), or whether the intention is to highlight the needs of the one hundred or more smaller ‘developing countries’ and ‘economies in transition’. If the intention is to address the latter, we suggest modifying objective 2(c) to refer to ‘developing countries and economies in transition’, which is the term used by the United Nations’ Intergovernmental Working Group of Experts on International Standards on Accounting and Reporting (ISAR). We note that the Constitution refers to ‘emerging markets’ in paragraph 37(f) and recommend that whatever term is used in paragraph 2(c) should also be used in 37(f).

How might the IASCF and the IASB implement objective 2(c)?

Referring to the ‘special needs of emerging economies’ in the objectives of the organisation raises expectations among constituents. Objective 2(c) refers back to objectives (a) and (b), which are to develop high quality standards and promote their use and rigorous application. We believe that the forthcoming IFRS for Private Entities will help enhance access to capital by companies, regardless of size, in developing countries and economies in transition. We believe that the IASCF’s programme to develop comprehensive training materials to accompany the IFRS for Private Entities and make them available without charge in multiple languages will help bring about use and rigorous application of the standard.

At the same time, we also believe that the main challenges in developing countries and economies in transition are a lack of capacity and experience in many different aspects of the financial reporting infrastructure generally, such as accounting education and training, support materials and software in local languages, effective enforcement of standards, an professional accountancy body that complies with the obligations that IFAC imposes on its members, and experienced, effective external auditors. Building capacity in these areas is, for the most part, beyond the remit of the IASCF and the IASB. But in our view they are closely related to what is intended by the inclusion of ‘emerging economies’ in objective 2(c).

While we support clarifying objective 2(c), we believe that the intention expressed remains appropriate and should not be deleted from the Constitution. However, it is important that the IASCF and the IASB and their constituents have a clear understanding of what is intended by that objective and that constituents have realistic expectations of what the IASCF and the IASB can and cannot do to achieve it.

- 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?*

We agree that the IASCF Constitution should require that the IASB should develop financial reporting standards that are based on ‘clear principles’ i.e., the objective of the IFRS. These principles must be explained clearly in each IFRS. We would use the phrase ‘clear principles’ in the Constitution in preference to ‘principles-based’, for which there is no consensus on what that phrase means. The Constitution should not be overly-prescriptive on what should be implied by ‘clear principles’, but it could comment as follows:

Financial reporting standards are based on clear principles that result in financial reporting information that is a faithful presentation of economic reality and is responsive to users’ needs for clarity and transparency. In addition, such standards will be consistent with a clear Conceptual Framework; will be based on an appropriately-defined scope that addresses a broad

area of accounting; are written in clear, concise and plain language; and allow for the reasonable and appropriate use of professional judgement.

We acknowledge that any IFRS based on clear principles will be accompanied by application guidance, but we would expect that this would be kept to a minimum and illustrate the principles rather than detailed examples of particular facts and circumstances. Extensive application guidance is often an indicator that the principle in the standards is not as clear as it should be.

If the Trustees incorporate a ‘clear principles’ requirement in the Constitution, the IASB should be asked to amend its *Due Process Handbook* to accommodate and elaborate on how it implements the requirement in practice – in accordance with its usual period for public comments. This will help to ensure that there is consensus among the IASB’s constituents about (i) what ‘financial reporting standards based on clear principles’ means in practice; and (ii) that how the IASB expects to achieve that objective in practice is appropriate and accepted.

- 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.*

We believe that it is important to clarify that financial reporting by not-for-profit entities and public sector entities are potentially very different and that any discussion should not address these two sectors as if they were necessarily the same or faced the same issues.

The IASB’s primary function at present is ‘private sector’ financial reporting standards. We believe that this responsibility remains appropriate and should not change at this time. At present, we are uncertain whether any of the IASB members has significant experience in the public sector and thus whether the IASB has the appropriate skills to set both public- and private sector financial reporting standards. We believe that, in the medium-term at least, there are many issues requiring attention in private sector financial reporting and the IASB should not have the constitutional distraction of having to address public sector issues.

Currently the International Public Sector Accounting Standards Board, which operates under the auspices of the International Federation of Accountants, issues International Public Sector Accounting Standards. In setting these standards, the IPSASB ‘considers and makes use of’ International Financial Reporting Standards as well as pronouncements from other sources with an over-arching objective that IPSAS are consistent with IFRS ‘to the extent those pronouncements are applicable and appropriate to the public sector’ (IPSASB *Interim Terms of Reference*, 10). There is a high degree of cooperation between the IASB and IPSASB and the respective staff members. This should be encouraged to continue (see below, Q4).

In due course, although not as a current priority, the IASB should address issues in financial reporting by not-for-profit entities. There are some specialist areas (e.g. non-reciprocal transactions/ contributions; accounting for collections, heritage assets, etc; and financial statement presentation in the lack of an ownership structure).

- 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?*

We note that nothing in the Constitution prohibits the IASB from cooperating or collaborating with any other body with a legitimate interest in financial reporting standards. Indeed, we have seen and support the IASB's outreach not only to financial reporting standard-setters and regional bodies that are closely involved in financial reporting standards, such as the European Financial Reporting Advisory Group, but also to standard-setters that operate in areas that are complimentary to financial reporting, such as the International Valuation Standards Committee and the UN ECE and CRIRSCO groups on the measurement of oil and gas reserves.

This *collaboration* contributes to the success of IFRS as a global reporting language, but we think that it is an operational aspect of standard-setting. If the Trustees think that it is important to document willingness or an undertaking to enter into such cooperation, it should ask the IASB to amend their *Due Process Handbook* how this might be done while preserving the Board's operational transparency.

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.*

We note that the IASC Foundation Trustees announced the completion of Phase I of the Constitution review on 29 January 2009. Included in that announcement was the formation of the Monitoring Group and the publication of the Terms of Reference agreed between the IASCF and the Monitoring Group Members and Observer.

We believe that the IASC Foundation Constitution should be amended to reiterate the principles recited in paragraphs 5 and 4 of the Memorandum of Understanding, for example:

Governance of the IASC Foundation

- 3 The governance of the IASC Foundation shall rest with the Trustees. In discharging this responsibility, the Trustees shall collaborate with the IASCF Monitoring Board in the manner specified in the 'Memorandum of Understanding to strengthen the institutional framework of the IASCF' dated [dd mmm 2009] (cf MoU paragraph 4). That MoU does not alter the terms of the relationship between the Trustees and the IASB, neither does it alter the Trustees' responsibilities as described in this Constitution (cf MoU paragraph 5). ~~and such other governing organs as may be appointed by the Trustees in accordance with the provisions of this Constitution.~~ The Trustees shall use their best endeavours to ensure that the requirements of this Constitution are observed; however, they are empowered to make minor variations in the interest of feasibility of operation if such variations are agreed by 75 per cent of all the Trustees.

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?*

In our view the mandatory geographical apportionment at the Trustee level is, and continues to be appropriate.

However, it would be useful to all constituents to understand the basis for the apportionment, for example, whether it is based on national or regional GDP or securities markets' capitalisation or other indicators. In our view, the formula for the apportionment should be fixed but the actual distribution should be flexible and should be reviewed from time to time.

- 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.*

Funding the organisation (paragraph 13(a))

While noting the progress highlighted in the Trustees' press release of 29 January 2009, we share the concern of others about the progress of funding arrangements (paragraph 13(a)). See also our response to Q8.

Operating procedures for the Trustees (paragraph 13(b))

The IASCF's standard-setting components (IASB and IFRIC) have developed and issued documents that explain what they do and how they do it (their *Due Process Handbooks*). The Standards Advisory Council has a similar document in their *Terms of Reference and Operating Procedures*. We are concerned that the operations of the Trustees (paragraph 13(b)) are not well understood and that some of the stress on the organisation stems from this lack of understanding. Consequently, we would encourage the Trustees to document their operating procedures in a manner similar to the IASB, IFRIC and SAC.

Open meetings (paragraph 13(f))

While we note that there are public sessions at meetings of the IASCF Trustees (paragraph 13(f)), we would encourage more sessions to be opened to the public and for better observer resources to be provided. (Again, the IASB, IFRIC and SAC provide very detailed resources to Observers, which are very helpful to Observers and others to understand those discussions and to ensure better and more accurate communication with constituents.)

Oversight of the IASB

Before we can comment on the “effectiveness of the Trustees’ oversight activities of the IASB” (paragraph 15), it would be helpful for us to understand how the Trustees undertake this exercise and the criteria they employ. Therefore, once again we encourage the Trustees to document their operating procedures and to include in that document the criteria against which they assess the effectiveness of the IASB.

Standards Advisory Council

We note the appointment of the reconstituted Standards Advisory Council in February 2009 and support the inclusion of members as representatives of constituencies on the Council. We think that this group has the potential to be very useful to the IASB, provided that it is seen as an effective conduit for an *exchange* of views between constituents and the IASB.

Consequently, we recommend that, as part of its responsibility to monitor the effectiveness of the IASB, the Trustees develop criteria that will allow them to assess how effectively the IASB engages with and responds to the Standards Advisory Council.

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. 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.*

We are firmly in favour of a principle that those parties who use the IASC Foundation ‘works’ (IFRS and related documents) should bear the burden of funding the IASC Foundation’s standard-setting activities. We believe that this is best left in the hands of local financial market regulators, who in turn should be responsible for raising the money from their constituents, including but not necessarily limited to preparer companies. We also stress that the method of funding should maintain *and be seen to maintain* the independence of the IASB from national and regional governments, the accounting profession and individual preparer entities.

Insofar as they support this approach to funding the IASCF, we support the principles already established by the Trustees: that the funding should be broad-based; compelling; open-ended; and country-specific.

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.*

We note that, in the United States, the FASB and the Financial Accounting Standards Advisory Council undertake an annual survey of the FASB’s constituents on the FASB’s technical agenda. This survey has a high degree of credibility both at the FASB and with constituents. In particular

the survey assists the FASB in identifying trends in financial reporting, which in turn assists them in making resource allocations as appropriate.

In the past, the IASB has not been particularly successful in developing communications with constituents with respect to how it determines its technical agenda and assigns relative priorities. We encourage the IASB, SAC and the Trustees to give constituents an opportunity to comment on the IASB's agenda and relative priorities. Part of the Trustees' oversight responsibilities would be to determine how the IASB uses the input it receives; how it communicates to those who participate in the survey about how it has used those responses; and how its resource allocation decisions and priorities were influenced by the feedback it received.

The IASB must have the discretion to make changes to its technical agenda without excessive interference; however we agree that it would be appropriate for the Trustees to review specifically the exercise of that discretion as part of its annual review. The Board needs the ability to be flexible, while in normal circumstances maintaining its wide consultation with constituents, the SAC and others.

Some constituents are of a view that the agenda has been too heavily focused on convergence with US GAAP and 'esoteric' conceptual issues for several years. While many of the IASB's projects are part of the Memorandum of Understanding with the FASB, the IASB has also undertaken projects that have been responsive to requests from Europe, New Zealand, China and Canada. Their consultation has increased, as has the quality of the documentation supporting agenda proposals.

The regular review of the technical agenda that occurs during public IASB sessions, which more recently have been accompanied by a thorough assessment developed by the senior staff, are very useful documents for regular followers of the IASB. However, they are not documents designed to arrest the public's attention. Consequently, we are concerned that the perception that some constituents are more important than others remains and the IASB should improve how it communicates its agenda-setting decisions to its constituents.

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.

In general, the procedures in the IASB's Due Process Handbook (and the IFRIC equivalent) are satisfactory and sufficiently flexible to permit the effective discharge of the IASB's standard-setting responsibilities, however there are areas in which the IASB's due process could be enhanced further.

We support the IASB's self-imposed decision to issue a discussion document for all significant new topics. However, there is some concern that, by including their 'preliminary views', there is a perception that the IASB is stifling debate or inviting constituents to join a conversation already in progress. These constituents would prefer to see discussion papers present the issues and possible approaches in as neutral a fashion as possible. On the other hand, we acknowledge that if a particular alternative has been included in the discussion document for reasons of completeness,

but has little likelihood of forming the basis of an IFRS, the IASB should be honest with its constituents at as early a stage as possible.

We believe that one way in which the IASB could enhance its due process would be to require a substantive redeliberation of a preliminary view if there is a *substantial un-orchestrated* level of opposition to a principle. The IASB would need to debate why so many constituents were opposed to the IASB proposal. Nor should they ignore opposition on conceptual grounds: often opposition is based on practical considerations that the IASB may not have deliberated.

The IASB should also be encouraged to conduct field tests when their proposals are controversial or change existing practice in an *untested* manner. These field tests should be conducted in a variety of jurisdictions to demonstrate that the proposal is a substantively better treatment than any other.

We would also encourage the Board to make a preliminary assessment of the practical and cost/benefit consequences of a particular approach before committing itself to that approach.

Finally, we wish to support the views of many constituents expressed in public and in correspondence with the IASB that any changes to IFRS must be accompanied by an opportunity to comment on such proposals. While we acknowledge the extraordinary circumstances of October 2008, if it is to maintain its reputation as the global independent private-sector financial reporting standard setter, the IASB should ensure that some period for comment (normally a minimum of 30 days) be offered for all standard-setting activities. The Trustees should not permit the IASB to bypass its due process in response to pressure from any region or jurisdiction. This is an operational aspect of standard-setting and is best documented in the IASB's Due Process Handbook. (See also our comments on Q11.)

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?*

We do not support creating a separate 'fast track' procedure for changes to IFRS.

In extraordinary times, the FASB due process provides for shortening the "normal" comment period, and this has been enacted for some of the recent projects associated with the credit crisis. While recognising the urgency of those projects, we commend the balance shown by the FASB to continue to ensure some period for comment rather than overriding its due process. We note that the IASB's Due Process Handbook (paragraphs 97-98) also provides for very short comment periods without having to obtain an explicit permission of the IASC Foundation Trustees. However, we think that the Due Process Handbook should be amended to acknowledge that comment periods shorter than 30 days could be used in particularly extreme circumstances. While we acknowledge the extraordinary circumstances of October 2008, if the IASB is to maintain its reputation as the global independent private-sector financial reporting standard setter, the IASB should not bypass its due process in response to pressure from any region or jurisdiction.

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?*

Comments on the composition must await the appointment of the 'new' SAC, but as this will be the third time the SAC has been restructured in seven years, its record as a troublesome group for which to define the appropriate membership and role is well known.

The SAC can be very effective in bringing to light different views on financial reporting issues and as such, provides valuable input to the IASB's agenda-setting and technical deliberations. In particular, we support the inclusion of members as representatives of constituencies on the Council.

We have noted elsewhere in this response ways in which the IASB might work with the SAC more effectively and discuss in a meaningful way with it why the IASB intends to act or has acted in a particular way, how it has taken some views of the SAC into account and why it disagreed with others. This would help to make the SAC more in the nature of 'insiders' and better able to act in their ambassadorial role (see paragraph 2 of the SAC's Terms of Reference).

13 *Are there elements of the terms of reference of the SAC that should be changed?*

We believe that the SAC's terms of reference as defined in paragraph 38 of the Constitution and elaborated in the SAC's *Terms of Reference and Operating Procedures* are appropriate.

Other issues

14 *Should the Trustees consider any other issues as part of this stage of their review of the Constitution?*

Paragraphs 24 and 41 of the Constitution provide that the IASB Chairman shall also be the CEO of the IASC Foundation. Given the very heavy technical workload of the IASB Chairman (including travel to meet with constituents), we recommend that the Foundation and the standard-setting activities be separated completely by appointing a CEO of the IASCF, one who is not a member of the IASB or the IASB/ IFRIC staff.

In addition, paragraph 43 refers to specific roles within the IASCF (director of operations and commercial director). We see no reason why some senior roles should be named and others not. We recommend that this paragraph be deleted or made more generic.