



Setting the global standard for investment professionals

23 September 2008

Mr. Gerrit Zalm
Chairman of the Trustees
International Accounting Standards Committee Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Chairman Zalm:

The CFA Institute Centre for Financial Market Integrity ("the Centre")¹ and the Corporate Disclosure Policy Council ("the CDPC")² welcome this formal review of the governance of the IASB and IASC Foundation and particularly the decisions of the Trustees to provide opportunities to comment on the review process (the "Review"). CFA Institute, the Centre and the CDPC support strongly the objectives and activities of the IASB and its predecessor organization, the IASC.

Executive Summary of Positions

The Trustees of the International Accounting Standards Committee (IASC) Foundation initiated their second five year review of the organization's constitutional arrangements. A summary of our positions on key proposals are:

Monitoring Group: We support the Trustee's proposal to create a Monitoring Group with accountability to public authorities. This group will strengthen the overall process for standard setting by conducting liaison activities with governmental and other organizations. Furthermore, it will provide an effective means for overseeing the functioning of the IASB and its Trustees to ensure their objectives are met.

However, we feel that the proposed membership of the Monitoring Group could be strengthened by including investors. Investor representation would provide direct experience with standard setting issues and enhance public confidence in the quality of standards.

¹ The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment professionals in 134 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

² The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The Council is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the Council provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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Investor Representation on the Trustees: Investor representation on the Trustees should be expanded to include more investors. Currently, the Trustees are dominated by preparers, auditors, and regulators. Increased investor representation greatly enhances the confidence of users in the oversight of the standard setting process.

Functions of the Monitoring Group: The proposed functions of the monitoring group are reasonable and appropriate. This includes approval of the appointments of Trustees; overseeing the functioning of the Trustees; and serving as the interface between the IASB and public authorities and other organizations.

Self Interest Threat and Governance: The development of the plans for the institution of the Monitoring Group are in an early stage. The plans call for the revision and reform of the Foundation's governance and procedures to ensure the IASB's long-term sustainability and independence. We encourage the Trustees to expose the Memorandum of Understanding, which will define the terms of reference of the relationship between the Monitoring Group and the Trustees to the public for comment. Furthermore, we stress that the Monitoring Group be designed to act solely in the public interest.

Role of Trustees' Appointments Advisory Group: We do not feel that there is a role for the Trustees' Appointments Advisory Group since these selections and appointments will be the responsibility of the Monitoring Group.

IASB Funding: We believe that the Monitoring Group must seek and obtain an entirely independent and sustainable source of funding for the IASB. This will ensure independence of the IASB and its standard-setting function from the influence of special interests.

Expanding IASB Membership: We believe the proposal to expand the IASB to 16 members is unnecessary to ensure that it efficiently and effectively meets its objectives. Of much greater importance to us is that the IASB comprise full time members with no remaining responsibilities or obligations to any other bodies or organizations and that it have adequate investor representation. Furthermore, we believe that increased investor representation on the IASB is critical to firmly establishing public confidence in the standard setting process. To that end, we strongly urge the Trustees to require that if new positions are created, such positions are filled with investor representatives.

Geographical Dispersion: The proposed regional representation is appropriate to ensure the representation of global views in the standard setting process, however, we believe the targets for geographical diversity should be re-assessed no less than every 5 years to ensure the targets adequately and fairly represent a broad base of international interests.

General Comments

Given the importance of financial reporting to global markets, and the convergence of national standards to International Financial Reporting Standards (IFRS), we support the efforts of the Trustees to establish a



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governance system for the IASB that will ensure those standards are set in accordance with the “operating premise” of the current IASC Foundation Constitution³ as follows:

*...[A]ccounting standards should be set following an extensive and transparent due process by a highly professional, independent body, the IASB, **appropriately protected from particular national, sectoral or special interest pleading.** [Emphasis added]*

A core part of this effort is to develop a robust infrastructure to support the long-term *independent and sustainable* standard setting function of the IASB. We believe that the ultimate success of IFRS will rest not only on the governance structure but on the capacity of that structure to respond quickly and effectively to the changing information needs of the investors. In the sections that follow, we offer suggestions for consideration by the Trustees that we believe would strengthen the proposed governance framework.

Investor Representation on the Trustees

As an aside, given that the second phase of the governance review will address issues with the Foundation, we want to stress that increased investor representation would enhance the effectiveness of the Trustees and contribute to public confidence in their oversight of the IASB. Currently, investor representation among the Trustees is limited. Such limited direct input from investors impairs the ability of the Trustees to meet its primary objective, which is to provide decision-useful information to present and potential capital providers or investors of an entity. Similarly, the Trustees’ own advisory body, the Standards Advisory Committee (SAC), has little representation of investors. The current membership is dominated by preparers, auditors, regulators, and institutional employees rather than investors. Thus, investors have little influence in the process currently. We strongly encourage the Foundation to appoint appropriate investor (See Appendix I for definition of “investor”) representatives to the Trustees. This further strengthens the confidence of users in the oversight of the standard setting process.

Summary of Views Related to the Monitoring Group

Composition of the Monitoring Group

In general, we support the Trustees’ proposal to create a Monitoring Group with accountability to public authorities. We believe that it would be helpful to have a highly knowledgeable and respected body of members who can: (1) Conduct liaison activities with governmental and other organizations, and (2) Monitor and oversee the functioning of the IASB and its Trustees to ensure their objectives are met.

However, we feel that the proposed membership of the Monitoring Group could be strengthened by expanding the representation to include investors who have direct experience analyzing and investing in various sectors. Investors constantly monitor the markets and track developments. Those who invest their wealth or that of their clients are constantly apprised of new developments including the

³ *Review of the Constitution, Public Accountability and the Constitution of the IASB, Proposals for Change.* IASC Foundation, London England. July 2008. paragraph 2.



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appropriateness of available financial information. Investors in many ways are the early-warning system for deficiencies in financial reporting and the need for new or revised standard setting. For this to occur investors should have full membership so that they will be able to contribute to the deliberations of the Group as they are being held rather than through indirect involvement with advisory committees. Also, direct membership would enhance the confidence in the quality of the standards and the comprehensiveness of financial reporting.

Functions of the Monitoring Group

We believe generally that the proposed functions of the Monitoring Group are reasonable and appropriate. They include: 1) approval of the appointments of Trustees; 2) overseeing the functioning of the Trustees; and 3) serving as the interface between the IASB and public authorities and other organizations. The Monitoring Group should be limited to performing these functions and not include participating in matters related to setting the technical agenda of the IASB. We also believe that both the Trustee nomination and oversight processes must be fully open and transparent. For example, actions taken by the Monitoring Group should be documented and should be released for public review and consideration. The documents should contain sufficient detail for interested reviewers to be able to determine the complete nature of the issue, what alternatives were considered, and the rationale for the actions taken.

Self Interest Threat and Governance

While we believe that a Monitoring Group is an important component of an efficient and effective governance system for the IASB, we stress that the Monitoring Group should be designed to act solely in the public interest. There is the risk that members may tend to act in their interests or in those of the governments or organizations they represent. Although any self-regulatory body is subject to the threat, the risk is particularly concerning in the context of global capital markets. The decision of whether to invest and the returns on investment are affected by the information available to the markets and the regulation and enforcement of the standards used by participants in those markets.

Consequently, when the charter for the Monitoring Group is being developed, we recommend that consideration be given to the self-interest threat, and to steps that can be taken to mitigate it, as well as to ensure that the Monitoring Group remains free of the threats. In fact, we believe that it would benefit the Monitoring Group and the Trustees to submit the charter for public comment. Such a step may identify significant omissions and other difficulties that the Trustees and Monitoring Group could address in timely fashion. In addition, it would enhance the public's and investors' confidence in the Monitoring Group and its activities.

We recognize that the Trustees are at an early stage in their development of a Monitoring Group. Those plans call for the revision and reform of the Foundation's governance and procedures and the development of a robust governance structure for the IASB that can ensure its long-term sustainability and independence. Given the early stage of development, much ambiguity remains to be resolved regarding the distinct duties, obligations and functions of the Monitoring Group and the Trustees. At this stage, there is potential for overlap to exist between the duties of the two bodies, and the proposals do not yet resolve either the ambiguity or the possible conflicts. For example, a much clearer division of



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responsibilities, duties, and obligations must be established between the Monitoring Group and the Trustees. We are aware that a Memorandum of Understanding (MoU) will be developed that will describe the terms of reference of the relationship between the Monitoring Group and the Trustees. We encourage the Trustees to expose the MoU for public comment since this document is important to the success of the IASB and the Trustees.

Role of Trustees' Appointments Advisory Group

We believe that selection and appointment of the Trustees is an appropriate governance function of the Monitoring Group. While we believe that nomination of candidates should be open to any interested parties, we do not believe that the Trustees' Appointments Advisory Group has any clear role to play in the proposed new Monitoring Group governance structure and should be eliminated.

IASB Funding

We believe that the Monitoring Group must seek to obtain an entirely independent and sustainable source of funding for the IASB. Currently, the Foundation relies upon a system of voluntary contributions to fund all of its operations. Regardless of how diversified such contributions might be, no such system can ultimately ensure the independence of the IASB and its standard-setting function from the influence of special interests, a responsibility specifically raised in the Constitution. With the creation of the Monitoring Group, we believe that this important function should be assumed by this body.

Continued Independence of the IASB

Finally, regarding the establishment of the Monitoring Group and the development of the charter and the MOU, we believe that explicit provision should be made for ensuring the independence of the IASB and its standard setting function from either the Monitoring Group or the Trustees. That is, neither of the latter two should have any authority over the standard-setting agenda of the Board or the standards themselves. Rather, the responsibilities of the Monitoring Group and the Trustees should be limited to the appointment of the IASB members, and to oversight and monitoring of the strategy and due process of the IASB. We are concerned about "mission creep" in the new governance structure, a point raised repeatedly in the June 19th roundtable and by a variety of participants in that meeting. This tendency should be resisted in the interests of the long-term sustainability of the IASB and IFRS.

This concern is closely related to the question of special interest influence already recognized in the Constitution and the self-regulatory threat noted above. Furthermore, the Monitoring Group and Trustees should make certain that no other authority or organization gains such power, either directly or indirectly. Although the Board can and should seek the views of a wide range of constituencies, in the final analysis, they should be guided by the ultimate objective of their standard setting activities and should remain free of any pressures that do not serve that objective.



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Summary of Views Related to the IASB's Composition

Expanding IASB Membership

We believe the proposal to expand the IASB to 16 members is unnecessary to ensure that it efficiently and effectively meets its objectives. Of much greater importance to us is that the IASB comprise full time members with no remaining responsibilities or obligations to any other bodies or organizations and that it have adequate investor representation. Continued part-time employment of members may compromise the amount of time those members have to devote to the matters of the IASB. The work plan of the IASB is very aggressive as projects related to completion of the Memorandum of Understanding and other improvements are made to the reporting standards. IASB members have a significant work load, which is not conducive to part-time involvement. Furthermore, part-time members are by definition less independent than full time members. The appearance of independence, as well as independence in fact, will be a major determinant of the future success of IFRS as the single global financial reporting standard. The fact that a potential member is unwilling to sever all connections to an employer must raise immediate questions regarding the candidate's ultimate loyalty, financial arrangements and the degree of commitment to the public interest that is required of an IASB member by the Constitution.

Despite the objective of the IASB as stated in the Framework⁴ to create standards that meet the needs of investors, only one part-time member, or 1/26th of the current membership weight (4%), is devoted to the *direct* participation of investors. This representation weight *declined* in 2007 from one full time member. This circumstance raises questions about the commitment of the Trustees to develop a single set of global financial reporting standards that will meet the needs of investors in the world's financial markets. With only a single standard setter in the future (i.e., no competition) this limited representation by investors will not contribute to the long-term sustainability of the standards and the confidence of investors in the standard setting process.

Financial markets, investment strategies, and instruments are becoming increasingly complex and specialized. This complexity demands that the Board have the benefit of expert knowledge *at the table* regarding those instruments when deliberating how to proceed, and decisions are being made about the agenda, prioritization of projects, and the details of the standards themselves.

Thus, we recommend that the Trustees take this opportunity to require a significant increase in the representation of investors on the IASB. Expanding the size of the Board to 16 without mandating increased investor representation, will further dilute the already marginalized representation from this group. To avoid this, we strongly urge the Trustees to require that if new positions are created, such positions are filled with investor representatives. The representation should be sufficiently large and broad so that major sectors of the financial markets and securities can be represented. Given the proposed expansion of the Board to sixteen members a minimum of five of the members should possess direct and extensive experience in investment decision making.

⁴ *Framework for the Preparation and Presentation of Financial Statements*, International Accounting Standards Committee (1989), adopted by the IASB in 2001. Paragraph F-9.



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Geographical Dispersion

We concur with the proposal to provide four members from Europe, four from North America, four from Asia/Pacific and four additional members selected at-large and believe this will promote investor confidence in, and global compliance, with the standards. Such a regional representation will also provide a platform for full due process and reception of views in the setting of standards. However, we believe the targets for geographical diversity should be re-assessed no less than every 5 years to ensure the targets adequately and fairly represent a broad base of international interests.

Conclusion

We thank the Trustees for the opportunity to provide input to the Constitution Review. However, we have reservations about the proposals with regard to investor representation in the governance infrastructure and the standard-setting activities of the IASB. The Constitution explicitly recognizes the importance of capital providers and we believe that their role must be given substance if IFRS are to be sustainable and to succeed as the single set of global financial reporting standards.

If you, other Trustees or your staff have questions or seek further elaboration of our views, please contact either: Matthew M. Waldron, CPA, by phone at +1.434.951.5321, or Patrick Finnegan, CFA, by phone at +1.212.754.8350. Alternatively, you may reach us at Matthew.Waldron@cfainstitute.org or Patrick.Finnegan@cfainstitute.org.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy
Council

cc: Corporate Disclosure Policy Council



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Appendix I

Definition of Investor

The “investor” referenced in our letter should be an individual who has achieved, through education, examination and experience, a level of professional competency. For example, a candidate could include an investment professional with a decade or more of buy-side or sell-side experience who is the holder of a relevant professional designation (such as a CPA or Chartered Financial Analyst® (CFA®)) and/or who has an MBA with a concentration in accounting or finance. An extremely important aspect to the “investor” definition is the ability to bring to accounting standard setting decisions an emphasis on the usefulness of financial statement data for investment decisions, including the need for comparability, consistency, and transparency. Preparers and auditors of financial statements may not understand how those statements are used, and usually have a preference for flexibility and confidentiality (preparers) and auditability (auditors). In essence, an investor is an individual whose career advancement and compensation are tied directly to their success or failure at making significant investment decisions.

As in any profession, “investors” come in a variety of flavors – frequently starting in assistant analyst support positions, moving up to full analyst responsibilities where their recommendations are actively used in investment decisions, advancing further to management roles (i.e., overseeing the activities of other investment professionals), and finally achieving executive positions within their companies or institutions. It is important for the IASCF to recognize that as an individual makes that last transition, their role as an “investor” may undergo a significant change. The orientation of the Chief Executive Officer or other management level officer of a mutual fund, bank, or brokerage firm is likely to be much more closely associated with the priorities of preparers, since they are themselves responsible for preparing such public financial statements, and less linked to the needs and desires of analysts who are using these statements. While it is extremely important for the IASCF to receive input from such individuals, it is likely that financial statement users in non-management ranks and their immediate supervisors (such as directors of research) may provide more representative input as “investors.”