

# COUNCIL OF INSTITUTIONAL INVESTORS

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## Via Email

September 25, 2008

Tamara Oyre  
Assistant Corporate Secretary  
IASC Foundation

*Re: Discussion Document—Proposals by the Trustees of the International Accounting Standards Committee (IASC) Foundation to amend the Constitution<sup>1</sup>*

Dear Ms. Oyre:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 140 public, corporate and union pension funds with combined assets of over \$3 trillion.<sup>2</sup> The Council appreciates the opportunity to comment on the IASC Foundation’s July 2008 discussion document entitled “Review of the Constitution—Public Accountability and the Composition of the IASB Proposals for Change” (“Discussion Document”).

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<sup>1</sup> International Accounting Standards Committee Foundation, Review of the Constitution—Public Accountability and the Composition of the IASB, Proposals for Change (July 2008), [http://www.iasb.org/NR/rdonlyres/12CC476D-B88F-418A-826F-71A7465FC2E0/0/Proposal\\_and\\_issues\\_for\\_the\\_Constitution.pdf](http://www.iasb.org/NR/rdonlyres/12CC476D-B88F-418A-826F-71A7465FC2E0/0/Proposal_and_issues_for_the_Constitution.pdf) [hereinafter *Discussion Document*].

<sup>2</sup> Additional information about the members of the Council of Institutional Investors (“Council”) is available on the Council’s website at [http://www.cii.org/about/council\\_members](http://www.cii.org/about/council_members).

## **General comments**

As a leading voice for long-term patient capital, the Council strongly believes that independent private sector accounting standard setting is critical to the development of high quality accounting standards that meet the needs of investors—the key consumers of financial reports. Last year, after months of research and deliberations by the Council’s staff,<sup>3</sup> policies committee, and board of directors,<sup>4</sup> the Council’s general members<sup>5</sup> unanimously approved the following policy addressing the independence of accounting standard setting:<sup>6</sup>

[F]inancial statements and their related disclosures are a critical source of information to institutional investors making investment decisions. The well-being of the financial markets—and the investors who entrust their financial present and future to those markets—depends directly on the quality of the information . . . financial statements and disclosures provide. The quality of that information, in turn, depends directly on the quality of the standards that: . . . preparers use to recognize and measure their economic activities and events . . . . The result should be accurate, transparent, and understandable financial reporting.

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<sup>3</sup> A listing of the Council’s staff is available on the Council’s website at [http://www.cii.org/about/council\\_staff](http://www.cii.org/about/council_staff).

<sup>4</sup> A listing of the Council’s board of directors and their affiliations is available on the Council’s website at [http://www.cii.org/about/council\\_board](http://www.cii.org/about/council_board).

<sup>5</sup> A description of the general members of the Council is available on the Council’s website at [http://www.cii.org/about/council\\_members](http://www.cii.org/about/council_members).

<sup>6</sup> The corporate governance policies of the Council are part of a living document that is constantly reviewed and updated. The policies are intended to set standards or recommended best practices that the Council members believe companies and boards should adopt. The policies are available to the public and can be downloaded without charge at <http://www.cii.org/policies>.

The responsibility to issue and develop accounting . . . standards should reside with independent private sector organizations with an appropriate level of government input and oversight. Those organizations should possess adequate resources and the technical expertise necessary to fulfill this important role. Those organizations should also include significant representation from investors and other users of audited financial reports on the organizations' boards and advisory groups. Finally, those organizations should employ a thorough public due process that includes solicitation of public input on proposals and consideration of user views before issuing final standards. The United States Congress, the Securities and Exchange Commission ("SEC"), and other federal agencies and departments should respect and support the independence of the designated accounting . . . standard setting organizations and refrain from interfering with or overriding the decisions and judgments of those bodies.<sup>7</sup>

We support the IASC Foundation's review of the governance structure and operating procedures of the Foundation and the International Accounting Standards Board ("IASB"). Consistent with the Council's policy referenced above, we urge the IASC Foundation to consider the following issues as part of their review:

1. Independent and adequate funding: The governance structure and operating procedures should ensure that the IASB has a secure, stable, and adequate source of funding that is not dependent on voluntary contributions of companies and their auditors that are subject to the standards.
2. Qualified and independent board: The governance structure and operating procedures should ensure that the IASB members are qualified, full-time, and independent in appearance and in fact.
3. Qualified and adequate staff: The governance structure and operating procedures should ensure an adequate number of qualified, full-time staff devoted to the standard-setting process and to supporting the needs of the IASB.

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<sup>7</sup> See Council Policies, Other Council Governance Policies, 1. Independence of Accounting and Auditing Standard Setting (adopted Mar. 20, 2007), <http://www.cii.org/UserFiles/file/council%20policies/05-22-08%20independence%20of%20accounting%20and%20auditing.pdf>.

4. Pre-eminence of investor views: The governance structure and operating procedures should ensure that the IASB has a through public due process that includes active solicitation of investor views and needs and that those views and needs are given pre-eminence in the standard setting process.
5. Significant investor representation: The governance structure and operating procedures should ensure that investors have significant representation on the IASB, the IASC Foundation, and other related oversight, monitoring, and advisory bodies.
6. Protections from undue political interference: The governance structure and operating procedures should ensure that the technical decisions and judgments of the IASB are protected, as much as possible, from being overridden by governmental agencies and departments for reasons that are inconsistent with the development of high quality financial accounting and reporting standards that meets the needs of investors.<sup>8</sup>

Consistent with those six issues and the Council's aforementioned policy, we offer the following additional comments in response to the specific questions raised in the Discussion Document:

### **Questions relating to the Monitoring Group**

#### **Q1 Do you support the creation of a link to a Monitoring Group in order to create a direct link of public accountability to official institutions?**

We do not object to the creation of a link to a Monitoring Group. Our above referenced policy recognizes that some level of government input and oversight of the accounting standard setting body is appropriate. We, however, are not confident that the Monitoring Group would achieve its stated purpose of "complement[ing] and enhanc[ing] confidence in the governance of the organization, while still safeguarding the independence of the standard-setting process."<sup>9</sup>

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<sup>8</sup> See Press Release, Council of Institutional Investors Expresses Concerns about SEC Proposal (Aug. 28, 2008), <http://www.cii.org/UserFiles/file/press%20release%20SEC%20ifrs%20proposal%2008-28-08.pdf> [hereinafter *Press Release*].

<sup>9</sup> *Discussion Document*, *supra* note 1, at 10.

We note that some commentators have already suggested that the Monitoring Group lessens confidence in the governance of the IASC Foundation because the group appears to be a vehicle for special interests to interfere with or override the decisions or judgments of the IASB and, thereby, impair the independence of the standard setting process.<sup>10</sup> We believe sufficient “public accountability to official institutions” can be achieved by the IASC Foundation without the need for a Monitoring Group by: (1) having an open, thorough, and publicly observable standard setting process that focuses on investors’ information needs; and (2) having ongoing oversight and periodic evaluation of the standard setting process by the IASC Foundation or similar oversight body that is independent of the IASB and has significant representation from qualified investors.

**Q2 The proposals contemplate a Monitoring Group comprising representatives of seven public authorities and international organizations with a link to public authorities. While recognising that the Monitoring Group is an autonomous body, the Trustees would welcome comments regarding the Monitoring Group’s membership and whether other organizations accountable to public authorities and with an interest in the functioning of capital and other financial markets should be considered for membership.**

If a Monitoring Group is formed, we believe the membership should include significant representation from qualified investors. We note that our views and related policy on this issue are consistent with the recent conclusions and recommendations of the United States Securities and Exchange Commission’s Advisory Committee on Improvements to Financial Reporting (“Advisory Committee”).<sup>11</sup>

In recommending that the Financial Accounting Foundation (“FAF”)—the oversight body to the Financial Accounting Standards Board (“FASB”)—add investors to its board of trustees, the Advisory Committee stated:

Investor perspectives are critical to effective standards-setting, as investors are the primary consumers of financial reports. Only when investor perspectives are properly considered by all parties does financial reporting meet the needs of those it is primarily intended to serve. Therefore, investor perspectives should be given pre-eminence by all parties involved in standards-setting.<sup>12</sup>

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<sup>10</sup> See, e.g., Floyd Norris, *Bye Bye Independence*, <http://norris.blogs.nytimes.com/2007/11/06/> (Nov. 6, 2007, 7:25 PM EST).

<sup>11</sup> Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission 57 (Aug. 1, 2008), <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>.

<sup>12</sup> *Id.* (omission of emphasis).

Having significant representation on the Monitoring Group would also be generally responsive to the views of many non-U.S. institutional investors.<sup>13</sup> For example, an analysis of International Financial Reporting Standards by French institutional investors concluded:

The **governance process of the IASB**, and more generally of the overall structure of international standard setting including the IASC Foundation . . . is often criticised for the scant attention paid to the viewpoints of users of financial statements.<sup>14</sup>

We understand that the Monitoring Group is intended to address a specific perceived deficiency of participation from public authorities, but that perceived deficiency is not, in our view, a legitimate basis for denying significant representation on the Monitoring Group from the primary consumers of financial reports.

**Q3 The Trustees will remain the body primarily responsible for the governance of the organization and the oversight of the IASB. Their responsibility to a Monitoring Group will enable regulatory and other authorities responsible for the adoption of IFRSs to review the Trustees' fulfillment of their constitutional duties. Does the formulation of the Monitoring Group's mandate and the Trustees' reporting responsibilities, as described in proposed Section 19, appropriately provide the link, while maintaining the operational independence of the IASC Foundation and the IASB?**

If a Monitoring Group is formed, we believe that its mandate should be narrowly defined. More specifically, in our view, the mandate of the Monitoring Group should focus primarily on educating and communicating with representatives of public authorities around the world about the benefits of independent private sector accounting standard setting. Such a mandate could actually enhance the independence of the IASB and perhaps reduce the real risk that public authorities may take actions that are inconsistent with the IASC Foundation's stated objective "to develop . . . a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information . . . ."<sup>15</sup>

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<sup>13</sup> See, e.g., Federation Francaise des Societes d'Assurances, Investor Perspectives on IFRS Implementation 7 (Dec. 7, 2007), [http://www.iasplus.com/resource/2007investorperspectives\\_en.pdf](http://www.iasplus.com/resource/2007investorperspectives_en.pdf).

<sup>14</sup> *Id.*

<sup>15</sup> *Discussion Document*, *supra* note 1, at 8.

**Q4 Given the proposed creation of a Monitoring Group, would there be a continued need for the Trustee Appointments Advisory Group in the selection of Trustees? If so, what should be the role and composition of the Trustees Appointments Advisory Group?**

As indicated in response to Q3, if the Monitoring Group is created we would support narrowly defining its mandate and that mandate would not include “approv[ing] the appointment of Trustees.”<sup>16</sup> We, therefore, would not object to having the Trustee Appointments Advisory Group continue to assist the IASC Foundation in discharging their responsibility for nominating and appointing Trustees. Consistent with our response to Q2, however, we would require that the composition of the Trustee Appointments Advisory Group have significant representation from investors to ensure that the needs of the primary customers of financial reports are adequately served by the standard setting process.

**Questions related to the IASB’s composition**

**Q5 Do you support the principle behind expanding the IASB’s membership to 16 members in order to ensure its diversity, its ability to consult, liaise and communicate properly across the world, and its legitimacy?**

We do not object to expanding the IASB’s membership to 16 members. Although we have some concerns that a board of that size may be “too large to be efficiently functional,”<sup>17</sup> we generally agree with the Discussion Paper that having IASB members actively involved in “consultation, liaison and communications”<sup>18</sup> with investors and other interested parties around the world is an important element of a high quality international standard setting process.<sup>19</sup>

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<sup>16</sup> *Id.* at 13.

<sup>17</sup> The Council of Institutional Investors, Corporate Governance Policies § 2.18 (updated Apr. 11, 2008), <http://www.cii.org/UserFiles/file/council%20policies/CII%20Corp%20Gov%20Policies%204-11-08%20Final.pdf> (“Absent compelling, unusual circumstances, a board should have no fewer than 5 and no more than 15 members (not too small to maintain the needed expertise and independence, and not too large to be efficiently functional”).

<sup>18</sup> *Discussion Document*, *supra* note 1, at 15.

<sup>19</sup> *Cf.* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Teresa S. Polley, Chief Operating Officer, Financial Accounting Foundation 3 (Feb. 11, 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/February%2011.%202008%20Comment%20Letter%20on%20FAF%20Proposal%20\(final\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/February%2011.%202008%20Comment%20Letter%20on%20FAF%20Proposal%20(final).pdf) (opposing reduction in FASB members because of the need for members to “engage in external communications and dialogue with investors and other interested parties—important elements of a high quality standard setting process”).

**Q6 Do you agree with the geographical formulation suggested by the Trustees?**

We generally do not agree with the geographical formulation suggested by the Trustees. We recognize that geographical diversity is important to the selection of IASB members and the standard setting process. We, however, generally oppose rigid formulas for the composition of the IASB.<sup>20</sup>

We believe the proposed geographical formulation would, at a minimum, create the perception that individual IASB members are expressing the views of a geographical constituency that they represent rather than their individual views. In our opinion, the IASC Foundation should choose members of the IASB based, first and foremost, on their demonstrated technical competency and knowledge of financial accounting and reporting.<sup>21</sup> In addition, consistent with our response to Q2, we would expand the criteria for IASB membership described in the Discussion Paper's "Annex to the Constitution"<sup>22</sup> to include requiring (1) significant representation from qualified investors, and (2) that *all* IASB members have a clear understanding of, and are committed to serving, the information needs of investors.<sup>23</sup>

**Q7 The Trustees are suggesting that the Constitution should provide flexibility on the matter of part-time membership. Do you support that proposal?**

We generally do not support the proposal providing flexibility on the matter of part-time membership. We acknowledge that to-date the IASB part-time positions may have "attracted high qualified candidates."<sup>24</sup> We, however, believe that having full-time board members is absolutely essential to ensuring the ongoing independence of the IASB.<sup>25</sup>

Part-time board members could potentially be conflicted by positions taken by their employer and could face difficult decisions as to which constituency they owe their allegiance.<sup>26</sup> Those potential conflicts are not hypothetical. They have occurred with part-time accounting standard setters in the past.<sup>27</sup>

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<sup>20</sup> See, e.g., Letter from Ann Yerger, Executive Director, Council of Institutional Investors, to Erik Wong, Project Manager, IASC Foundation 1 (Feb. 23, 2005) [hereinafter *Wong Letter*] (on file with Council).

<sup>21</sup> *Id.*

<sup>22</sup> *Discussion Document, supra* note 1, at 25.

<sup>23</sup> See *Wong Letter, supra* note 19, at 1.

<sup>24</sup> *Discussion Document, supra* note 1, at 16.

<sup>25</sup> See *Wong Letter, supra* note 19, at 2.

<sup>26</sup> *Id.* at 2.

<sup>27</sup> Establishing Financial Accounting Standards, Report of on Establishment of Accounting Principles 8 (Am. Inst. of Certified Pub. Accountants Mar. 1972) (on file with Council) ("A part-time, volunteer APB will continue to be subject to doubts as to the disinterestedness of its members—their freedom from client and other pressures").

As one example, the creation of the FASB as the first accounting standard setter in the U.S. with full-time members was largely in response to concerns that the decisions of the part-time members of the prior accounting standard setting organization—the Accounting Principles Board—were influenced by “conflict[s], real or apparent, between the member’s private interest and the public interest.”<sup>28</sup> We believe the part-time members of the IASB would likely be subject to similar and perhaps more frequent conflicts of interest.<sup>29</sup>

In conclusion, we wish to emphasize that the Council continues to support the ongoing efforts of the IASC Foundation and the IASB to work cooperatively with the FAF, the FASB, investors, and other interested parties towards convergence to a single set of high quality financial reporting standards.<sup>30</sup> We believe those efforts will prove to be of great value to Council members and other market participants in better evaluating and comparing investment alternatives throughout the world.

We appreciate the opportunity to comment on the Discussion Paper. We would be happy to respond if you have any questions or need any additional information.

Sincerely,



Jeff Mahoney  
General Counsel

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<sup>28</sup> *Id.* at 72.

<sup>29</sup> *See, e.g.*, Donna L. Street, International Convergence of Accounting Standards: What Investors Need to Know 28 (Oct. 2, 2002),

[http://www.cii.org/UserFiles/file/resource%20center/publications/International%20Convergence%20White%20Paper%20\(Final\)%2011-14-07.pdf](http://www.cii.org/UserFiles/file/resource%20center/publications/International%20Convergence%20White%20Paper%20(Final)%2011-14-07.pdf) (quoting A. Wyatt that “with lobbying from ‘multiple governments with differing priorities and multiple business communities with various interests to protect’ pressures on the IASB will eventually exceed those ever faced by any national standard setter . . .”).

<sup>30</sup> *See, e.g.*, *Press Release, supra* note 8.