

# BALANCING ACT

A MAJOR REVIEW IS SET TO SHAKE UP STANDARD SETTING IN GLOBAL FINANCIAL REPORTING, SAYS COLIN FLEMING

A flurry of exposure drafts from the International Accounting Standards Board in the last few months has dominated the headlines. But perhaps more interesting are two related, but separate, reviews of the IASB's governance structure – these are being conducted by the International Financial Reporting Standards Foundation Trustees and the IFRS Foundation's Monitoring Board.

These reviews matter because the IASB of 2011 is light years away from the IASB of 2001. It is no longer a means towards global accounting convergence; it is on the threshold of being the global financial reporting standard-setter. Being specifically identified as a G20 agency places the IASB at the centre of global public policy.

The problem facing the IFRS Foundation is that its governance structures for the IASB were never designed to support such a high public policy profile and need a radical overhaul. The trustees' review is one of the five-year reviews mandated by the IFRS Foundation's constitution. The issues raised were largely uncontroversial and would mark a further welcome and necessary development of the trustees' oversight of the IASB.

More critical is the Monitoring Board's governance review, issued in February 2011. The Monitoring Board was established in 2009 to provide a formal link between the IFRS Foundation and capital market authorities in jurisdictions that allow or permit the use of IFRS.

## GLOBAL MISSION

The governance review examined 'institutional aspects relating to governance, in particular the composition and the respective responsibilities of the Monitoring Board, trustees and IASB to put in place a governance structure to promote the IASB's 'primary mission of setting high-quality, globally accepted standards' while striking an appropriate balance between independence and accountability.

In places, it is apparent the report was itself a

balancing act between those who wanted the Monitoring Board to restrict its activities to 'monitoring' the IFRS Foundation and the IASB, and those who favoured a more interventionist course.

The balance is represented by a three-tier governance model which breaks down as follows:

- the Monitoring Board provides legitimacy as the link, via competent market supervisors and/or regulators, to national governments in jurisdictions that require or permit the use of IFRS;
- the IFRS Foundation trustees oversee the day-to-day activities of the IASB and related standard-setting activities, promote the transparency of the organisation and buffer the independence of the IASB from political, sectoral and regulatory interference. The trustees are accountable to the Monitoring Board for the governance of the IFRS Foundation and the IASB;
- the IASB acts as an independent standard-setter, operating within a clearly defined and documented system of due process. The IASB is accountable to the IFRS Foundation trustees, being responsible for its actions in the development of IFRS.

Many of the Monitoring Board's proposals were non-controversial. It wants to increase the transparency of nominations to the IFRS Foundation trustees and clarify the criteria for candidates, improve visibility of its own activities and assist in achieving a stable funding system for the IFRS Foundation.

## DIVERSIFY BOARD

One of the more important suggestions was to increase the membership of the Monitoring Board from its current five members to between 10 and 15.

At present, members are made up of the European commissioner for the internal market, and the chair of the Financial Services Agency (Japan), the US Securities and Exchange Commission and the



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International Organization of Securities Commissions (IOSCO) technical and emerging markets committees. In addition, the Basel Committee on Banking Supervision participates as a non-voting observer.

The Monitoring Board concluded that its members should be representative of the world's capital markets but it also recognised the need to strengthen its engagement with prudential authorities and other international organisations, including the Financial Stability Board, the International Association of Insurance Supervisors, the IMF and the World Bank.

Whether this is done through participation as observers or through an advisory committee is something to be worked out in the coming months.

### CONTROVERSIAL VOTE

As well as expanding representation, there is a commitment to act by consensus. Many see decision-making by consensus as most appropriate for the Monitoring Board's role in the governance structure of the IFRS Foundation because it provides an extremely broad political basis for the strategic direction of the IFRS Foundation. Others, for example the European Commission, want unanimity in some matters but would accept qualified majority voting for others.

Critics of any form of majority voting, at least at this stage, see a danger that the gains in terms of political buy-in made by expanding the membership would be removed immediately by allowing the existing members to dominate decisions via another mechanism. This issue is highly sensitive, politically-charged and absolutely critical to the Monitoring Board's activities.

Some suggestions, however, were more controversial, in particular whether the Monitoring Board should have an 'explicit ability' to place an item on the IASB's technical agenda.

For many, this would compromise the independence of the IASB. Others see it as unnecessary, since the Monitoring Board already has the ability to 'refer matters of broad public interest related to financial reporting for consideration by the IASB'.

Given that the IASB is implementing a more thorough due process around its agenda-setting, and that the trustees are also stepping up their oversight activities through the standard-setting cycle, the emerging consensus seems to be that this explicit ability is unnecessary – for now.

The Monitoring Board suggested that it should 'have a more prominent role' in the selection of the IASB chair, perhaps even approving the trustees' selection. There is another balance to be struck here: the IASB chair has a much higher public policy profile than it did when Sir David Tweedie was appointed in 2000. That suggests that the Monitoring Board might have a role to play. But having the power to appoint would risk politicising the appointment.

### DELIVER ACCOUNTABILITY

The likely compromise is that the Monitoring Board's involvement would be limited to approving the criteria for the IASB chair and providing feedback on the trustees' assessment of short-listed candidates against those criteria. This would provide for meaningful input from Monitoring Board members, while maintaining the independence of the appointment itself.

The governance structure of the IFRS Foundation must facilitate achieving the ultimate goal of a single set of high-quality global financial reporting standards. It needs to support that goal while balancing the need for accountability to public authorities and the independence of the standard-setter.

But the governance structure must also be seen to deliver accountability and independence in such a way that jurisdictions not already using IFRS can adopt the standards with the same degree of confidence that current users have. The governance review has already been identified as one of the issues identified as an important factor in the US Security and Exchange Commission's decision on whether to adopt the use of IFRS in the US later this year.

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