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PRESENTS**

**THE 2008 KEN SPENCER MEMORIAL
LECTURE**

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KPMG LECTURE HALL, KPMG BUILDING, 10 SHELLEY STREET,
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**Lecturer: Professor Stephen A. Zeff, Herbert S. Autrey Professor of
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**Master of Ceremonies: Mr Jeffrey Lucy AM, Chairman,
Financial Reporting Council**

Mr Ken Spencer

Mr Ken Spencer played a significant role in the development of international accounting standards. Mr Spencer's career covered numerous roles, including as a former Trustee of the International Accounting Standards Committee, Managing Partner of KPMG's Melbourne office as well as a range of company directorships. He was the Chairman of the Australian Accounting Standards Board when it began the process of harmonising Australian standards with international pronouncements in the mid-1990s.

A copy of Professor Stephen Zeff's lecture "IFRS Developments in the USA and EU, and Some Implications for Australia" follows.

(Please note that the views expressed in this paper are not necessarily those of the FRC.)

IFRS Developments in the USA and EU, and Some Implications for Australia¹

Stephen A. Zeff
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It is a pleasure and honour to be giving the Ken Spencer Memorial Lecture. I first met Ken in the early 1980s, and I interviewed him in May 2003 for a history of the International Accounting Standards Committee (IASC). Ken was a leader of the accountancy profession in Australia and globally. In his service on the IASC board and as chairman of the Australian Accounting Standards Board, he was faithful to his principles and to his strong and abiding belief that accounting and its standards should respond to the public interest.

Today I would like to discuss some developments in the last several years both in the United States and the European Union (EU) and their consequences for Australia. The two major developments in the United States are the decision by the Securities and Exchange Commission (SEC) to drop the reconciliation requirement for foreign registrants that adopt International Financial Reporting Standards (IFRS) and the serious consideration which the SEC is currently giving to allow US publicly traded companies to adopt IFRS. The developments in the EU involve its ever-lengthening endorsement process and the increasing pressure being brought on the International Accounting Standards Board (IASB) and its oversight body, the International Accounting Standards Committee Foundation (IASCF) trustees, to alter their composition and the character of their operations. At the same time, there has been the FASB's appeal to the EU to accept IFRS without any endorsement process.

The developments in the United States have been lauded by the IASB and in Europe. They represent an impressive vote of confidence in the IASB and in the efforts

¹ This paper was prepared as the basis for the Ken Spencer Memorial Lecture, delivered on 28 May 2008 in Sydney.

being made by national standard setters and securities market regulators around the world. The United States has already taken a long stride towards joining the more than 110 countries and other jurisdictions that have committed themselves to allow or require the use of IFRS for some or all reporting entities.

Developments in the United States

SEC drops the reconciliation requirement

In the 1990s, the IASC was pointing towards the day when, after endorsement of its core International Accounting Standards (IAS) by the International Organization of Securities Commissions (IOSCO), the SEC would drop its Form 20-F reconciliation requirement for foreign registrants using IAS. In May 2000, IOSCO announced its endorsement, yet the SEC declined to act. Fortunately, in June 2000 the European Commission announced that it would propose that all listed companies in the EU adopt IAS in their consolidated statements from 2005 onwards. This bold action by the European Commission assured a large customer base, some 7,000 companies, for the newly constituted IASB, which succeeded the IASC in 2001. It should be mentioned that, since the 1990s, the SEC has allowed foreign registrants to use IAS, albeit with a requirement to reconcile to US GAAP.

After repeated urgings from two successive EU Commissioners responsible for Internal Market, the SEC finally began to fulfil expectations. In April 2005, the SEC's Chief Accountant proposed a 'roadmap' towards eventual acceptance of IFRS in the financial statements of foreign registrants without reconciliation to US GAAP.² Nonetheless, many were sceptical that this roadmap would produce a tangible result. The SEC had excited hopes on more than one occasion since the early 1990s that significant progress by the IASC would lead to a withdrawal of the reconciliation requirement for foreign registrants adopting IAS.

In July 2007, the SEC issued a proposed rule release to waive the reconciliation requirement in such circumstances, and on 15 November 2007, despite being apprised of numerous views to the contrary (including dissents expressed by a former SEC Chairman and a former SEC Chief Accountant), the SEC adopted the rule, effective immediately.

² See <http://www.sec.gov/news/speech/spch040605dtn.htm>.

Everyone was surprised that the SEC would approve the rule with immediate effect. There was speculation that pressure from the Department of the Treasury had hastened the SEC's decision, mainly, one supposes, to accommodate criticism of the reconciliation requirement from sources within the EU. This prompt action may have been part of the US reaction to a rising chorus of opinions expressed overseas that the US securities market was less than friendly, chiefly owing to the impact of the Sarbanes-Oxley Act of 2002. (Indeed, during 2007, nine of Australia's 24 foreign private issuers with the SEC as of 31 December 2006, including four of the seven that were listed on the New York Stock Exchange, withdrew from the US securities market, mostly citing high compliance costs.) There had also been a threat that, if the SEC did not accept IFRS financial statements without a reconciliation, the EU would act to require a reconciliation to IFRS of US GAAP financial statements filed in Europe.³

Yet the belief has been expressed by some critics that dropping the reconciliation requirement might significantly weaken the IASB's resolve to push towards convergence between US GAAP and IFRS.⁴

The SEC insisted in its rule release that companies and their auditors, in order to avoid the reconciliation requirement, must affirm compliance with 'IFRS as issued by the IASB'. The SEC, in a minor concession to the EU, said that it 'will accept from existing registrants from the EU that have already utilized the IAS 39 carve out in financial statements previously filed with the Commission financial statements that do not include a reconciliation to U.S. GAAP, if those financial statements otherwise comply with IFRS as issued by the IASB and contain a reconciliation to IFRS as issued by the IASB'.⁵

Some European banks had taken advantage of the EU's carve-out of IAS 39 for a certain hedging activity, only one of which was an actual SEC registrant. The carve-out is the only discrepancy between 'IFRS as issued by the IASB' and 'IFRS as adopted by the EU'. By coincidence, on the same date as when the SEC adopted its rule, 15 November

³ See, for example, EU Commissioner Charlie McCreevy's speech to a meeting with the UK Hundred Group of Finance Directors, 22 March 2007, at <http://www.iasplus.com/europe/0703mccreevyg100.pdf>, and the remarks by a US Treasury Department official in March 2006, at <http://www.ustreas.gov/press/releases/js4106.htm>.

⁴ See, for example, the view expressed in October 2007 by former SEC Chief Accountant Lynn E. Turner (Turner 2007).

⁵ Sec. III.A.3 in <http://www.sec.gov/rules/final/2007/33-8879.pdf>.

2007, the EU finally endorsed IFRS 8, on segment reporting, after a year's deliberations at various levels as part of the EU's elaborate, time-consuming, and politicised endorsement process. Critics of the standard brought pressure on the European Parliament, and one of its committees, in an unprecedented move, instructed the European Commission to conduct an impact assessment of IFRS 8, via a questionnaire survey, before it was prepared to act on final endorsement. For a while, it looked as though the EU would create yet another carve-out. I will return to the EU's ever-lengthening endorsement process later.

What are some implications of this SEC action for Australia? If the Australian Accounting Standards Board (AASB) at some future time were to approve an Australian version of an IFRS that departs in a substantive way from 'IFRS as issued by the IASB', Australian registrants with the SEC, which must adhere to AASB standards and Australian law, may no longer qualify for a waiver of the reconciliation requirement.

What impact around the world is the SEC likely to have? As of 31 December 2006, SEC registrants and reporting companies come from 51 countries and other jurisdictions.⁶ In many of these countries and jurisdictions, the 'IFRS as issued by the IASB' provision in the SEC's rule release may give pause to standard setters, stock exchanges, and regulators when they contemplate departing from newly issued IASB standards (and IFRIC interpretations). The effect may be to promote a higher degree of international comparability as well as faithfulness to the IASB's standards.

SEC may allow US companies to adopt IFRS

A second step which the SEC took in 2007 was to explore the possibility of allowing US companies to adopt IFRS. If foreign registrants can use either US GAAP or IFRS without reconciling their earnings and shareholders' equity to US GAAP, it would seem only equitable for US companies, which compete for capital in the same securities market, to be able to use either US GAAP or IFRS as well—to provide a 'level playing field', as some would call it. In August 2007, therefore, the SEC issued a 'concept release' to take a sounding on this novel course of action. The release posed 35 questions relating in one way or another to the possibility of permitting US companies to adopt

⁶ The number of countries with at least one SEC registrant was 46.

IFRS as an option to US GAAP. The Commission said it ‘recognizes that having a widely used single set of high quality globally accepted accounting standards accepted and in place could benefit both the global markets and investors’.⁷ But the concept release did not explicitly address whether, at some future date, all US companies might be required to adopt IFRS. Large US-based multinationals with overseas subsidiaries that are required to use IFRS, as well as US companies with global competitors that already use IFRS, would, one supposes, be keen to adopt IFRS in their consolidated statements as soon as practicable.

All of the Big Four accounting firms submitted letters of comment favouring the general direction in which the SEC was heading, but they differed on particulars. They all pointed to the need for a careful plan of transition and conversion, and they argued as well for an eventual requirement that US companies adopt only a ‘single set of high quality globally accepted accounting standards’, namely IFRS.⁸ En route to mandated IFRS, the firms favoured a period of ‘early adoption’ of IFRS. Samuel DiPiazza, the global chief executive of PricewaterhouseCoopers International, was quoted in the *Financial Times* in February 2008 as saying, ‘It is certainly possible for all [US] large-cap companies to be on IFRS by 2015’.⁹ The Financial Accounting Foundation (FAF) and the FASB, in their comment letter, also agreed with the concept release that ‘having a widely used single set of high quality globally accepted accounting standards’ is the ideal. But their submission reflected the anxiety, in regard to diminished comparability, over having a period of years when US companies could be reporting by either of two different GAAPs: US GAAP and IFRS. They argued against having such an interim period and instead proposed working with the IASB to produce an ‘improved version’ of IFRS. Affected parties on the US side, they said, should develop a blueprint to identify (1) the areas of IFRS that require improvement and (2) the target date or dates for the stages of completion for the transition leading eventually to the mandated use of IFRS by

⁷ Section III.A, at <http://www.sec.gov/rules/concept/2007/33-8831.pdf>.

⁸ This passage in the SEC’s concept release was clearly meant to refer to IFRS. Indeed, all of the Big Four accounting firms, in their letters of comment, named IFRS as the ultimate ‘single set’. For the four letters, see <http://www.sec.gov/comments/s7-20-07/s72007-44.pdf>, <http://www.sec.gov/comments/s7-20-07/s72007-46.pdf>, <http://www.sec.gov/comments/s7-20-07/s72007-33.pdf>, and <http://www.sec.gov/comments/s7-20-07/s72007-23.pdf>.

⁹ ‘Effects of Credit Crisis Spreading Says PwC Chief’, *Financial Times*, 7 February 2008, p. 17.

all US companies.¹⁰ Evidently, this blueprint was intended to accelerate work on the major projects set out in the February 2006 Memorandum of Understanding (MoU) between the FASB and the IASB.

Indeed, in April 2008, when the IASB and FASB met to update their MoU, they discussed a subcommittee proposal ‘to outline the improvements of existing IFRS that are needed to facilitate mandatory adoption of IFRS in all major capital markets’. The subcommittee had been tasked with developing recommendations with the following two assumptions: ‘For capital markets not yet adopting IFRSs, the target date of mandatory adoption is no later than 2013’ and that ‘A “quiet period” of at least a year before that date is provided’.¹¹ This was a transparent attempt to tailor the remainder of the boards’ MoU completion plan to the anticipated timing of the SEC’s expected decision to require US companies to adopt IFRS.

After almost 70 years of the use of US GAAP emanating from a succession of private-sector standard setters as well as from the SEC, Americans would find the prospect of switching from US GAAP to IFRS to be a dizzying one indeed. Questions abound:

- What would become of the Financial Accounting Standards Board (FASB)?
If the FASB remains in existence, its role is likely to be one of conveying US views to the IASB on pending and prospective IASB projects, very much as the UK Accounting Standards Board does today. At the request of the IASB, the FASB may do the groundwork on particular projects.
- Would US companies take undue advantage of the relatively fewer rules in IFRS?
Very likely, they would. These gaps in guidance probably would be filled in by the SEC in its Staff Accounting Bulletins, which means that some methods of implementation of IFRS allowed by regulators in other countries may not be available to US companies and foreign registrants in the US securities market. Such actions by the SEC might well detract from the global comparability of

¹⁰ For the FAF/FASB letter, see <http://www.sec.gov/comments/s7-20-07/s72007-20.pdf>.

¹¹ See the IASB’s ‘Information for Observers’ dated 21 April 2008, at <http://www.iasb.org/NR/rdonlyres/EDE9142B-E772-4945-97F4-77E78A383DE3/0/0804j03obs.pdf>.

IFRS, unless, as suggested below, other countries and jurisdictions feel obliged to follow the SEC lead.

- How would loan agreements and other contracts keyed to US GAAP be affected?
The loan agreements and other contracts would need to be renegotiated in such a way as to preserve the essence of the original protection of the parties.
- Would companies that use LIFO be able to adopt IFRS?
More than one-third of major US companies use LIFO for some or all of their inventories. As it would be politically very difficult to eliminate the LIFO method of inventory costing from the Internal Revenue Code, the SEC might urge the tax-writing committees of the Congress to recommend deletion of the ‘LIFO conformity rule’ from the Code. The Treasury would probably support this elimination in order to enable all US companies to avail themselves of the use of IFRS.
- What would be the effect on reporting by private companies in the United States?
While SEC regulations apply only to the roughly 12,000 companies registered with the Commission, there are an estimated 20 million private business entities in the United States, including 5 million corporations. Most state corporation laws are virtually silent on whether, and, if so, how they are to report to shareholders. It will be unnecessary to revise state laws so as to allow such corporations to use IFRS, because the American Institute of Certified Public Accountants (AICPA) recently revised Rules 202 and 203 of its Code of Ethics to refer to the use of IFRS as an alternative to US GAAP when giving an audit opinion on the fair presentation of financial statements.¹² The IASB is developing a simplified version of IFRS for small and medium-sized entities, and, in the light of the AICPA revision, it will be available for private companies in the United States as well.

In its comment letter on the SEC’s concept release, the FAF and FASB directed a recommendation at the EU without mentioning it by name: ‘Agreements are needed to eliminate the separate review and endorsement processes that various jurisdictions apply

¹² See <http://www.iasplus.com/usa/aicpa/0805rule203.pdf>.

to each IFRS after it is issued by the IASB. These after-the-fact jurisdictional processes are inconsistent with the objective of a single set of high-quality international accounting standards, as evidenced by the local variants of IFRS that have developed in some jurisdictions.’

SEC Chairman Christopher Cox announced in a speech on 18 April 2008 that, by the end of the year, the Commission will consider an updated roadmap ‘for continuing the progress that the United States is making in moving to accept IFRS in this country’ (Cox 2008b). While the SEC and Cox have not explicitly stated that the SEC eventually plans to move towards a requirement that US companies adopt IFRS, with or without a period of ‘early adoption’, this intention can be read between the lines of its concept release and Cox’s aforementioned speech. Cox said in a January 2008 speech, ‘IFRS is coming’ (Cox 2008a). My own expectation is that the SEC will require all publicly traded US companies to adopt IFRS by 2013 to 2015.

When stating expectations, one must take into account that there will be a turnover of three of the five members of the Commission during 2008. The places for the two Democratic members and for one of the three Republican members, but not the Chairman, will be filled by Presidential nominees once they have been confirmed by the Senate. It is not known whether, and to what degree, the newly appointed Commissioners share the SEC’s thinking about the adoption of IFRS by US companies. In December 2007, the SEC held two roundtables at which it sought reactions to its concept release. The clear consensus of the participants, who were drawn from a wide range of backgrounds, was in support of allowing US companies to adopt IFRS.¹³

What does the eventual adoption of IFRS by most or all US companies mean for Australia? The impact could be great for the rest of the world. Once the United States goes over to IFRS, the eyes of the SEC and the FASB, if it is still around, will be trained even more intently on the IASB. Traditionally, the SEC’s accounting staff has monitored the FASB’s standard-setting process and that of its predecessors assiduously. The SEC has referred to this monitoring as ‘oversight authority’. In its concept release, the SEC makes it crystal clear that the SEC alone has the statutory responsibility for approving

¹³ Webcasts of these two roundtables, held on 13 and 17 December 2007, may be viewed at <http://www.sec.gov/news/otherwebcasts.shtml>.

accounting standards for required use by publicly traded companies. It has regularly looked to the private sector for the setting of such standards, and at times it has forcefully intervened with its views on the FASB's current projects (see Zeff 2007). The SEC can place items on the FASB's agenda, and it plays an active role in vetting new members of the FASB. How will all of this play out once the IASB supplants the FASB as the body that sets standards to be used by US companies subject to the SEC's jurisdiction?

In the last few years, the SEC's accounting staff has maintained, for it, a somewhat lower profile on the standards being developed by the IASB and on the manner in which foreign registrants have implemented IFRS in their financial statements. The SEC has worked with the Committee of European Securities Regulators and with country regulatory bodies on issues where its views on implementation have been at variance with those reflected in the financial statements of EU registrants. Once the entire private-sector standard-setting process for US companies moves from Norwalk to London, the SEC may well believe that it must become more aggressive in carrying out its statutory responsibilities for investor protection. And, like the EU, it may develop a screening process of its own for newly issued IASB standards.¹⁴ At the same time, US companies, which have been known for their intense confrontational style when reacting to proposed standards by the FASB, will train their sights on the IASB. In the past, when US companies or trade associations have found themselves in opposition to a proposed FASB standard, they have often succeeded in persuading one or more members of Congress to their side. Major examples include accounting for oil and gas exploration, marketable securities, employee stock options, and business combinations. The members of the House or the Senate might hold a public hearing as a pretext to direct public criticism at the FASB, introduce proposed legislation ordering the SEC not to enforce the standard once it is issued, or some of both. In a several instances, such a threat has been enough to induce the FASB to modify the proposed standard. Will this come to happen also with standards proposed by the IASB? Will the full force of the SEC, on the one hand, and of Corporate America, on the other, place significant pressure on the IASB and on the IASCF trustees' norms for monitoring the work of the IASB, including the composition

¹⁴ Stig Enevoldsen, the Chairman of the Technical Expert Group of the European Financial Reporting Advisory Group (EFRAG), has said that he believes the SEC will develop its own scrutiny procedure for newly issued IASB standards (Enevoldsen 2008).

of the IASB's membership and its rules of procedure? Will the SEC insist that the IASB, like the FASB, hold public hearings on all major projects? If so, this would prolong the IASB's due process, which is already lengthy. Australia and other countries that have accepted IFRS in principle may come to find that the adoption of IFRS by US companies is a mixed blessing.

The SEC's role in shaping interpretations of IFRS

If indeed the SEC's accounting staff becomes more outspoken (as it was under Chief Accountant Lynn E. Turner and his predecessors), especially once IFRS becomes the sole coin of the realm in the United States, the SEC may become more insistent that its interpretations of IFRS should govern financial reporting in the US capital market, whether in the financial statements of foreign or US registrants. In view of the sheer importance and reputation of the US securities market as well as the international respect accorded the SEC as the leading securities market regulator, the SEC's well-formed views on proper interpretations may become accepted also in other countries. After 1 January 2011, when Canada completes its transition to IFRS, the SEC will have more than 400 foreign registrants using IFRS. In view of the historical inclination of leaders of Australia's company sector and securities market to look towards the United States on many matters, I would not be surprised if the SEC's interpretations were to acquire considerable valence here. Since 2004, the SEC has posted on its website the accounting staff's letters of comment on registrants' financial statements, thus making publicly available their hitherto confidential interpretations of accounting standards.

Developments in the European Union

The EU's rigorous endorsement process

Recent developments not only in the United States but also in the European Union have important implications for other countries, such as Australia, which have signed on to the use of IFRS. The developments in the EU relate to the continuing pressures brought on the IASCF trustees and on the IASB as well as the EU's ever-lengthening endorsement process for each new IASB standard and IFRIC interpretation.

One must take account of the difference in political and regulatory culture in the EU than in the United States and other common law countries. In the United States, accounting standards are set in the private sector but with close scrutiny by the federal government's securities commission. The SEC has apparently been comfortable since the 1930s with accounting standards being set in the private sector. Indeed, it was the SEC that originally encouraged the organized accountancy profession to set accounting standards. In Canada, since the early 1970s the provincial securities commissions have effectively given the private-sector standard setter a blank cheque. In the UK, private-sector standard setting has been largely free of influence from the public sector. One does not see this level of comfort in continental Europe. From the early years of the IASC in the 1970s, the European Commission has been suspicious of private-sector standard setting, even by a supposedly independent body, as not being in the public interest. The Commission embraced the work of the IASC in June 2000 only when it became painfully evident that 'it was the only game in town'. During the first five years of the IASB, the European Commission has made the final decision on endorsement after receiving advice from 'political' and 'technical' panels. Today, as will be seen, the European Parliament is no longer willing to leave this decision entirely to the Commission. In an acutely political context, it asserts the right to intervene with its own decision on accounting standards that are proposed to become, in effect, EU law.

As I have mentioned, the decision announced by the European Commission in June 2000 to propose that all EU listed companies use IAS in their consolidated statements was a pivotal event in the ascent of international accounting standards. As part of its announcement, the Commission presaged a two-tier endorsement mechanism, at both the political and technical levels. All new or revised standards, as well as interpretations, would need to be vetted or screened before the Commission could endorse them officially for required use by listed companies in the EU. Immediately, this provision gave rise to apprehension in the private sector that, by this means, the Commission might intervene in the setting of international accounting standards, perhaps leading to EU GAAP.¹⁵ The political tier emerged as the Accounting Regulatory Committee, composed of representatives from EU governments. The technical tier

¹⁵ See Camfferman and Zeff (2007, p. 431-32).

became the Technical Expert Group (TEG) of the newly created, private-sector European Financial Reporting Advisory Group (EFRAG). Today, the TEG is composed of 15 accounting specialists, including three non-voting representatives of national standard-setting bodies from Europe's three largest economies. Both panels are charged with giving advice to the European Commission, following which the Commission decides on the endorsement of newly issued IASB standards and IFRIC interpretations. A 'hiccup' occurred in 2003-04, when French banks protested vigorously against parts of IAS 39 on accounting for financial instruments, and they even prompted the French President to speak out against the standard. Pressure on the European Commission was intense, and it responded by endorsing IAS 39 with two carve-outs, one of which has since been negotiated away after the IASB amended IAS 39 following discussions with the Commission (Zeff 2008, pp. 225-27). But the other carve-out remains. Therefore, a number of banks, mostly French, do not follow 'IFRS as issued by the IASB' but instead adhere to a different 'IFRS as adopted by the EU' (the sole difference today being the carve-out), a phrase which all EU companies and auditors must, by law, cite in their affirmations of compliance accompanying companies' consolidated statements.

Then, in 2006, the European Commission established the Standards Advice Review Group (SARG) to provide assurance that the advice given by EFRAG is 'balanced' and 'objective', whatever that means. This decision came at a time when the European Parliament decided that it should become, in effect, the ultimate arbiter of whether new IASB standards and IFRIC interpretations should be endorsed for required use in the EU, under what is now called 'regulatory procedure with scrutiny'.¹⁶ The Parliament's Committee on Economic and Monetary Affairs conducts an enquiry, and the European Council also participates as a party that must affirm endorsement. This process of endorsement can consume months following the IASB's approval of a new standard or IFRIC interpretation, and, as mentioned above, required a full year for IFRS 8, on operating segments, a standard which does not even affect earnings or shareholders' equity. It is a supplemental disclosure.

During the IASB's deliberative process, moreover, European trade associations, major companies, and banks lobby the standard setter on controversial or sensitive

¹⁶ See <http://www.iasplus.com/europe/0804endorsement.pdf>.

standards, just as affected parties in the United States have, for decades, lobbied the FASB. Thus far it is clear that Europe behaves as if the IASB were its ‘neighbourhood standard setter’. IFRS-using countries, such as Australia, in other parts of the world can hardly secure a sympathetic hearing for their views in competition with the steady flow of insistent views emanating from the EU’s powerful bloc of 27 member states and the three countries belonging to the European Economic Area (Iceland, Liechtenstein, and Norway). Furthermore, they must stand silently on the sidelines while the EU proceeds through its lengthy and tortuous endorsement process, which provides the EU member states as well as vocal private-sector interests with opportunities to intervene at one stage or another. The endorsement process now proceeds very much as does the legislative process. The impact on Australia would be any changes in a final standard or interpretation which might be reluctantly conceded by the IASB in order to secure endorsement by the EU.

European pressure on the IASCF trustees

Since 2004, there has been mounting pressure on the IASCF trustees, mostly, I believe, originating in Europe, to change the nature and character of the organisation. Some changes have already been made, while others are in near-term prospect. These changes—together with the pressure that the SEC is likely to bring on the IASB once it allows or requires US companies to adopt IFRS—will undoubtedly influence the tenor of the standard-setting process and very likely the content of the standards themselves. For these reasons, the consequences of this pressure are important for Australia and other countries that have committed themselves to adopt IFRS.

Composition of IASB membership. In 1999, when the IASC was restructuring itself, the SEC insisted that technical expertise be the sole criterion for membership on the board. Many Europeans, including the European Commission, supported geographical representation as the principal criterion, arguing that the countries that had committed themselves to implement the IASC’s standards should have the dominant voice and vote in their formulation. After a bruising battle, the SEC won the day.¹⁷ Accordingly, the initial IASCF Constitution stipulated that ‘The foremost qualification

¹⁷ See Camfferman and Zeff (2007, chap. 13) for an extensive treatment of the restructuring of the IASC.

for [IASB] membership shall be technical expertise' (paragraph 20). In 1999, the SEC said it preferred a 7-member board, whereas some leading figures in continental Europe wanted a 21-member board. A compromise was reached with a 14-member board.

By 2004, there was already pressure, almost entirely from Europe, to alter the primary criterion for IASB membership. In 2005, the IASCF trustees changed the 'main qualifications' for board membership to be 'professional competence and practical experience' (paragraph 19). The desired membership of the board was to represent 'the best available combination of technical expertise and diversity of international business and market experience'. To critics of the original Constitution, technical expertise as the primary qualification was evidently seen as meaning that abstract theory and technical refinement would take precedence over the practical wisdom of highly experienced professionals. In an annex to the revised Constitution, 'demonstrated technical competency and knowledge of financial accounting and reporting' is now listed as one of six criteria for board membership. Yet there is no question that technical expertise was significantly demoted as a criterion.

At the IASCF trustees' meeting last March,¹⁸ as a result of further pressure, they proposed an enlargement of the board from 14 to 16 members and the addition of geographical representation as a membership criterion: four members from North America, four from Europe, four from the Asia/Oceania region, and four from any region of the world so as to assure 'overall geographical balance'. This struggle over membership criteria will remind many of the intense debates during the IASC's restructuring in 1999. It will be interesting to see how the SEC reacts to a somewhat larger board membership and to the imposition of geographical representation as a constraint when appointing members.

Proposed form of accountability to the public sector. Pressure from the European Parliament is now becoming evident. In February 2008, two committees of the Parliament issued reports in which they made known their demands that the IASCF trustees and the IASB should behave more like a body in the public sector, with the high degree of transparency and extensive program of consultation that is normally associated

¹⁸ See <http://www.iasb.org/NR/rdonlyres/B88A5F7A-89F0-4A8A-9ECC-79B5AE68FA16/0/AP2AProposalsandIssues.pdf>.

with the work of legislative committees when proposing legislation.¹⁹ After all, EU endorsement means that an IASB standard or IFRIC interpretation carries with it the force of law.

In one of the two reports, the Committee on Economic and Monetary Affairs somewhat menacingly asserted that the EU should move from a ‘reactive’ to a ‘proactive’ attitude in its relations with the IASCF and the IASB. The Committee complained that ‘the IASCF/IASB lack transparency, legitimacy, accountability and are not under the control of any democratically elected parliament or government, without the EU institutions having established the accompanying procedures and practices of consultation and democratic decision-making that are usual in its own legislative procedures’, yet the Committee commended the IASCF/IASB for having ‘sought to improve these deficiencies’. Additionally, the Committee said it wants to see ‘more representatives with a European background within the international standard-setting bodies’. There are currently two members on the IASB from the UK, two from France, and one from Sweden, and the IASCF trustees have yet to choose a successor to the German member who retired last year. In view of the IASCF trustees’ recent proposal to guarantee Europe only four members on a 16-member board, will this satisfy the Committee in view of the present European membership of five on a 14-member board? The Committee felt that the IASCF/IASB should be integrated ‘into the system of international governance e.g. the International Monetary Fund, the Organisation for Economic Co-operation and Development, the World Bank’. The Committee also urged the IASB to conduct an impact study of all interested parties before issuing a new standard.

In the other report, dated in October 2007, the Committee on Legal Affairs said that it ‘[d]eplores the fact that the [IASB] lacks democratic control and pluralistic input and thus arrives at decisions that do not adequately reflect the reality of European companies’. The criticism of the IASB by both Committees was particularly strong in regard to its project on small and medium-sized companies. It was stated that the EU’s endorsement procedure applies only to standards and interpretations for publicly traded

¹⁹ See <http://www.iasplus.com/europe/0801econreport.pdf>.

companies, and is not applicable to the recognition of IFRS for small and medium-sized entities.

To be sure, these public statements by the two Parliamentary committees may be mostly an exercise in political posturing, yet one must take cognizance of the fact that the Parliament has inserted itself forcefully into the EU endorsement process, and the Committee on Economic and Monetary Affairs is the committee of first instance in such matters. Furthermore, on 24 April 2008, the Parliament ‘adopted’ the Committee’s report by an overwhelming majority.²⁰ Yet an ‘adoption’ may be more pro forma than substantive.

While standard setting in Australia now occurs in the public sector, the standard setter’s principal role is to coordinate with the IASB and to incorporate IFRS into Australian Accounting Standards. If the IASB is heading toward a future in which it effectively comes under the wing of the public sector, with influence from the EU being dominant, how will this affect the standards it sets for the world?

‘Monitoring Group’. Also at their March 2008 meeting, the IASCF trustees recommended creation of a Monitoring Group. When new IASCF trustees are being selected, it would be authorized to approve or reject nominations submitted by the existing trustees, which have been a self-appointing body. It would also undertake to confirm that the trustees are fulfilling their Constitutional responsibilities. The governance of the IASB would, however, remain with the trustees. The Monitoring Group would include four members from IOSCO, represented by the chairmen of the SEC and of Japan’s Financial Services Agency, as well as by the chair or deputy chair of IOSCO’s Emerging Markets Committee and of IOSCO’s Technical Committee. Other members would be the responsible member of the European Commission, the managing director of the International Monetary Fund, and the president of the World Bank. This proposal was seen as being responsive to the criticism by the Parliamentary committees.²¹

²⁰ See <http://www.iasplus.com/europe/0804parliamentresolution.pdf>.

²¹ See IASCF Chairman Gerrit Zalm’s address to the European Parliament, 8 April 2008, at <http://www.iasb.org/News/Announcements+and+Speeches/Chairman+of+the+Trustees+addresses+European+Parliament.htm>.

In 2005, the trustees had taken a more modest step in this direction. When they revised the Constitution in that year, the trustees established ‘a high level advisory group to consist of five to seven leaders of official international and regional organisations’.²² The trustees are to consult the advisory group prior to making trustee appointments. Included in the initial membership of the advisory group were Paul A. Volcker (the former chairman of the US Federal Reserve Board and former chairman of the IASCF trustees), as chairman, and the heads of IOSCO, the Financial Stability Forum, the Asian, African, and Inter-American Development Banks, the European Central Bank, the World Bank, and the International Monetary Fund.

Also in 2005, the trustees revised the Constitution to increase their number from 19 to 22, chiefly to admit two more members from the Asia/Oceania region. This rebalancing was achieved without North America and Europe losing any of their designated allotment of six trustees each, and so the trustees expanded the size of the total trustee membership. To represent the Asia/Oceania region, trustees from China and India were added for the first time. Australia continues to be represented by one trustee, as it has from the beginning.

It remains to be seen whether the authority of the Monitoring Group, coupled with that of the advisory group set up in 2005, will satisfy the demands of the two European Parliamentary committees, and of Parliament itself, as well as other critics of an accounting standard setter in the private sector which can make EU law. For its part, the European Commission has reacted favorably to the proposed reform. The Commission has also welcomed the IASB’s *ex ante* impact assessments and *ex post* reviews of new standards and IFRIC interpretations.²³

Conclusion

Apart from the substantive accounting issues relating to each new IASB standard and IFRIC interpretation, important questions have been raised about the propriety of the organisation and composition of the IASCF trustees and the IASB as well as about the

²² Article C17 in the proposed revised Constitution, at <http://www.iasplus.com/resource/0506constrev.pdf>. At their 21 June 2005 meeting, the trustees approved the Constitutional amendments mentioned in this section.

²³ See the European Commission’s report dated 14 March 2008, at http://ec.europa.eu/internal_market/accounting/docs/ias/iasb3report_en.pdf.

degree of oversight exercised by major governmental and international bodies in the public sector. All of this suggests that the IASB has ‘arrived’ as the preeminent world standard setter for company financial reporting. The maturity of any international organisation in a standard-setting role brings with it recurring questions about its authority and responsibility in the eyes of bodies representing sectoral, national, regional, and international interests, both in the public and private sectors, and the IASB is no exception. Australia has reason to be proud of having been one of the strongest supporters of the IASC and an early and strong supporter of the IASB. But all of the other countries, including Australia, which have committed to adopt IFRS will have to face a future in which the United States and the European Union will likely possess the dominant influence over the IASB’s operation and the viability of its standards and interpretations.

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