Working in the Public Interest: The IFRS Foundation and the IASB

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Introduction and summary

The International Accounting Standards Board (IASB) develops International Financial Reporting Standards (IFRS Standards) that are used widely around the world. The IASB is the independent standard-setting body of the International Financial Reporting Standards Foundation, a private not-for-profit foundation.

The IASB is a unique organisation. For example, it is the only privately organised member of the Financial Stability Board (FSB), which mainly consists of public regulators and government officials. Despite the IASB's private character, the use of its main product—IFRS Standards—is mandated by law in 116 jurisdictions, while 12 more permit the use of IFRS for domestic or foreign registrants on regulated markets. The vast majority of jurisdictions prescribe IFRS without substantive modifications.

As such, the IASB is responsible for one of the most pervasive, legally binding economic standards in the world. However, the fact that an organisation with strong private features is responsible for producing Standards on which public policy depends is for some also a source of discomfort.

The IASB is sometimes portrayed as a self-regulating body that is lacking in democratic accountability. Some have expressed concern that the IFRS Foundation is overly exposed to private, commercial interests and has insufficient regard for the public interest.

They argue that these perceived fragilities in its governance also permeate the quality of the IASB's standard-setting. In their view IFRS Standards are, beneath a veneer of technocratic neutrality, in reality too closely geared towards meeting the needs of short-term investors. By supposedly relying excessively on market-value-based fair-value accounting, the IASB is seen as having too little regard for prudence in accounting. Some believe that this promotes short-termism and excessive dividend policies in the capital markets.

All of these questions merit consideration and in this paper we will try to address them.

We will argue that the standard-setting of the IASB is motivated by a strong sense of public interest as embodied in our Constitution and, more recently, our Mission Statement. While the most active users of financial reporting are investors and creditors in the capital markets, the IASB recognises that its Standards are of great value for the public at large, in all its guises. We will explain why we advocate neutrality in accounting, even though we know that perfect objectivity is aspirational and hence impossible to attain. Far from fostering irresponsible profit-reporting and excessive dividend extraction, IFRS aims to impose rigour and discipline on the capital markets, thus promoting trust, economic growth and long-term financial stability. IFRS is also a very cost-effective way of promoting confidence in emerging economies.

We will argue that, while it is true that the IASB and the IFRS Foundation have significant private characteristics, they are not self-regulatory bodies. Public authorities play a crucial role in the governance of the IFRS Foundation, the standard-setting due process and the adoption and enforcement of IFRS. The IFRS Foundation is formally accountable to public authorities and the IASB engages very intensively with the public regulatory community.

The IASB's governance guarantees strict independence of its Board Members from commercial interests in the same way as is usual in the public sector.

The accountability of the IASB is further enhanced by a highly transparent and well-developed system of due process, which is generally considered to be exemplary among standard-setters.

Most importantly, neither the IFRS Foundation nor the IASB has any power to impose IFRS in any jurisdictions. Local legislatures and/or regulators decide which accounting standards are appropriate in their jurisdiction. In most cases, that assessment has resulted in full adoption of IFRS.

Every five years, the Trustees consult publicly on the structure and effectiveness of the IFRS Foundation. The current review asks a series of questions about many important issues related to our standard-setting, our governance and our funding.[1] We welcome all feedback, on these and other topics. In the past we have demonstrated that we listen carefully to such suggestions, that we are open to change and quick to implement. We will continue to strive to do so in the future.

1. The public interest of IFRS

From its inception, the IFRS Foundation has emphasised that IFRS Standards are created to serve the public interest. In our recently published Mission Statement[2] we define our mission as 'to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world'. This statement is further explained as follows:

- IFRS brings **transparency** by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
- IFRS strengthens **accountability** by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Our Standards provide information that is needed to hold management to account. As a source of globally comparable information, IFRS is also of vital importance to regulators around the world.
- IFRS contributes to economic **efficiency** by helping investors to identify opportunities and risks across the world, thus improving capital allocation. For businesses, the use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs.

Of these three interrelated objectives, the goal of strengthening accountability is especially worth noting. In modern capital markets, the majority of economic actors (publicly listed companies, banks, insurance companies, hedge funds and asset managers) are working with other people's money. Significant distance can exist between the providers of capital and the people to whom they have entrusted that capital. Modern capital markets are therefore rife with moral hazard, as the financial crisis has amply demonstrated. Solid accounting standards that impose discipline and rigour in financial reporting are essential for containing this moral hazard.

Our Standards bring transparency, accountability and efficiency to financial markets around the world.

Our mission statement sums up our contribution to the public interest as **'fostering trust, growth and long-term financial stability in the global economy'**. High quality accounting standards contribute to trust in the economy. Even for people who never look at financial reports, it is important that accounting standards lead to financial reporting that is both informative and trustworthy.

Academic research has shown that a single set of high quality accounting standards brings significant benefits to the global economy.[3] IFRS contributes to growth by improving capital allocation and lowering the cost of capital, not only in developed countries, but also in emerging economies. For countries such as Brazil, Malaysia and Korea, the adoption of IFRS was an integral part of a strategy to increase the international appeal of their capital markets and to foster economic growth. For the same reason, the World Bank has promoted the adoption of IFRS in many emerging economies while the Financial Stability Board has designated IFRS adoption as one of twelve 'key standards' for creating sound financial systems.[4]

The third element of public interest we mention in the Mission Statement–long-term financial stability—is less obvious at first sight. Fostering financial stability is not the primary goal of accounting standards; this is primarily the remit of prudential regulators, whose task it is to safeguard the solvency of the financial system. The transparency provided by accounting standards can in the short run even lead to instability as problems buried deep within a company's balance sheet are brought to light. However, problems can best be addressed if they are first made visible by high quality accounting. That is why we believe that the transparency provided by high quality accounting standards is indispensable for, and contributes to, long-term financial stability.

Our commitment to the public interest also translates into continuous enhancements to the openness and inclusiveness of the IASB's due process and structure. To ensure that the public interest is taken fully on board, our *Due Process Handbook* emphasizes the importance of the role of the regulatory community in our standard-setting.[5]

2. The audience of IFRS

The IASB's existing *Conceptual Framework* defines the primary users of financial statements as 'present and potential investors, lenders and other creditors'; in short, those economic actors who entrust or consider entrusting their money to the reporting entity. Some investors feel this primary audience is defined too broadly; they believe that only existing investors should constitute the primary audience of accounting. Others believe the audience of IFRS is defined too narrowly: they point to the previous version of the IASB's *Conceptual Framework*, which also included 'customers, governments and their agencies and the public' as users of financial statements. One study even suggested that the IASB 'privileges commercial interest when defining the rules of financial reporting'.[6]

The first thing to note is that our current definition of 'primary users' is not as limited as it may seem at first sight. In the modern economy, a large percentage of ordinary people invest in the capital markets. They do so either directly or indirectly, for example through participation in pension plans or mutual funds. Capital market actors are not just wealthy investors or hedge funds; many institutional investors act in a fiduciary capacity for ordinary people, often on a not-for-profit basis. Consequently, we strongly disagree with the notion that the IASB somehow 'privileges' commercial interests. There is a significant public interest in ensuring that investors—whoever they are or represent—have access to reliable financial statements.

Generally speaking, our Standards close the information gap between the management of a company and other stakeholders who have a viable interest in better understanding the financial well-being of that company. This may include investors and creditors, but also trading partners and customers.

Moreover, our Mission Statement states our belief in the public interest of our work. Clearly, fostering trust, economic growth and long-term financial stability are of immense importance to the public at large. This makes the public at large–even those who do not invest in capital markets—a stakeholder in our work. Perhaps this issue could be clarified during the current revision of the *Conceptual Framework*.

Some have argued that IFRS is too attuned to meeting the needs of short-term investors, to the detriment of those with a longer-term investment horizon. For example, a recent report stated that: 'While much of the financial sector is concerned with short time frames for economic decision, most clearly expressed in market-based fair-value accounting, other stakeholders (such as employees, civil society actors and regulators) have a longer-term orientation, often extending product or business cycles'.[7]

We share the concern that too many actors in the financial markets are driven by short term incentives. That is the very reason why the IASB aims to set standards that make it difficult to manipulate earnings and that bring hidden liabilities to light.

We believe, however, that in practice it is difficult to distinguish between long-term and short-term investors and we also believe that their information needs may not be very different. Pension funds and insurance companies trade assets regularly, while even long-term investors need to monitor which short-term developments may well represent the beginning of a longer-term trend. Moreover, many long-term 'value' investors use such short-term triggers as an opportunity to buy high quality assets at an attractive price.

Studies have shown that IFRS Standards are not tilted towards fair value,[8] and many long-term investments are reported on the basis of historical cost accounting. At the same time, it is clear that market values can be highly relevant for all investors. Obviously, for an institutional investor, the current value of shares that it acquired 20 years ago is much more relevant than the original acquisition price. We believe that IFRS, which relies on a 'mixed attribute' approach that combines historical cost accounting and fair value measurement, is appropriate for both short-term and long-term investment horizons.

Our existing *Conceptual Framework* also mentions that regulators are not considered to be a primary user of financial statements, because the objectives of general purpose financial reporting and the objectives of financial regulation may not be consistent. While it is true that regulators may have different policy objectives, our more recently issued Mission Statement mentions that IFRS is a vital source of information for the global regulatory community. We intend to clarify this apparent contradiction between the *Conceptual Framework* and the Mission Statement.

In practice, the IASB works very closely with the regulatory community, as mandated by our *Due Process Handbook*. In addition, as a member of the FSB, the IASB meets with G20-regulators on a regular basis. As a consequence, accounting issues are routinely discussed at the FSB. The IASB also has strong relations and cooperation agreements with the International Organization of Securities Commissions (IOSCO), the Basel Committee and many other international, regional and national supervisory authorities.

These agreements ensure that our work is coordinated with other developments in financial regulation globally.

3. The characteristics of IFRS

a. Accounting standards should portray economic reality, rather than shape it

Accounting standards aim to portray economic reality, rather than shape it. A comparison between the Basel capital requirements and IFRS makes this difference clear. While the Basel capital requirements tell banks how much capital they *should* have, IFRS Standards are 'merely' designed to show how much capital a bank actually has.

Accounting standards aim to describe economic reality as faithfully and neutrally as possible. They are not, and should not be thought of as a tool to change or hide reality. In other words, the way something is measured should not be changed just because the answer is not very attractive. Nevertheless, we acknowledge that accounting often involves judgement and that it is not a completely objective, purely technical discipline. Because of this, we work hard to view complex accounting issues from many different angles and to avoid an ideological approach to accounting. However, even if we acknowledge that accounting standards cannot achieve 100 per cent objectivity and precision, we aim to come as close as possible to this ideal. It would indeed be perverse to do the opposite and make subjectivity the goal of accounting, just because perfect objectivity is impossible to achieve.

b. Why even neutral standards can generate controversy

If the only ambition of IFRS is to portray economic reality as it is, why is it that accounting issues can at times generate heated debate? One answer is that because accounting is as much of an art as a science, there is obviously a lot of room for differences of opinion on both a) what is economic reality and b) how best to reflect that in accounting measurements. Consequently, accounting is subject to a lot of genuine, healthy intellectual debate, which we can only welcome.

However, there are also less noble motives for debate about accounting standards. Companies that report under IFRS have big interests at stake in accounting. Remuneration and reputations are often closely linked to profits, so there is an obvious incentive for some to favour Standards that provide a degree of flexibility to manage earnings. Companies also like their balance sheets to look lean, so our efforts to bring off balance sheet items onto the balance sheet can often meet fierce resistance.

Accounting standards aim to describe economic reality as faithfully and neutrally as possible.

Over the years, accounting standard-setters around the world have improved the rigour and discipline of their standards to limit the possibilities of earnings management and to bring previously undisclosed liabilities onto the balance sheet.

Those companies most affected often argued that the change to accounting standards would seriously damage their business model or cause too much volatility. Previous examples of such controversies include the expensing of stock options and getting pension liabilities on the balance sheet. Before these changes were introduced, management were able to give away, seemingly for free, large amounts of shareholder value in the form of stock option grants. Likewise, the financial consequences of management providing enhanced pension benefits were not adequately reflected in the balance sheet. Because of these changes, the consideration of such commitments is now discussed in the board room and scrutinised by investors.

At the time, these were hugely controversial changes, accompanied by extensive political lobbying. Today, such reporting is simply seen as normal practice. These experiences underscore the importance of the IASB serving the public interest, as well as the need to protect the ability of the IASB, having followed an extensive and open due process, to introduce often controversial enhancements to financial reporting.

In the end, the improved transparency provided by our Standards usually leads to better management of the risks that they make visible, thus reducing volatility in the long run.

The discipline of IFRS counteracts the tendency of some companies to show their results in the most favourable light. Almost all companies publish their own non-GAAP measures along with the IFRS financial statements. The fact that the vast majority of these adjusted earnings are higher than IFRS-defined earnings underlines the discipline and rigour imposed by our Standards.[9] In this way, IFRS helps to keep capitalism honest.

c. IFRS contributes to prudence in capital markets

In the existing revision of the *Conceptual Framework*, the IASB removed the reference to the concept of 'prudence', because it believed that the term lacked precision and was open to too much interpretation. In recent years, some have come to attach greater significance to the change than was intended. Removing the word 'prudence' was never meant to give the green light to imprudent behaviour or Standards, nor is there any evidence that it did.[10] Nevertheless, partly because of the concerns that have been raised, the IASB has proposed to reintroduce a reference to prudence in the proposed revision of the *Conceptual Framework*.

Our proposed revision defines prudence as 'the exercise of caution when making judgments under conditions of uncertainty', so as to prevent understatement of liabilities and overstatement of assets and profits. We have also made clear that prudence cannot mean that profits are artificially understated. That would open the door to the creation of hidden reserves, which would most probably be released when earnings are under pressure, thus masking a negative performance of a company. Income smoothing can often lead to very imprudent accounting.

Some argue that IFRS allows for too much recognition of unrealised income, which could lead to unwarranted profits and dividend distribution. In itself, it is true that IFRS (or any other accrual-based accounting standard, for that matter) recognises unrealised income (both profits and losses). The whole essence of accrual accounting is that economic events are recognised regardless of when cash transactions occur. For example, it makes no sense to recognise the full expense of a factory in the year when it is paid for, while its economic life is expected to span at least 20 years.

Not only does it make little economic sense to base accounting on realised profits - it is also very dangerous. Suppose a bank has a portfolio of financial instruments of which 90 per cent are loss making while only 10 per cent have a value above the purchase price. If this bank's profit were based on realised income, it could easily show a profit by merely selling the profitable assets and by holding on to its loss-making assets. The bank would report a decent profit, while actually being in serious financial trouble.

In other words, basing reported profits purely on realised income makes the income statement very easy to manipulate.

Our Standards do not govern dividend policies; that is the responsibility of the relevant public authorities in any jurisdiction. In most countries, dividend policies are dealt with by company law or regulation. Our contribution to this process is to provide the full and necessary information to inform such decision-making.

In sum, we believe that IFRS contributes to prudence–in the general sense of the word—in capital markets. To appreciate the rigour and discipline imposed by IFRS, a comparison with public sector accounting is instructive. In many public sector accounts, vast amounts of statutory social security liabilities are not recognised or consolidated. While companies must show their employee pension liabilities, many governments simply do not, or not completely. While not perfect, IFRS Standards, especially after the improvements in lease accounting, ensure that the balance sheet accurately reflects the full extent of a company's liabilities.

d. Complexity

There is little doubt that in the past decades, annual reports have increased in complexity and length. Some of this can be attributed to the disclosure requirements of IFRS, but non-IFRS regulation—often made at a national level— can often have a bigger role.[11]

Moreover, much of the complexity of accounting is a reflection of an increasingly complex economic reality. That view is shared by others. For example, in its recent report on its evaluation of the IAS Regulation[12], the European Commission concluded that much reporting complexity is unavoidable, because it reflects the underlying complexity of business. Insurance, pensions and derivatives are all highly complex financial instruments for which there is no simple accounting.

The distinction between equity and liabilities has become increasingly blurred. Business acquisitions inevitably lead to complex accounting.

Setting accounting standards therefore requires significant technical expertise. Even though our Standards are principle-based, they contain a lot of technical detail to enable companies to apply the Standards properly. The complete suite of Standards is highly interrelated and changing one Standard often has repercussions for other Standards. All this makes accounting standard-setting a highly complex activity.

Much of the complexity of accounting is a reflection of an increasingly complex economic reality.

While we believe that complexity is here to stay, we are working hard to make it more manageable. For example, our Disclosure Initiative is aimed at making improvements to our Standards that will encourage companies to avoid immaterial information and boilerplate disclosures. We are also working closely with securities regulators and auditors, whose support is needed to make this a success. This initiative should help to make disclosures more succinct and understandable.

Moreover, because the IASB is finishing its work on major new Standards, we will be able to devote more time to improve the consistency of our existing Standards, making them easier to apply in practice.

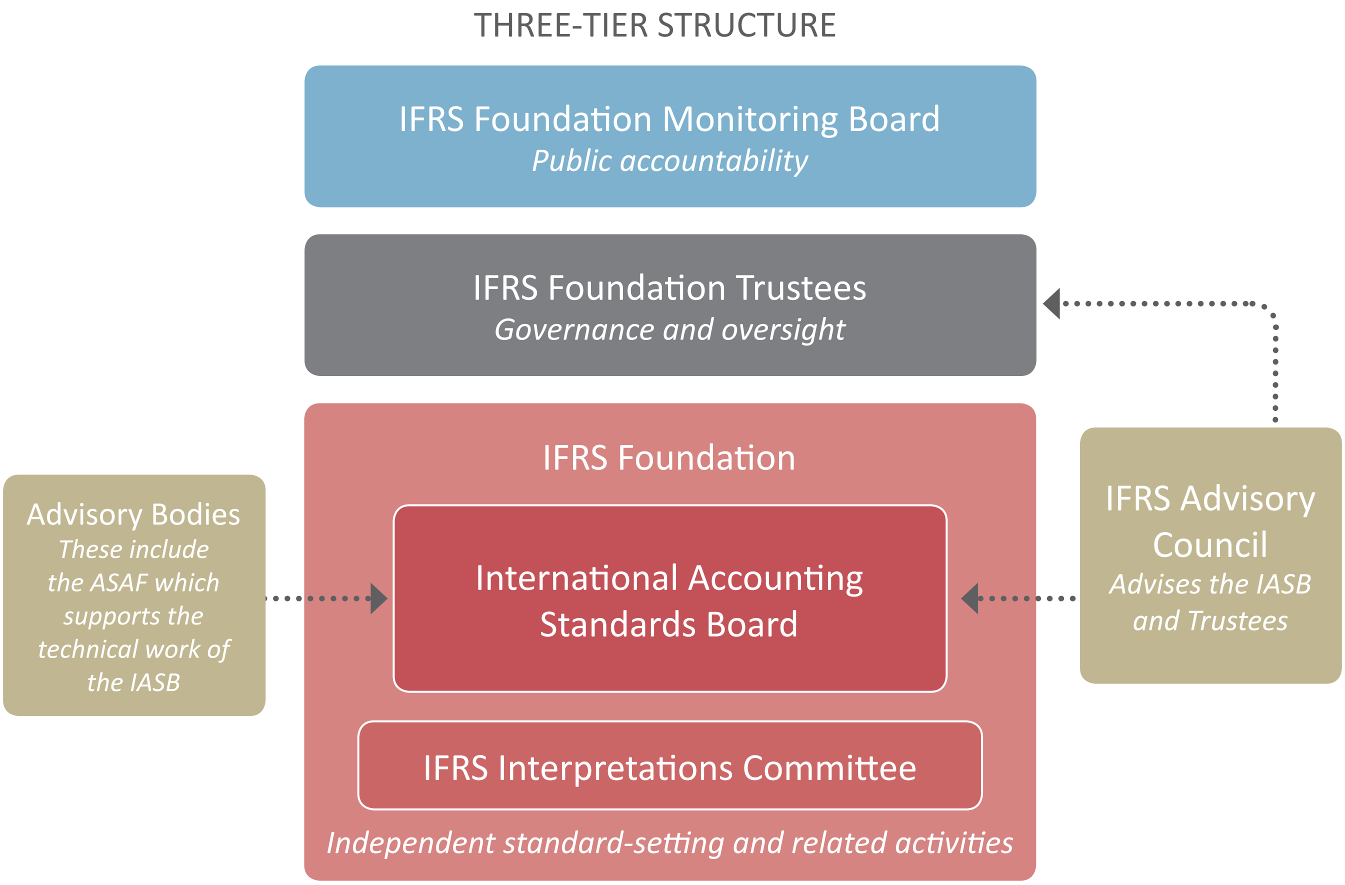
Finally, the IASB's comprehensive due process (as described in more detail in the next section) provides stakeholders from around the world with a mechanism to ensure that the Standard once completed can be applied as efficiently as possible across both developed and emerging economies.

e. The scope of IFRS: is it too narrow?

Alongside financial reporting, there are many other developments in the realm of corporate reporting, such as sustainability reporting and non-financial corporate governance reporting. Until now, our position has always been that the IASB is especially qualified at financial reporting and that we should stick to our trade. This is sometimes seen as the IASB being not sufficiently responsive to wider public reporting needs. However, we believe other types of reporting, or accounting-related policies (such as dividend distribution policies) are best left to the remit of the relevant authorities or other standard-setters. IFRS delivers the reliable and globally consistent financial information upon which public policy can be built.

At the same time, we have a constructive relationship with the International Integrated Reporting Council, enshrined within a Memorandum of Understanding, which promotes integrated reporting of both financial and non-financial information. We also participate in the Corporate Reporting Dialogue, a forum that brings together organisations that issue standards and frameworks with international impact. In our current *Review of Structure and Effectiveness* we are seeking feedback on whether the IASB should play a more proactive role in non-financial reporting.

4. Governance, finance and accountability



International economic organisations can be divided into international treaty organisations, such as the International Monetary Fund and the World Bank, and non-treaty organisations, such as the Financial Stability Board and the Basel Committee that rely more on 'soft power'. The IFRS Foundation and the IASB clearly belong to the latter group, with a mix of private and public characteristics in our governance. Generally speaking, the IFRS Foundation and the IASB have less pronounced public characteristics than other organisations, but the highest degree of transparency and public consultation in their due process.

a. The three-tier structure, independence and public accountability

The IFRS Foundation was founded under the auspices of global securities regulators (IOSCO) as a private, not-for-profit body in 2001, with the aim of contributing to the development of global financial markets and cross-border activity. Similar governance models can be found in many countries, including Germany, Japan, Korea, Malaysia, the Netherlands and the US.

The IFRS Foundation is governed by a Board of 22 Trustees, who together are responsible for general oversight and appointments to the IASB.

The composition of Board of Trustees provides a balanced representation of geographical background and skills. Of the current 21 Trustees, 13 have a background that is predominantly in public service, while eight originate from the private sector.

One of the most important objectives of this governance arrangement was to guarantee an independent but accountable IASB as the global standard setter.

As described previously, accounting standards that lack sufficient rigour and discipline can provide opportunities for misinformation.

If financial reports are to offer unbiased and reliable information, then the accounting standards on which they are based must be developed in an independent setting, protected from undue commercial influence.

The following arrangements are in place to foster the independence of the IASB:

- The full-time members of the IASB are prohibited from having any side activities or functions that might pose a conflict of interest. They cannot fulfil any functions in private business, represent business organisations or have any undisclosed financial interests that may call into question the independence of their decision-making. At present, we have no part-time members, but were they to be appointed, their independence would be strictly vetted by the Trustees. In practice, the IASB's independence requirements are not different from (or even stricter than) those of most public authorities. Of the currently 14 IASB members, six have a background in public service.
- The Trustees appoint the members of the IASB according to a rigorous vetting process and provide oversight of the management of the IFRS Foundation and its finances. The Trustees also provide oversight of the due process of the standard-setting, but they are not able to influence the content of the Standards. Moreover, Trustees abide by strict conflict of interest rules, provide an annual declaration of interests and must recuse themselves of any discussion where a conflict of interest may occur. All the Trustees are required by the Constitution to act in the public interest in all matters. The Trustees are nominated for appointment by the Monitoring Board after a demanding vetting process.
- The governance of the IASB is completed by the Monitoring Board, which was established in 2009 following a major public consultation. The Monitoring Board is a group of capital market authorities, principally securities regulators. It provides the IFRS Foundation with a formal accountability mechanism to public authorities.

Accounting standards that lack sufficient rigour and discipline can provide opportunities for misinformation.

The principal responsibilities of the Monitoring Board are to:

(i) participate in the nomination process of Trustees and approve their appointments;

(ii) provide input on selecting the IASB Chair;

(iii) review the Trustee arrangements for financing the IASB;

(iv) review the Trustees' oversight of the IASB's standard-setting process, in particular with respect to its due process arrangements;

(v) confer with the Trustees regarding their responsibilities, in particular in relation to the regulatory, legal and policy developments that are pertinent to the IFRS Foundation's oversight of the IASB; and

(vi) refer matters of broad public interest related to financial reporting for consideration by the IASB through the IFRS Foundation.

With the establishment of the Monitoring Board, the IFRS Foundation acquired a three-tier structure, with a top layer of public oversight. The Monitoring Board also has the right to review the financing arrangements of the IASB and the due process arrangements.

Consequently, although the IFRS Foundation remains a private organisation, a clear public oversight layer has been established.

The current members of the Monitoring Board are representatives of the Board and the Growth and Emerging Markets Committee of IOSCO, the European Commission, the Financial Services Agency of Japan, the US Securities and Exchange Commission, the Brazilian Securities Commission and the Financial Services Commission of Korea. The Basel Committee on Banking Supervision participates in the Monitoring Board as an observer.

Both the composition of the IASB and that of the Trustees seek to be representative of the world's capital markets and to ensure a broad international base. The geographical composition of the Trustees is currently: six each from Europe, Asia/Oceania and North America, one each from Africa and South America and two 'at large' positions. This distribution is subject to oversight by the Monitoring Board, which also approves the appointment of the Trustees. The composition of the IASB shows a similar geographical distribution: four members each from Asia/Oceania, Europe and North America, one each from Africa and South America and two 'at large'. Currently two Board vacancies are not filled, pending the *Review of Structure and Effectiveness*.

In the previous strategy review of the IFRS Foundation, and the Monitoring Board's separate review of our governance, the vast majority of respondents considered this to be an appropriate structure. Nevertheless, in the current *Review of Structure and Effectiveness* we are again asking our constituents if they have suggestions for further improvements in the functioning of our governance arrangements.

b. Ultimate sovereignty remains with adopting jurisdictions

It is important to note that the IASB is not a government agency empowered to promulgate rules or regulations that have the force of law. In all jurisdictions that use IFRS, those Standards only become public law by deliberate act of national or (in the case of the EU) supranational public authorities. Adoption of IFRS takes place on an entirely voluntary basis, so there is no surrender of sovereignty in accounting.

Many jurisdictions have endorsement procedures for the adoption of individual Standards. Of all IFRS jurisdictions, the European Union has the most stringent endorsement procedure in place. The existence of endorsement procedures is not a paper tiger. The IASB is fully aware that if it does not take the views of its constituents sufficiently into account, there will be an increased risk of a jurisdiction not fully applying new IFRS Standards. The fact that most jurisdictions chose to adopt IFRS without modifications is partially due to the responsiveness of the IASB to suggestions and concerns of its constituents.

In summary, we do not believe it is correct to characterise the IFRS Foundation and the IASB as self-regulatory bodies. As a whole, our governance contains a mix of public and private elements. While parts of its governance are privately organised, the IFRS Foundation is firmly embedded in a public environment.

c. Funding

Questions are sometimes asked about the funding of the IFRS Foundation as a possible source of conflicts of interest. While we acknowledge in the current *Review of Structure and Effectiveness* that the way in which our funding arrangements function can be further improved, we believe they have in practice not been a source of conflicts of interest.

Over the years, the IFRS Foundation has sought to significantly increase its reliance on publicly sponsored contributions.[13]

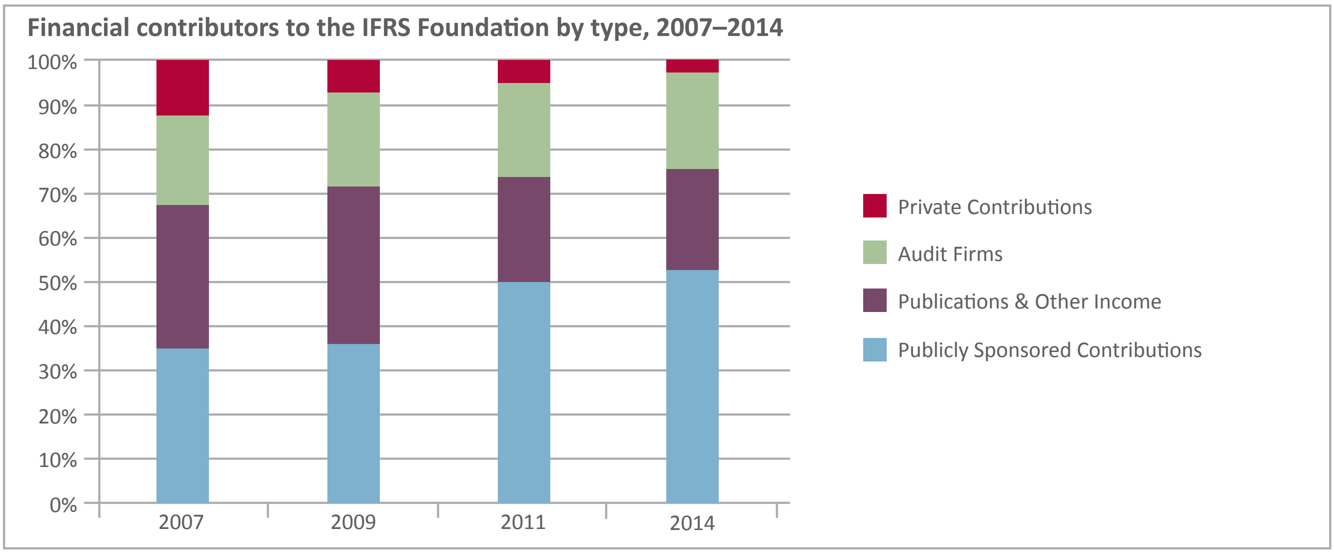
As can be seen in the diagram overleaf, this strategy has been largely successful, with an increase in publicly sponsored contributions from 34 per cent to 52 per cent, more than offsetting a decrease in income from publications and licences.

While total private contributions dropped from 32 per cent to 25 per cent, the contributions from the audit firms are still quite significant – leading some to express concerns about the independence of the IASB from those firms.

The first thing to note is that it is arguably very reasonable for the audit firms to contribute to the IFRS Foundation. Compared to the past, when they had to work with a myriad of national accounting standards around the world, the spread of IFRS presents an immense cost saving to the audit firms in terms of development and maintenance of accounting expertise.

But even if it is reasonable that the audit firms should contribute in exchange for the benefits they derive from IFRS, it can be argued that the fact that this contribution is made on a voluntary basis could make the IASB potentially vulnerable to pressure. While the Trustees are aware of and acknowledge this concern, in their view it is one of perception rather than reality.

Because the audit firms' clients work with IFRS Standards, the firms have a significant professional interest in IFRS. Some might suspect the firms to have an interest in making IFRS as complicated as possible so as to generate auditing fees. What we witness in practice, however, is that the principal private interest of the audit firms runs parallel with the public interest of making the Standards clear and auditable.



While the contributions from the audit firms seem intrinsically reasonable and do not pose material conflicts of interest to the IASB, some may argue that even the perception of conflicts of interest can raise concerns. In the *Review of Structure and Effectiveness* we ask whether our constituents have suggestions as to how the funding model might be strengthened.

d. Due process

The independence of the IASB is complemented by an elaborate system of accountability that exceeds that of most other international bodies. The IFRS Foundation has developed a very thorough *Due Process Handbook* for the IASB to follow in developing new and amended Standards. That handbook requires the IASB to operate in line with three main principles: transparency, full and fair consultation and accountability. Among the main provisions are that all Board papers are available from our website and all standard-setting meetings are held in public and can be observed through the Internet.

The IASB welcomes comment letters from individuals as well as private and public bodies. Feedback received is weighted based on the merit of the ideas presented, rather than the perceived importance of the submitter. Every round of public consultation is accompanied by an extensive programme of outreach activities, including public round tables and online webcasts, as well as both group and one-to-one meetings with interested parties. The IASB also consults extensively with its various advisory bodies, including the IFRS Advisory Council, the Accounting Standards Advisory Forum, the Capital Markets Advisory Committee, the Global Preparers Forum, the IASB's Emerging Economies Group as well as other project-specific advisory bodies.

In our public consultation, we try to ensure that we get balanced feedback from all relevant parties. Generally, we have no problem getting feedback from companies, because they have a huge interest in our Standards, and they have the resources and technical expertise to write comment letters.

For others, finding resources and technical knowledge can be more difficult. We therefore spend a great deal of time ensuring that the non-technical audience can also participate in the development of IFRS. Whenever we publish major proposals we also produce high level 'snapshot' summaries, written for a general business audience. These are accompanied by a comprehensive programme of outreach activities, all designed to allow others, such as investors, policymakers and the public at large to better understand our work and to be able to comment on the general principles of what we propose.

All comment letters are posted with equal prominence on the project section of the IASB website, while the IASB's consideration of such feedback is subject to a full audit trail. Each Standard issued includes an accompanying Basis for Conclusions, which sets out the rationale for the IASB's decisions. At the end of the project, the IASB also normally publishes a Feedback Statement that explains how it responded to the broad themes received throughout the consultation.

Finally, the entire due process is then subject to a comprehensive, end-to-end life cycle review by the Trustees' Due Process Oversight Committee before the final Standard can be issued by the IASB. Concerns about alleged due process infractions are extremely rare.

5. Afterword

In this document we have tried to give a nuanced view of our governance and the nature and quality of IFRS. We recognise that all is not yet perfect; our Standards can be improved further and in our *Review of Structure and Effectiveness* we are asking open questions on issues such as funding and our governance arrangements.

However, the fact remains that more than 80 per cent of countries have voluntarily chosen to adopt our Standards. The fact that so many of those jurisdictions have resisted the temptation to modify IFRS is most likely due to the following reasons:

First of all, almost all jurisdictions are convinced of the benefits of having a single set of accounting standards around the world. Many respondents in the European Commission's evaluation of the IAS regulation confirmed this view. For many emerging economies, the adoption of IFRS has been a very cost-efficient way to enhance the credibility of their capital markets. Our constituents know that as soon as individual jurisdictions start tinkering with IFRS, these benefits would evaporate. Most jurisdictions are fully aware that even small changes to the Standards may lead to inconsistencies or unintended consequences.

Secondly, while we acknowledge that accounting is not an exact science, accounting standards are much less political in nature than other economic standards, which is probably another reason why most jurisdictions feel comfortable entrusting this task to an international standard-setter.

Thirdly, IFRS Standards are recognised to be of high quality, although we acknowledge that further improvements are always possible.

Finally, most jurisdictions draw a great deal of comfort from the combination of their own adoption or endorsement procedures and our inclusive and transparent system of due process. This ensures that our constituents are properly engaged in our standard-setting process. We believe we are an organisation that listens carefully to its stakeholders and we remain committed to continue doing so in the future.

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1 http://www.ifrs.org/Alerts/PressRelease/Pages/Trustees-seek-public-input-on-review-of-the-structure-and-effectiveness-of-the-IFRS-Foundation.aspx

2 http://www.ifrs.org/About-us/Pages/IFRS-Foundation-and-IASB.aspx

3 For a summary of such research, see Tarca (2012) The Case for Global Accounting Standards – Arguments and Evidence, www.ifrs.org

4 See "Key Standards for Sound Financial Systems", www.financialstabilityboard.org

5 http://www.ifrs.org/DPOC/Documents/2013/Due_Process_Handbook_Resupply_28_Feb_2013_WEBSITE.pdf

6 The European Union's role in International Economic Fora, Paper 7: IASB, p.37. European Parliament, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy

7 The European Union's role in International Economic Fora, Paper 7: IASB, p.37. European Parliament, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy

8 See Nobes (2015) Is the IASB really hell-bent on introducing fair value?, http://pwc.blogs.com/ifrs/2015/09/is-the-iasb-really-hell-bent-on-introducing-fair-value-.html. It is a persistent myth that the IASB would have a strong preference for market-based fair value accounting. The fact is that for most companies, especially in the non-financial sectors of the economy, historical cost accounting is still dominant. Even for traditional banking business, such as lending activities, cost-based measurement is prevalent. IFRS prescribes fair value accounting judiciously, usually for activities that take place in active markets and for instruments, such as derivatives, that are highly sensitive to market conditions. For these instruments, historical cost does not provide meaningful information. In the Exposure Draft of the *Conceptual Framework*, the IASB reaffirms that it does not see fair value as the default measurement model.

9 Why inconsistent reporting of exceptional items can cloud underlying profitability at non-financial FTSE100 companies, Standard and Poor's (2014), www.standardandpoors.com/ratingsdirect

10 While an alleged lack of prudence in IFRS is sometimes associated with the financial crisis, it is important to note that the reference to prudence was only removed well after the outbreak of the crisis.

11 For example, see: Institut Messine (2015), "L'excès d'information financière nuit-il à l'information financière?", www.institutmessine.fr

12 European Commission (2015), Evaluation of regulation on the application of International Accounting Standards, www.europa.eu

13 Publicly sponsored contributions can vary from jurisdiction to jurisdiction. What they have in common is that they are arrangements initiated by public authorities and that contributions are collected at a central level. After collection at the central level, an annual, centralised, contribution is made to the IFRS Foundation, so that in such arrangements there is no direct financial link between the IFRS Foundation and private parties that participate in the publicly sponsored collection scheme.