

# COUNCIL OF INSTITUTIONAL INVESTORS

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Suite 500 • 888 17<sup>th</sup> Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • [www.cii.org](http://www.cii.org)

## Via Email

March 26, 2009

Tamara Oyre  
Assistant Corporate Secretary  
IASC Foundation

*Re: Discussion Document: Review of the Constitution, Identifying Issues for Part 2 of the Review<sup>1</sup>*

Dear Ms. Oyre:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 130 public, corporate and union pension funds with combined assets of over \$3 trillion.<sup>2</sup> The Council appreciates the opportunity to provide its views on the International Accounting Standards Committee Foundation’s (“IASCF” or “Foundation”) December 2008 discussion document entitled, “Review of the Constitution, Identifying issues for Part 2 of the Review” (“Discussion Document”).

## **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 fall, the Council’s general members approved an update to our existing policies supporting the independence of accounting standard setters.<sup>3</sup>

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<sup>1</sup> International Accounting Standards Committee Foundation, Review of the Constitution, Identifying Issues for Part 2 of the Review (Dec. 2008), [http://www.iasb.org/NR/rdonlyres/4E80F1BE-8BC5-48F8-8EEC-46B2123D7481/0/Constitution\\_Review\\_PartII\\_Consultation.pdf](http://www.iasb.org/NR/rdonlyres/4E80F1BE-8BC5-48F8-8EEC-46B2123D7481/0/Constitution_Review_PartII_Consultation.pdf) [hereinafter *Discussion Document*].

<sup>2</sup> For more information about the Council of Institutional Investors (“Council”) and its members, please visit the Council’s website at [http://www.cii.org/about/council\\_members](http://www.cii.org/about/council_members).

<sup>3</sup> Council, Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters (adopted Oct. 7, 2008), [http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf).

The policy includes the following statement:

[F]inancial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the financial reporting standards that . . . enterprises use to recognize, measure and report their economic activities and events; . . . . The result should be timely, transparent and understandable financial reports.<sup>4</sup>

As we indicated in our September 2008 letter in response to the initial “Proposals by the Trustees of the . . . Foundation to amend the Constitution” (“September Letter”):

We support the IASC Foundation’s review of the governance structure and operating procedures of the Foundation and the . . . 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.

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<sup>4</sup> *Id.*

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.
4. Pre-eminence of investor views: The governance structure and operating procedures should ensure that the IASB has a thorough 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>5</sup>

This last issue is particularly critical in light of the October 2008 decision by the IASCF to suspend established due process procedures in response to pressure from the financial services lobby and European politicians.<sup>6</sup> That highly questionable action was then compounded by the International Accounting Standards Board (“IASB”) decision, approved without any public due process, by fourteen of the sixteen board members, to amend IAS 39 and IFRS 7 in a manner that the Board members knew or should have known was not an improvement to financial accounting and reporting from the perspective of most investors.<sup>7</sup>

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<sup>5</sup> Letter from Jeff Mahoney, General Counsel, Council, to Tamara Oyre, Assistant Corporate Secretary, IASC Foundation 3-4 (Sept. 25, 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/September%2025%202008%20Council%20Letter%20to%20Oyre%20\(final\)\(1\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/September%2025%202008%20Council%20Letter%20to%20Oyre%20(final)(1).pdf) [Hereinafter *September Letter*].

<sup>6</sup> See, e.g., Glenn Kessler, *Accounting Standards Wilt under Pressure*, Wash. Post, Dec. 27, 2008, at A01, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/12/26/AR2008122601715.html>.

<sup>7</sup> *Id.*

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

### **Questions for consideration**

**1. The Constitution defines the organization'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 organization 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?<sup>8</sup>**

As indicated in our general comments, and consistent with our policy and the conclusions of the Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission,<sup>9</sup> we believe that the primary objectives of the IASCF and IASB, as described in the Constitution, should be revised to explicitly focus their responsibilities on serving the needs of the primary consumers of financial reports.

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<sup>8</sup> *Discussion Document, supra* note 1, at 6.

<sup>9</sup> Financial 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>.

We, therefore, would revise the aforementioned language in the Constitution as follows:

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 investors, in the world's capital markets and other users make economic decisions.

Deleted: participants

...

to take account of, as appropriate, the special needs of investors in small and medium-sized entities and investors in emerging economies.

Our proposed revisions reflect our agreement with those commentators who have opined that “[b]y missing the opportunity of clear empowerment of users in IFRS governance, the trustees risk finding themselves torn between conflicting objectives.”<sup>10</sup>

- 4. There are other organizations 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 the possibility of closer collaboration with a wider range of organizations whose objectives are compatible with the IASC Foundation's objectives? If so, should there be any defined limitation?**<sup>11</sup>

Consistent with the Council's policy and our general comments, the IASCF Constitution should be amended to require closer collaboration with investors and investor organizations. It should also be amended to contain explicit language that the views and needs of investors should be given pre-eminence in the standard setting process.

<sup>10</sup> Nicolas Veron, *Fuzzy Oversight Will Not Solve Standards Issue*, Fin. Times, Feb. 5, 2009, at 16, available at <http://www.ft.com/cms/s/0/25420800-f2e1-11dd-abe6-0000779fd2ac.html>.

<sup>11</sup> *Discussion Document*, *supra* note 1, at 6.

- 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 organization 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.**<sup>12</sup>

As indicated in the September Letter:

We . . . are not confident that the Monitoring Group [as currently contemplated] 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.”

....

[W]e believe the membership [of the Monitoring Group] 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 .

...

....

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.<sup>13</sup>

- 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?**<sup>14</sup>

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<sup>12</sup> *Discussion Document*, *supra* note 1, at 6.

<sup>13</sup> *September Letter*, *supra* note 5, at 4-6.

<sup>14</sup> *Discussion Document*, *supra* note 1, at 7.

Consistent with the views we expressed in the September Letter regarding the proposed composition of the IASB,<sup>15</sup> we do not support the fixed geographical distribution system for appointing IASCF Trustees. We recognize that geographical diversity is important to the selection of Trustees. We, however, believe that the geographical distribution system detracts from what, in our view, are far more important selection requirements.

More specifically, and consistent with our policy, the Trustees should include significant representation from the investor community. In addition, Trustee candidates should be required to demonstrate a commitment to actively supporting the improvement of financial accounting and reporting for the benefit of investors.

Trustee candidates should also be required to demonstrate a commitment to actively supporting and defending the independence of the IASB. Finally, we are concerned that the geographical distribution system may also create “representative” Trustees composed of individuals that are more likely to perceive their roles as promoters of the short-term and potentially narrow public interests of the region they represent, rather than promoters of improving financial accounting and reporting that best serves the information needs of all investors.<sup>16</sup>

- 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 organization. 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.<sup>17</sup>**

We do not necessarily object to the IASCF Trustees enhancing their oversight of the IASB. We, however, strongly object to the Trustees having involvement in the IASB’s agenda setting process as suggested by Section 15(c) of the Discussion Document.<sup>18</sup>

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<sup>15</sup> *September Letter*, *supra* note 5, at 8.

<sup>16</sup> *See id.*

<sup>17</sup> *Discussion Document*, *supra* note 1, at 7.

<sup>18</sup> *Id.* at 11.

Without a significant change in the selection criteria and composition of the Trustees, as described in response to question 6, we believe that expressly providing the Trustees a role in the IASB's agenda setting process will only result in potentially even greater special interest group influence over the standard setting process to the detriment of investors and the capital markets.<sup>19</sup> As indicated in our general comments, the October 2008 decision has severely shaken investor confidence in the IASCF and the IASB. That confidence will not be regained by providing the Trustees, particularly the existing Trustees, with a direct or indirect role in the IASB's agenda setting process.

- 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. (For an update on the funding status, see <http://www.iasb.org/About+US/About+the+IASC+Foundation/Funding.htm>)**

**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 organization's financing.<sup>20</sup>**

Notwithstanding the Trustees' progress towards the establishment of a broad-based funding system, we remain concerned with the IASCF's financing. We agree with those experts who have concluded that "economic . . . independence is an important guiding principle in institutionalizing a standard setting body that is responsive to the needs of investors and capital markets."<sup>21</sup>

We note that per review of the IASB's website it appears that the first, second, third, and fourth largest single contributors to the IASB's "long-term funding" are Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers.<sup>22</sup> The combined voluntary contributions of those "big four" accounting firms amounts to approximately thirty percent of the IASB's entire funding.<sup>23</sup>

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<sup>19</sup> Cf. Letter from Jeff Mahoney, General Counsel, Council, to Ms. Teresa S. Polley, Chief Operating Officer, Financial Accounting Foundation 4 (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) (raising concerns about providing the FASB Chair with decision-making authority to set the FASB technical agenda) [hereinafter *February Letter*].

<sup>20</sup> *Discussion Document*, *supra* note 1, at 7.

<sup>21</sup> Luzi Hail et al., *Global Accounting Convergence and the Potential Adoption of IFRS by the United States: An Analysis of Economic and Policy Factors* 78 (Feb. 2009), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1357331](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1357331).

<sup>22</sup> International Accounting Standards Board, *Long-term funding commitments 3* (last visited Mar. 23, 2009), <http://www.iasb.org/About+Us/About+the+IASC+Foundation/Long-term+funding+commitments.htm>.

<sup>23</sup> *See id.* at 1-3.

Consistent with our policy, we believe that the IASB should have an adequate, stable, and mandatory funding source.<sup>24</sup> Such a funding source, if properly structured, would contribute to improving the IASB's independence and likely enhance the credibility of its standards.

- 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.<sup>25</sup>**

As indicated in response to question 7, we agree with the Trustees that providing the IASB with full discretion in developing and pursuing its technical agenda is an essential element of preserving the independence of the standard-setting process. Allowing the Trustees or other potentially less independent groups to have the authority to, for example, remove a project from the IASB's technical agenda, particularly if the project was supported by most members of the IASB or most investors, would likely impair the independence of the IASB to the detriment of investors and the capital markets.<sup>26</sup>

- 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*.<sup>27</sup>**

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<sup>24</sup> Cf. *February Letter*, *supra* note 21, at 4 (addressing the funding of the Governmental Accounting Standards Board).

<sup>25</sup> *Discussion Document*, *supra* note 1, at 7-8.

<sup>26</sup> Cf. *February Letter*, *supra* note 21, at 4 (Opposing proposal to provide the Financial Accounting Standards Board Chair with decision-making authority to set the FASB technical agenda).

<sup>27</sup> *Discussion Document*, *supra* note 1, at 8.

As indicated in our policy and general comments, we believe that the procedures of the IASB should focus primarily on the needs of investors. We, therefore, believe that the Constitution's description of the principles and elements of the IASB's required due process and the related procedures included in the *IASB Due Process Handbook* should be revised to make explicit that, at each and every stage within the IASB's due process, investor perspectives are given pre-eminence.

**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?<sup>28</sup>**

As indicated in our general comments, we have grave concerns about the independence of the IASB as a result of its October decision. We acknowledge that there may be some limited "cases of great urgency" in which it may be appropriate for the IASB to pursue a 'fast track' procedure. Unlike the October decision, however, any 'fast track' procedure should *never* be permitted: (1) to completely eliminate the solicitation and consideration of investor input; and (2) to be used to promulgate a standard that, from the perspective of most investors, is clearly not an improvement to financial accounting and reporting.

**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?<sup>29</sup>**

We congratulate the IASCF for their recent efforts to increase the investor representation on the SAC, including inviting the Council to participate on the SAC. Even as reconstituted, however, it appears that of the forty-one organizations represented on the current SAC there are no more than seven organizations that could even remotely be considered representatives of investors—the primary consumer of financial reports.<sup>30</sup> Consistent with our policy and general comments, we encourage the IASCF to correct this imbalance as soon as practicable. In that regard, as always, we are more than willing to assist the IASCF in any way we can to identify other qualified investor organizations and individuals to participate on the SAC.

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<sup>28</sup> *Id.* at 8.

<sup>29</sup> *Id.*

<sup>30</sup> See IAS Plus International Accounting Standards: IASB Standards Advisory Council (last visited Mar. 23, 2009), <http://www.iasplus.com/restruct/advisory.htm#sacmembers>.

- 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?<sup>31</sup>**

We have no proposed changes to the elements of the terms of reference for the SAC at this time, with the exception of increasing the investor representation on the SAC as discussed in response to question 12.

- 14. Should the Trustees consider any other issues as part of this stage of their review of the Constitution?<sup>32</sup>**

We respectfully request that the Trustees carefully review and consider the contents of this letter, the September Letter, and other input from investors. We believe that the Trustees must take the decisive actions necessary to begin the process of regaining investor trust and confidence in the IASCF and the IASB.

We appreciate the opportunity to comment on the Discussion Document. As always, 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>31</sup> *Discussion Document, supra* note 1, at 8.

<sup>32</sup> *Id.*