

Written statement by Governor Susan Schmidt Bies

IASB reform

At the International Accounting Standards Committee Foundation Meeting, New York, New York

June 3, 2004

Thank you, Mr. Chairman, for the opportunity to speak today on matters relating to the review of the constitution of the International Accounting Standards Committee Foundation (IASCF) and the International Accounting Standards Board (IASB). I would like to focus my remarks on several issues the Trustees' Constitution Committee has identified for further consideration. These issues were posted to the [IASB web site](#) on March 22, 2004. The IASCF selected these issues after reviewing the comments it received following the publication of its November 2003 consultation document *Identifying Issues for the IASC Foundation Constitution Review*.

The Federal Reserve has been working to promote common high-quality accounting standards around the world, with a focus on the global standards-setting activities of the IASB. The goal of common global accounting standards will require a high degree of convergence between U.S. and international standards, and efforts toward full commonality are well under way. The potential financial stability benefits are significant--high-quality global accounting standards can lead to enhanced transparency, which will, in turn, improve market discipline and foster stable financial markets. I believe that your efforts and this constitutional review are very important because they will lead to more effective oversight and expert advisory arrangements that will help ensure that high-quality international standards will be developed based on sound principles and appropriate due process, and in a manner consistent with the public interest.

Addressing The Challenges Facing Small- and Medium-Sized Entities

The first question raised by the Trustees' Constitution Committee's document was whether the objectives of the IASC Foundation should expressly refer to the challenges facing small- and medium-sized entities (SMEs). The committee has been considering some specific mention in the constitution of the special needs of SMEs and emerging economies. A specific objective of this nature would help to ensure that appropriate attention is given to the implementation of international standards by SMEs and emerging-market economies. In addition, I encourage an appropriate involvement of people with such backgrounds in the advisory groups and organization of the IASCF and IASB.

The committee has also indicated that it recognizes that educational activities could play a role in reinforcing these objectives and that special mention of the organization's educational efforts could be included in the constitution. I support the inclusion of such language directly into the constitution since this would highlight the IASCF's recognition and commitment to more comprehensively address the implementation needs of important constituents.

Number of Trustees and Their Geographical and Professional Distribution

Another issue raised for this review was the number of trustees and their geographical and

professional distribution. The committee is considering changing the geographical-distribution term *Asia/Pacific* to *Asia/Oceania* to reflect the fact that North American countries on the Pacific Ocean were not meant to be considered as part of this grouping. In addition, the committee is considering expanding the number of trustees to provide more representation from the Asia/Oceania region and emerging-market economies. The committee is considering expanding the number of trustees from nineteen to twenty-two, with six trustees each being appointed from North America, Europe, and the Asia/Oceania region and four trustees being appointed from any area, subject to an established overall geographical balance. I support the clarity provided by the new term *Asia/Oceania*, and I strongly encourage a balanced distribution of trustees between all geographic regions. I also support the appointment of trustees from emerging-market economies because such appointments would give these economies a voice and strengthen their commitment to high-quality accounting standards. However, I do have concerns about the continued effectiveness of the trustees if their numbers are unduly expanded. Therefore, although some limited expansion could always be considered, on balance I would prefer to see a reallocation within the existing numbers, over time, as the existing trustees' terms of office come to an end.

The committee believes that the trustees should remain responsible for the selection of new trustees when vacancies arise, and the committee notes that the trustees have advertised the need for applicants for all vacant positions. It has been pointed out that the trustees have consulted with the relevant organizations in the region where the vacancies arose in order to achieve an appropriate balance of professional backgrounds. In addition, the committee suggests that the requirements regarding professional backgrounds should be relaxed and that the following language should be added to the constitution:

The Trustees shall be comprised of individuals that as a group provide an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and other officials serving the public interest. To achieve such a balance, Trustees should be selected after consultation with international organizations of auditors, preparers, users and academics. Organizations consulted shall include the International Federation of Accountants and national and international bodies representing preparers, users, and academics. The Trustees shall establish procedures for inviting suggestions for appointments from these relevant organizations and for allowing individuals to put forward their own names, including advertising vacant positions.

I support the broad thrust of this revision. Typically, international organizations representing preparers, users, and academics should be consulted to ensure representation from these groups. The same principle should apply in order to ensure appropriate representation from the accounting profession (with International Federation of Accountants (IFAC) and other relevant bodies being consulted). However, I believe that this language should also include references to international regulatory organizations such as the International Organization of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision (Basel Committee). This is important because these international organizations also represent the public interest, strongly support high-quality international accounting standards, and have extensive experience in addressing accounting issues and practices.

Oversight Role of the Trustees

The committee suggests a strengthening of the language of the constitution to emphasize both the trustees' oversight role and the organization's responsibilities in providing educational services. There is a need for more active ongoing public interest oversight of the

IASB's work than is currently exercised by the trustees. This oversight should include regular reviews of matters such as major strategic decisions and liaison activities, the observance of due process in the standards-setting process, and the overall performance of the IASB. In addition, continual review is needed to ensure the adequacy of the range of resources available to the IASB to properly address the demands placed upon it. I support the language suggested by the committee that would emphasize the trustees' responsibility for its oversight role. In addition, I encourage trustees to have an in-depth, confidential meeting with the Standards Advisory Council (SAC)--that is, without the IASB in attendance--at least annually to learn the SAC's views about the IASB and its agenda, proposals, and standards. Perhaps a committee of the trustees could also periodically obtain major constituents' views about the IASB's activities and practices.

Funding of the IASC Foundation

The trustees have established a long-term funding committee to examine various options, including a fee-based system similar to the one created in the United States. I encourage the committee to explore possible new funding arrangements but to continue to be mindful that any final funding arrangements should not undermine the independence, or the perceived independence, of the standards-setting process.

Composition of the IASB

The committee believes that the size of the IASB should remain at fourteen members. Moreover, the committee is suggesting that the constitution provide some flexibility regarding the number of part-time members. One possibility is to require no fewer than two part-time members and no more than four part-time members. In addition, the committee is suggesting amending the criteria for selecting IASB members in a manner that might provide for more flexibility in determining the number of full-time and part-time members of the IASB. Under the committee's suggested approach, the foremost qualification for membership would be professional competence and practical experience. I strongly support these types of revisions to the criteria for Board member selection.

It is difficult to determine the appropriate number of part-time board members. There are advantages and disadvantages associated with having part-time board members as well as full-time members. One advantage is that part-time members may bring a useful appreciation for and direct contact with the application of the standards in practice. On the other hand, this could detract from the perceived independence of the board. Trustees need to weigh carefully, in light of experience with the existing part-time positions, whether or not the overall effectiveness and balanced perspective of the board is likely to be enhanced by continuing to appoint some part-time members. If the conclusion is that some part-time positions should be retained, consideration should be given to allowing the trustees some flexibility in deciding how many part-time members should be appointed at any one time.

The committee is also suggesting a modification to the constitution that would relax the requirements regarding specific professional backgrounds. Instead, the constitution would require that the board reflect an appropriate mix of practical experience among auditors, preparers, users, and academics, and that at least one IASB member have recent experience in each of these fields.

I support this suggested modification. However, I hope that the trustees will explicitly recognize that central banks and banking supervisors are extensive users of financial statements, including those prepared in accordance with IASB standards. In my view, the trustees need to ensure a proper mix on the board in terms of the balance among both

different accounting traditions and different professional backgrounds. A lack of balance is not conducive to building widespread support and acceptance for the IASB's standards. In particular, I recommend that the IASB have a larger percentage of members with professional experience in implementing accounting policies and procedures for financial instruments and related risk disclosures including, for example, an understanding of the problems and practical issues associated with fair-value accounting. Furthermore, the trustees should be responsible for ensuring that the board, as a whole, has the necessary diversity of expertise, skills, and professional backgrounds.

Although the trustees need to ensure that a variety of professional backgrounds are represented on the board, it is not necessary or desirable for the constitution to specify precise quotas for particular backgrounds. For this reason, the committee's suggested flexible approach seems reasonable. It should be noted that even if the board's skill base is strengthened, appropriate consultation and collaboration with external experts (for example, the Standards Advisory Council and other advisory groups) should remain an important part of the IASB's due process.

Appropriateness of the IASB's Existing Formal Liaison Relationships

Another issue the committee has highlighted for discussion is the current liaison relationships of the IASB. The committee believes that liaison activities remain important, and there is an increased recognition that the IASB should liaise with a broad range of national standards setters. The committee is suggesting revising the constitution to give the IASB greater flexibility to liaise with a broader range of standards setters than those currently recognized by the constitution. I support this revision. In most jurisdictions there are a number of other organizations with a major interest in the quality of the accounting standards and the standards-setting process that should also be included (for example, banking and insurance regulators, securities regulators, authorities responsible for enforcing compliance with accounting standards, and auditor oversight authorities).

The constitution refers to developing accounting standards that require high-quality, transparent, and comparable information in financial statements to help participants in the capital markets and other users make economic decisions. Although it is acknowledged that the needs of investors are a key consideration in setting accounting standards, the needs of other users also should be given appropriate weight. The IASB should always seek to develop standards that meet the needs of both investors and other user groups. Central bankers, banking supervisors, and other prudential regulators are all major users of general-purpose financial statements, and this is reflected in the significant resources the Federal Reserve, the Basel Committee, and others devote to analyzing and commenting on the IASB's proposals and providing technical advice to the IASB. In addition, banks themselves and other financial-services institutions make extensive use of financial statements in making lending and other decisions. The IASCF needs to focus on securing the involvement of users in this wider sense rather than merely focusing on investors and analysts.

Consultative Arrangements of the IASB

The committee recognizes the importance of due process and consultative arrangements. However, it indicated that it does not want to enshrine additional details in the constitution related to due process because issues related to the IASB's due process are covered as part of the trustees' duties and responsibilities.

The observance of due process and transparency are essential elements of the standards-setting process and I urge the trustees to consider how to achieve improvements in both

areas. The IASB has already made efforts to act transparently--for example, by publishing summaries of its discussions on its web site and in monthly updates--but more can be done in this area.

Lessons can be learned from the protracted debates over the revision of IAS 39 in terms of how to demonstrate to stakeholders that the IASB fully understands and has properly considered all their views. One lesson is the potential value of public hearings on controversial issues. The IASB should be accountable to the trustees for how it exercises its discretion in this respect. The length of time that elapsed between the publication of the IAS 39 Exposure Draft in June 2002 and the publication in December 2003 of a "final" text has highlighted the need for the IASB to give greater attention to the issue of transparency in its process for finalizing standards once public consultation has ended. The Board could, for example, consider making some of the current working text of a proposed standard public before the standard as a whole has finally been agreed on. The value of opening board meetings to the public is reduced if observers are denied access to the papers needed to properly follow the board's discussions. I am very pleased to learn that consideration is now being given to making IASB papers available to observers. In my view, this would be a major step forward.

The process followed by the IASB in developing new standards allows for public comment on published exposure drafts. The IASB provides feedback on major points made by commenters by explaining its reasons for accepting or rejecting them. The regular board meetings are public and information about IASB's decisions is provided regularly through various periodic publications. In addition, each exposure draft and final standard is accompanied by a "Basis for Conclusions" to help readers understand the reasons for the board's decisions and the main alternatives the board considered. In theory, these procedures should help ensure that due process is followed in the standards-setting process.

In practice, however, the process would run more smoothly and achieve greater consensus if there were more opportunity for input at an earlier stage. I have heard concerns from some constituents that the IASB seems to have already carefully examined the significant accounting issues involved in a project and have sometimes developed a predetermined mindset or bias--before the start of public consultation. To improve the due process and the efficiency of the consultations it would be highly desirable if public consultation were initiated at an earlier stage of the discussions. The IASB has the capability to publish, and invite comments on, discussion papers at an earlier stage in the standards-setting process, but this is not required. The IASB should make more use of such discussion papers and be required to specifically consider their use in relation to all of its projects.

I believe that the public roundtables held in 2003 on IAS 32 and IAS 39 helped the board reach a better understanding of a number of the issues and concerns raised by commenters. The IASB should consider making greater use of such public hearings in the future. I also believe that the IASCF could consult more with the Standards Advisory Council as it seeks to address issues associated with the technical agenda of the IASB.

Voting Procedures of the IASB

The constitution currently requires eight members to approve an international accounting standard, and the committee is considering whether to retain this requirement or require nine votes for the approval of exposure drafts, international accounting standards, international financial-reporting standards, or final interpretations of the International Financial Reporting Interpretations Committee (IFRIC). It has been pointed out that many commenters have

suggested that the trustees consider requiring a supermajority of two-thirds for approval of final decisions.

I do not believe that requiring a two-thirds supermajority vote would necessarily lead to effective and timely decisionmaking, and such procedures could ultimately stymie the efforts of the IASB to issue high-quality standards within reasonable time frames. I believe that retaining the simple majority vote or moving to a nine-vote requirement, as mentioned in the committee's paper, could be an appropriate approach for all matters before the IASB involving exposure drafts, standards, or final interpretations.

Resources and Effectiveness of the IFRIC

Although the IASCF did not ask extensive questions about the IFRIC in the first part of the constitutional review, many commenters raised questions about operational issues. The committee points out that the trustees are examining many of the questions raised. The IFRIC is also conducting an internal review of its procedures, and will make recommendations to the trustees.

In the context of the implementation of international accounting standards in a number of countries in the near future, many questions about interpretation are likely to arise. I share the concerns of many commenters that IFRIC may not be able to address all these questions in a timely manner. I am therefore encouraged to hear that a review is underway of the working practices of IFRIC and the resources available to it to meet its important responsibilities.

Composition, role, and effectiveness of the SAC

The trustees are aware of the important role of the SAC and of its input into the IASB's deliberations. The committee is suggesting that the constitution be modified to state that the trustees will select the chairman of the SAC and that the SAC chairman may not be a member of the IASB or IASB staff. In addition, the constitution should make specific mention of the requirement for regular liaison between the trustees and the SAC. As you know, our chief accountant serves on the SAC.

I strongly support the changes suggested by the committee. I believe that the SAC should select its own chair, rather than the IASB chair continuing in the role, because the SAC needs to be seen as independent of the IASB. In addition, as mentioned previously, I recommend that the trustees should have, at least annually, an in-depth confidential meeting with the SAC--that is, without the IASB being present--to obtain the SAC's candid views and advice on the IASB's agenda, proposals, and standards, as well as on its actual due-process practices. I am encouraged to see that the trustees are seeking feedback from SAC members on how the SAC can more effectively meet its stated objectives in the future. The SAC could operate more effectively by ensuring that sufficient time is given to key topics, such as financial-instruments accounting and risk disclosure. This would allow for better discussions at SAC meetings and the opportunity for the SAC to give clearer advice to the IASB. Moreover, the use of new discussion techniques (for example, smaller discussion groups of SAC members) should be considered as a means of improving the functioning of the SAC.

Conclusion

Thank you for the opportunity to share my views at this hearing. Please understand that the Federal Reserve strongly supports your efforts to enhance the oversight activities of the IASCF and the standards-setting processes of the IASB. Such enhancements should help ensure that the IASB will continue to develop high-quality international standards based on sound principles and appropriate due process, and in a manner consistent with the public

interest.

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Last update: June 3, 2004