New Political Economy
Publication details, including instructions for authors and subscription information:
http://www.tandfonline.com/loi/cnpe20

The International Accounting Standards Board

Shawn Donnelly [a]

[a] Department of Political Science, University of Bremen, Enrique-Schmidt-Str. 7, 28359, Bremen, Germany

Version of record first published: 09 Mar 2007.

To cite this article: Shawn Donnelly (2007): The International Accounting Standards Board, New Political Economy, 12:1, 117-125

To link to this article: http://dx.doi.org/10.1080/13563460601068875

New Political Economy, Vol. 12, No. 1, March 2007

Routledge
Taylor & Francis Group

GLOBAL MONITOR

The International Accounting Standards Board

SHAWN DONNELLY

The International Accounting Standards Board (IASB) is a private organisation of professional accountants that sets International Accounting Standards (IAS) and newer accounting rules known as International Financial Reporting Standards (IFRS). IAS represent a project to harmonise financial reporting requirements that illuminates resources and other information of interest to investors, employees, tax authorities, public regulators and law makers concerned with corporate governance issues. The European Union (EU), South Africa, Australia, Russia, New Zealand (from 2007) and Canada (by 2011) require companies to use them, while over 90 further countries allow their use. The IASB therefore has a great responsibility for ensuring transparency and usefulness of information about companies, and the role that their governance plays in ensuring the stability of financial systems through transparent corporate governance.

Between 2000 and July 2005, the IASB transformed itself from a collegial, private interest association dominated by accountants in common law countries and with cooperative links to other professional associations to a hierarchical, centralised international organisation producing standards sanctioned by a number of securities regulators at the national, regional and international levels. It therefore has a significant and global impact on the way that company information is made public. At the same time, the national standard setters and accounting firms now resist centralisation and detailed rule development. This Global Monitor piece provides an introduction to and analysis of the IASB and its relations with these actors.

The International Accounting Standards Committee (IASC) Foundation[1] is the umbrella organisation that sets the parameters for the work of the IASB by appointing its members and overseeing its activity. The President of the IASC Foundation chairs the IASB. The Trustees also appoint the members of two other bodies described below that are important to the IASB's work: the Standards Advisory Council (SAC) and the International Financial Reporting Interpretation

Shawn Donnelly, Department of Political Science, University of Bremen, Enrique-Schmidt-Str. 7,28359 Bremen, Germany.

ISSN 1356-3467 print; ISSN 1469-9923 online/07/010117-9 © 2007 Taylor & Francis
DOI: 10.1080/13563460601068875

Committee (IFRIC). The Foundation comprises 22 Trustees, 18 of whom represent the regions of North America, Europe and Asia/Oceania (with 6 Trustees per region) and who represent various professions, including accountants (preparers), auditors, users (financial institutions and public authorities) and academics. They replace themselves by appointment and are led by the IASC Foundation President in appointing Board members, overseeing their work on standards and ways to reduce the inconsistencies with American standards, which stand apart from IAS.

The IASB actively develops IAS, IFRS and detailed Interpretations of IFRS for accountants and auditors to apply to the extent that national laws and practices make this possible. The Board takes all final decisions on standards, so that authority is centralised in its hands, with other participants relegated to the role of providing advice. There are 14 members chosen on the basis of experience and expertise with reporting standards and current reporting issues in corporate governance and financial markets. Twelve Board members are active managers, while the other two are independent, part-time members to oversee the Board's internal governance. All are appointed for terms of five years, renewable once, and replaced on a staggered basis.

The Board adopts standards in consultation with national standard setters and with the SAC. Countries that lacked standard setters created them so that their interests would be represented to the Board. This happened in continental Europe and Asia, where accounting standards reflected civil commercial codes rather than professional practice. For example, in Germany the government instituted two private bodies in 2004, the German Accounting Standards Committee (Deutsche Rechnunglegungsstandardscommittee, DRSC) and the German Standardisation Council (Deutsche Standardisierungsrat, DSR) to cover the relationship with the IASB. The DRSC represents Germany in London and the DSR advises the government regarding the alignment of IAS and the German standards specified in the Commercial Code (Handelsgesetzbuch, HGB). In France, the government established a National Accounting Council (Conseil National de Comptabilité, CNC) in 1996 with representation from the professions under the wing of the Finance Ministry, thereby ensuring a public sector presence despite the involvement of private sector participants. It plays a similar role in the context of IAS development.[2] Other, mostly private, interests are represented to the Board in the SAC. Over 40 representatives of the accounting and auditing professions sit on the SAC. There are no representatives from 'users' (institutional investors and shareholder rights advocates), despite IASB claims that it is interested in bringing them into the process.[3] Most members are chief financial officers of large corporations or accountants. In addition, several international organisations have seats. The International Monetary Fund (IMF), the World Bank, the United Nations Conference on Trade and Development (UNCTAD), the Basel Committee and the International Organisation of Securities Exchange Commissions (IOSCO) are members of the Council. The European Commission, the US Securities and Exchange Commission (SEC) and the Japanese Financial Services Authority have observer status.

The 12 members of the IFRIC more strongly represent accountancy and audit companies,[4] although the IASB maintains that it wishes to have a broader representation of various groups interested in standards. This reflects the fact that the decisions IFRIC takes are highly technical in nature, providing a comparative advantage to the accounting firms that are already confronted on a daily basis with applying standards to specific circumstances. Together, the Board, national standard setters, the SAC and IFRIC ensure the private development of standards with a view to application by companies, taxation and regulatory authorities.

Reasons for the rise of the influence of the IASB

There are a number of reasons why IAS have made such headway since 2000. Corporate governance scandals worldwide have increased the demand of investors and public officials for standardised, transparent information based on a 'fair and true representation' of the current market value of company assets, liabilities and income.[5] Above all, the IASB has moved to make all financial market transactions visible on company balance sheets, while the IASB's American counterpart, the Financial Accounting Standards Board (FASB), continues to allow off-balance-sheet transactions even though they played a role in the Enron collapse.[6]

A second reason is EU's adoption of IAS as the basis of offering comparable company financial information to attract investors, promoting a single European financial market and combating financial crime by managers, auditors and financial analysts.[7] The EU's IAS directive of 19 July 2002 required European companies to publish their consolidated financial reports[8] using IAS and IFRS by January 2005. It delegates standard-setting powers to the IASB and requires the member states to develop national standard setters staffed by accounting and auditing specialists. However, IAS accounts are published in addition to national accounts and only for consolidated accounts of the largest companies, minimising adjustment pressure on the economy.

A third reason is that securities exchange regulators collectively demand that the Board develop more comprehensive and detailed standards. IOSCO promotes internationally standardised listing rules, including universal acceptance of IAS company accounts alongside national standards,[9] so that companies may be listed on stock exchanges worldwide. IOSCO takes credit for pushing the IASB to concentrate authority to produce more extensive standards efficiently and for getting EU regulators to accept IAS as equivalent to local standards for foreign companies listing on their exchanges.[10]

A final, if limited reason for the growing influence of IAS standards is the IASB's coordination with the American standard setter, the FASB. The FASB is staffed by experts from the private sector and its standards are officially recognised by the SEC, the statutory regulator, which enforces their use for all companies listed in the USA.[11] The IASB and FASB attempt to avoid conflicts and promote similarities where they can. In September 2002, the IASB and the FASB launched the Short-Term Convergence Project as part of the Norwalk Agreement to cooperate on bringing standards closer together.[12] The 'special relationship' between the two bodies is further emphasised by the presence of five American IASC Trustees and five American Board members, and by the FASB's special status as a cooperation partner in ongoing joint projects.

However, continuing differences between the IASB and the FASB limits IAS's reach. The definition and calculation of income is one important factor. The FASB examines changes in the financial position of the company (assets and liabilities), while the IASB looks at earnings and expenses. This means that the book value of financial derivatives could improve company accounts under American standards, but not under IAS.[13] American law makers underlined their continued belief in the asset/liability method in the Sarbanes/Oxley Act of 2002, despite the role of derivatives in company collapses.[14]

Controversial issues

Controversies within and about the IASB are found in discussions of its constitutional reform in 2005 and the Board's efforts to sort out its relationship with national standard setters.[15] This problem is difficult enough for countries that have accepted IAS. The relationship with the FASB also creates controversy among other stakeholders in the IAS process.

The special relationship between the FASB and the IASB has drawn criticism from many national standard setters in countries that use IAS and from the big four accounting firms. The FASB has a privileged bilateral relationship with the Board with the intent of shaping IAS despite the fact that there is no prospect of the USA adopting them. FASB officials may chair IAS working groups, but other national standard setters may not. These objections were reflected in the letters of comment by national standard setters and accounting firms on the IASB's 2005 draft memorandum of understanding on the relationship between the Board and national standard setters after the latter demanded clarification in the 2005 constitutional review.[16] European standard setters have also demanded at least as strong a relationship between the Board and their own regional organisation, the European Financial Reporting Advisory Group (EFRAG). EFRAG coordinates EU and non-EU standard setters and represents them to the European Commission. This would balance American influence with common positions of the European accounting community.

There has been widespread concern among national standard setters about how well they are able to advise the Board and whether the Board actually listens to them, putting concerns for efficiency against inclusiveness. The draft memorandum of understanding expected national standard setters to communicate Board decisions and thinking to national audiences rather than bringing inputs into the standard-setting process, which generated objections.[17] The Board accepted these claims for input in a revised draft in February 2006. In contrast, there are a number of calls from some accountants' and auditors' associations in English-speaking countries to be recognised as standard setters alongside official setters on account of their members' implementation of standards. They wish to see standards remain flexible enough to be applied in many different circumstances. Their concerns were not reflected in the new draft.

Weak SAC influence over the Board has disappointed a number of its members. The accountancy firm Ernst & Young has been the only one to complain that the SAC's large size inhibits meaningful deliberation, as it values efficiency over breadth of input.[18] The IASB constitution requires there to be at least

30 members on the council to bring in a variety of viewpoints about the desirability and impact of measures proposed by the Board, and to suggest new ones where this is deemed necessary. Despite this, the SAC lacks institutionalised interlocutors on non-financial reporting issues, such as director statements (also known as management commentaries) covering the company's treatment of so-called stakeholder issues relating to employees, the community and the company's long-term strategy.[19] This is all the more surprising given the IASB's intent to move into this area of reporting standards as a means of improving corporate governance through transparency. The Board proposed rules of procedure in 2006 that would commit it to giving the SAC proper time to respond to drafts, responding to demands from IOSCO for greater transparency and accountability.[20] This focuses on the quality of response rather than activist input, however. The questionable utility of the SAC, coupled with the lack of signalling by the Board to include a broader group of interested parties with a stake in proposed reporting standards, may also have something to do with the fact that the stakeholder community has not involved itself in recent talks on management commentaries.

Rules, principles and backlash

IAS caused few problems for national standard setters and accountancy firms in the past because that they did not prescribe in detail how they should be applied. The IAS and IFRS standards are principles-based rather than rules-based, so that their adoption and application is flexible across companies and countries. This minimised conflicts with existing laws and accounting practices, and the Board praises it as a competitive advantage over standards with many rules, including US standards. Principles are also compatible with the use of innovative securitisation products in corporate finance, which provides for greater legal certainty for financial service providers in Europe, and sends a signal to US investors that IAS as a rule do not directly conflict in principle with their own standards allowing risky instruments.[21]

Another feature of the relationship between IAS and IFRS and national standards that facilitated their co-existence is that the former are often used as reporting alternatives standing alongside national standards, rather than as a full replacement. National standards, to the extent that they continue to deviate from IAS norms, are rules-based in civil code countries and often retained for the purposes of dividend calculations and tax assessment. EU member states now require consolidated accounts of listed companies to be published in IAS, but national law may require national accounts as well. Canada, which decided in 2006 to adopt IAS for domestic companies, will allow companies listed in the USA to continue using US standards instead. A natural incentive to harmonise national accounting standards with their IAS counterparts exists, so that companies can present one set of accounts instead of two, but using two standards means that IAS can be applied without the inevitable political wrangling over the distributive effects of accounting changes to the country's tax system.

The principles-based approach also means that the IASB has been able to make plans for a project to extend accounting principles beyond purely financial matters and into the general statements accompanying company reports without opposition from national standard setters.[22] This means that the IASB's activity is likely to support the Organisation for Economic Cooperation and Development (OECD)'s strategy to promote transparency and qualitative information about corporate governance as part of financial reporting without raising concerns about firm demands on reporting standards that could become easily politicised.[23]

The IASB's 2005 reform placed the easy accommodation of national standards and international principles under question. IFRIC's enhanced role as an interpreter of IFRS raises the possibility of rules-based development of standards, thereby challenging the role that national standard setters have in influencing the standards they develop and threatening greater conflict with commercial codes in civil law countries. The IASB's reorganisation in 2005 was indeed intended to centralise the organisation and place more emphasis on top experts who would communicate decisions to the national standard setters. Upgrading IFRIC to develop more concrete rulings followed from explicit demands from IOSCO,[24] but has been resisted by many national standard setters, especially from developing countries, and countries with codified accounting standards oppose the strong development of rules-based standards through interpretations, because they would clash with local rules and practices.[25] The reluctance of national governments and standard setters to accept such rulings is one important reason why IFRIC has passed only five interpretations to date.

IFRIC's ambitions have also come under heavy fire from the four main accountancy firms, who have one third of the seats on the panel and undertake the actual accounting and auditing that would be subject to IFRIC's rulings. During the constitutional review of 2005, KPMG, Ernst & Young, Deloitte and PricewaterhouseCoopers all raised concerns that IFRIC was taking or was trying to take firm rules-based decisions that it considered out of line with realities on the ground, interfering with their discretion in concretely applying accounting standard principles.[26] It wanted to ensure that IFRIC would only issue interpretations in truly exceptional circumstances and that national standard setters would be prohibited from issuing their own interpretations. This would effectively leave them as the primary developers of a new set of IAS-oriented generally accepted accounting practices in discussion with national standard setters. The Board signalled willingness in 2006 to limit interpretations to cases when these are necessary to clear up problems of understanding in IFRS.[27] Whether the Board and the big four have a mutual understanding of when this obtains remains to be seen.

Some developing countries resisted IFRIC's role to issue interpretations by suggesting in 2005 that national standard setters should issue their own interpretations of IAS.[28] This generated opposition among other standard setters, accounting firms and the Board itself on the grounds that it would fragment rather than harmonise standards under the IAS label.[29] The Board suggested instead in May 2006 that international standards (not interpretations) could be formulated to include optional features that national standard setters could ignore, and that national standard setters be allowed to upgrade IAS with additional requirements.[30] Making some parts of IAS and IFRS optional would relieve the pressure of possible interpretations at the expense of coherence, and it unlikely the Board would make substantial use of the option. This plan potentially gives national standard setters a stronger role than was foreseen in 2005. The Board had suggested then that national standard setters act mainly to identify local obstacles to implementing standards, but to defer interpretations to IFRIC after monitoring their application locally. The four main accounting firms have mentioned guidelines instead of interpretations as an acceptable compromise that they would prefer to fragmentation of standards. Their voluntary nature would leave their autonomy intact while strengthening their own leverage over chief financial officers of the companies they audit, without the constraint of hard rules.[31]

These issues have not been resolved yet. IOSCO and the Board continue to prefer the development of standardised rules, the former more impatiently than the latter. This would also bring IAS and US standards much closer together, a goal that the IASB values. Meanwhile, national standard setters and accounting firms are wary of the constraints these rules would bring. If they prevail against the Board, IAS, IFRS and related guidelines will become the foundation of accounting practices shaped by the Board, but developed foremost by the accounting firms.

Consequences for standard setting and their use

Accounting standards play a key role in the governance of political economies. They determine the degree of financial transparency in the corporate economy, the degree of comparability across companies and countries and the ability of various groups, particularly shareholders, employees and the state, to make claims on the company's resources and to hold managers accountable for their performance. For this reason, IAS are part of the World Bank/IMF Reports on Observance of Standards and Codes (ROSC) programme to promote good corporate governance in developing countries and emerging markets, and an officially recognised part of the international financial architecture.[32]

The first IAS were released in 1975, but were general. The rule structure now competes with national standards in the short term and challenges them in the longer term through the use of interpretations. The IASB has fashioned itself into a functionally organised setter of accounting standard principles, staffed by accountants and auditors from various countries and with links to national standard setters who are responsible for bringing national rules in line with principles. The Board has responded to demands from national standard setters for more input, but it is unclear that changes will be substantial. The participation of stakeholder groups and a major new user, the EU, has not been increased. Meanwhile, the FASB cultivates a special relationship with the Board to ensure that IAS do not conflict greatly with its own standards, without adopting IAS itself. The differing treatment of income from derivatives is one of the reasons why layering of IAS on top of American standards has not been possible, as is the latter's stronger emphasis on fixed rules, for the time being at least.

Finally, IAS have the potential to transform capitalism in civil code countries in the long term. The IAS' focus on transparency of information and current market value benefits outside investors over insider knowledge. This incites more shareholder pressure on management to raise dividends in civil code countries. The focus on current market value of the company's assets and liabilities (rather than historical values) also infuses volatility into the company's declared value. This generates new incentives for companies to manage the risk of fluctuations either through financial engineering, or to stop long-term investment in social and economic competitiveness goals typical of non-liberal forms of capitalism.[33]

Notes

1. The following details are based on the new IASC Foundation Constitution of 21 July 2005, which revises the first constitution of 2000.
2. Conseil National de Comptabilité, 'Missions du Conseil national de la comptabilité', http://www.minefi.gouv.fr/minefi/entreprise/comptabilite/index.htm, 2005.
3. Andrew Sheng (Chairman of the IOSCO Technical Committee), Letter to Paul Volcker, Chairman of the IASB, 9 February 2004.
4. http://www.iasb.org/about/ifricmembers.asp.
5. Andreas Noelke, 'Introduction to the Special Issue: The Globalization of Accounting Standards', *Business and Politics*, Vol. 7, No. 3 (2005), pp. 1–7.
6. Peter Jeffrey, 'International Harmonization of Accounting Standards and the Treatment of Off-Balance Sheet Treatment', *Duke Journal of Comparative and International Law*, Vol. 12, No. 2 (2002), p. 351.
7. *International Accounting Standards (IAS) Regulation* (1606/2002, amended 2238/2004), Deutscher Bundestag, *Drucksachen* 14/23767 (2002).
8. This means that the standards would not apply to subsidiary companies. This would affect the largest companies in the European market and reduce the adjustment pressure on smaller, more national firms.
9. Craig James, 'International Accounting Standards: Are They Coming to America? (Interview with International Accounting Standards Committee Chairman Arthur R. Wyatt)', *CPA Journal Online*, October 1992.
10. See IOSCO Technical Committee, *Statement on the Development and Use of International Financial Reporting Standards in 2005* (February 2005).
11. Foreign companies may issue reconciliation statements that explain the differences to US standards.
12. This project is led by the Canadian Accounting Standards Board. See IASB, *Short-Term Convergence Project Report Summary* (March 2004).
13. For a full discussion of differences between FAS and IAS, see Halsey Bullen & Kimberley Crook, *Revisiting the Concepts: A New Conceptual Framework Project* (FASB and IASB, 2005).
14. *Ibid*., p. 8.
15. The positions of the actors are documented in comment letters on the constitutional review found at http://www.iasb.org/current/constitution_docs.asp.
16. All comment letters are available at http://www.iasb.org/current/comment_letters.asp?showPageContent = no&xml = 16_146_79_10082005.htm.
17. See, for example, Antoine Bracchi (French Conseil National de Compabilité), Letter to IASB (Warren McGregor), 29 July 2005.
18. See Ernst & Young, Letter to IASCF (Tom Seidenstein), 11 February 2004, p. 8.
19. IASB *Discussion Paper: Management Commentary* (October 2005).
20. Sheng, Letter to Paul Volcker.
21. Jeffrey, 'International Harmonization of Accounting Standards', p. 350.
22. See IASB Discussion Paper, 'Management Commentary', October 2005. The IASB's project has been led by the New Zealand standard setter in cooperation with its British, Canadian and German counterparts since 2002.
23. OECD, *OECD Principles of Corporate Governance* (OECD, 2004).
24. Sheng, Letter to Paul Volcker, Chairman of the IASB.
25. See, for example, Institute of Chartered Accountants of India, 'Comments on Draft Memorandum of Understanding on the role of accounting standard-setters and their relation with the IASB', undated, and Bracchi, Letter to IASB.
26. Deloitte Touche Tohmatsu, Letter to Tom Seidenstein (IASB), 22 February 2004; Ernst & Young, Letter to Tom Seidenstein, 11 February 2004; PricewaterhouseCoopers, Letter to Tom Seidenstein, 10 February 2004; KPMG, Letter to Tom Seidenstein, 9 February 2004.

27. IASC Foundation, *Draft Due Process Handbook for the IFRIC* (May 2006).
28. See comment letters from India and Indonesia.
29. A notable exception was the Italian standard setter, the Organismo Italiano di Contabilità. See letter to the IASB on the draft memorandum, 28 July 2005.
30. IASB, *Statement of Best Practice: working relationships between the IASB and other accounting standard-setters* (February 2006).
31. I am grateful to Shyam Sunder for this observation.
32. World Bank, *Reports on Observance of Standards and Codes: Overview of the ROSC Accounting and Auditing Program*, Washington, January 2004. See also Barry Eichengreen, *Financial Crises and What to Do About Them* (Oxford University Press, 2002), p. 19.
33. Wolfgang Streeck, 'Introduction: Exploration into the Origins of Nonliberal Capitalism in Germany and Japan', in Wolfgang Streeck & Kozo Yamamuro (eds), *The Origins of Nonliberal Capitalism* (Cornell University Press, 2005), pp. 1–38.