

ISDA

International Swaps and Derivatives Association, Inc.
One New Change
London EC4M 9QQ
United Kingdom
Telephone: 44 (20) 7330 3550
Facsimile: 44 (20) 7330 3555
email: isda@isda-eur.org
website: www.isda.org

Tom Seidenstein
Director of Operations and Secretary
IASC Foundation
30 Canon Street
London
EC4M 6XH
United Kingdom
constitution@iasb.org.uk

Wednesday 11th February, 2004

Identifying Issues for the IASC Foundation Constitution Review

Dear Mr Seidenstein,

ISDA appreciates the opportunity to comment on the review of the IASC Foundation's constitutional arrangements, which govern the operating procedures of the Foundation, the International Accounting Standards Board ("IASB" or "the Board") and requires five-yearly reviews of the Constitution. We applaud the Constitutional review process, and the intention of the Foundation's Committee to identify organizations with which to consult, including organizations representing business groups.

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such we believe ISDA brings a unique and broad perspective to the IASB's work on accounting for financial instruments.

Over the past twelve months we have worked closely with the IASB on specific aspects of the proposed amendments to IAS 39, specifically in relation to the fair value measurement of derivative portfolios and we hope this was informative and beneficial to the overall process. The work has benefited ISDA as we now have a more detailed understanding of the way in which the IASB sets its agenda, discusses and concludes on technical matters and approves accounting standards.

We recognise and appreciate the significant amount of work done by the IASB since its inception, and we believe that substantial improvements have been made to the accounting standards, in particular in relation to financial instruments. Although ISDA still has concerns over certain aspects of these standards we're committed to assisting the IASB in achieving its objectives to develop a quality set of global accounting standards. As a result of this work we have identified a number of issues surrounding concerns over the process of setting accounting standards, which we consider could in part be addressed through changes to the constitution. In particular:

- The IASB could improve its standard setting process. In our view the IASB underestimated the timeframe and resources required to complete IAS 32 and 39. As a result, the Board was under considerable pressure not to re-expose the standards and were openly concerned about potential further delays to completion. We feel that the number of decisions and subsequent changes made to IAS 32 and 39 justified further rounds of exposure, whether as a complete draft or in more manageable shorter consultations (e.g. derecognition, fair value measurement, and so on). We believe this would have improved the transparency of the standard setting process.
- Where the IASB propose an accounting methodology that is not currently being used under existing national or international GAAP, ISDA would like to see the results of a more thorough field test made public. Field tests should involve not just the preparers of accounts, but the specialist business lines likely to be impacted, and the users of accounts as well.
- The IASB should build on existing ties with key industry bodies with a view to more regular consultation. This would help ensure the Board understands the implications and the level of industry concern surrounding new proposals and enable them to make more informed decisions when approving new standards. We feel this would also help focus the minds of the industry in giving prompt, helpful and constructive advice.
- The IASB should be encouraged to hold education sessions for the entire Board on complex accounting issues. While we would not expect all Board members to be experts on every subject, the vote of each Board member is critical in determining the resulting accounting standard. We have been particularly concerned that a reasonable understanding of financial instruments is currently limited to a very few Board members.
- The Board and staff of the IASB should also be encouraged to maintain a current and up-to-date knowledge of the interpretation and application of existing accounting standards, and in particular on how both IFRS and other GAAPs are being applied across the world.
- The Trustees could spend more time promoting the work of the IASB as a high quality global standard setter and ensure that an appropriate plan is in place for getting the right individuals to serve on the IASB.

In setting out our comments below, we have in general followed the structure and references set out in the consultation paper. Certain of our comments relate to more than one of the questions asked in which case we have grouped these questions together in our response.

We would be pleased to discuss our comments with the Trustees or staff. Please contact either Melissa Allen, Chair of the European Accounting Committee on 7595 8819, or Ed Duncan, Assistant Director of European Policy for ISDA, at 7330 3574.

Yours sincerely



Melissa Allen
Chair of the ISDA European Accounting Committee
Global Risk Solutions
BNPParibas



Ed Duncan
Assistant Director of European Policy at ISDA

A Name and objectives**A2 Should there be a specific objective to address the special challenges facing small and medium-sized entities (SMEs)?**

No comment. ISDA leaves this to more appropriate industry bodies to comment.

C Trustees**C4 Does the potential benefit of expanding the number of Trustees, possibly to accommodate a broader range of views, outweigh the risk that meetings would become more cumbersome and less effective if larger, potentially reducing a strong sense of commitment and participation by individual members?****C14 & C16 The intention of these provisions is to protect the independence of the standard-setting process while ensuring sufficient due process and consultation. Does there need to be a specific requirement for the Trustees to review the strategy and the procedures of the IASB at intervals?**

We do not consider that increasing the number of Trustees would necessarily improve the effectiveness in which they carry out their duties. Far more important is that the Constitution provides a framework that enables the Trustees to protect the independence of the standard-setting process while ensuring sufficient due process and consultation. We would also encourage the Trustees to spend more time promoting the work of the IASB as a high quality global standard setter and ensure that an appropriate plan is in place for getting the right individuals to serve on the IASB.

We have described below (see question D32) certain instances where we consider that the IASB has not followed the due process outlined in the Introduction to International Financial Reporting Standards (“IFRS”) and consider that the constitution should require that the Trustees review the strategy and procedures of the IASB with the IASB at regular intervals.

C6 The Trustees have a largely fixed geographical distribution. Is such a fixed distribution appropriate, or does the current distribution need review?**C7 & C8 Although a broad distribution of professional backgrounds is clearly necessary, is the distribution enshrined in the Constitution appropriate?**

The Trustees should come from a variety of professional backgrounds and be well-respected representatives of the world’s capital markets. International agencies should nominate Trustees from developed and emerging economies that both currently apply IFRS and those working towards the adoption of IFRS. However we do not consider that the distribution of professional backgrounds needs to be enshrined in the constitution.

C18 Should the language of the Constitution be changed to require a review of the Constitution “at least every ten years” rather than every five years?

In light of the increased use of IFRS from 2005, we consider that a five-year interval is more appropriate.

D International Accounting Standards Board

D19 Should the number of IASB members be reduced to make the Board more workable?

Increasing or reducing the number of Board members would not necessarily make the Board more workable. Far more important is that the Board members are individuals that have both relevant and recent practical accounting and industry experience. ISDA considers that serving five years on the Board is too long to be away from the members' field of expertise and that a term of three years would be more appropriate. The Board should establish an on-going educational process that ensures that board members with a more limited understanding of specific technical subjects are provided with the relevant analysis of the practical implication of any proposals. This will enable them to make better-informed decisions when approving accounting principles and standards and be better prepared to participate in Board meetings.

Our members have commented on the need for focus groups, consisting of Board members and industry experts, to be set up to discuss new projects. We would like to see these become a formal part of the standard setting process.

D19 Should the part-time positions be eliminated in recognition that the workload of IASB members is heavy and requires substantial time for consultation with interested parties?

We have seen from our work with the Board on IAS 39 that to satisfy their responsibilities, each Board member is required to spend a substantial amount of time on IASB business. In view of the level of commitment required and to ensure the Board members are independent of all other external organisations, we consider the Board should only be made up of full time members.

D22 Should the requirement for this distribution of particular professional backgrounds be relaxed in light of the desirability of attracting the best-qualified individuals?

The Constitution should require the Trustees to ensure that the Board members are individuals that have both relevant and recent experience from a balanced range of backgrounds. We consider that the Trustees should appoint the best-qualified individuals available to them and we do not believe that the Constitution should in any way restrict their choice.

D22 The IASC Foundation (like other standard-setting organisations) has experienced difficulty in securing the involvement of the analyst and investment community. ("Users"). Is there any way to encourage that group to increase its involvement?

We agree that standard setting organisations continue to find it hard to secure the involvement of analysts and the investment community. We believe that as part of the Board's efforts to form closer ties with key industry bodies, and through the establishment of more formal focus groups on new projects, both the analyst and investment community could be encouraged to increase its involvement. The Foundation should also consider "users" in a broader context. For example, within banks, there are many "users" of financial statements, some of whom are analysts producing research and others who support the business in making investments, credit decisions and developing new products for clients.

D23 Does this kind of formal liaison relationship seem important for ensuring convergence of accounting standards? Should special consideration be given to liaison with emerging economies, not currently represented by the existing liaison relationships?

The Trustees have selected formal liaison relationships with countries that in the main will adopt IFRS from 2005. We believe this is an effective way to share experience and help with the aim of convergence with other accounting standards. The IASB should therefore consider establishing new formal liaison relationships with other countries not adopting IFRS in 2005.

D32 The Constitution describes the principles and elements of required due process for the IASB. The IASB's procedures are listed in more detail in the Preface to International Financial Reporting Standards. If respondents do not believe the procedures laid out in the Constitution are sufficient, what should be added?

Over the past twelve months we have worked closely with the IASB on specific aspects of the proposed amendments to IAS 39. As a result of this work, we now have a more detailed understanding of the way in which the IASB sets its agenda, discusses and concludes on technical matters and approves accounting standards.

We noted during the development of IAS 39 that the IASB does not at all times follow the process as described in the introduction to International Financial Reporting Standards. For example, this states that the IASB will give "consideration of the desirability of holding a public hearing and of the desirability of conducting field tests....". Although the Board held a public hearing on IAS 32 and 39, we are not aware of any consideration given to conducting field tests. Given the significant changes proposed by the standard and the potential impact, we consider that field tests were imperative. When significant accounting changes are considered, public hearings and field tests should become a key part of the standard setting process.

Furthermore, we were disappointed that at times during the last year, the IASB decided to avoid changes which might lead to re-exposure and thus potential delays, even if those changes merited consideration. Although the deadlines agreed with the EU Commission were important, short-term decisions should not outweigh the long-term objective of quality accounting standards.

The IASB should also be encouraged to hold education sessions for the entire Board on complex accounting issues. While we would not expect all Board members to be experts on every subject, the vote of each Board member is critical in determining the resulting accounting standard. We have been particularly concerned that a reasonable understanding of financial instruments is currently limited to a very few Board members.

The process for finalising each standard also needs to be improved. We understand that prior to publishing a standard, a review is carried out of the final draft to ensure there are no fatal flaws in the wording. We consider that the final standards would benefit greatly from a wider participation in this process, and specifically by those groups that have been closely involved in discussion on the particular aspects of the standards in question.

In summary, we consider that the process, as set out in the Introduction to IFRS needs to be

reviewed, revised and expanded to ensure that an effective and transparent standard setting process is developed.

F Standards Advisory Council (SAC)

F40 Are the current procedures and composition, in terms of numbers and professional backgrounds, of the SAC satisfactory? Is the SAC able to accomplish its objectives as defined in Section 38?

F40 Is the manner of selection of the SAC chairman appropriate?

We do not believe that changes in the membership of SAC should be considered in isolation. We agree that there are too many members of SAC for the current forum to successfully meet its stated objectives. However, ISDA believes that the members of SAC represent a valuable pool of resources and rather than reducing its membership, we would like to see changes in the structure of SAC. In particular, we think sub-councils should be established to deal with certain technical matters (eg, Financial Instruments, Insurance) with each sub-council responsible for informing the IASB of the views of SAC's members on particular projects.

ENDS