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DRAFT RE: CESR's response to the consultation regarding International Accounting

Standards Committee Foundation Review of the Constitution Part 2

The Committee of European Securities Regulators (CESR) has considered EFRAG's draft comment letter on the second part of the International Accounting Standards Committee Foundation's (IASCF) review of the Constitution.

We thank you for this opportunity to comment on your draft letter and are pleased to provide you with the following comments:

1. In general, CESR is supportive of the comment letter prepared by EFRAG.
2. In its review, the IASCF raises a number of questions for consideration related to the Constitution of the IASCF, the IASB and other bodies within the organisation and asks in particular whether the sections relating to the Monitoring Board should be modified to reflect more accurately the creation of the Monitoring Board and its proposed role. Following its creation as a result of the first part of the Constitutional Review in 2008, the Monitoring Board will play a key role in the future work of the IASCF and in the governance of the IASB. Amongst other things, the Monitoring Board will participate in the process for and approve the appointment of the Trustees. According to the Constitution, the Monitoring Board's main task will be to provide advice to the Trustees on how they should meet their responsibilities. In addition there will be a Memorandum of Understanding between the Monitoring Board and the Trustees. Like EFRAG, CESR thinks the description in the current version of the Constitution is sufficient.
3. The Trustees welcome comments on the effectiveness of their oversight activities relating to the IASCF and the IASB. CESR believes the creation of the Monitoring Board will contribute to enhancing the effectiveness of the work done by the Trustees and does not consider further amendments to be necessary until more experience has been gained of how the new structure is working in practice.
4. CESR notes that decision-making within the Monitoring Board is by consensus. All other groups within the IASCF follow a different decision making process based on simple or qualified majority. CESR believes decision making principles should be consistent throughout the IASCF organisation.



5. CESR supports EFRAG's suggestion that the IASB's agenda process should be more consultative. However, rather than transferring to the Trustees, CESR believes responsibility for setting and prioritising the agenda should remain with the IASB only or vest in both bodies jointly, because this responsibility is an essential element in preserving the independence of the standard setting process. Similarly, CESR also believes use of public consultation leads to a more transparent and legitimate standard setting process which positively contributes to the independence of the IASB.
6. In setting and implementing its agenda, CESR thinks the IASB should set itself an objective of ensuring the stability of the new standards it approves, as would be expected of high quality solutions grounded on a principle based approach. This objective would also be in line with the aim of achieving global high quality accounting standards that establish a good basis for consistent application and enforcement. The Trustees should also ensure, as EFRAG has suggested, they take into consideration the potential impact of the volume of the IASB's proposed activities so that constituents are not overly burdened with vast amounts of consultative material and new standards within a relatively short timeframe.
7. CESR supports EFRAG's suggestion of having some form of explicit process which explains why the IASB is not of the view re-exposure is necessary in some cases even when significant changes to ED's have been made. However CESR thinks that the number of responses is not a relevant indicator here, as an assessment regarding possible re-exposure should be based on the technical quality of the arguments raised by the respondents.
8. The paper also invites comments regarding possible fast track procedures for making changes to IFRSs in cases of emergency. Unlike EFRAG, CESR is of the view that the IASB should develop due process procedures – including public consultation – that enable it to amend its standards in response to emergency circumstances. In addition thought should be given to using the Monitoring Board, as a high-level group, to advise the IASB on the degree of apparent consensus regarding the urgency of a specific proposal which in turn could help the IASB in deciding what due process procedures are appropriate including the length of the public consultation period.

Our detailed comments are set out in the appendix to this letter. I would be happy to discuss any of these issues further with you.

Yours sincerely,

Eddy Wymeersch



Appendix: Answers to the questions included in the IASCF Constitution Review Part 2

Question 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?

1. Like EFRAG, CESR considers it is appropriate to place special emphasis on participants in the world’s capital markets and other users making economic decisions. Owing to their high quality and complexity IFRSs are mainly intended for use by listed companies, however the reference made in the Constitution to their taking into account the particular needs of small and medium-sized entities and emerging markets could increase the importance of IFRS over the coming years and as such is considered helpful.
2. However, it is important that IFRS remains a single set of high quality, global standards and by definition small and medium-sized entities need accounting standards that are simpler and therefore potentially of a lesser quality than their listed counterparts. The particular needs of small and medium-sized entities should not therefore detract from the aim of striving for the global high quality solution that IFRSs represents for listed entities.

Question 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?*

3. Along with EFRAG, CESR thinks that an explicit reference to the principles based approach should be included in the Constitution but does not believe it is necessarily desirable to keep such reference merely high-level. Clear guidance should be added on what “principles based” means dealing specifically with the need to find a proper balance between a very broad principles based approach and the requirement for published implementation guidance, the main criterion here being the need to ensure consistent application. Consequently where the principle is clear and the risk of inconsistent application is low, there will be no need to publish implementation guidance whereas in cases where the principles within a particular area are complex and the risk of inconsistent application is high, there will be a need to publish extensive implementation guidance.

Question 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 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.*

4. CESR supports EFRAG’s view that extending the IASB’s remit to not-for-profit entities and/or the public sector is not appropriate at this time as this could potentially represent a significant drain on the IASB’s resources at a time when there are many more important and



urgent accounting issues already on the IASB's agenda. Given the IASB's workload both current and foreseen, such an extension might not be wise and might mean the main objectives of IFRS remain unachieved. CESR shares EFRAG's view that the IASB's agenda is too full already.

5. CESR's view is that such activities should be performed by other independent organisations which could be created under the IASC Foundation, not by the IASB itself. CESR recommends the IASCF should consider creating a structure similar to the existing IFAC, with several Boards under its scope. This idea could be further explored as a response to the objective of closer collaboration with organisations whose objectives are compatible with those of the IASCF, as touched on in question No. 4

Question 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?*

6. We agree with EFRAG that there is no reason why, in principle, the Constitution should not allow for closer collaboration with organisations other than standard setters, by expanding the scope set out in paragraph 28 of the Constitution. However, in practice the current situation has not prevented the IASB from close cooperation with other organisations, such as EFRAG or CESR. We do not therefore see a strong need for such a provision to be explicitly implemented in the Constitution itself.

Question 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.*

7. CESR is of the same view as EFRAG that the description included in paragraphs 18 to 23 of the 1 February 2009 version of the Constitution is sufficient and no further changes seem to be needed. CESR considers such changes represent a significant enhancement to the governance of the IASCF as an organisation and thinks more experience needs to be gathered before proposing other additional changes. CESR would though like to highlight that the bodies in charge of the enforcement of the standards should also be involved in the process related to governance of the organisation.

Question 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?*

8. On the issue of the fixed geographical distribution of the Trustees, CESR, like EFRAG, is of the view that it is important to maintain a balance from amongst the regions that apply IFRS throughout the world. In the latest amendments to its Constitution however, the IASB has reflected new developments in the adoption of IFRSs in the world by allocating one seat on its board to South America and another to Africa. This new geographical balance should also be reflected in the composition of the Trustees as it would be helpful if their composition was consistent with that of the IASB. Including countries which are adopting IFRSs would allow input to be gathered about their experiences of that adoption phase and subsequently when they start applying IFRSs. Such input might throw light on a number of additional difficulties and peculiarities that may benefit the work the IASB undertakes.



Question 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.

9. CESR supports EFRAG’s view that major changes to improve the governance of the IASCF and the IASB are not needed.
10. CESR also agrees with EFRAG that the Trustees role has changed to focus now more on oversight and that as part of that oversight role, the Trustees should review the IASB’s intention to issue a vast amount of consultative material over a fairly short period of time. CESR questions whether the IASB’s constituents will be able to cope with all the material the IASB intends to issue and the Trustees should therefore consider the potential impact this proposal may have on users, preparers, auditors and regulators.

Question 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.

11. The Trustees have invited comments regarding the future financing. Financing has been substantially improved and important arrangements made with national organisations. CESR is of the view that the process of financing the IASCF and the IASB should be reviewed and encourages the Trustees to continue their efforts to achieve a long term financing mechanism that represents a sustainable source of financing for the future.
12. An important consideration for the IASCF and the IASB is that such financing should be independent. We share EFRAG’s views on the need to secure a transparent and stable financing mechanism that would permits the IASB both to act and be perceived to act independently.

Question 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.

13. CESR is generally supportive of the views of EFRAG on this issue of the IASB’s agenda setting process.
14. Currently the Constitution gives the IASB full discretion to develop and pursue its technical agenda and the Trustees have seen this discretion as an essential element in preserving the independence of the standard setting process. Under current arrangements, prioritisation of ongoing projects within the agenda is not subject to public consultation. The IASB is in general very transparent and consults widely on all standards, interpretations and amendments to the current standards. Setting its agenda is one of the most important steps the IASB makes and given accounting standards are developed in the public interest, prioritisation of the projects on which the IASB should focus would also appear to be in the public interest and should consequently be subject to input from the future users of the standards being developed. Such public consultation would serve to enhance still further the



already high current level of transparency in the work done by the IASB. CESR therefore shares EFRAG's view that the IASB's due process should include public consultation whilst the agenda is being set, including an explanation of why certain issues have been added to or removed from the technical or research agenda. For example as EFRAG points out, many constituents in Europe have been asking the IASB to continue its project on common control transactions which has currently been paused..

15. Public consultation would also give the IASB an opportunity to justify the number of changes to standards and interpretations it proposes every year and the level of staff it needs to undertake its agenda. In the process, stakeholders would also be given the opportunity to comment on the appropriateness of the scope of each specific project proposed by the IASB as on some occasions when the IASB proposes minor piecemeal changes, it runs the risks of causing confusion and imposing compliance costs without clear benefits as well as of its proposed changes having unforeseen side effects on other standards. A principles-based, high quality standard setting process should encompass an objective of ensuring the standards set are stable, an objective which is also consistent with the aim of achieving high quality, global accounting standards that establish a good basis for consistent application and enforcement. As mentioned previously, such a process should also, oblige the IASB and the Trustees when setting their agenda to take into account the potential impact and burden the output from that agenda might impose on users and other stakeholders. Such a step may also help the IASB determine the appropriate number of standards or interpretations to be addressed or issued on an annual basis.

Question 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.*

16. CESR agrees with EFRAG that the IASB's written due process procedures are generally very good, although there is room to improve the way in which they are implemented.
17. CESR supports EFRAG's suggestion that the IASB should have some sort of explicit process requiring it to explain its reasons for deciding not to re-expose an ED even in cases where significant changes have been made (for example because the changes reflect almost unanimous views from respondents). CESR would like to highlight however that in its view the number of responses received should not be a criteria relevant to assessing whether re-exposure is necessary as such a decision should be based on the technical quality of the arguments raised in those responses. Consequently CESR believes re-exposure should be obligatory whenever the final standard differs substantially from the ED except for those cases, where the IASB has maintained its position and rejected the comments made by respondents. Such rejections should however be properly justified in the basis for conclusions paragraphs in the standard.

Question 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?*

18. CESR is of the view that the IASB should develop due process procedures – including public consultation – that enable it to amend its standards in response to emergency circumstances. The need for such procedures was demonstrated during the current financial crisis and their development might help alleviate constituents' concerns about some changes recently made to certain IFRSs.



19. As part of these fast track procedures, the IASB should consider using the Monitoring Board, as a high-level group, to assist it in assessing the degree of apparent consensus regarding the urgency of a specific proposal and in turn in deciding what due process procedures are appropriate including the length of the public consultation period.

Question 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?*

and

Question 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?*

20. We are generally supportive of EFRAG's comments on these issues.
21. In addition some further changes could be made to increase the effectiveness of the SAC for example:
- Increasing the frequency of meetings (which currently take place only 3 times a year);
 - Allowing the SAC Chairman to attend IASB meetings as an observer;
 - Putting in place a mechanism for voting and for making a public record of the different positions held;
 - Obliging the IASB to justify in a public document why it has not incorporated some matters into IFRS on which there is a common view from the SAC; and
 - Reducing the number of SAC members.

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

22. In addition, CESR would like to raise the issue of the board members' mandate. Under the current Constitution the full time members of the Board are appointed for a term of up to five years, renewable once. Consequently a member of the Board can hold that position for up to 10 years. To ensure members of the Board maintain a high level of technical experience in the various aspects of preparing and reviewing financial statements, the IASB should consider all or some of the following:
- Increasing the number of part time members of the Board and reducing the number of full time members. The IASB used to have two part-time members which were increased to three under the last amendment which also increased the total number of Board Members to 16. Increasing the number of part-time members though is not without its drawbacks (for example they may face potential conflict of interests or have less time to devote to the IASB's agenda consequently reducing the quality of the standard-setting process). Consequently any proposal to increase the number of part-time members should be thought about carefully and should probably be combined with one or both of the two other measures we propose of:.
 - Reducing the term of appointment for board members to less than five years (for example to that applicable to Trustees i.e.3 years renewable once); and
 - Not allowing the term of appointment to be renewed. As an alternative, the Trustees could specify that the technical experience of Board members standing for re-election is subject to assessment.



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23. To give IASB Board members access to alternative viewpoints during Board meetings, allowing the participation of a limited number of observers might be helpful. As observers would not be in a position to cast votes, they would not affect the independence of IASB.