Factors impacting on the future of the IASB

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Abstract
This paper investigates the factors influencing the future of the IASB, using as the point of departure, a review of its historical progression towards becoming the global accounting standard-setting authority. It concludes that the IASB is an organisation vulnerable to (1) political lobbying of influential institutions, (2) US accounting authorities decision makers, (3) potential accounting scandals, and (4) cultural differences resulting in the misapplication of its standards around the world. Such factors should be borne in mind when charting the next steps for the IASB and in evaluating the comparability and quality of accounts produced under IFRSs around the world.

Keywords
FASB International harmonisation
Form 20-F reconciliation Principles-based accounting model
IASB Rules-based accounting model
IASs SEC
IFRSs

1 Introduction
The period from 2005 to 2006 can possibly be described as one in which the largest accounting revolution in recent history occurred. This period saw the implementation of International Financial Reporting Standards (IFRS)\(^1\) reaching a total of over 100 countries across the globe following the European Commission (EC) issuing Regulation 1606/2002 in July 2002. This regulation required publicly listed firms in European Union (EU) member states to adopt IFRS for financial years beginning on or after 1 January 2005. The adoption of IFRS over time resulted in the application of a common set of financial standards.

\(^{1}\) The term “IFRS” or “IFRSs” refers to accounting standards and interpretations adopted by the International Accounting Standards Board (IASB) and incorporates both accounting standards and interpretations issued by the IASB as well as accounting standards and interpretations issued by the International Accounting Standards Committee (IASC) (known as “IASs”). The terms “IFRS” and “IFRSs” are used interchangeably throughout the text. Accounting standards and interpretations issued by the IASC only, are referred to as IASs.
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reporting standards not only in the EU but also among companies in many other countries that require or permit IFRS (KPMG 2007; Armstrong, Barth, Jagolinzer & Riedl 2007).

However, one noticeable absentee from the “global IFRS team” has been the USA. Its reluctance to endorse IFRS has stemmed from the presumption that US Generally Accepted Accounting Principles (GAAP) is the most stringent and highest quality body of accounting standards in the world (Zarb 2006; FASB 1999). In June 2007, a significant event occurred when the powerful US securities regulator, the Securities and Exchange Commission (SEC), proposed eliminating the requirement for non-US registrants on US stock markets, who file financial statements according to IFRS, to reconcile their reported numbers to US GAAP (the so-called “Form 20-F reconciliation”) (SEC 2007a). This proposal was followed by a concept release published by the SEC which proposed to grant even US companies the choice of preparing their financial statements according to either US GAAP or IFRS (SEC 2007:b). On 15 November 2007, the SEC accepted its proposal to abolish the Form 20-F reconciliation for non-US registrants who file accounts under IFRSs as published by the IASB (SEC 2007c). This decision by the SEC is critical for the future development of the IASB since removal of the Form 20-F reconciliation is tantamount to the SEC allowing IFRSs to stand on an equal footing with US GAAP and represents a major step in achieving a single set of high-quality international accounting standards.

The aim of this article is to determine the most obvious factors that will affect the future direction of the IASB and international harmonisation of accounting standards. This study employs the literature review technique to analyse the factors impacting on the development of the IASB and its predecessor, the IASC, from 1973 to 2007. The findings of this literature study show that although a single set of written standards may eventually prevail globally, the IASB remains an organisation vulnerable to four important factors, namely: (1) the influences of political lobbyists attempting to censor onerous accounting requirements; (2) the strong US influence on international accounting standard setting flowing from the historical significance of its standard-setting authorities and the size and impact of its economy; (3) accounting scandals that may ensue following the misapplication of open-ended principles contained in international accounting standards; and (4) varied interpretations and applications of accounting standards flowing from cultural differences. This study should assist potential users in understanding the limitations of having a global accounting standard-setting body as well as the factors to be borne in mind when evaluating the comparability of accounts prepared using a single set of global accounting standards.

The remainder of the paper is set out as follows: section 2 analyses the historical background on the IASC. Section 3 discusses the relationship between the FASB, the SEC and the IASC, while section 4 examines the SEC’s influence on the restructuring of the IASC and the formation of the IASB. Section 5 analyses the events leading to the adoption of IFRS by the EU, while section 6 describes how the attitude of the USA towards the IASB (previously IASC) has changed in recent years. Section 7 addresses the implications for the future of the IASB, while section 8 contains concluding remarks.

2 Historical background on the IASC (1973-2000)

Many participants of the Eighth International Congress of Accountants in 1962 voiced the need to be able to compare financial statements from different parts of the world. In
response, the American Institute of Certified Public Accountants (AICPA) published a book on the various accounting standards and practices in various countries and also formulated the idea of a single body of accounting principles by members of an international committee (AICPA 1964). In addition, with the rise of the multinational entity, both Wilkinson (1965) and Morgan (1967) wrote on the growing need for accounting harmonisation in First World countries. In fact, Wilkinson (1965:11) was one of the early authors to define accounting uniformity as “each company presents only one set of accounts for all investors, of whatever nationality”. Sir Henry Benson, former president of the Institute of Chartered Accountants in England and Wales (ICAEW), felt that international harmonisation could be achieved by establishing a uniform set of international accounting principles (Benson 1976). These ideas would eventually culminate in the establishment of the International Accounting Standards Committee (IASC) some years later.

The IASC was founded in London on 29 June 1973 as a result of an agreement by the accounting bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the UK and Ireland, and the USA, and the Board of the IASC consisted of these countries at that point in time. The intent of the IASC was to release international accounting standards which would be capable of worldwide acceptance and observance. Originally, the IASC was the exclusive preserve of the founding national accounting bodies, whose selection was agreed upon between the ICAEW and the AICPA. The accounting bodies were represented in nine delegations of three members each who would attend and vote at Committee meetings. The Committee also had a chairman and a secretary general. By 1987, various other national accounting bodies from other countries had joined the Committee (Camfferman & Zeff 2007).

The IASC’s pre-1987 standards adopted the Anglo-Saxon treatment of most accounting transactions and allowed a choice between two or more treatments to ensure compatibility with the national requirements of member countries (Cairns 1997). During this period, the IASC remained rather ineffectual owing to the fact that its Board consisted solely of accountants and it lacked governmental endorsement to ensure compliance with its standards (Camfferman & Zeff 2007). In 1988, the IASC reached an understanding with the International Organisation of Securities Commissions (IOSCO), the worldwide association of national securities regulatory commissions, whose membership comprised security market regulators including the SEC, the London Stock Exchange and similar bodies throughout the world. The terms of the understanding were that if the IASC improved its standards to an acceptable level of quality, the IOSCO would consider endorsing the IASC’s standards as the basis for reporting by foreign companies seeking stock exchange listings worldwide (Moulin & Solomon 1989). At long last, this promised authoritative recognition for the IASC standards. In response, the IASC embarked on an improvements project in respect of its accounting standards but, as discussed in section 3 below, failed to gain endorsement of its revised standards by IOSCO in 1994. However, in July 1995, the IASC reached a new agreement with the IOSCO whereby it confirmed that by 1999, it would prepare an agreed-upon set of Core Standards for financial statements covering all the major financial reporting issues as well as the accounting for financial instruments (IASB [S.a.]).

In December 1998, with the approval of IAS 39: Financial Instruments: Recognition and Measurement, the IASC complied with the requirements for the Core Standards set by the
IOSCO. The IOSCO began to review the Core Standards in 1999, but it was not until May 2000 that the IOSCO recommended that its members allow issuers of financial statements to use the 30 IASC Core Standards (known as the “IASC 2000 Standards”) in their multinational offerings and cross-border listings (IASB [S.a.]c). However, the endorsement of the IASC 2000 Standards by the IOSCO was a qualified one: IOSCO identified outstanding substantive issues relating to the IASC 2000 Standards and specified “supplemental treatments” to address each of these concerns. This included an earnings reconciliation where it expected the jurisdiction to apply, as part of its host country national GAAP, an alternative method to that required by the IAS (IOSCO 2000). This reconciliation requirement was identical to what the SEC required for foreign registrants that filed accounts under US GAAP.

Nevertheless, although the IASC was disappointed about not obtaining full endorsement by the IOSCO, the qualified endorsement served to provide it with the credibility and political influence it needed to make the implementation of its standards a reality. It would also pave the way for the June 2000 EC proposal which required all EU listed companies to prepare consolidated accounts according to IASC standards commencing in 2005. The EC endorsement of IASs is discussed in section 5. It should be noted that the IOSCO’s endorsement of the IASC 2000 Standards was also in part due to the IASC Board expanding to include a more diverse range of members in the 1990s. The enlarged Board now included financial executives and various non-accountant delegations such as financial analysts, the EC, IOSCO and also the FASB (IASB [S.a.]c). This contributed to greater transparency in the standard-setting process and increased the sophistication of the technical debate surrounding the setting of these standards, thereby ensuring that its accounting standards were both practical and theoretically sound (Camfferman & Zeff 2007).

3 The relationship between the FASB, the SEC and the IASC (1973-2000)

Dennis Beresford, former chairman of the FASB from 1987 to 1997, perhaps best summarised the relationship of the SEC with the IASC in the following statement: “It’s kind of like a carrot held in front of the IASC … they don’t ever get any closer. It’s like the carrot being held in front of the horse that’s hauling your cart” (Eaton 2005:6). This aloof attitude of the SEC stemmed from the premise that US GAAP is the most stringent and highest quality body of accounting standards in the world. The SEC and US private sector accounting bodies maintained that US GAAP possessed the quality and robustness to provide transparent, consistent, comparable, relevant and reliable financial information (SEC 2000b). Consequently, in order for companies to list securities in the USA and gain access to the “most prominent capital market in the world”, the SEC imposed the requirement for non-US companies to either file accounts under US GAAP or provide a Form 20-F reconciliation of their earnings and shareholders’ equity to US GAAP (King 2001:323).

For many years, the USA’s attitude towards international harmonisation has been ambivalent. On the one hand, the country has long maintained the need for international uniformity of accounting standards (see e.g. Beazley 1968), but, on the other, it held that it was not prepared to take an active part in establishing a standard-setting body and would rather watch as a spectator as its development unfolds. This was most evident in the
following words of Donald J. Kirk, the 1983 chairman of the FASB: “We have our plate full with the problems just in this country. I personally am very pessimistic about any super-national standard setting” (Kirk 1984:5).

However, the SEC became particularly concerned following the 1988 understanding between the IASC and the IOSCO, which proposed allowing foreign registrants on all recognised securities exchanges to adopt IASC standards provided the existing IASC standards were revised to a level acceptable to the IOSCO. The SEC knew that if the IOSCO approved the adoption of IASC standards it would be tantamount to the SEC dropping its Form 20-F reconciliation requirement for accounts filed using IASC Standards and it could not prevent US registrants from likewise adopting IASC standards by switching from US GAAP. The SEC had no intention of swapping its oversight authority over the FASB for a more uncertain relationship with the IASC based in London. As a result, the SEC’s passive involvement with the development of the IASC and the IOSCO endorsement process suddenly became far more active and aggressive. Cairns (1997) notes that, by the end of 1993, confidence was high that the IOSCO would endorse the whole set of the Core Standards submitted by the IASC as part of its Improvements Project. However, the SEC was opposed to a piecemeal endorsement of the revised standards and was in favour of endorsing the complete suite of core standards. To gain approval of the IASC revised standards, the IOSCO required unanimous consent of all its members, which included the prominent SEC. In June 1994, the IOSCO advised the IASC, that it believed that of the core standards, four were unacceptable and that it would not endorse any further IASs (even the ones it found acceptable) until all the core standards had been revised (Cairns 1997). The announcement meant retention of the Form 20-F reconciliation requirement and demonstrated the significant influence the SEC had on the IOSCO. It also thwarted the requisite authority the IASC needed to implement its standards.

In 1999, the FASB published a book entitled International accounting setting: a vision for the future. In it, the FASB emphasised the need to participate in the development of quality international accounting standards and to accelerate convergence between different nations (FASB 1999). In February 2000, the SEC published a concept release requesting comment to establish whether IASs were of sufficient comprehensiveness and high quality to be used without being reconciled to US GAAP (SEC 2000b). The concept release was justified partly by a drive to induce more cross-border listings and offerings in the USA for companies that had forgone listing in the USA as a result of resistance to adopting US accounting practices. The SEC received almost 50 comment letters in response to this concept release. Many of the foreign respondents (e.g. the Institute of Chartered Accountants in Australia, the Institute of Chartered Accountants in England and Wales, the Financial Reporting Council and the European Commission) were in favour of the use of IASs as an alternative to US GAAP. However, most US respondents, notably the Big Five accounting firms, were against acceptance of IASs (SEC 2000a). Perhaps the response of the American Institute of Certified Public Accountants (AICPA) best summarises the USA’s view of the IASC at the time (Melancon & Eliot 2000):

“Although individual IAS may be of high quality, we do not believe the body of IASs is of sufficiently high quality to be used without reconciliation to US GAAP in cross-border filings in the US at this time ... The existing Core Standards contain significant recognition and measurement alternatives and are, as a whole, written generally and are susceptible to varied interpretation. As a result, different companies following IAS might apply IAS differently for similar transactions.”
The US accounting community, however, were not only concerned about the quality of the existing body of IASs, but also about the adequacy of the IASC infrastructure to allow it to act as a global accounting setting body and the lack of an independent oversight body to ensure enforcement of its standards (Schwartz 2001). Consequently, the SEC’s influence once more impacted on the IOSCO’s qualified endorsement of IASs by retaining the Form-20F reconciliation requirement for foreign registrants who do not file accounts under US GAAP (Camfferman & Zeff 2007). Nevertheless, the FASB’s response to the concept release was more positive and supportive of the IASC when it stated (Jenkins & Johnson 2000): “We believe that more widespread use of IASC standards outside US markets is desirable and that the IASC, once restructured, will play an increasingly important role in the evolving global financial reporting infrastructure.” This promising change in attitude would pave the way for future cooperation between the FASB and the IASB.

4 The SEC’S Influence on the restructuring of the IASC and the formation of the IASB (2001)

According to Oliverio (2000), a revised IASC structure was instituted in 1982. This structure comprised two tiers, namely the IASC and the IASC Board. The IASC consisted of the members of the International Federation of Accountants (IFAC), a global organisation whose membership consisted of the various professional accountancy bodies around the world. The IASC Board, on the other hand, consisted of representatives from 13 IFAC member countries, who were appointed by the IFAC Council and were responsible for approving standards, exposure drafts and final interpretations. Steering committees were responsible for preparing exposure drafts and members of these committees were appointed by the IASC Board who sought both a geographical spread as well as a mix of accountants in public practice, preparers and users. A Standing Interpretations Committee (SIC) was formed to issue interpretations on accounting issues likely to receive divergent or unacceptable treatment in the absence of authoritative guidance (Oliverio, 2000).

However, in time, the IASC came to the realisation that there were certain deficiencies and inadequacies in its organisational structure. In December 1998, the IASC issued a strategy working paper (SWP) entitled “Shaping IASC for the future” to address these issues. The SWP did not seek to change the status quo in respect of the structure of the IASC Board (its members would continue to be the professional accountancy bodies of IFAC member countries), but proposed that it would expand its membership to include a wider group of countries (20) and other interested organisations (5). The IFAC Council, which previously appointed members of the IASC Board, would be replaced by a Board of Trustees with the authority to appoint Board members and the chairpersons of a Standard Development Committee (who would replace the Steering Committee function) and SIC (IASC 1998; Oliverio 2000).

In response to the SWP, 84 letters of comment were received. The most notable opponent of the proposals was the SEC which felt that the recommendations placed too much power in the hands of national accounting standard setters. In brief, they proposed a structure whereby the ultimate standard-setting authority should rest in an independent decision-making body consisting of technical experts, and that the IASC would need to distance itself from the accountancy profession. In this way the IASC could be regarded as an independent international standard setter. Other respondents, mainly from Europe, were also of the opinion that the proposals in the SWP vested too much power in national accountancy bodies.
standard setters and felt that they did not go far enough in spreading this power on the basis of geographical, economic and political importance. They held that the proposal would leave the real power and influence in global accounting standard setting under the control of the most developed and influential accountancy bodies (i.e. from the UK, Australia, Canada and the USA) rather than a wide and balanced group of countries (Camfferman & Zeff 2007).

However, it was the structure preferred by the SEC that eventually carried the most weight and the IASC consequently published a revised SWP in November 1999 entitled “Recommendations on shaping IASC for the future”. This revised SWP proposed that the current IASC would no longer consist of the professional accountancy bodies that were members of IFAC. Instead, the IASC would be governed by a 19-member board of trustees. The trustees would be selected from diverse geographical backgrounds and be responsible for appointing members of the IASC Board (the standard-setting board), the SIC and the Standards Advisory Council. The trustees of the IASC would be appointed by a nomination committee and would also be responsible for fundraising, approving the budget and constitutional changes. However, more importantly, the IASC Board members (members of the standard-setting board) would consist of an independent panel of technical experts without any prescribed geographical representation with the sole authority for developing and approving IASs and EDs. The SIC would continue in its present form with 12 members, mostly accountants in public practice. (IASC 1999; Oliverio 2000). The proposed revised structure for the IASC was only a slightly modified version of the proposals submitted by the SEC as discussed above and closely resembled the structure of the FASB. Furthermore, on 13 January 2000, the SEC chairman, Arthur Levitt, was elected to act as chairman of the IASC Nomination Committee which was established for the purpose of selecting the initial trustees for the restructured IASC. Of the 19 trustees initially appointed by this nomination committee, a total of six came from North America.

At a meeting in São Paulo, Brazil, on 13 to 17 March 2000, the “old” IASC Board approved a new Constitution based on the organisational structure recommended in the November 1999 report. With the new structure in place, on 8 March 2001, the trustees invoked Part B of the IASC Constitution, which effectively brought the IASB into existence. In this newly formed IASB, five of the 14 board members were also from North America. The increased US presence in the IASB (trustees and board members) caused the EU to assert that the IASC could no longer call itself an international organisation and it had given in to pressure from the USA (Oliverio 2000; IASB [S.a.], IASC 2000; Deloitte [S.a.]).

The events surrounding the IASC’s revised organisational structure meant that the IASC became more “appealing” to the SEC. However, in so doing, the IASC demonstrated its vulnerability and desperation to please the SEC, which effectively restructured the IASC and its due processes to conform to US requirements, at the same time still viewing IASs like any other “foreign accounting standards” requiring a Form 20-F reconciliation to US GAAP to be filed.

5 Events leading to and surrounding the adoption of IFRS by the EU (2002-2005)

According to Cairns (1997), the EC’s strategy on accounting harmonisation was strongly influenced by the growing need of larger European companies to make their financial
reports more understandable and relevant to international capital markets. Until 1995 the EU had lacked a common set of accounting standards in terms of which international companies could prepare their accounts, and furthermore, the EU Accounting Directives were outdated and inadequate for companies wishing to access international capital markets (Cairns 1997). Consequently, European companies seeking capital on international markets would not be able to rely on their accounts prepared under national legislation and would be increasingly drawn towards US GAAP instead, because there was no European equivalent of accounting standards accepted in capital markets worldwide (EC 1995). Fearing a worldwide accounting harmonisation on the basis of US GAAP over which the EC had no influence whatsoever, in November 1995, the EC issued a policy statement in which it recommended support for the IASC whose accounting standards had “a clear prospect of recognition in the international capital markets” (EC 1995).

It soon became evident that the 1995 EC Communication had not assured the ascendancy of IASC standards over US GAAP in Europe as the EC may have expected. In October 1998, the EC reported that the number of European companies listing (and therefore adopting US GAAP) on the New York Stock Exchange (NYSE) and the National Association of Securities Dealers Automated Quotations (NASDAQ) had increased almost fivefold since 1990. This created growing pressure on the EC to promote the use of IASC standards for EC listed companies to stop the proliferation of US GAAP into Europe (EC 1998). Following the heated debates surrounding the restructuring of the IASC, coupled with the revision of the IASC Core Standards commencing in 1999 and the IOSCO’s qualified endorsement of IASs in May 2000, the EC made a further radical mind shift by issuing a Strategy Statement in June 2000 entitled “EU financial reporting strategy: the way forward”. This document proposed that all EU companies listed on a regulated market would be required to adopt IASC standards in their consolidated financial statements. This proposed requirement would ensure that securities could be traded on EU and international capital markets on the basis of a single set of financial reporting standards. If this new policy change were to be accepted, the IASC would immediately obtain the political power it had so desperately sought since its failure to obtain the required endorsements of the IOSCO both in June 1994 and May 2000. This would also mean that an estimated 6 700 listed companies in 15 countries would need to comply with IASs from the beginning of 2005 (EC 2000). In July 2000, the EU’s Council of European Economic and Finance Ministers (ECOFIN) endorsed the EC’s new strategy and the proposal was implemented by a Regulation of the European Parliament and the Council of Ministers on 19 July 2002 (European Parliament and Council of the EU 2002). The IASB (as it was now known since its formation in April 2001) was tasked with revamping the standards it had inherited from the IASC in time for Europe’s adoption in 2005. In May 2002, the IASB published proposals to amend 16 existing standards in an attempt to remove inconsistencies, limit choices and provide better guidelines for users for the EU adoption (IASB 2002).

The endorsement mechanism of IFRSs was to occur in a two-tier structure (EC 2000:7-8). A body known as the European Financial Reporting Advisory Group (EFRAG) would issue recommendations on IFRSs at the technical level, while the Accounting Regulatory Committee (ARC) would ensure ratification at the political level. This filter mechanism to the adoption of IFRS opened the door for political lobbying to the EC to amend or screen IFRSs which could adversely affect the financial results of influential institutions. The most vigorous debate surrounding the adoption IFRSs by the EC centred on the adoption IAS 39. The main opposition were the French banks who were
concerned about the volatility effects on earnings that fair value accounting as proposed by IAS 39 would have on banks’ derivatives and other trading positions. These institutions used their political influence at the highest levels, and in July 2003, France’s President, Jacques Chirac, sent a letter to the then European President, Romano Prodi, urging the EC not to adopt the full version of IAS 39 as it would have “nefarious consequences” for financial stability if adopted in full (Gosling 2003).

In an attempt to settle the matter, the IASB invited senior officials from European banking and securities regulators and the accounting and insurance industries to form a consultative group to advise the IASB on issues relating to IAS 39 (IASB 2004a). Their deliberations were followed by an amendment to IAS 39 that enabled hedge accounting to be used more readily for a portfolio hedge of interest rate risk (known as macro hedging) (IASB 2004b). In view of the controversy surrounding IAS 39, the IASB emphasised in a statement made by Sir David Tweedie, IASB Chairman, that “a standard on financial instruments was an essential element of any complete set of accounting standards”. The IASB asserted that it would not bow to political pressure by amending its standards in order to meet the needs of influential parties because failure to adopt tougher accounting standards would lead to more corporate scandals (such as Enron), undermine the audit profession and result in possible corporate collapses (Gosling 2003). These sentiments were echoed by the Fédération des Experts Comptables Européens (Federation of European Accountants) (FEE) which emphasised the need for endorsed IFRS to be the same as IFRS issued by the IASB. They were concerned that if certain elements of IFRS were not endorsed, this would be a major impediment to convergence with US GAAP and would cause Europe to lose its credibility and cause disadvantages for companies that opted for applying IFRSs in full (FEE 2004).

Unfortunately, the political pressure from the French banks was too great and at its meeting in Brussels on 1 October 2004, the ARC voted to recommend endorsement of IAS 39 for use in Europe, with two carve-outs. The carve-outs (1) prohibited the use of the fair value option in IAS 39 as it applies to liabilities, and (2) allowed the use of fair value hedge accounting for interest rate hedges of core deposits on a portfolio basis. On 19 November 2004, the EC accepted the ARC recommendation and endorsed the modified version of IAS 39 for use in Europe (Deloitte [S.a.]). From the IASB’s perspective, the political power it obtained from the EC endorsement had become fragile. Although the IASB did not amend its own standard on financial instruments to placate the EC, the effect of the carve-out from IAS 39 meant that the EC could pick and choose between IASB standards (or parts thereof) and effectively by-pass the IASB, irrespective of whether or not it wished to amend its standards. This would set a precedent for future carve-outs of IFRSs (see also section 7.1) and would mean that the perceived independence and power vested in the IASB were now dependent on an external legislative enforcement mechanism for approval of its standards.

6 The USA’S revised attitude to the IASB (2002-2007)

The perceived superiority of US GAAP over international accounting standards as pointed out in section 3 was shattered after the Enron bankruptcy in December 2001 and other accounting scandals that surfaced in 2002, following the bursting of the late-1990s stock market bubble (Véron 2007). While most of the blame for the accounting scandals was placed on faulty audits provided by large accounting firms (especially Arthur Andersen), many had concerns about the complexity of the so-called “rules-based US accounting
system” which allowed Enron to comply with the technical requirements of GAAP but violate its intent (FASB 2004). A “rules-based system” prescribes what practitioners should do in various situations, whereas a “principles-based system” relies on the judgment of accounting practitioners and auditors in applying accounting principles to different situations (Walker 2007).

In response to such concerns, in 2002, the FASB published a proposal entitled “Principles-based approach to US accounting setting”, in which it requested comments on whether the USA should move to a more “principles-based approach” in order to remove the detail, complexity, numerous implementation guidelines and exceptions to principles that are inherent in current US GAAP (FASB 2002a). Many respondents were in favour of such an approach and in October 2002, the IASB and the FASB signed the Norwalk agreement which committed the boards of the two bodies to remove differences between IFRS and US GAAP and encourage coordination of their respective activities (FASB 2002b).

Convergence between the IASB and the FASB appears to have taken a more visible route over recent years. For instance, James J. Leisenring, the previous vice-chairman of the FASB until June 2000, and Anthony Cope, long-time member of the FASB, were appointed as full-time board members of the IASB in January 2001 (FASB 2001). In addition, both boards now meet annually in Norwalk and London and staff work together daily via telephone, email and video conferencing exhibiting the familiarity of co-workers in the same office (Reason 2005). Furthermore, the two boards have committed to co-coordinating their respective standard-setting agendas wherever possible via the 2006 Memorandum of Understanding which sets specific milestones to be achieved by 2008 (IASB 2006).

Another vital step towards convergence was the revision of various US Statements of Financial Accounting Standards (SFASs) by the FASB to align with the relevant IFRS. For example, SFAS 151 Inventory costs – an amendment of ARB no. 43, chapter 4 (issued in November 2004) changed the accounting requirement for abnormal manufacturing costs to be in line with IAS 2 – Inventories. In addition, the FASB issued SFAS 154 – Accounting changes and error corrections – a replacement of APB opinion no. 20 and FASB statement no. 3, which adopted the IASB’s requirement for retrospective application of certain voluntary changes in accounting policies to align with IAS 8 – Accounting policies, changes in accounting estimates and errors.

However, the US influence on the standard-setting process of the IASB has also become apparent. For example, the IASB issued IFRS 5 – Non-current assets held for sale and discontinued operations which converges with the main requirements of SFAS 144 – Accounting for the impairment or disposal of long-lived assets and IFRS 8 – Operating segments was a direct copy of the US Standard SFAS 131 - Disclosures about segments of an enterprise and related information. In addition, the format of IFRSs issued by the IASB of late resembles that of SFASs, in that they now have both a basis of conclusion section as well as an implementation guidance section.

The revised approach of the SEC and the FASB to the IASB stems from a recognition that the IASB has become a true international accounting standard setter. This is evidenced by the fact that it possesses an adequate organisational structure, its standards are of a high quality and it enjoys the political approval of more than 100 countries around the world (including the EU, Canada, Australia and Japan) – all of which have or are in the process of
requiring the adoption of IFRS. Not surprisingly, on 2 July 2007, the SEC issued a proposed rule to eliminate the requirement for foreign registrants that present financial statements in accordance with IFRS (as published by the IASB) to reconcile their accounts to US GAAP using Form 20-F (SEC 2007a). According to former SEC Commissioner, Roel Campos, one of the other compelling reasons for the proposal was to reduce the costs to foreign issuers wishing to raise capital in the USA (SEC 2007a). In fact, Holgate (2007) and Wingfield (2007) note that the proposal was part of a general US concern about recent losses of business of the NYSE to the London Stock Exchange owing to the onerous regulatory environment in the USA. On 15 November 2007, the SEC voted unanimously in favour of the removal of the Form 20-F reconciliation requirement which also meant the removal of the ability of the SEC to use the reconciliation as a weapon for dealing with foreign companies that fail to comply with US GAAP (SEC 2007c). This, in turn, has contributed additional political strength to the IASB which sees the approval of IFRSs by the world’s largest economy as being the final hurdle to achieving global harmonisation of accounting standards.

In August 2007, the SEC issued a concept paper requesting comment on whether US companies may make use of IFRS as an alternative to US GAAP (SEC 2007b). Although there are significant impediments in adopting such a proposal (e.g. the IASB’s need to converge with US GAAP may no longer exist and the lack of training and education of IFRS in the USA), it nevertheless evidences a complete change of attitude by the SEC towards the IASB.

7 Implications for the future of the IASB

On the basis of the literature study, the authors are of the opinion that although the IASB may have developed an acceptable organisational structure and its standards are of sufficiently high quality to have obtained the necessary political endorsement and be internationally acceptable, it still remains a vulnerable organisation whose future will be influenced by certain external factors evident from the article. The following points are now discussed individually:

☐ Political influence of lobbyists and suppliers of funding
☐ US influence on international accounting standard setting
☐ Accounting scandals as a result of misapplication of the principles-based accounting standards
☐ Different interpretations and applications of accounting standards due to cultural differences

7.1 Political influence of lobbyists and suppliers of funding

The carve-out by the EC of certain sections of IAS 39 was a significant event that set a precedent to effectively bypass the IASB and ignore standards that would prove too onerous for the most influential political lobbyists. This possibility reared its head in the EC once again following the IASB’s issuance of IFRS 8 in November 2006 as various EU institutions and governmental bodies began lobbying against its application. The EC called for an “impact study” to be performed before it would endorse IFRS 8, despite the fact that both the EFRAG and the ARC had unanimously supported its adoption
(PricewaterhouseCoopers 2007). The carve-out of sections of IFRSs is not limited to the EU, but also occurs in developing countries where IFRSs were implemented, but are not a “one-size-fits-all” solution to their accounting needs. Phuvanatnaranubala (2005) proposed that Thailand adopt IFRSs but allow carve-outs from certain standards (such as IAS 39, IAS 14 – Segment reporting and the goodwill requirements of IFRS 3 – Business combinations) which could have negative consequences for emerging market companies. Similarly, Mir and Rahaman (2005) report that the treatment of foreign exchange gains and losses as required by IFRSs in IAS 21 – The effects of changes in foreign exchange rates – cannot be implemented in Bangladesh because of conflicts with the Companies Act of 1994, which requires capitalisation of gains and losses arising from foreign exchange rates under all circumstances. As mentioned in section 5, the danger of this phenomenon is that it undermines the authority of the IASB and, in turn, creates several mini-GAAPs as opposed to one global set of accounting standards. According to Sir David Tweedie, this is an issue that would need to be “nipped in the bud” (Economist, 2007). In order to achieve consistency and prevent varying applications of IFRSs in different jurisdictions, the SEC has stated that it will only accept financial statements by non-US registrants who prepare their accounts under IFRS as issued by the IASB rather than national or regional variations (SEC 2007c).

Furthermore, political intervention to circumvent onerous accounting standards is not unique to the IASB, but also occurs in the case of domestic standard setters. In this regard, Sacho (2003) reports how political pressure forced the FASB to withdraw Exposure draft no. 124 (ED-E-124) – Accounting for stock-based compensation in favour of firms whose earnings would be affected by ED-E-124’s proposals. Calomiris (1997) mentions how the Japanese government prevented the recognition of bank loan losses during the 1990s in order to avoid political resistance and economic crisis.

The IASB, like other accounting standard-setting bodies, is thus vulnerable to the whims of organisations that adopt its standards, and for it to avoid the proliferation of “mini GAAPs” and carving out of onerous accounting requirements, the IASB may be forced to amend its standards to coerce such influential parties into applying IFRS. This may undermine the independence of the IASB and the quality of accounting standards issued by it in the future. Nevertheless, the IASB may be shielded from this to some extent because it is a global standard-setter rather than a national standard-setter, although it still remains vulnerable to political lobbying in one form or another.

Up to February 2008, the IASB, unlike the FASB, which is funded by contributions from public companies that pay mandatory accounting support fees, relied on voluntary contributions from a relatively small number of companies, accounting firms, international organisations and central banks. AccountancyAge (2008) reported that despite the efforts of the IASB to expand the number of donors, it still fell short of its 2008 target. Of the estimated £16 m budget for 2008, only £12.5 m had been raised by February 2008. Furthermore, the main corporate contributors have come from the USA, Japan and Germany. Hence the independence of the IASB remains a concern to many, and in February 2008, the trustees of the IASB agreed to implement a new funding system that is “broad-based, compelling, open-ended and country-specific”. The IASB has asserted that this new funding scheme would ensure that future funding commitments are shared by a variety of market participants and countries and that the IASB remains unaccountable to elected politicians or regulators (IASB [S.a.]b; Mahoney 2007; IASCF 2006;
Nevertheless, it is felt that as the IASB’s importance grows and its funding commitments expand, it is likely that politically influential organisations will become more involved in the funding of the IASB and in the appointment of its trustees. The danger of such a system will be that the IASB may lose its autonomy and the quality of the accounting standards will be tainted by political considerations rather than the economic substance of transactions.

### 7.2 US influence on international accounting standard setting

As mentioned earlier, the SEC’s decision to remove the Form 20-F reconciliation may represent the first step towards the USA adopting IFRS. Recent research has also shown that the equivalence of US GAAP and IFRS is becoming more apparent. Barth, Landsman, Lang and Williams (2006), for example, found that IFRS accounting standards were of comparable quality to US GAAP. Similarly, the results of a study by Van der Meulen, Gaeremynck and Willekens (2006) showed that US GAAP and IFRS performed equally well on qualities such as value relevance, timeliness and accruals quality. Furthermore, the FASB and IASB Joint Convergence Programme would hopefully in due course contribute to eliminating other differences between IFRS and US GAAP. With US GAAP and IFRS converging, the equivalence of the two sets of standards becoming more pronounced as well as the cost constraints associated with allowing both sets of standards to be used in the US, it appears likely that the USA may move to adopting IFRS over time. In so doing, the world’s largest economy would align its accounting pronouncements with those of the rest of the world. Herz (2007) supports some of these sentiments, and notes that creating a choice between US GAAP and IFRS will result in additional cost and complexity in US financial reporting and that educational infrastructure would be required to support both sets of accounting standards.

From an analysis of the development of the IASB over time, it is evident the USA has already had a profound effect on the IASB’s organisational structure, standard-setting process and the conferring of political power on the IASB. Hence there is no reason to believe that this trend would not continue if IFRSs are promulgated in the USA. However, before IFRSs are promulgated in the USA, they will need to meet the approval of the SEC and the US financial accounting bodies. It would also be unrealistic to imagine that the world’s largest economy would adopt IFRSs without profoundly influencing the development and future of the IASB and IFRSs. Furthermore, owing to the litigious nature of the US business environment, more detailed rules could be issued in future IFRSs, resulting in IFRSs resembling the existing US model to meet US requirements. It would therefore seem that as and when the USA embraces IFRSs, the Americanisation of the IASB may become more apparent.

### 7.3 Accounting scandals as a result of misapplication of the principles-based accounting standards

Eaton (2005) highlights the role that the high-profile US corporate scandals of 2001 to 2002 had in precipitating a shift in US accounting attitude towards the IASB (see section 6). This was the result of the circumvention of the highly detailed rules that are characteristic of US GAAP (i.e. the so-called “rules-based accounting model”). IFRS has been characterised as a “principles-based model” which lacks prescriptive rules and is more open-ended. Owing to the complexity of the IASB’s accounting standards as well as its lack of prescriptive
rules, it is possible that the IASB is exposing itself to repercussions of accounting scandals resulting from the misapplication of the principles contained in its standards irrespective of whether these are caused by fraud or error.

In fact, Walker (2007) contends that reliance on practitioners and auditors alone to apply principles-based standards may not necessarily lead to full observance of such principles. In June 2007, KPMG issued a report in which various senior individuals in the European accounting and regulatory sector expressed their opinions on the effect of the first time adoption of IFRS in Europe. Overall, the report emphasised that no major volatility in capital markets occurred as a result of the adoption of IFRS.

However, it should be noted that IFRS was implemented at a time when the European companies were experiencing a bullish market and there would thus be little reason for finance directors to misinterpret principles inherent in IFRSs to distort earnings. As users and preparers become more au fait with IFRS and learn more about the loopholes in the standards this could result in its manipulation and misapplication. This is especially true in relation to the determination of contentious fair value amounts in accounts that could potentially result in material fluctuations in earnings. All these factors may contribute to global accounting scandals which may force the IASB to swing the pendulum the opposite way and adopt rules-based accounting standards – once again demonstrating its vulnerability. The insecurity of the IASB is well illustrated in the following statement by the chairman, Sir David Tweedie (KPMG 2007): “I hope the principles-based approach will gain the upper hand. Certainly that’s what we are intending to try. If we lose it now we will be rules-based.”

7.4 Different interpretations and applications of accounting standards due to cultural differences

Tsakumis (2007) posits that accountants are expected to apply accounting standards consistent with their cultural values. Consequently, he finds that financial reporting decisions differ between countries because of differences in the cultural values of the accountants applying those rules, especially those rules that require the application of judgement such as recognition of contingent liabilities, impairment adjustments and fair value determinations. This has implications for IFRSs that are now applied in approximately 100 countries around the world with no independent global enforcement body to ensure consistent application of its principles-based accounting standards. This is especially relevant for countries (such as France, China and Switzerland) whose national accounting frameworks have historically been a function of local company law and tax directives rather than an independent set of capital market reporting standards (KPMG 2007). The current set of IFRSs has been based on the Anglo-Saxon (US, UK, Canada and Australia) model and as such, non-Anglo-Saxon countries may apply newly introduced principles differently from Anglo-Saxon countries using their own cultural values and interpreting IFRSs in ways that conform with their old national GAAPs and Company Law requirements.

Gray (1988) and Oberholster (1999), maintain that cultural values are a function of various factors such as internal and external influences inherent in each contrasting culture. As discussed in section 7.3 above, trying to force countries to adopt accounting standards by applying the same template has flaws and may not result in their consistent application. This is particularly relevant to developing countries that historically have not had their own
nationally developed accounting standards. These countries have been “pushed” by the World Bank and other imperialist institutions to adopt IFRS or develop national standards based on IFRS as a prerequisite for obtaining loans (Mir & Rahaman 2005). This does not take into account the different contextual variables in emerging economies. The situations mentioned and specificities may render IFRS either difficult to apply in developing countries, or may even lead to results not intended by standard setters (Phuvanatnaranubala 2005). In fact, Mir and Rahaman (2005) argue that the adoption of IFRS in Bangladesh and other developing countries cannot be an overnight process and will be fraught with pitfalls leading to increased confusion and conflict among accounting practitioners and professional bodies. They argue that IFRS effectively mirrors accounting standards developed in the USA and the UK and that these are unsuitable for certain developing countries. Consequently, outright adoption of IFRS by developing countries is a simplistic solution that could lead to severe problems in implementation, because there is a risk that the standards may not have been developed with the needs, culture and regulatory infrastructure of developing countries in mind. Therefore distorted and incongruous results may occur.

The IASB currently has one body known as the International Financial Reporting Interpretations Committee (IFRIC) that reviews, on a timely basis in the context of current IFRSs, the accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance, with a view to reaching consensus on the appropriate accounting treatment (IASB [S.a.][a]). However, the IASB, unlike the FASB with the SEC, does not have an international regulator to determine whether interpretations of international accounting rules have been applied correctly. Consequently, much of the work in ensuring similar interpretations has fallen on national guidance groups, auditors and regulators who have also begun issuing interpretations of various standards (KPMG 2007). If all these interpretive and regulatory bodies do not work in harmony and in so doing avoid adding multiple rules and varying interpretations to the principles of IFRS, this could lead to added complexity and varying interpretations of IFRS resulting in country-specific IFRSs (“mini-IFRSs”). Comparability requires not only uniform accounting standards but also their consistent application. Failure by the IASB to achieve convergence in interpretation of its standards will result in a lack of comparability and could lead to a situation similar to the USA where there are too many interpretations which could lead to inconsistency in the application of IFRS.

8 Summary and conclusions

This paper investigated the evolution of the IASB from an insignificant London-based accounting standard-setting body (the erstwhile IASC) whose standards were almost unimportant, to its eventual development as the ultimate international accounting standard setter. It was found that the IASB’s development was shaped by many external forces, the most important being the US accounting authorities (i.e. the SEC and the FASB) and the EC. The US attitude to harmonisation was shown to be a paradoxical one. On the one hand, they were committed to harmonisation due to the internationalisation of global business, but on the other, felt that the IASC (later the IASB) was not the appropriate vehicle to achieve the goals of an international accounting system. Consequently, the SEC still insisted on a Form 20-F reconciliation for all foreign registrants who did not file accounts under US GAAP. The SEC demonstrated its influence on the IASC by blocking the IOSCO’s
endorsement of IASs in 1994 and ensuring a qualified endorsement of IASs in May 2000, and was the most influential in restructuring the IASC Board in 2001.

However, it was the June 2000 EC strategy statement that recommended the adoption of IASC Standards for all EU listed companies which finally gave the political endorsement the IASC so eagerly sought. This was followed by the implementation of IFRSs in Europe in 2005, and by 2007, almost 100 countries worldwide either require or allow the use of IFRS for the preparation of financial statements by listed companies, and other countries are moving to do the same (SEC 2007b). Owing to loss of business in the USA as a result of its onerous listing requirements, coupled with the growing similarities between IFRSs and US GAAP, in 2007, the SEC voted in favour of removing the reconciliation requirement for non-US issuers, and it has also recently considered the possibility of allowing US issuers to prepare financial statements in accordance with IFRSs issued by the IASB. These critical events represent an indication that the USA is committed to achieving international harmonisation.

From an analysis of the historical development of the IASB, it is evident that it is an organisation vulnerable to various external factors. Firstly, lobbyists of influential political institutions may oppose accounting requirements that would have an adverse affect on their earnings. Such parties could either influence the relevant legislative authorities to carve out onerous accounting requirements from promulgated IFRSs or require the IASB to amend IFRSs to meet the lobbyists’ objectives. This would undermine the perceived independence of the IASB and the quality of its accounting standards. Secondly, Camfferman and Zeff (2007) note that the EC support for the IASC in June 2000 was granted only to prevent a de facto worldwide accounting harmonisation to US GAAP over which Europe would have no influence whatsoever. As mentioned earlier, the SEC’s relaxation of the Form 20-F reconciliation has been dually justified. On the one hand, it is a concrete step towards facilitating international accounting harmonisation, but on the other, it also represents a conscious effort by the SEC to woo back foreign investors to the NYSE and NASDAQ who have been frightened away by having to prepare Form 20-F statements that were burdensome, costly and largely uninformative. It is possible that because of its track record in shaping the development and granting power to the IASB, the USA will continue to mould the IASB to conform to the US rules-based model, and the IASB could therefore become a tool for the exertion of US hegemony. Thirdly, the IASB may also be influenced by the risk of potential accounting scandals resulting from misapplication of the principles in IFRS. This may cause the IASB to apply a rules-based model to circumvent manipulation resulting from open-ended principles-based accounting standards which rely on judgement rather than on prescriptive rules. The IASB’s harmonisation programme therefore not only remains vulnerable to carve-outs, which are a deliberate policy taken by national regulators, but is also susceptible to different applications of its standards by companies that may not be visible. Similarly, different cultures with different accounting backgrounds and legislative requirements are bound to have varied applications and interpretations of the principles inherent in the Anglo-Saxon model of accounting of current IFRSs. A one-size-fits-all approach may not always be appropriate for developing countries whose situations and distinctive characteristics differ from those of developed countries leading to IFRSs being applied and interpreted differently. Governments are unlikely to cede sovereign prerogatives in the name of global accounting uniformity and different applications of IFRS requirements will affect the comparability of financial statements prepared under IFRSs in different parts of the world.
The conclusion to be drawn is that the IASB is at a delicate juncture and its future will be strongly influenced by the aforementioned external factors. The IASB will thus remain a vulnerable standard-setting body and needs to be pliable in order to maintain the political influence it currently has. Consequently, potential investors and users of IFRSs around the world need to grasp the potential limitations of harmonisation and of having a global accounting standard-setting body. Only time will tell whether the external factors influencing the IASB, will derail the quest for a set of quality international accounting standards and true global harmonisation flowing from the IASB.

Bibliography


Factors impacting on the future of the IASB


