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Dear Ms Oyre

Review of the IASC Foundation's Constitution Part 2

Thank you for the opportunity to provide comments on the Constitution Review Part II. Please find following our response to some issues raised in the Comment document and some broader questions that we would like to highlight for consideration. Our comments reflect the views, in part or in whole, of the staff members who participated and do not represent the views of the Department of Accounting and Finance or The University of Birmingham.

The International Accounting Standards Committee Foundation has achieved a remarkable feat in creating the basis for a set of accounting standards that has been adopted both widely and by the jurisdictions of major capital markets. Part II of the Constitution review is being undertaken in a substantially different environment than at the last review five years ago. Key developments include:

- The sub-prime credit crisis and subsequent capital market crash;
- The ongoing convergence project with the FASB;
- The growth in digital reporting;
- The improvements in governance from Part I of the Review of the Constitution; and
- The prospect of the SEC's roadmap for IFRS adoption being taken up in a climate of international economic co-operation in the wake of much international diplomacy and the London G20 summit.

Adoption of IFRSs by the U.S. would substantially complete the IASC Foundation's mission to achieve a globally accepted set of accounting standards.

This part of the review of the Constitution is therefore timed to provide a mid-term platform for developments in accounting standards in a substantially different environment both for the IASC Foundation and for the global economy. Our comments are based on the need to begin building the long-term frameworks for a different stage of development for the IASC Foundation and IASB in anticipation of their different 'market' position and changed international realities.

Objectives of the organisation

Some of the issues that emerge in this section are related to the work being carried out in the review of the conceptual framework and so raise a tension between those issues at the strategic-level which are suitable for inclusion in the Constitution and those that are more technical standards-development issues for inclusion in the conceptual framework. The approach adopted here seeks to embed in the Constitution issues that are related to the infrastructure of the standards setting process and/or that we feel should be protected from political pressure arising out of the 'exigencies' of capital market or other economic conditions.

Important areas in the Constitution for which the Foundation is ultimately accountable include the:

- Focus on the public interest; and
- The development of 'high quality' accounting standards and '...information ... to help participants in the world's capital markets'.

Verifying the achievement of these goals may be as hard as achieving them. For example, who is the 'public' in a global setting, what is in their best interest (Baker, 2005; Humphrey et al. 2006)? What makes a set of accounting standards 'high quality'? It may also be that these targets change over time. IFRSs may be said to be high quality on the basis of the significant numbers of countries adopting them. Once they gain acceptance, however, judging that they are maintained at 'high quality' requires a different test, since jurisdictions become 'locked in' to the standards and it would require major disruption to re-establish local standards. Once dominant, the standards-setters have less motivation to pursue goals deemed necessary for acceptance. This may be to the advantage of achieving 'high quality' accounting standards for the public interest – or it may not.

The role of a wider range of parties involved in the governance structure of the IASC Foundation in the form of the Monitoring Board and SAC is important to providing meaning and boundaries to principles that otherwise lack the ability to guide specific decisions. The Foundation needs to reconsider the meaning of 'public interest' and 'high quality standards' to provide a set of goals that can be agreed among a broader set of relevant stakeholders (still only partially represented in the Monitoring Board and will be dependent on how 'relevance' is prioritised in the membership of the reconstituted SAC). The restrictive focus on capital markets fails to recognise the wider significance of accounting in the world economy. It will be important for the continuing legitimacy of the IASC Foundation that representation in the standard setting process is broad.

1. *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?*

We have four points for consideration for this part of the objective.

a) Ability to consider the special needs of SMEs

As the primary objective is focused upon providing information to help economically-orientated users in international capital markets, it appears to somewhat preclude any serious consideration of ‘the special needs of small and medium-sized entities’ (IASCF, 2008: 9), who generally do not participate directly in international capital markets.

Furthermore, the criterion for trustees and IASB members explicitly fails to seek representation or understanding of the needs of small and medium-sized entities, whilst placing emphasis on ‘international business and market experience’ (IASCF, 2008: 13). Taken together, it is difficult to see how objective 2(c) can be seriously pursued without a change in focus beyond capital markets and a revision in the expertise required of Board members and the SAC to include smaller businesses. This is an area worth pursuing, however, given the importance of SMEs in employment and economic development.

b) The need to reconsider the capital market focus in the light of the implications of the credit crisis

While critiques of the dominance of the capital market perspective in the IASC Foundation pre-date the current crisis (Kwok and Sharp, 2005), it should provide the motivation to reconsider the scope and focus of the IASB in setting standards that do not just affect the distribution of capital in the share markets of the world, but also affect the bond and debt markets, the effective running of businesses with a view to long-run sustainability rather than short-term profit, employment and accountability for social and environmental values. The IASC Foundation has a timely opportunity to give greater effect to its ‘public interest’ role by specifically incorporating a concern not just to provide information for capital markets, but to do so with an awareness that decisions are made based on the information provided and that wider concerns than profitability and narrow conceptions of what constitute assets and liabilities should inform the standard-setting process.

The accounting research literature has been active in attempting to re-define the role of accounting in relation to sustainable business and so the IASC Foundation could seek to disconnect its view of public benefit from a strict concern with capital markets and seek a wider constituency (see for example, Hines, 1991; Birkin and Woodward, 1997; Mathews, 1997).

c) The lack of focus on 'other users'

This point is the corollary of the move to a broader understanding of the impact of capital markets on all of society; and would include as users employees and the unemployed, environmentalists, and poverty stricken communities in developing countries. The recent announcement at the G20 meeting in London identifies this interconnectedness in the wake of the credit crisis that has crippled the world's economy. It seems insufficient therefore that the work currently being undertaken on the conceptual framework allows the simple assumption that the economic information provided for investors will be sufficient for 'other users' (Young, 2006).

While it is true that no one set of accounting standards can meet the needs of every stakeholder, broadly defined, the problem is that to privilege one set of users with one narrowly defined capital market philosophy precludes at an institutional level the consideration of issues affecting other stakeholders. The IASC Foundation could take this opportunity to redirect its attention to a more encompassing approach that explicitly includes the needs of non-capital market participants. This could be affected in part through the prioritising of representatives of unions, social accounting experts and developing country NGO's in the membership of the SAC for example.

d) A broader definition of 'economic'

In accordance with the current international concern about global warming and sustainability and a broader definition of users, the IASC Foundation could consider its role in supporting and harmonizing efforts to improve and extend the application of corporate social reporting.

This may be approached by seeking relationships with bodies that are separately promoting approaches to a broader scope for accounting including: GRI, EBR, WICI and The Prince of Wales' Accounting for Sustainability project (see below also).

2. *In the opinion of the Trustees, the commitment to drafting standards based upon clear principles remains vitally important and should be enshrined in the Constitution. Should the Constitution make specific reference to the emphasis on a principle-based approach?*

Accounting and accounting standards are socially constructed (Hines, 1988; Hopwood, 1994; Young 2003), but they are also part of the infrastructure of economies and should not be perceived to be the product of short-term political pressure. There is a risk of pressure on the IASB to progressively abandon principles-based standard setting by adding more guidance. A recent example of pressure based on a short-term issue is the

IASB's response to the fair value outcry. If principles are considered fundamental, it is important that they are protected by inclusion in the Constitution.

However, although much has been debated about rules versus principles-based standards, the Constitution does not define what it means by principles-based standards. For many, the distinction between different 'types' of standard is unclear where principles-based standards can become rules-based standards given additional implementation guidance (for example, see ICAS, 2005).

In addition, the IASC Foundation should consider in its appointment of IASB members and as part of its longer-term strategy that the principles of accounting as articulated in the conceptual framework will not be sufficient to underpin the development of accounting standards that meet the growing demand to report on social and environmental issues to a more broadly defined set of stakeholders.

Similarly the principles may need to be significantly redefined in the light of the possibilities opened up by digital reporting. The IASB will need expertise in this area and consider the longer term implications for the structure of accounting and reporting (Fisher, 2004; Wallman, 1997).

3. *The Trustees and the IASB have limited their focus primarily to financial reporting by private sector companies, partly because of the need to set clear priorities in the early years of the organisation. The Trustees would appreciate views on this point and indeed whether the IASB should extend its remit beyond the current focus of the organisation.*

The adoption of IAS/IFRS in New Zealand integrated public sector accounting requirements into the private sector standards. This creates particular difficulties and highlights areas of conceptual differences and unintended consequences. Given the work that the IASC Foundation could do to enhance private sector reporting in CSR and the existence of an international public sector standard setting body this does not appear to be a priority at the time of this review. The need to have representation from yet another set of stakeholders and experts also suggests that even in the longer term this could make the IASC Foundation's mission unwieldy.

4. *Should the Constitution be amended to allow for the possibility of closer collaboration with a wider range of organisations, whose objectives are compatible with the IASC Foundation's objectives? If so, should there be any defined limitations?*

If it is necessary to amend the Constitution in order to allow greater collaboration that would be a positive step in seeking to achieve a broader focus for international

accounting standards. Groups such as GRI, EBR and WICI are working in areas of interest.

The need for a limitation arises only out of the need to use IASC Foundation resources effectively and trying to engage in too much collaboration may prove counter-productive. Just as the Foundation will need to prioritise 'relevance' in choosing SAC organisation representation, a similar assessment (but perhaps with a different basis for assessing relevance) will need to be applied here.

Governance of the organisation

Rather than addressing the individual issues identified in the Constitution review document, the issues we identify are related to the need to broaden the representation and effective input of stakeholders in the global economy. The emphasis on narrow accounting technical expertise was important in the membership of the IASB to achieve acceptance of IFRSs (Martinez-Diaz, 2005), however the outcome is that the decision making processes at the IASC Foundation and IASB have been dominated by representatives of the Big Four accounting firms (Perry and Noëlke, 2005; see also Porter, 2005). Moving into the next stage of development, the IASC Foundation should expand its understanding of the types of expertise that are required to generate standards for reporting that meet the demands of the next decade. This could include expertise in; measuring and reporting social and environmental impacts, the development of standards for meaningful narrative descriptions, and digital reporting. Expertise in these areas is certainly not the preserve of the Big Four and broader perspectives could usefully be ascertained.

International Accounting Standards Board

9. *... 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.*

Although the IASB has 'full discretion over its technical agenda' (IASCF, 2008: 14), the trustees are required to 'consider' but not 'determine' the IASB's agenda (IASCF, 2008: 11). The Constitution is not clear about how this key inter-relationship may work, given the importance of agenda-setting to the perceived neutrality of standard setting. For example, although the Trustees may only 'consider' the IASB's technical agenda, they also have the power to renew the contracts of IASB members, which, taken together, potentially provides significant influence over the agenda-setting process.

A similar issue arises in relation to the new Monitoring Board. There is a tension between accountability to a group and maintaining independence. The tension in this dual role of the Monitoring Board is highlighted by the newly elected Chair - Mr. Hoogervorst's comment:

I was very pleased to participate in today's initial meeting of the Monitoring Board with the IASCF Trustees. Through the Monitoring Board, world securities regulators will have a means for engaging with the IASCF Trustees to provide a rigorous external review of IASCF operations, policies, and procedures, while at the same time *protecting the independence of the IASB* in its standard setting work. As such, the Monitoring Board serves as a forum for IASCF accountability and gives securities regulators a formal means for providing *input to the IASCF and IASB regarding the implementation of IFRS.*" (emphasis added).

It is important that the IASB is responsive to a balanced range of views and exercises independent judgement regarding the specifics of the standards and its work agenda. Independence in this setting suggests a lack of bias and the application of judgement through due process with transparency.

The risk in relation to a fast track procedure to be created is that it opens up the possibility that powerful lobby groups may use pressure situations to bias the standard setting process. Accounting standards are part of the infrastructure of international capital markets and economies and in line with that should be developed with appropriate due process and not changed unless there is a demonstrated long-term need for change. This approach fits with the principles-based premise for setting standards.

Standards Advisory Council

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?*

The function of SAC members is to provide independent feedback or critique on standard-setting proposals whilst also supporting 'the IASB in the promotion and adoption of IFRSs throughout the world' (IASCF, 2008: 14). It could be argued that the two roles may be somewhat inconsistent where the unambiguous support required by SAC members in *promoting* IASB activity (perhaps for standards that they or the organisations to which they belong are opposed) may inhibit the independence of their critique. The bracketed rider that "((t)his objective does not preclude SAC members from participating in genuine and objective critiques of the work of the IASB to assist better understanding and transparency of issues and solutions.)" is perhaps most telling by its inclusion.

While it makes sense that members of the SAC should not hold views that are antithetical to the existence of the IASB, it is unnecessary to require them to commit to involvement directly in promoting adoption of IFRSs. This may have been seen as appropriate at a time when adoption was a key issue for the IASC Foundation however,

as it looks to framing its role as a dominant standard setter it is more important to make the SAC unequivocally an independent source of advice.

Other issues

On a wider theme, the user groups identified as potential members of the SAC may help redress the historic imbalance in standard setting of user under-representation. However, given the focus of the Constitution on providing information to participants of international capital markets, the user groups represent those agents allocating capital on behalf of others. No users or stakeholders representing wider societal interests are mentioned, nor are they represented by national governments due to the private supranational status of the IASB. As the capital markets are designed to serve societies rather than themselves, it could be argued that the standard setting process seeks little representation from those ('users') who are affected by capital allocations based on accounting information. In broad regulatory terms, one could argue that the governance of the process should not be undertaken by those it is seeking to govern, but by those whose interests it is intended to serve.

Sincerely,

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Dr Nicholas Rowbottom

Mrs Anne Ullathorne

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See also:

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