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DEPARTMENT OF ACCOUNTING

ACHIEVING IASB INDEPENDENCE:
Creating an independent International Accounting Standards Board (IASB) through the examination and comparison of the organizational structures of the IFRS Foundation, the Financial Accounting Foundation (FAF), and the German Accounting Standards Committee (GASC)

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ABSTRACT

The International Accounting Standards Board (IASB) has been largely criticized for its lack of independence from governmental and political influences. This paper aims to create an organizational structure for the IFRS Foundation, the non-profit corporation that oversees the IASB, that will enhance the independence of this international accounting regulator and enable it to meet the needs of financial statement users around the world by issuing neutral and high quality accounting standards. In this paper, the organizational structure and independence of the IFRS Foundation is compared to its American and German counterparts, the Financial Accounting Foundation (FAF) and the German Accounting Standards Committee (GASC), in order to identify the current independence issues facing each of these organizations and use their best practices to establish an independent structure for the IFRS Foundation. This study finds that the main independence concerns facing the IFRS Foundation, the FAF, and the GASC are governmental influences from the European Union (EU), the U.S., and Germany, respectively. Furthermore, it also finds that the best way to enhance the independence of the IFRS Foundation is to remove the direct influence of national governments from the decision-making and member appointment processes and to allocate positions on advisory and decision-making boards of this organization to members based on their technical expertise and industry, rather than geographic distribution.

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INTRODUCTION

The current global economy consists of the corporations that operate in hundreds of nations, investors that buy and sell securities in financial markets across the globe, and financial statements that are prepared according to a multitude of different national accounting standards. As such, financial statement users demand a single set of high quality accounting standards that reflect the economic reality of transactions and can be used in any and all markets and securities exchanges. With the coming convergence of U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), the International Accounting Standards Board (IASB) has assumed the role of issuer for this necessary set of standards. However, in order to effectively complete this task, the current independence issues plaguing this international standards-setter must be rectified.

This paper aims to create a more independent organizational structure for the IFRS Foundation, the non-profit organization that contains the IASB, through comparisons to and evaluations of the Financial Accounting Foundation (FAF) that oversees the Financial Accounting Standards Board (FASB) in the United States and the German Accounting Standards Committee (GASC) that oversees the German GAAP and IFRS Interpretations Committees in Germany. Chapter 1 examines the history of these three organizations, providing the political and social contexts for developments in their organizational structures. Chapters 2-4 examine the independence of the IFRS Foundation, the FAF, and the GASC by focusing on the governmental influences facing these three standards-setters and conducting analyses of their responses to specific real-world events. Lastly, Chapter 5 outlines the proposed changes to the IFRS Foundation's organizational structure in light of the conclusions reached in Chapters 1-4.

CHAPTER 1

Organizational Structures and Operating Procedures

International Accounting Standards Committee (IASC) (1973-2000)

Amid the increased globalization of corporations, capital markets, and investment interests, the professional accounting bodies of the United States, the American Institute of Certified Public Accountants (AICPA); the United Kingdom, the Institute of Chartered Accountants of England &Wales (ICAEW); and Canada, the Canadian Institute of Chartered Accountants (CICA), proposed the establishment of an international study group to examine and compare the accounting and auditing policies within the three nations in 1966 (*ICAEW*). This idea came to fruition in 1967 with the formation of the Accountants International Study Group (AISG). Finally, at the urging of ICAEW President Sir Henry Benson, a single body responsible for the formation of international accounting standards, the International Accounting Standards Committee (IASC), was created in 1973 with the accounting standards boards of the United States, United Kingdom/Ireland, the Netherlands, Canada, Australia, Japan, Germany, France, and Mexico as founding members. Representatives from these organizations made up the original IASC Board, with 7 votes required to approve new pronouncements, named International Accounting Standards (IAS) (*IAS Plus*).

In 1974, Belgium, India, Israel, New Zealand, Pakistan, and Zimbabwe were added as the IASC's first associate members. Membership increased steadily over the next quarter century until 1998, when the admission of Bolivia, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Haiti, Iran, and Vietnam to the IASC increased the total membership to 140, representing both national accounting standards boards and independent organizations from 101 countries. By this time, nations such as Italy, Taiwan, Malaysia, India, and South Africa, and organizations such as the Federation of Swiss Holding Companies, the Nordic Federation, and the International Association of Financial Executives Institutes were IASC members (*IAS Plus*). Additionally, the Financial Accounting Standards Board (FASB), the European Commission, and the Republic of China were established as IASC Board observers in 1988, 1990, and 1997, respectively (*IAS Plus)*.

Despite this vast increase in IASC membership, the size of the IASC Board did not significantly change since member status did not guarantee a seat on the Board, the voting body ultimately responsible for passing new Standards. As discussed previously, the original Board structure was composed of the founding nine members of the IASC, with seven votes required to ratify a new Standard. However, the IASC Constitution was altered in 1975 to allow two additional members on the IASC Board (*IAS Plus*). In 1978, South Africa and Nigeria claimed these two spots, but with nine votes required to pass a new Standard, substantial control remained with the founding members. In 1982, the number of members was again increased to include 13 appointed representatives from member countries and up to four representatives from any organization with an interest in financial reporting (*IAS Plus*). Filling the two additional seats on the Board were Italy in 1983 and Taiwan in 1984. In 1986, the International Coordinating Committee of Financial Analysts Associations, the first non-accounting standards board member, was added. Also of consequence in 1982 was the passing of a provision that eliminated special constitutional status to founding members. As such, these nations were no longer guaranteed spots on the Board. In 1988, the first founding member was removed from the Board as Jordan, Korea, and the Nordic Federation (representing accounting bodies in Norway, Denmark, Sweden, Finland, and Iceland) replaced Mexico, Taiwan, and Nigeria. Additional changes to the Board included India replacing Korea in 1993; Malaysia and Mexico replacing Jordan and Italy in 1995; India and South Africa agreeing to share their representation with Sri Lanka and Zimbabwe, respectively, in 1995; and the addition of the International Association of Financial Executives in 1996. **Appendix A** illustrates the voting Board members, number of total Board members, and the required votes to pass a standard from 1983-2001 (*IAS Plus*).

With the overall mission of developing international accounting standards that are "capable of rapid acceptance and implementation world-wide," the IASC Board required not only a high level of knowledge about financial reporting, but also a great deal of technical expertise from its members (*ICAEW*). To aid their decision-making process, additional input was obtained from across the globe and within all industries through a series of cooperative relationships formed with third-party organizations. For example, the IASC initiated the formation of a "mutual commitment" with the International Federation of Accountants (IFAC) in 1978, met with working groups from the Organization for Economic Cooperation and Development (OECD) regarding accounting policies in 1979, and proposed a cooperating relationship with the United Nations Intergovernmental Working Group on Accounting and Reporting in 1980. However, the IASC's strategy of obtaining consultative help from outside of the organization changed in 1981 with the formation of the IASC Consultative Group. Established to advise the IASC on the direction and technical nature of the board's research and agenda, this group consisted of individuals with accounting and financial backgrounds, such as bankers and stockbrokers, and accounting and non-accounting organizations similar to those who the Board previously partnered with. Additions to the Consultative Group included the International Organization of Securities Commissions (IOSCO) in 1987, the FASB in 1988, the

European Commission and bank regulators in 1990, accounting educators in 1994, and actuaries in 1997 (*IAS Plus*).

In 1994, the IASC Advisory Council, responsible for seeking funding for the organization and for providing oversight of the IASC Board, was created. This body, however, was not provided with the legal authority to take action against the IASC Board and its members were selected by the same individuals that they were charged with overseeing, the IASC Board. In 1997, the Standards Interpretations Committee was created. With twelve voting members, this committee developed preliminary standards, for which members and accounting and financial professionals were allowed to comment and provide feedback on, and provided aid to financial statement preparers and auditors on issues not directly addressed within the Standards. Also in 1997, the IASC created working groups with national accounting standards setters, with the intended purpose of transitioning these nations from their domestic GAAP to IAS. **Figure 1** illustrates the organizational structure of the IASC as of the year 2000.

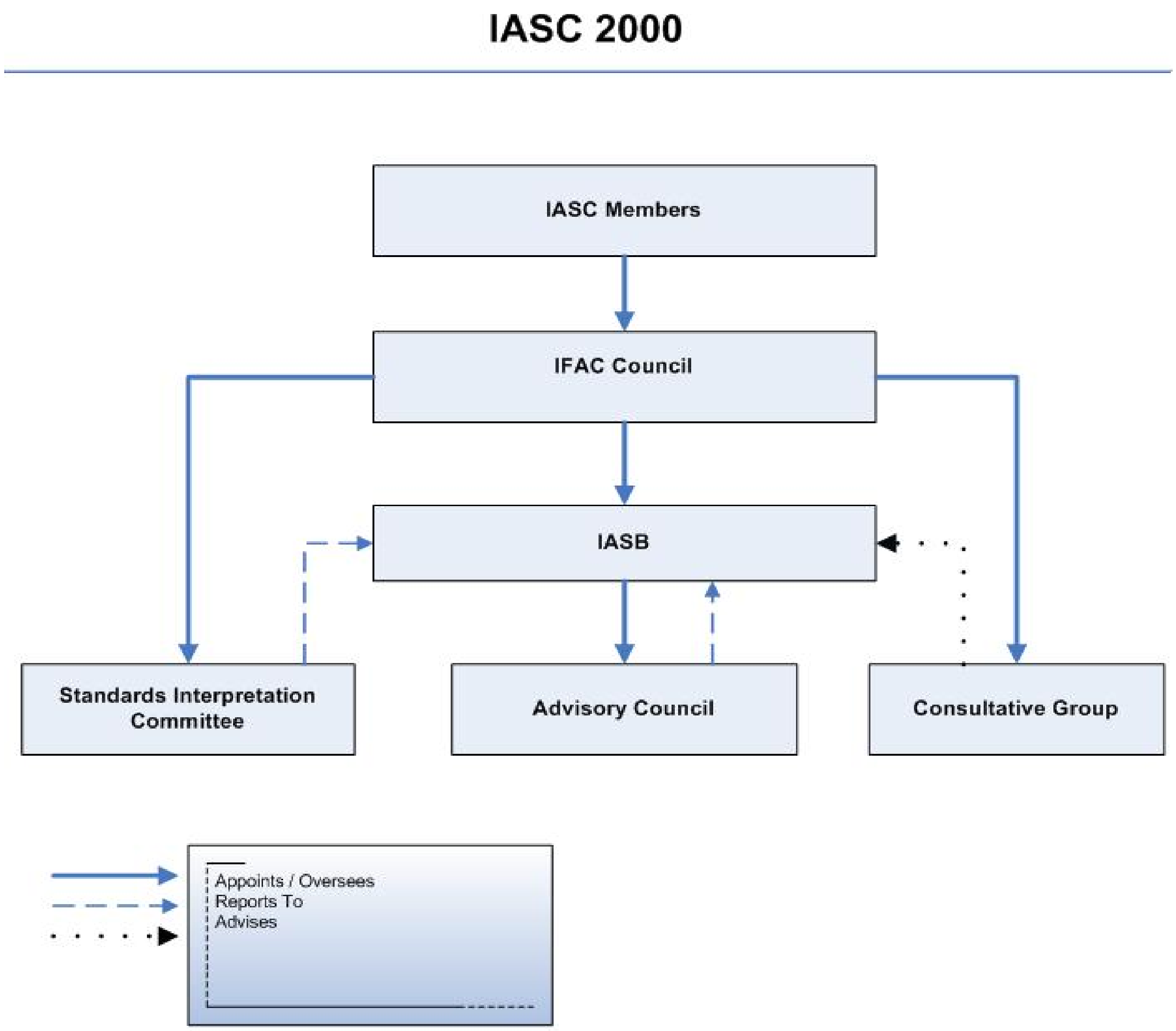

Figure 1: Organizational Structure of the IASC (2000)

In 1999, the IASC completed its first set of "core standards," which provided guidance on all major financial reporting issues and also voted unanimously on the need for organizational restructuring. This year also marked an important date in the Board's financing as it received the lowest percentage of total revenue from member donations, 29%, in its history and the lowest percentage of total revenue from donations, 25%, since 1989. Instead, with the first issuance of its completed core standards, revenue from the licensing and sale of these pronouncements generated 39% of its revenue for the year.

The IASC's financing structure changed quite dramatically from its formation in 1973 until 1999. Initially, the bulk of the organization's revenues, 88%, were derived from member fees with a small amount coming from donations, 11%, and other sources. This continued until 1989, when members' fees represented 91% of revenues and donations amounted to approximately 1% of total financing. However, coinciding with South Africa's decision to utilize IAS in 1993; German corporations reporting under IAS and the European Commission's encouragement that all EU nations report under IAS in 1995; the Arab Society of Certified Accountants endorsement of IAS for its 22 member nations in 1997; and laws in France, Belgium, Germany, and Italy that allowed corporations to report their consolidated financial statements under IAS in 1998, the IASC's funding structure began to involve an increasing amount of donations. Reaching its high point in 1996, donations from corporations, governments, private organizations, investors, and lobbyists accounted for 43% of their overall revenue while members' fees only made up 32% (*IAS Plus*).

IASC / IFRS Foundation (2001-Present)

The decision to restructure the IASC in 1999 resulted in a complete overhaul of the organization's structure. The primary changes were the replacement of the IASC Board with a 14-member International Accounting Standards Board (IASB); the creation of the IASC Foundation, a non-profit corporation chartered in Delaware to oversee the IASB; and the establishment of the IASC Trustees, a 19-member independent body responsible for both providing the governance over the IASB and securing funding to run the organization. Under this new structure, the IASB was given the full responsibility and power to issue international accounting standards, now called International Financial Reporting Standards (IFRS), while the Trustees were charged with providing oversight without influencing or establishing agendas or standards. In order to implement this new governing structure, the IASC Board appointed a twelve-person Nominating Committee, headed by SEC Chairman Arthur Levitt, in 1999 to select the IASC Trustees. The first IASC Trustees, headed by former U.S. Federal Reserve Board Chairman Paul Volcker, were selected in 2000. The first chairman of the IASB, chairman of the UK Accounting Standards Board David Tweedie, was selected in 2000 while the rest of the members were appointed in 2001. Also part of the new organizational structure was the IASB Standards Advisory Council, a 49-member body appointed and overseen by the Trustees responsible for advising the IASB when making accounting policy decisions. Lastly, the Standards Interpretations Committee, renamed the International Financial Reporting Interpretations Committee in 2002, was placed under the direction of the IASB, as well as the Trustees (*IFRS*).

In 2009, the IFRS Trustees voted to expand the IASB to 16 members by 2012, stated that no more than 3 part-time IASB members could exist at any point, and recommended a specific geographic mix for the Board. Although no rigid mandate was established to achieve global representative balance, the current IFRS Foundation's Constitution suggests the following IASB member distribution: four from Asia/Oceania, four from Europe, four from North America, one from Africa, and one from South America ("Constitution"). While these members are not appointed to represent the interests of their native country, as noted by Dr. Tommaso Padoa-Schioppa of IASC Foundation in his 2006 speech during the "Future of IASB-Funding" Conference in 2006 in the Deutsche Bundesbank, individuals are undoubtedly largely influenced by national interests and pressures (Padoa-Schioppa). Also in 2009 was the establishment of the Monitoring Board, an independent body comprised of public authorities that is responsible for the oversight of the Trustees. Current members of the Monitoring Board include the "responsible member of the European Commission," the chair of the IOSCO Emerging Markets Committee, the chair of the IOSCO Technical Committee, the commissioner of the Japan Financial Services Agency, the chair of the SEC, and the chair of the Basel Committee on Banking Supervision (as an observer) ("Constitution"). Lastly, in 2010, a vice-chair was added to the IASB and the duration of the second term for Board members appointed after July 2, 2009 was limited to three years. Other than the superficial name changes of the IASC Foundation to the IFRS Foundation, the International Financial Reporting Interpretations Committee to IFRS Interpretations Committee, and Standards Advisory Council to IFRS Advisory Council, this is the current organizational model employed by the IFRS Foundation. **Figure 2** shows the organizational structure of the IFRS Foundation as of April 2012.

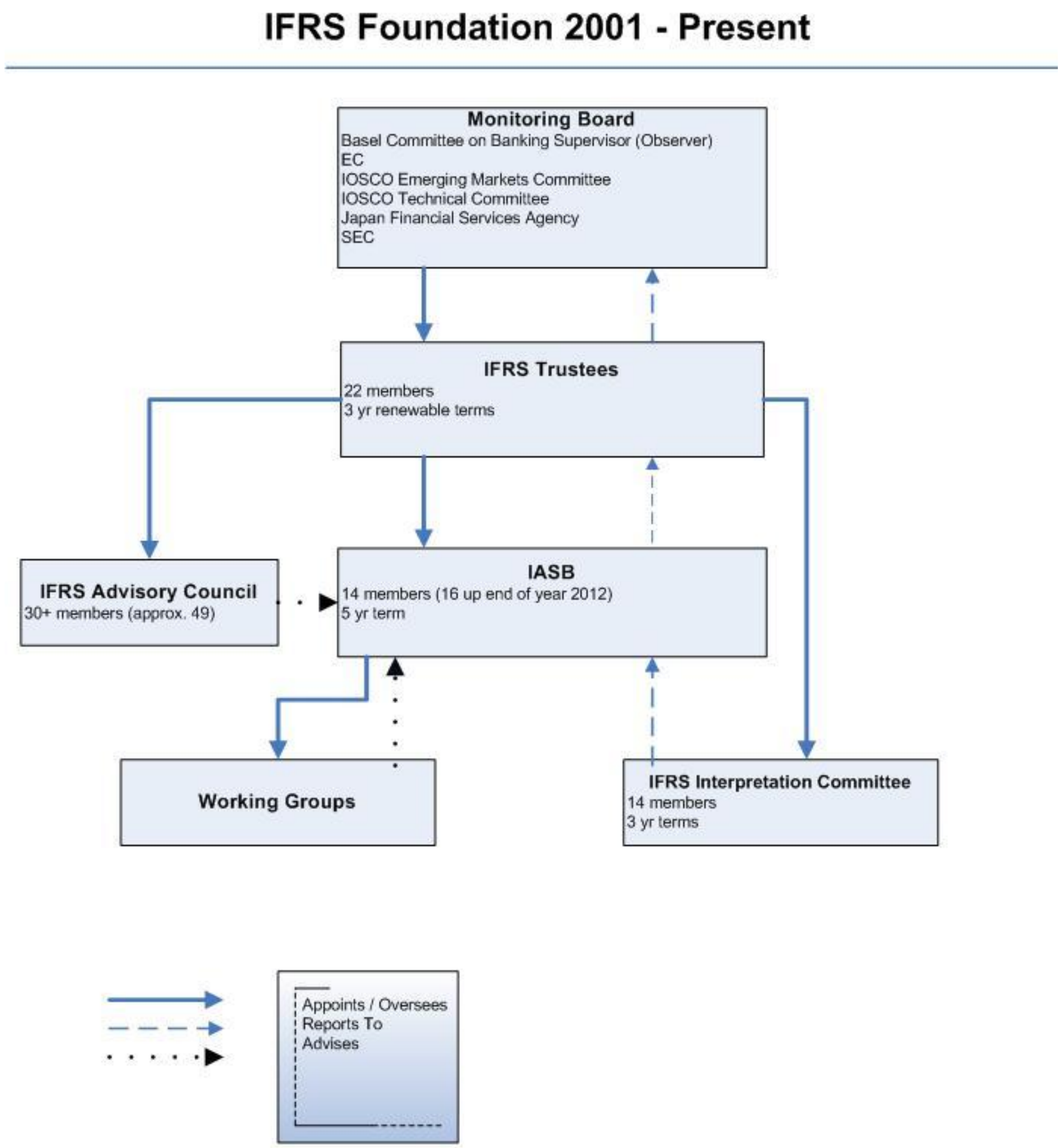

Figure 2: Organizational Structure of the IFRS Foundation (2012)

Delving deeper into the organizational structure, it is extremely important to know how members of the IASB, IFRS Advisory Council, IFRS Interpretations Committee, and IFRS Foundation Trustees are selected and what qualifications are required for each of these positions in order to evaluate the existing organizational structure. According to the IFRS Foundation's

Constitution, the main criteria for selecting IASB members is "professional competence and practical experience," which are further defined as possessing the following skills and characteristics: "technical competence and knowledge of financial accounting and reporting; the ability to analyze; communication skills; judicious decision-making; awareness of the financial reporting environment; the ability to work in a collegial environment; integrity, objectivity, and discipline; and commitment to the IFRS Foundation's mission and public interest" ("Constitution"). Outside of the recommendations for global representation, no other formal criteria exist to judge potential IASB members. Much like the principles-based IFRS issued by the IASB, these generic requirements afford the Trustees a great deal of autonomy in appointing members. For example, among the original 14 IASB members in 2001 were an accounting professor and associate dean, the former Chief Accounting Officer (CAO) for Daimler-Chrysler AG, the former CFO of Volvo, a member of the PricewaterhouseCoopers global management team, and the former Executive Director of the Australian Accounting Research Foundation (AARF) (*IAS Plus*). IASB members are appointed by the IFRS Foundation Trustees for terms of five years with a three year renewable second term.

Similar to the IASB, the language used in the IFRS Foundation's Constitution is very ambiguous when describing Trustee qualifications. Requiring that Trustees "show a firm commitment to the IFRS Foundation," "be financially knowledgeable," and "have an understanding of the challenges associated with the adoption and application of high quality global accounting standards," the Monitoring Board is afforded a great deal of judgment when appointing Trustees ("Constitution"). However, unlike the rough suggestion of global balance within the IASB, there exists a mandated geographic mix among Trustees. As such, there must be six Trustees from Asia/Oceania, six from Europe, six from North America, one from Africa, and one from South America. The only other selection criterion is the recommendation that two Trustees be members of international public accounting firms. Although there are no active senior partners from international public accounting firms among the current Trustees, this group does include the former CEO of PricewaterhouseCoopers and the former Chairman of KPMG Hong Kong (*IFRS*).

The IFRS Interpretations Committee, also appointed by the Trustees, consists of 14 members with renewable three-year terms. Once again there are no clear-cut requirements for selection as the Constitution states that it should be comprised of the "best available combination of technical expertise and diversity of international business and market experience" ("Constitution"). The IFRS Advisory Council has the most flexible and diverse makeup of all committees and bodies associated with or within the IFRS Foundation. Comprised of 30 or more members "having a diversity of geographical and professional backgrounds," these individuals provide feedback to the IASB concerning major projects or standards being conducted or discussed by the IASB. The Advisory Council also provides aid to the Trustees and is headed by a chairman that is independent of the IASB and appointed by the Trustees (*IFRS*).

Utilizing what it calls a "due process," the IASB standard-developing process consists of six stages: setting the agenda, planning the project, developing and publishing the discussion paper, developing and publishing the exposure draft, developing and publishing the standard, and periodic re-evaluation after the standard is issued (*IFRS*). For purposes of this study, the only relevant steps are the decision whether to pursue a project by itself or jointly with another standards-setter, the period for which proposals are made available for comment, and the vote for final approval. After soliciting feedback on existing standards and current financial accounting issues from its technical staff, the IFRS Advisory Council, the IFRS Interpretations Committee, and external consultants, the IASB must decide whether to pursue a project alone or jointly with another standard-setter (*IFRS*). Perhaps the most famous and important example of a joint project is the current IASB-FASB convergence project that started in 2002 with the signing of the Norwalk Agreement, a memorandum of understanding between the IASB and FASB noting their commitment to the goal of establishing a single set of international accounting standards ("Memorandum of Understanding: Norwalk Agreement"). Once a preliminary version of the intended final standard is drafted, it is disseminated to the public and made available for public comment. Although there is no set time proposed standards must be made available for comment, it is typically not less than 60 days and is usually 120 days for major projects. After receiving public comments, making possible alterations, and sending the proposed standard to the IFRS Interpretations Committee for external review, final voting is held by the IASB (*IFRS)*. In order for a new IFRS to be issued, 10 votes are required if all 16 members are present and 9 votes are required if less than 16 members are present ("The Constitution").

Financing the IFRS Foundation is the responsibility of the Trustees. According to the IFRS website, any funding regime must "ensure that the IFRS Foundation and the IASB have the ability to engage interested parties throughout the world in the shaping of financial reporting standards, while maintaining the capability to respond to crises" (*IFRS*). Furthermore, as agreed to in 2006, the four guiding principles of their efforts to secure financing are that it should be broad-based, meaning that it includes all major global capital markets; compelling, meaning that it helps avoid free-riding; open-ended, meaning that arrangements should be flexible and not infringe on organizational independence; and country or jurisdiction-specific, meaning that financing should be received in a manner that is consistent with the size of a nation's GDP (*IFRS*). Of these four principles, "compelling" and "open-ended" seem to be contradictory as they suggest deriving funding from sources who are largely impacted by financial accounting standards but who do not wish to exert their influence on the overall decision-making process. Since the IFRS Foundation is a private organization, it has no power to force national governments, standard-setting bodies, private organizations, or individuals to provide funding. It is precisely this constraint that has fueled a large amount of criticism over the IASB's true independence from corporate and political influences as relying on private donations creates the possibility of tailoring standards and decisions to match the desires of its financial contributors.

According to the 2011 IFRS budget, there are seven primary funding streams utilized by this body: publicly sponsored/nationally administered financing streams, direct voluntary contributions, international accounting firms, central banks and international institutions, trustee fees, publications, and interest income. In 2011, these methods were scheduled to contribute 48%, 8%, 26%, 1%, 0.5%, 15.5%, and 1%, respectively (*IFRS*). As can be seen, the vast majority of financing is provided by the publicly sponsored/nationally administered funding regimes and international accounting firms. While at first glance nationally administered financing may seem to be the most independent way for the IASB to generate revenue, the funds received in this manner from nations such as Germany and France represent donations from private organizations and would more accurately be categorized as voluntary contributions.

As of 2010, the following countries and organizations have agreed to long-term financing commitments with the IFRS Foundation: Germany (German Accounting Standards Committee), France (Ministry of Finance), the United Kingdom (Financial Reporting Council), Italy (Organismo Italiano di Contabilita), Spain (Stock Exchange), the Netherlands (Ministry of Finance), Sweden, Switzerland (Swiss Business Associations), Luxembourg (Burse of Luxembourg), Norway, South Africa (Financial Reporting Council), Canada (Canadian Institute of Chartered Accountants), Japan (Financial Accounting Standards Foundation), China (China Accounting Standards Committee and the Ministry of Finance), Australia (Financial Reporting Council), India (major stock exchanges), Korea (Korea Accounting Standards Board), Hong Kong (securities regulator, monetary authority, and stock exchanges), New Zealand (Accounting Standards Review Board), individual companies and organizations from the U.S., the Big Four public accounting firms, Grant Thornton, BDO, and Mazars. These long-term commitments are broken down by source in **Appendix B** (*IFRS*). This table illustrates that despite the ability of the Trustees to obtain voluntary financing from national accounting standards bodies, national governments, and public accounting firms, 38.23% of long-term financial commitments to the IFRS Foundation are from private companies and organizations and 28.56% are from levies on individual companies, which, as mentioned above with France and Germany, are often voluntary contributions. This follows precisely with the expectation that those who have the greatest desire to influence IASB decisions are most willing to provide funding and shows the conflict between the “compelling” and “open-ended” concepts prescribed by the Trustees.

In order to develop a complete and exhaustive understanding of the funding of the IFRS Foundation, it is also necessary to discuss the sources of such financing by region and nation as one of the four main financing goals established by the Trustees was securing funds from nations in proportion to their respective GDPs. Although exact figures are not provided by the IFRS Foundation regarding the donations of private corporations or individuals, instead labeling them as “less than £25,000” or “£25,000 +,” an evaluation of the organization’s ability to meet this goal can still be conducted by examining the contributions made by Germany, France, the United Kingdom, and the United States. The United States, which does not utilize IFRS, provides more funding than France, the second largest nation that uses these reporting standards. It is also noteworthy that while Germany and France have comparable GDP's, France contributed £888,099 in 2009 from the French Ministry of Finance and none from domestic companies while in Germany the German Accounting Standards Committee (GASC) contributed £1,234,975; 60 companies and organizations contributed less than £25,000; and 30 companies contributed more than £25,000. Since the funds donated through the GASC and the Ministry of Finance were both based on donations provided by private organizations, this difference is even more interesting. In contrast to the other two European nations, the United Kingdom contributed £800,000 through a levy on UK listed companies and provided no other private donations. Such differences in funding received from nations with comparable GDPs evidences the fact that the final decision over funding ultimately rests with each nation. Lastly, contrary to its goal of eliminating free riders, only 31 nations contributed money to the IFRS Foundation in 2009 while over 100 nations either required or utilized IFRS in some manner (*IFRS*).

Financial Accounting Foundation (FAF)

The origin of consistent and comprehensive accounting standards in the United States can be traced back to the Security and Exchange Acts of 1933 and 1934. Establishing the Securities and Exchange Commission (SEC) as the body charged with oversight of all sales and exchanges of securities within the U.S., requiring all corporations that sell or exchange securities on exchanges within the U.S. to register with the SEC, and granting the SEC the power to determine financial reporting regulations for all companies that offer securities to the public, these acts were instrumental in shaping and developing U.S. accounting standards. In 1935, the SEC created the Office of the Chief Accountant and mandated that historical accounting be used for the preparation of financial statements (Zeff, "Evolution of US GAAP"). In subsequent years, the SEC began to look to the private sector for the creation and improvement of these accounting standards although it never formally abdicated its power to determine such rules. For over two decades, the SEC depended on the Committee on Accounting Procedure, a subcommittee within the American Institute of Accountants (AIA), the precursor to the American Institute of Certified Public Accountants (AICPA), for the development of accounting principles. However, in 1959, at the urging of harsh criticism within the industry led by Leonard Spacek, lead partner for Arthur Andersen, the AICPA created the Accounting Principles Board (APB) to take over for the Committee on Accounting Procedure. Composed of a representative from each of the Big Eight public accounting firms, financial executives, academics, and accounting professionals, this 21-member group was charged with "narrowing the differences in accounting practice" (Zeff, "Evolution of US GAAP"). Increased pressure from corporations led to the inclusion of financial executives on the APB and representatives from the Big Eight were included with the purpose of ensuring that these firms would impose increased pressure on their clients to follow the newly developed rules and standards (Zeff, "Evolution of US GAAP").

The APB operated until 1973, releasing a series of 17 "Opinions" on wide-ranging accounting topics from deferred taxes to business combinations, at which point the market perception of this body eroded to the extent that the Big Eight announced their loss of confidence in the APB as a "source of sound financial reporting" (Zeff, "Evolution of US GAAP"). Ellen M. Heffes commented in June 2011 in the *Financial Executive* that several concerns existed concerning the APB's "lack of perceived transparency, openness in its due process, and…conflicts of interests," from 1959-1973 (Heffes). In 1970, the AICPA created the Wheat Committee, a group chaired by former SEC chairman Francis Wheat that was charged with studying how financial accounting standards should be created and implemented (Schroeder, Clark, and Cathey 9). The final recommendation of this committee was the elimination of the

APB and the creation of the Financial Accounting Foundation (FAF), an independent entity for which decisions regarding accounting pronouncements would be made by a seven person board called the Financial Accounting Standards Board (FASB). In contrast to the APB, which was at that point an 18-member board comprised entirely of AICPA members who worked part-time, the FASB would be made up of seven full-time members that came from a variety of professional backgrounds (Allen and McDermott 182).

The newly created FASB had three immediate advantages over its predecessor in that it limited independence concerns by using paid, full-time members as opposed to unpaid, part-time members, it eliminated the skewed balance of power given to public accounting firms in the APB, and allowed for a faster response time for accounting issues with full-time participants (Schroeder, Clark, and Cathey). The organizational structure of the FAF consisted of a Board of Trustees, the seven-member FASB, and the newly created Financial Accounting Standards Advisory Council (FASAC). Primarily responsible for securing financing for the FAF and appointing members to both the FASB and the FASAC, the Board of Trustees was composed of members appointed by organizations whose members have a "special knowledge and interest in financial reporting" (Schroeder, Clark, and Cathey 9). Originally, representatives from the American Accounting Association, the AICPA, The Financial Executives Institute, the National Association of Accountants, and the Financial Analysts Federation were charged with selecting these Trustees (Schroeder, Clark, and Cathey 9). The goal of the FASAC, a body consisting of at least 20 members that possess a great deal of knowledge and experience concerning financial reporting such as CFO's, financial managers, academics, and auditors, was to advise the FASB concerning technical material, agenda topics, and procedural issues.

Several important organizational and structural changes have been made since the FAF's initial formation in 1973. The first significant alteration occurred in 1977 when the FAF voted to change the voting requirements in the FASB. Originally, all new standards, rulings, and decisions required a super-majority, 5 out of 7 votes. After increased industry pressure over the FASB's inability to adequately respond to the changing accounting landscape, majority voting that required only 4 votes to reach a consensus was enacted (Zeff, "Evolution of US GAAP" 22). In 1984, the Emerging Issues Task Force (EITF) was also created to help alleviate this issue. Designed to help the FASB focus on major issues by eliminating their need to focus on small specialized items that can be solved using existing standards, this group was composed of a variety of auditors, preparers, and users of financial statements (*FASB*). The typical relationship between the EITF and the FASB is that if the members of the EITF can reach a consensus on a certain issue, then no action by the FASB is necessary. If not, then the FASB strongly considers adding this subject to their agenda (*FASB*).

As a direct result of these changes, a flurry of accounting pronouncements on topics ranging from defined benefit plans to futures contracts to industry specific rulings such as software costing were passed in the next decade. As a result, industry pressure to slow down the activity of the FASB caused the FAF to change voting requirements back to the previous super-majority ruling in 1990 (Zeff, "Evolution of US GAAP"). The fact that seven Statements were issued by the FASB in 1988-1989 while only four were issued in 1990-1991 indicate the possible effects of this change (*FASB*). Additionally, as of 1992, the FASB indicated that the majority of feedback received from accounting and financial professionals was largely related to the complexity of the standards rather than the frequency (Boresford and Van Riper 80). The next major alteration of the FASB came in 2002 with the passage of the Sarbanes-Oxley Act in the wake of accounting scandals at companies such as Enron and Tyco. A major provision of the legislation was the requirement that the majority of Trustees not be associated with accounting firms (Williams). Additionally, the SEC was required to specify a private-sector standards-setter that is given the responsibility for established accounting standards that are "generally accepted" for securities laws. The SEC subsequently reaffirmed their commitment to the FASB.

The FAF added an additional subgroup in 2005 by creating the Investor Task Force (ITF). This group is composed of the world's largest asset management firms, such as T. Rowe Price, General Electric Asset Management, Mellon Financial Corporation, and Wellington Management. Specific analysts and representatives from these firms are asked by the FASB to provide industry specific insight on certain items to help the Board make decisions. This group is very closely related to the Investors Technical Advisory Committee (ITAC), a body that provides technical advice to the FASB concerning difficult and challenging investment items. The main difference is that instead of a pool of representatives from various firms, this committee is comprised of 11 to 13 members who all work in a field where financial reporting is a primary purpose (*FASB*).

Following the formation of the FAF Trustees' Special Committee on Governance in 2007, the FAF decided to implement several changes in its structure. These changes included allowing additional groups to nominate Trustees, although the final decision still rested with the Board of Trustees; changing the Trustees' service time from one three-year term with a possible second three-year term to a single five-year term; changing the number of Trustees from 16 to a flexible number between 14 and 18; reducing the number of FASB members from seven to five; and requiring that future FASB members possess investment experience ("The Financial Accounting Foundation Board of Trustees Approves Changes to Oversight, Structure, and Operations of

FAF, FASB, and GASB”). In order to appropriately respond to the changes and issues arising out of the financial crisis in the fall of 2008, the Financial Crisis Advisory Group (FCAG) was created in January 2009. Composed of 15-20 accounting leaders and experts throughout the world and chaired by one individual from the United States and one from Europe, this organization was created solely to advise the FASB and IASB on issues regarding this global event (*FASB*).

In 2006, the Private Company Financial Reporting Committee (PCFRC), a 13-member board (12 members and one chair) that is composed of four users, four preparers, and four CPA practitioners that sets its own agenda and makes recommendations to the FASB on behalf of all non-public companies, was formed. The last additions to current FAF structure were the Not-for-Profit Advisory Committee (NAC) in 2006, the Small Business Advisory Committee in 2004, and the Valuation Resource Group (VRG) in 2007 (*FASB*). In 2010, the number of FASB members was changed back to seven. **Figure 3** shows the organizational structure of the FAF as of April 2012.

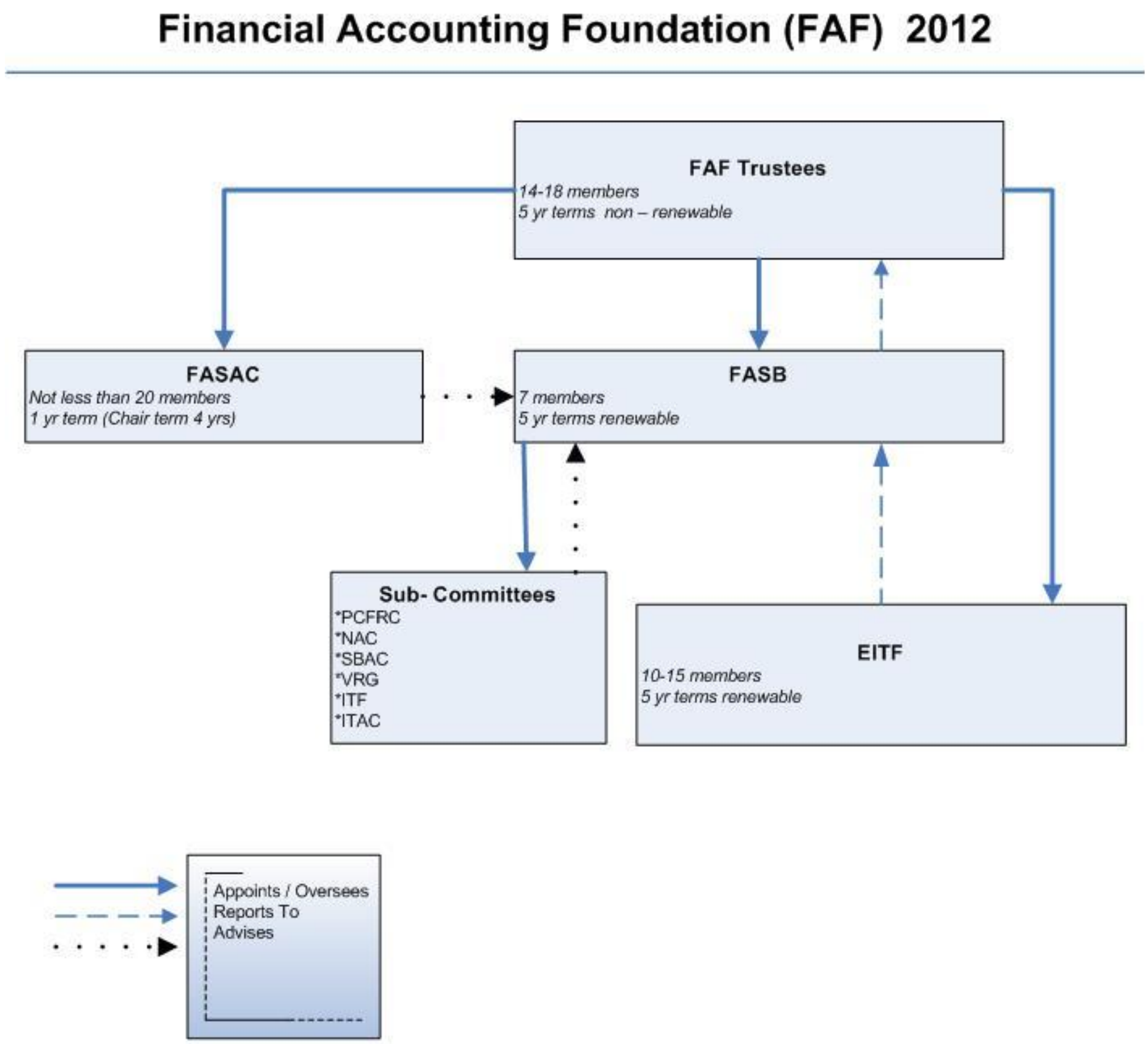

Figure 3: Organizational Structure of the FAF (2012)

A complete understanding of the FAF and its organizational structure requires a firm grasp of the qualifications and selection process for the FAF Trustees, FASB, and FASAC, and further exploration and analysis into the requirements set forth in the FASB by-laws concerning each committee's composition. As mentioned earlier, the total number of Trustees shall be a between 14 and 18, but the current FAF by-laws further state that these members shall be divided into five classes, with the term of the members in each class expiring in successive years and so that the terms of no more than six members expire in a given year ("By-Laws of the Financial Accounting Foundation"). Qualifications for FAF Trustees, as with the Trustees for the IFRS Foundation, are quite ambiguous. According to the FAF by-laws, at least three members, referred to as "Governmental Trustees," must have "extensive experience as financial officers or as elected officials of state and local governmental entities" ("By-Laws of the Financial Accounting Foundation"). The remaining members, with experience in business, investment, capital markets, accounting, business education, regulatory, or investor advocacy, are called "at-large" Trustees ("By-Laws of the Financial Accounting Foundation"). The other main stipulation for these positions is that the majority of Trustees must not be "associated persons" at the time of service or at no time in the previous two years, referring to involvement with public accounting firms ("By-Laws of the Financial Accounting Foundation"). Due to the vagueness of these qualifications, the Trustees are typically a very diverse group of individuals. For example, the current Board of Trustees contains the America's Partner for Ernst and Young, the General Manager of the San Francisco Public Utilities Commission, a Harvard Business School professor, and the Chief Accounting Officer for Microsoft.

Nominations for these positions are completed in two ways. First, nominations for 'at-large" positions are sought by the FAF through an array of investor groups, business organizations, financial and capital market participants, consumer groups, and accounting and business educators ("By-Laws of the Financial Accounting Foundation"). Secondly, "Governmental Trustee" nominations are completed through a group of "Governmental Organizations," consisting of the Government Finance Officers Association; the National Association of State Auditors, Comptrollers and Treasurers; the Council of State Governments, the International City/County Management Association; the National Association of Counties;

the National Conference of State Legislatures; the National Governors' Association; the National League of Cities; and the U.S. Conference of Mayors (“By-Laws of the Financial Accounting Foundation”). After nominations, final decisions regarding selections are made by the Board of Trustees themselves (“By-Laws of the Financial Accounting Foundation”).

Granted full power and authority to carry out the mission of the FAF, the seven members of the FASB are selected by the Board of Trustees for five year terms that are renewable only once (“By-Laws of the Financial Accounting Foundation”). According to FAF by-laws, FASB members should be full-time employees, should have concern for the investor and public interest in matter of financial accounting and reporting, and should collectively have extensive accounting, finance, and investing experience (“By-Laws of the Financial Accounting Foundation”). In order to avoid heavy turnover, no more than 2 members’ terms can expire in the same year (“By-Laws of the Financial Accounting Foundation”). Of the seven FASB members, one is selected by the Trustees as the chairperson and assigned duties including preparing the annual budget, transmitting long-term and short-term plans to the Trustees, hiring and firing staff to assist the FASB with their duties, and assigning members and staff to task forces and subcommittees for future and ongoing projects (“By-Laws of the Financial Accounting Foundation”). Since no further explanation concerning the desired backgrounds, professional experience, or characteristics of its members is provided, the historical diversity among FASB members is not surprising. For example, some of the past positions held by the current FASB members were vice president of accounting policies at J.P. Morgan, CFO of Reasor’s Holding Company, Chair of the Accounting and Information Systems Department at Michigan State, and Director of Research at the Center for Financial Research and Analysis (CFRA).

Similar to the FASB, FASAC members, including its chairman, are selected by the Trustees. However, several differences from the FASB exists as it is made of at least twenty members; members are unpaid, part-time employees of the FAF; and terms last only one year (with a possible three additional years) ("By-Laws of the Financial Accounting Foundation"). The FASAC chairman serves a four-year term and has the power to add and remove "special-purpose" members, as long as no more than three exist at any time, that have specific knowledge that may help the FASAC in carrying out their responsibilities ("By-Laws of the Financial Accounting Foundation").

Also important in discussing the FAF is the process utilized by the FASB in developing and issuing new pronouncements. The FASB's "due process" in setting standards is designed to increase transparency and is very similar to the system employed by the IASB. After an issue is brought to the attention of the FASB as a result of feedback from the EITF, FASAC, other consultative groups, or the general public, the chairperson and the other FASB members must decide on whether to add it to the technical agenda (*FASB*). In 2002, two members of the FASB were added to the EITF's Agenda Committee so that new and developing issues can be discussed and acted upon immediately by the Board ("Changes to U.S. Standard Setting"). Next, the FASB will deliberate at one or more meetings about the issues concerning this topic. At this point, a Discussion Paper may also be publicly released to obtain feedback from industry professionals. After discussion and, if necessary, reviewing comments on the Discussion paper, an Exposure Draft is released to public for a comment period not less than 30 days (*FASB*). No Exposure Draft or Discussion Paper can be issued without agreement from the majority of the FASB members ("By-Laws of the Financial Accounting Foundation"). After receiving feedback from the general public, which may also include a public roundtable discussion on the subject, the

FASB will spend at least one additional meeting discussing the matter and will either choose to vote on the standard again as was originally released or will change the standard based on the comments received before voting (*FASB*). The standard is passed only if a favorable majority is obtained. If not, either additional changes are made or the issue is dismissed (*FASB*).

Lastly, in order to understand how the FAF operates and what interests it truly serves, the financing regime employed by the organization must be discussed. Just as with the IFRS Foundation, the FAF Trustees are charged with securing financing for the organization. However, instead of vague and contradictory language in the organizational by-laws that describes how funding should be obtained from sources that are "compelling" and "open-ended," the FAF bylaws simply state that the Trustees "shall arrange financing" (FAF Constitution). This difference exists because, due in large part to the Sarbanes-Oxley Act in 2002, the FAF has a stable funding regime.

Currently, the FAF derives revenues from three main sources: accounting support fees, publications and subscriptions, and donations. According to the Sarbanes-Oxley Act (2002), equity and investment company issuers registered with the SEC are assessed accounting support fees based on their market capitalization. Equity issuers with an average monthly market capitalization of over $25 million and investment company issuers with an average monthly market capitalization or net asset value of over $250 million are assessed these fees ("2010 Annual Report"). The Public Company Accounting Oversight Board (PCAOB) acts as an agent for the FASB in collecting these fees and according to their website, an issuer's fee is simply equal to its proportionate share of the total average market cap of all issuers who are forced to pay (*PCAOB*). Publications and subscriptions are revenues generated through the licensing and sales of the standards, documents, and advice offered by the FASB. Lastly, contributions are voluntary donations, but in the case of the FAF, these amounts are almost entirely derived by the Government Accounting Standards Board (GASB), the body responsible for issuing accounting standards for national, state, and local governments in the U.S that is also part of the FAF. As such, in 2010, 74% of donations were from state governments, 8% were from local governments, 7% were from other GASB sources, and 11% were in the form of contributed services ("2010 Annual Report").

The breakdown of funding by source from 2000-2010 can be seen in **Appendix C**. This table illustrates that prior to the Sarbanes-Oxley Act (SOX), the FAF faced many of the same independence issues and uncertainty concerning its funding that is seen today with the IASB. For example, 34% of the FAF's funding in 2000 was in the form of donations, a number similar to the IASB's contribution from private companies/organizations in 2010, as seen in **Appendix B**. Prior to SOX, the FAF faced major criticisms of its funding structure, in particular its reliance on donations from public accounting firms. As noted in **Appendix C**, 33 percent of total funding in 2001 was derived from contributions. More specifically, 25 percent of contributions, or approximately nine percent of total funding was contributed by the Big Five public accounting firms (Schlank, "The Facts About FASB's Funding Controversy"). This problem is noted by former SEC Chairman Arthur Levitt's comment, "You can not imagine the problem of seeing the members of the board having to go hat-in-hand to the members of Corporate America looking for funding each year. It's crazy" (Schlank, "Former SEC Chairmen Urge Congress to Free FASB").

Section 109 of the Sarbanes-Oxley Act, in reference to the FAF and the FASB, states that "the budget of the Board…shall be payable from annual accounting support fees," as discussed earlier ("Securities Lawyer's Deskbook: The Sarbanes-Oxley Act of 2002"). Although at first glance this provision seems to eliminate the uncertainty and independence that Levitt referred to, in another way it actually lessens the freedom of the FASB as there is also one additional important part of Section 109. Although stable funding will be provided through these assessments on public issuers, Section 109 also states that the FASB's budget must be approved by the SEC ("Securities Lawyer's Deskbook: The Sarbanes-Oxley Act of 2002"). Prior to SOX, the FASB was already largely influenced by the SEC since they are allowed to act as the standards issuing body for U.S. corporations only at the grace of this organization which actually possesses the power to set such standards. Section 109 furthers this dependence, as was stated by FASB Chairman Edmund L. Jenkins in 2002, "We appreciate the commitment to supporting and strengthening the FASB's independence…but we caution Congress that any legislation mandating particular action or procedures by the FASB can compromise the very independence that the legislation seeks to enhance" (*FASB*).

Deutsches Rechnungslegungs Standards Committee (German Accounting Standards Committee) (DRSC) (GASC)

Unlike its American and British counterparts, German accounting regulation throughout the past century has been largely based on legislation and judicial rulings rather than the decisions of independent organizations with an interest in financial accounting. As such, for much of the last 100 years, no authoritative accounting standards body or bodies existed to provide guidance on financial reporting or accounting treatments of specific transactions in Germany. In fact, the Stock Corporation Law of 1965 (a reformed version of the previous Stock Corporation Law of 1937) was the only codified source of accounting regulation in Germany until 1985 (Walton, Haller, and Raffournier 94). However, even though private corporations often followed these guidelines, these standards had no legal authority towards those that weren't public share-issuing entities (Aktiengesellschaft) (AGs) (Walton, Haller, and Raffournier 94).

As such, a set of uncodified rules and regulations called the Grundsätze ordnungsmäßiger Buchführung (GoB) were utilized in place of codified guidance for private companies (Walton, Haller, and Raffournier 94). Translated as "principles of proper accounting," the GoB consisted of court decisions, legislation, accounting practice, and decisions made by the professional institution of the auditors (Walton, Haller, and Raffournier 93). Until a major shift in German accounting regulation in 1985, these uncodified rules served as the authoritative guidance for private entities while the Stock Corporation Law of 1965 served as guidance for AGs. During 1985 the Accounting Directives Act was passed and existing GoB rulings, as well as specific regulations created for specific entities, were added to the Handelsgesetzbuch (HGB), the German Commercial Code (Walton, Haller, and Raffournier 94). As a result of this change, the German Commercial Code now served as authoritative guidance for German GAAP for all entities, both public and private. With the continued lack of an independent organization granted the authority to release financial accounting pronouncements, additions to the German Commercial Code were made as new legislation, court decisions, and newly created accounting practices developed. Additional GoB serve as guidance for those instances not specifically addressed in the HBG, but is subordinate to the German Commercial Code if conflicting rulings are prescribed for identical events.

Since the German Commercial Code is overseen by the German government, and in particular the Ministry of Justice, the federal government was now provided final authority over accounting treatments and pronouncements of all entities. In 1998, due to the increased globalization of capital markets, the Ministry of Justice allowed for the formation of an independent accounting standards body, the Deutsches Rechnungslegungs Standards Committee (DRSC) (German Accounting Standards Committee, GASC) (Walton, Haller, and Raffournier 93). Referred to as the Standardization Agreement, the Ministry of Justice extended the following powers to the Accounting Standards Committee of Germany (ASCG), as outlined in Section 342(1) of the German Commercial code: to develop recommendations (standards) for accounting principles for consolidated financial reporting, to advise the Federal Ministry of Justice on planned legislation on accounting regulations, to represent Germany on international standard-setting bodies, and to develop interpretations of international financial reporting standards utilizing the German Commercial Code ("Annual Report 2010"). Modeled after the FASB, the original organization consisted of the Deutsche Standardisierungsrat (DSR) (German Accounting Standards Board, GASB), the General Meeting, Administrative Board, Management Board, and Consultative Committee. It is important to note that the GASB is only responsible for consolidated accounts; separate accounts are still governed under the authority of the German Commercial Code (HGB).

Membership in the General Meeting is available to "any legal person or any group of persons which is subject to the statutory duty to deal with accounting or financial reporting" (*Deutsches Rechnungslegungs Standards Committee e.V*). The only further requirement for membership is payment of an annual membership fee that varies according to entity type and size as described in **Appendix F**. While we have previously seen stakeholders attempting to purchase influence on the IASB by donating to the IFRS Foundation, the General Meeting represents a unique structure as actual votes can be purchased for the price of a membership fee. Currently, 71 companies and 16 individuals make up this association, which prohibits private organizations from becoming members (*Deutsches Rechnungslegungs Standards Committee* *e.V*). Private organizations who wish to participate in the GASC must become associate members with no voting rights (*Deutsches Rechnungslegungs Standards Committee e.V*). This committee, now referred to as the General Assembly, is tasked with setting the annual budget, amending the organization's constitution, selecting the members of the Administrative Board (now called the Executive Board), and selecting members of the Nominating Committee ("Annual Report 2010").

When the GASC was initially created, the Executive Board consisted of 18 members and had the primary responsibility of selecting the members of the German Accounting Standards Board (GASB) and approving their rules of procedure, reviewing the overall strategy of the GASC, and advising the technical committees without instructing these bodies (*Deutsches Rechnungslegungs Standards Committee e.V*). These 20 members represented five different segments. According to the DRSC website, the Nominating Committee nominates individuals for each of these segments and the General Assembly elected 10 individuals from "Capital market-oriented industrial companies or associations, 2 from "Non-publicly Traded industrial companies and associations," 2 from "Banks and associations," 3 from "Insurance companies and associations," and 3 from "Auditing and associations" (*Deutsches Rechnungslegungs Standards Committee e.V*). The Executive Board selected a chairman, deputy chairman, and treasurer amongst themselves, who along with two other Board members made up the Executive Committee ("Annual Report 2010"). All members of the Executive Board were volunteers (*Deutsches Rechnungslegungs Standards Committee e.V*). Even though the FAF and IFRS Foundation constitutions establish vague pre-requisites for the positions of their Trustees, the GASC Constitution lacked and continues to lack even such basic guidance. So, in order to fully understand the composition of the Executive Board and Committee, we can look at its current members. The current Executive Board consists of two university professors, the Managing Directors of Ernst and Young GmbH and Deloitte GmbH, and members of the Executive Boards of BDO, BASF, and Siemens ("Annual Report 2010").

The GASB, the original standard-setting body of the GASC charged with making and releasing German Accounting Standards (GASs), consisted of seven independent members who were elected by the Executive Board ("Accounting Standard Setting in Europe"). These seven members included a president and a vice-president and all members except for the president were part-time employees of the GASC ("Annual Report 2010"). Similar to the Executive Committee and Board, no specific criteria existed for the selection of these members. Therefore, once again, further analysis of the composition of the Board must be conducted to better understand this body. **Appendix D** examines the previous or concurrent employer of GASB members from 2005-2010. From this analysis, it is quite evident that public accounting firms and banks had an undeniable influence on the GASB and its operations as four of the seven members throughout this entire period had existing or recent ties to these entities. It is also noteworthy that at one point, two of the representatives were current or recent employees of a single bank, Deutsche Bank. The large influence afforded to the banking industry is most likely a consequence of the large private sector and reliance on creditor financing in Germany. However, with both representatives coming from a common bank, perhaps a greater consolidation of power is given to this single organization on the GASB. **Figure 4** illustrates the organizational structure of the GASC when initially created in 1998.

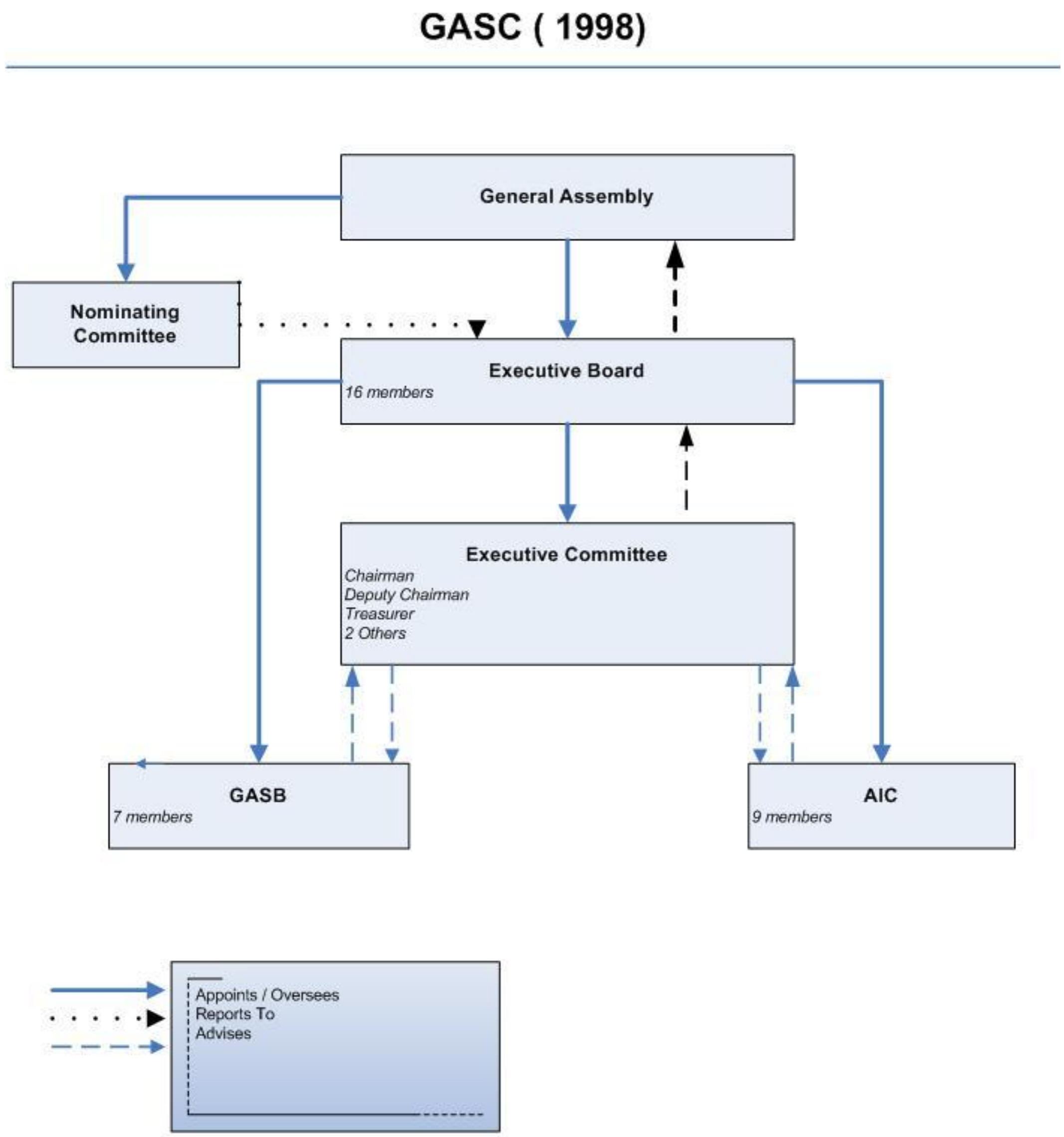

Figure 4: GASC (1998)

Shortly after its creation, the GASC created the Consultative Council, an advisory board selected by the Executive Board used to consult on technical and industry-specific subject material (Walton, Haller, and Raffournier 103). In 2004, this council was replaced by the Accounting Interpretations Committee (AIC), a six person advisory body selected by the Executive Board tasked with deliberating on the impact of recently passed IFRS ("Annual Report 2010"). If deemed an international issue, the AIC would refer the problem to the IFRS

Interpretations Committee. If it is a solely a national concern, the AIC would develop guidance concerning the application of the discussed standard and would provide this guidance to the GASB (Previts, Walton, and Wolnizer 79).

In 2011, facing major funding issues and intense criticism towards the GASC's usefulness, the organization completed a major restructuring. The main changes from this reorganization were the elimination of the GASB and AIC, the creation of the IFRS Committee and the German GAAP Committee, the expansion of the Executive Board (now called the Board of Directors) to 20 members representing pre-determined sectors, and the establishment of the president and vice-president as the members the sole members of the Executive Committee (*Deutsches Rechnungslegungs Standards Committee e.V*). Understanding the difficulty facing the GASB in providing guidance on both IFRS and German GAAP, the organization decided to divide these responsibilities by establishing two separate committees to deal with these issues. The IFRS Committee, chaired by the GASC President, is charged with preparing interpretations of IFRS, preparing responses to released IASB drafts, cooperating with the European Financial Reporting Advisory Group (EFRAG), advising on legislative activities, and implementing EU directives. The German GAAP Committee is granted responsibility for the preparation and announcement of GAS as defined in Section 342(1) HGB, as well as cooperation with the EFRAG and interpretations of EU directives that affect non-publicly traded entities (*Deutsches Rechnungslegungs Standards Committee e.V*).

Each of these technical committees is composed of seven members, all of which are volunteers, selected by the Executive Board (now called the Board of Directors) after being nominated by the Nominating Committee. The President of the GASC serves as a non-voting chair of the IFRS Committee and the Vice-President of the GASC serves as the non-voting chair of the German GAAP Committee. The only qualifications stated by the GASC for these positions are that they have “special expertise and experience in the field of accounting” (*Deutsches Rechnungslegungs Standards Committee e.V*). The IFRS Committee has two individuals from “Auditing and Association,” three from “Industry,” one from “Insurance,” and one from “Banking.” The German GAAP Committee has two from “Auditing and Association,” one from “Industry,” one from “Banking,” and two from a new “Academic” category.

The new Executive Committee (now called the Bureau), is composed of the President and Vice-President and it is responsibility of the Nominating Committee and the Board of Directors to appoint these full-time members. In addition to leading one of the technical committees, additional responsibilities for these individuals include development of the budget and being the legal representatives of the organization in court (*Deutsches Rechnungslegungs Standards Committee e.V*). **Figure 5** illustrates the GASC as of April 2012.

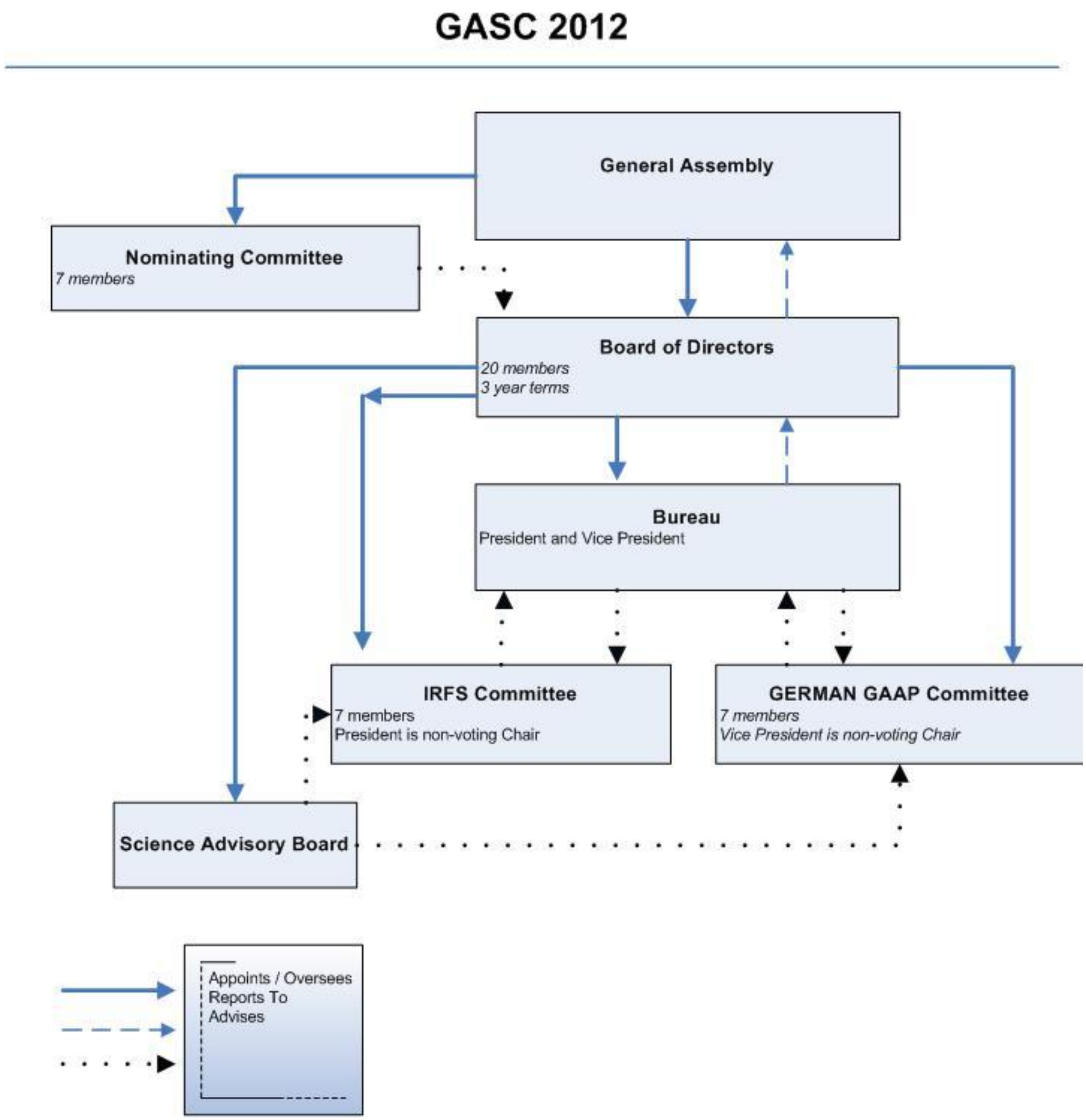

Figure 5: GASC (2012)

The GASC uses a multi-step "due process" for the development and issuance of accounting standards. First, a resolution requiring a two-thirds majority is passed on a draft comment by the GASB. Next, an exposure draft is made available for public comment for a period of at least 45 days. After receiving comments and perhaps making changes, a re-exposure draft by the GASB is released with at least a 30 day comment window. Taking into consideration these comments, as well as the public discussion if necessary, the final comment letter is voted on during a public meeting. If the standard obtains a two-thirds majority, then it is passed; if not, it is dismissed and the issue is closed ("Annual Report 2010").

In Germany, small-and-medium sized entities (SMEs) are and have been such an important component of their economy that a specific word, Mittelstand, was created to refer to this sector. SMEs make up nearly 80% of the private-sector employment in Germany and according to the chief economist at the German Chamber of Commerce and Industry, Volker Treier, "Mittelstand is the backbone of the economy" (Blackburn and Fuhrmans). Thus, accounting regulation throughout the nation's history reflects the importance of these entities. For example, since the majority of these firms are privately-owned, financing in Germany is primarily based on banks and creditors. As such, accounting regulations in Germany focus on distributable income, rather than presentation and full disclosure like US GAAP, so as to ensure that creditors receive payment (Sawani). This concept was further illustrated by Germany's response to the economic crises of the late 1920s and early 1930s. As opposed to the U.S., where the Securities Exchange Acts of 1933 and 1934 primarily protected the interests of shareholders in capital markets, Germany's Stock Corporation Law of 1937 (Aktiengesetz) was based on the concepts of prudence and creditor protection (Walton, Haller, and Raffournier 92). Additionally, a Deloitte study on the differences between UK and German accounting standards noted that financial security has traditionally been the main focus of the German financial statement user (Crampton).

German GAAP is not only tailored to SMEs, but as Axel Haller and Bridgitte Eierle wrote in their study on the implementation of IFRS in Germany, there has existed a "traditional dominant close connection between financial and tax accounting" in Germany (Haller and Eierle 36). Considering that for the majority of the 20th century German accounting regulation was a compilation of legislative and judicial decisions, made by the same people who are responsible for developing tax requirements and provisions, it is no surprise that the two concepts are so closely related. In contrast, in the U.S., financial and tax accounting have largely remained separate due to the existence of the FASB and the IRS. While similar standards for both tax and financial accounting ensure less work for government officials, as two entirely separate standards are not needed in many cases, combining the political nature of tax accounting into financial accounting largely impacts German corporations who report under German GAAP when attempting to raise capital. Thus, with increased globalization of capital markets, many investors called for German accounting reform or the usage of US GAAP or IFRS due to the fact that the "influence of tax law largely determines accounting for individual company financial statements" under German GAAP (Van Tendeloo and Vanstraelen 160).

In 2002, a major decision by the European Union (EU) regarding financial reporting played a large part in such German accounting reform. Regulation No. 1606/2002, referred to as the IAS Regulation, stated that all listed companies within the EU must prepare their consolidated financial statements in accordance with IFRS by 2005 (or 2007 if the company trades on both EU and other stock exchanges and currently uses US GAAP) (*IAS Plus*). Also important in this year was the decision by the EU to allow national governments and accounting standards bodies the option to include only certain parts of IFRS into their accounting framework (Haller and Eierle 28). In response to these EU rulings, Germany passed the Accounting Law Reform Act, Bilanzrechtsreformgesetz (BilReG), to address these changes (Haller and Eierle 29). This act required companies that were not yet publicly traded but applied for a trading of their securities on a German stock exchange to report their consolidated financial statements under IFRS, gave non-public companies the choice to use either German GAAP or IFRS, and required both public and non-public companies to report their financial statements in accordance with the German Commercial Code for dividend distribution and tax calculations.

In 2009, the German Parliament passed the Act to Modernize Accounting Law (Bilanzrechtsmodernisierungsgesetz), referred to as the BillMoG. The goal of this project was to provide SMEs with an alternative to IFRS, which is designed to meet the needs of international financial statement users. At the time, German law required all entities to report accounts and records designed for use by capital market investors; however, the majority of small-and-medium sized entities do not participate in these markets. After consideration of the recently released IASB draft on SMEs, it was decided that these standards were still too costly for these firms to employ (*IAS Plus*). The main provisions of this act were the exemption of sole proprietorships with less than €500,000 turnover and €50,000 profit from any obligation to keep accounts and records, the elimination of the need for an audit for small companies (less than 50 employees, assets less than €4.8 million, and annual turnover less than €4.8 million), and a reduction of disclosure requirements for medium-sized companies (less than 250 employees, assets less than €19.2 million, and annual turnover less than €38.5 million) (*IAS Plus*).

While this act was designed to alleviate some of the burden in preparing financial statements for SMEs, it also had a much larger consequence. With the establishment of separate standards for SMEs, combined with the requirement that all public German companies report under IFRS, the GASC's primary purpose now became the development of standards for small-and-medium sized entities. This has remained the primary focus of the GASC through today.

One of the primary provisions of the original agreement between the Federal Ministry of Justice and the GASC was that the functions in accordance to HGB 342(1) delegated to the GASC were to be performed at no cost to the government. This was again noted in the updated version of this agreement, signed in December 2011 ("Standardisation Agreement"). As such, the GASC's Constitution states that the "costs shall be covered by members subscriptions and donations, as well as income through licensing, publishing and other sources" ("Accounting Standard Setting in Europe"). This quote illustrates not only the manner in which the GASC derives revenues, but also illustrates the importance of subscriptions from members of the General Assembly. **Appendix E** illustrates the breakdown in GASC funding from 2005 until 2010. This exhibit clearly shows that member fees and donations are responsible for the bulk of the GASC's revenue. Also apparent is the decrease in funding received from corporate and individual members and donors over this period as a percentage of the overall funds received. Although the funds received to transmit to the IFRS Foundation are obviously not used in the general operations of the GASC, this category is included to illustrate the shift in corporate and private donor activity over this time period. This shift in funding, shown by the fact that almost one third of the funds received from 2006-2010 were given as part of donations to the IFRS Foundation, illustrates that a great deal of donors started to give money to this international standards-setter rather than the GASC following the EU requirement that German public companies report under IFRS starting in 2005 ("Annual Report 2010,"…"Annual Report 2006").

An additional issue causing this lack of funding by private and corporate donors is the belief that not all parties are paying their equal share. Since organizations and corporations are under no obligation to contribute to the GASC, unlike the SEC which invoices publicly-listed firms for accounting support fees ultimately provided to the FASB, there is a high proportion of free-riding. However, since the GASC does not possess the legal authority to levy such a fee to all corporations, and according to GASC President Liesel Knorr, "Constitutionally, in Germany, we are not supposed to invoice 1,000 companies when 100,000 might benefit from it," the GASC has faced major funding concerns.

Funding losses have also resulted from the perception that the GASC has not done enough recently to defend the interests of Germany corporations, organizations, and individuals. Recent criticism has focused on the organization's unwillingness to advocate for banks who had to book large impairment losses during the economic crisis, oppose the IFRS proposal for SMEs, or challenge the IASB on a multitude of concepts (Canham). This concept is further evidenced by Carolyn Canham's comments in the Financial Times in 2010 concerning the issues facing the GASC, "the most pressing are its inability to secure enough funding and concerns from constituents that it does not do a good enough job representing their views at the European and international levels…stakeholders…are less willing to part with funds" (Canham). Funding decreased to the point that the GASC was on the verge of collapse until the president was able to secure 95% of the organization's three-year budget by appealing to a host of existing and new members, mainly SMEs (Gyorkos). Although the organization has raised sufficient funding to operate under its new organizational structure for the foreseeable future, major concerns exist concerning its long-term viability.

CHAPTER 2

Independence Analysis – IFRS Foundation

From its inception, the International Accounting Standards Board (IASB) has represented a unique standards-setting model. Composed of individuals from various professional and educational backgrounds and countries, this body is tasked with developing reliable accounting standards for investors and managers in a multitude of nations, all with differing historical accounting systems, cultures, and business environments. With over 100 nations requiring or permitting the use of International Financial Reporting Standards (IFRS) for the financial reporting of domestic companies, it is impossible for the IASB to issue standards that are tailored to specific global markets or to particular regional accounting traditions. As such, more so than for any other accounting standards board, independence is of paramount importance for the IASB as IFRS must truly capture the essence and reality of financial performance and transactions.

A daunting task in and of itself, this responsibility is made even more difficult by two extremely important constraints facing the IASB. First, this accounting standards body has no legal authority to enforce its standards. Unlike the United States' FASB, which is granted authority to issue accounting standards for domestic firms by the Securities and Exchange Commission (SEC), an extension of Congress, the IASB has no such authoritative legal arm. Although many nations have agreed to recognize IFRS for financial reporting, these nations are ultimately responsible for which standards are followed and become law and which are excluded. Illustrating this point is the requirement for firms and auditors in the EU to add in their affirmations of compliance accompanying consolidated financial statements whether they followed "IFRS as issued by the IASB" or "IFRS as adopted by the EU" (Zeff, "IFRS" 276).

Secondly, the IASB has no enforcement mechanism to ensure that their standards are followed. Once again, unlike the SEC and the Public Company Accounting Oversight Board (PCOAB) in the United States, there are no enforcement mechanisms in place that ensure that firms and auditors are following IFRS as issued by the IASB. These constraints have placed the IASB at a considerable disadvantage and have greatly contributed to the large influence enjoyed by national governments, such as the United States, and the EU. This chapter will evaluate the IASB's independence by analyzing the influence of national governments and the EU on the Board and examining the actions of the IASB in three controversial cases (IAS 39, fair value accounting changes in 2008, and organizational changes after the IFRS Foundation's formation).

Governmental Influence

Although the IASB can't be considered to be under the jurisdiction of a specific sovereign state, it is certainly not devoid of governmental influence. On the contrary, the structure, operating procedure, and the very standards that it has produced have undoubtedly been influenced by national governments, trade organizations, special interest groups, and legalized unions of nations. Among these, it is the IASB's propensity to succumb to political pressures that worry the financial and accounting communities as IFRS continue to gain international traction and the U.S. moves towards convergence with these standards. Although IFRS are followed by a multitude of nations around the globe, two single governments, the U.S. and the EU, have had the greatest impact on the development and operation of the IASB and most clearly illustrate its willingness to bend to meet political agendas.

European Union (EU)

Similar to the increased globalization of markets that sparked the creation of the initial IASC in 1973, increased international securities trading in European financial markets in the late 1990s and early 2000s brought about the need for vast accounting reform. As of the year 2000, the EU consisted of 15 different nations, each with their own accounting regulations and rules. As such, in order to effectively evaluate the performance and financial health of foreign corporations, investors and analysts were required to have a firm grasp of accounting regulations and principles in each of these nations. Although many large international firms utilized US GAAP for financial reporting purposes, due to its acceptance as the "gold standard" of financial accounting and widespread understanding, such differentiation among member nations created a major hurdle for securities trading within the EU and with other international investors. As this issue was in direct conflict with one of the founding cornerstones of the EU, the free flow of capital among member nations, reform was desperately needed.

Historically, the convergence of European accounting regulations, or "harmonization" as referred to by the EU, was largely guided by the Fourth and Seventh Directives of the European Commission. According to the EU, directives are mandates passed by the European Commission that lay down certain conditions that must be met by member states by a specific future date. Commonly used to "bring national laws into line with each other," national authorities must meet these goals but are "free to decide how to do so" (*Europa.eu*). The Fourth Directive was created to revise the commercial codes of EU members that applied to business entities, regardless of their status of incorporation or liability (Bebbington and Song). However, this provision granted a great deal of leeway to each nation in establishing comparability across accounting standards, allowed exemptions for SMEs, and did not address consolidated financial statements

(Bebbington and Song). The Seventh Directive was issued to address the concern of consolidated statements, but the discretion afforded to member nations still allowed for widely varied national standards (Bebbington and Song). Although these enactments attempted to create a common system across the EU, national accounting standards were still largely based on historical accounting traditions, such as the close relationship between tax and financial accounting in Germany.

In response, the EU decided to explore all available options, including establishing their own accounting standards-setting body and adopting an existing set of accounting regulations. Perhaps the most obvious choice would have been the adoption of US GAAP as the financial reporting standard for all European firms. The attractiveness of this option rested in the facts that US GAAP was already treated as acceptable by all EU members and U.S. equity rules required all firms trading on U.S. equity markets to reconcile their statements to US GAAP (Posner 650). However, reluctance to relinquish such power to the U.S. forced this option to be quickly eliminated (Posner 651). The idea of a European standard-setter was also dismissed due to concerns over the EU's inability to form such an organization, as well as strong British resistance wishing to avoid a Brussels-controlled accounting regulator (Posner 651). As a result, in 2002, the EU passed the IAS Regulation, requiring all EU companies that were listed in a regulated market, or had plans to be listed in one, to utilize IFRS starting in 2005 (*Europa.eu*).

The result of this decision was not simply the adoption of IFRS within a large number of European markets, but more importantly, it forged an undeniable bond and link between the EU and the IASB. At the time of European adoption, the IFRS Foundation was an organization in flux and searching desperately for legitimacy in the marketplace. Having just finished a complete organizational restructuring in 2001, the IASB needed a strong foothold to legitimize its standards and compete with the FASB. Of the current G-20 members, not a single one had formally adopted IFRS as its reporting standard by the year 2002 (*IFRS*). Additionally, the largest financial market in the world, the New York Stock Exchange (NYSE), was firmly under the control of the widely respected FASB.

The IASB's primary goal is the development of accounting standards that can be utilized on a global basis. However, in the 1990s it realized that this could not be accomplished without the help of the world's largest two markets, the United States and Europe (Brackney and Witmer). With the U.S. markets regulated by the FASB and SEC, the IASB set its sights on gaining authoritative power over accounting regulations and standards in the EU (Sawani). Since its mission is to "work towards convergence not absolute replacement of national standards," the IASB-EU pairing was a perfect match on paper due to their similar desires to establish comparability without the existence of a singular set of accounting regulations (Sawani).

The adoption of IFRS involves trading off the potential influence that a country would gain regarding international accounting standards versus the loss of authority over its own standards (Ramanna and Sletten 11). Although reluctant to cede control to an independent body outside of European control, the EU decided that by becoming the IASB's largest customer (representing 7 of the top 25 largest nations based on GDP in 2002), controlling 5 of the original 14 IASB spots (including the chairman and vice-chairman), and 5 of the original 19 Trustee positions that it would have enough influence to dictate the IASB's policy. As such, at each step along the way to convergence, the EU has shown its intention to shape IFRS in its image (Brackney and Witmer).

In order to ensure that the EU did not lose complete authority over its accounting, the EU created two separate mechanisms, the Accounting Regulatory Committee (ARC) and the European Financial Reporting Advisory Group (EFRAG), as part of the IAS Regulation in 2002. The EFRAG is a consultative body that is tasked with advising the European Commission (EC) on the endorsement of the IFRS (*Europa.eu*). In practice, this organization operates through a 15-person technical group called the Technical Expert Group (TEG) that is composed of accounting experts and three non-voting members of national standards-setting bodies of the EU. Although the EFRAG's original goal was to influence the IASB and report to the EC on various rulings, its main role now is to respond to exposure drafts and comment letters of the IASB and report on their findings to the EC ("Strengthening the European Contribution to the International Standard-Setting Process"). Consisting of one voting member from each of the EU member states and chaired by the EC, the ARC is a public sector body that is granted the authority by the EU to either endorse or reject an IFRS as created by the IASB. If a standard is recommended for adoption by the ARC, the EC can issue a final regulation formally adopting the standard. But, if it is rejected by a simple majority vote then it is either sent back to the EFRAG or to the European Council for a final adoption decision (Brackney and Witmer).

While the EFRAG is simply a consultative group tasked with presenting the EU's concerns to the IASB and delivering an opinion on proposed IFRS to the EC, the ARC represents a deliberate injection of politicians into the standard-setting process for European nations. It is precisely this governmental and political involvement that organizations such the IASB and FASB have fought to remain independent of throughout their respective existences. Although the EFRAG participates in the due process utilized by the IASB in issuing IFRS, the establishment of the ARC has enabled Europe to have a "de facto, and largely secret, due process that kicks in when the IASB has finished its extensive public consultation" (Walton). This two-tiered acceptance process implemented by the EU severely limits the ability of the IASB to issue standards free of political pressure since in order for their standards to be implemented in the largest markets utilizing IFRS, political approval is necessary. In contrast, even though the SEC is tasked with monitoring the FASB, it rarely disagrees publicly with this board and plays a more active role in the due process before standards are issued (Walton). Thus, the largest single region and largest number of firms and markets following IFRS are free to enact only those standards which they see fit and which benefit their nation or region.

The EU's adoption of IFRS produced mixed results for the IASB. First of all, this decision made the IASB relevant by legitimizing it in the eyes of world leaders (Posner 653). Secondly, due to this elevated status and the fact that all EU nations would be required to use IFRS, the IASB was able to sign the Norwalk Agreement with the FASB in 2002 as the two organizations agreed to move towards convergence in international accounting standards ("Memorandum of Understanding: Norwalk Agreement"). Lastly, this also provided the IASB with a foothold in U.S. financial reporting. The prevalence of IFRS, as it was now required for all international European firms, and pressure from European officials and corporations was able to pressure the SEC into allowing foreign companies to be listed on U.S. equity exchanges using IFRS rather than requiring restatement to US GAAP.

Although the EU's adoption of IFRS set the stage for the IASB to assume a central role in the ongoing debate over international convergence of accounting standards, it ceded a significant portion of its authority to the EU at the same time. While it is true that the IASB would not be what it is today without the EU, this organization's influence on the Board is undeniable. By granting the ARC the authority to reject certain IFRS passed by the IASB, the

EU allowed itself the possibility to create certain "carve-outs" of IFRS in its commercial code. This threat of a "carve-out" is the only true power that the EU has towards the IASB and according to a 2009 French report, it should be used anytime European interests are threatened (Walton). The case analyses later in this chapter examine the EU's willingness to exercise this power and discuss the implications of this behavior on the existing and future relations between the IASB and the EU.

United States

Unwilling to idly sit by and allow European domination over the restructuring of the IASC, the SEC was heavily involved in the reorganization effort in the 1990s. By 1994, the SEC was already investing resources in reviewing the IASC's effort to improve its standards and released a statement in 1996 detailing the criteria needed in order for the SEC to consider IAS usage in the U.S. (Posner 644). Recognizing the potential importance of this organization with the increased globalization of markets, the SEC's main priority was to establish an issuance process and organizational structure for the IASB that resembled the FASB (Posner 644). As such, the SEC was insistent on ensuring that "technical expertise" be the sole criterion for board membership and pushed hard for a seven-member board (Zeff, "IFRS" 280). This proposal met stiff resistance from their European counterparts as they pushed for a 21-member board and regional representation, believing that countries showing commitment to the IASB should make the corresponding board decisions (Zeff, "IFRS" 280). Despite the fact that the U.S. did not follow IAS, the SEC won the battle concerning board member qualification as the new constitution stated, "the foremost qualification for [IASB] membership shall be technical expertise" (Zeff, "IFRS" 280). Additionally, even though the SEC did not entirely get its way in terms of the seven-member board it sought, it did manage to negotiate a compromise as the IASB member size was set at 14.

An additional illustration of the influence that the SEC and United States has had on the IASB can be seen in its representation on the Board and among the Trustees. For example, four of the original IASB members and five of the original Trustees were from the United States despite the fact that the nation did not even utilize IFRS. Furthermore, SEC Chairman Arthur Levitt was appointed as the head of the Nomination Committee for the selection of the initial Trustees following restructuring and former Federal Reserve Chairman Paul Volcker was chosen as the initial head of the Trustees. Moreover, despite the fact that the IASB and FASB are currently working towards convergence, it is the FASB that has been able to dictate the terms and pace of these proceedings based on the overall and generally accepted belief that it possesses the more independent and reliable funding stream and has managed to maintain greater separation from political and industry pressures. A statement made by FASB Chairman Herz in 2009, “If the U.S. is going to ride the IFRS horse, we have to make sure the IASB horse is stable” illustrates this perception. (Leone, “The Next Accounting Controversy”).

Further discussion concerning the IASB’s independence will be conducted by evaluation of the IASB’s actions and reactions to the following controversial topics and events: IAS 39, fair value accounting changes during the economic crisis, and alterations in the IFRS Foundation’s organizational structure after its initial formation.

IAS 39

Before corporations within the EU were required to report under IFRS, this organization's influence on the IASB's decision making was already readily apparent. As mentioned earlier, the IAS Regulation requires the review by the Accounting Regulatory Committee (ARC) of all standards issued by the IASB before they can be written into authoritative EU law. When IFRS was to first become implemented within the EU, the ARC was tasked with evaluating all existing IAS. The regulation stipulated that all decisions on existing IAS should be made by December 31, 2002, by which time the EFRAG had recommended adoption in full (Brackney and Witmer). Citing complications translating the standards into all eleven organizational languages, the ARC and the EU missed the deadline (Brackney and Witmer). However, also causing this delay was an exposure draft issued by the IASB in June outlining proposed changes to *IAS 39, Financial Instruments: Measurement and Recognition*. Since the precise application requirements and details of this draft are not particularly important for the purposes of this study, the understanding that this alteration revolved around the establishment of special accounting treatment for portfolio hedges of interest-rate risk, or macro hedges, is sufficient (Brackney and Witmer).

In line with the intentions of the IASB's due process for standard issuance, the EFRAG issued a comment letter voicing its concerns about these changes to the IASB (Brackney and Witmer). However, showing its ability and willingness to exercise its newly acquired power, European leaders, particularly those of Belgium, France, Italy, Portugal, and Spain, reacted in a more straightforward and demonstrative manner. French President Jacques Chirac called for an immediate meeting of the Economic and Financial Affairs Council (ECOFIN) to discuss how the IASB could be persuaded to drop not only the hedging requirements in IAS 39, but all fair value reporting requirements. One day later, the ARC voted to adopt all IAS except IAS 39 and IAS 29, another standard the European leaders took issue with (Brackney and Witmer).

Wanting to ensure that this macro-hedging concern was solved in time for official EU adoption in 2005, the IASB amended the standard with the help of the EU and issued an amended exposure draft in 2003 (Brackney and Witmer). However, the EU was still not satisfied with this revised standard and revisited the issue in 2004. A straw poll of the ARC in June of 2004 resulted in four nations opposing the adoption of the revised standard and six other abstaining (Brackney and Witmer). Although a majority was not reached and thus the standard was not outright rejected, it was apparent that major concerns still existed. The EC asked the EFRAG to investigate the potential effectiveness of a "carve-out," where the EU would adopt IAS 39 without the controversial aspects. After positive feedback from the EFRAG over the operating effectiveness of this decision, IAS 39 with the "carve-out" was adopted in 2004. At the behest of the European Central Bank (ECB), the IASB issued an amendment to IAS 39 that was adopted by the ARC in 2005, preventing banks from using fair value to write down their own liabilities due to declining credit worthiness, but the rest of the "carve-out" remained and still does (Brackney and Witmer).

From the actions, reactions, and behaviors of the IASB in this instance, we can learn a great deal about the independence of this standards-setter. First of all, by altering their originally proposed standard to meet the desires of European lawmakers, the IASB set the precedent that they are willing to alter their decisions in order to appease their largest market and increase their international importance. The fact that the IASB chose to alter its originally issued exposure draft would certainly not be a cause for concern if this was due to negative feedback received by the majority of stakeholders through the proper channels. Such responses from organizations such as the EFRAG are why the due process utilized by the IASB incorporates public exposure. However, by choosing to alter their initial decision concerning macro hedges since the EU decided to remove these regulations from its commercial law, the IASB proved that it is willing to submit to this multi-national body rather than face talks about its decreased relevance.

Also important from this case is the statement by the EU that they are both capable and willing to exercise their two-tiered acceptance mechanism to ensure that adopted standards match European desires. By forcing the IASB to initially alter IAS 39 and then again re-examine and reject this altered standard, the EU proved that it will not be satisfied with anything short of one hundred percent adherence to their desires. Both the EU and IASB firmly established a precedent for future relations between the two organizations with the manner in which they handled this situation. Therefore it is clear that in the future, “IFRS-using countries in the rest of the world...must stand silently on the sideline while the EU proceeds through its lengthy and tortuous endorsement process, which provides the EU member states as well as private sector interest groups with opportunities to intervene” (Zeff, “IFRS” 280).

Economic Crisis

During the fall of 2008, the intense global turmoil caused by the ongoing economic crisis had numerous prominent banks and financial institutions facing massive losses and on the verge of collapse. Due to fair market regulations that required banks and financial institutions to mark-to-market assets whose values were plummeting and unsellable, these organizations were facing billions of dollars in losses. Under U.S. accounting regulations, U.S. corporations were permitted to reclassify assets that they were actively attempting to sell as long-term “loans” in rare circumstances (Kessler). Since this treatment was not permitted under IFRS, European leaders vocally alleged that European companies were at a disadvantage and demanded accounting reform by the IASB. Invoking the provisions of the IAS Regulation, European officials threatened to take legal action to change the European commercial code to combat this issue, as French President Nicolas Sarkozy stated, “we will ensure that European financial institutions are not disadvantaged vis-à-vis their international competitors in terms of accounting rules and of their interpretation” (Bischof, Brüggemann, and Daske). Commissioner Charlie McCreevy of the European Commission, who was in charge of the EU internal market, stated that the EU intended to exploit a “loophole in the system – that all accounting rules must be adopted as legislation in the EU” and remove the existing legislation in place (Kessler). He later announced in a speech to the European Parliament that the European Commission had prepared the legislation to carve the relevant section of IAS 39 and was ready to adopt an EU version of IAS 39 (Bischof, Brüggemann, and Daske).

In July of 2008, IASB President David Tweedie said in reference to the IASB’s fair value accounting regulations, “We are certainly not thinking of any emergency measures to change what we do at present,” and in September of the same year board member Philippe Danjou stated, “There is no support within the banking community to change the [fair value] rules” (Bischof, Brüggemann, and Daske). Originally planning to issue an entirely new version of IAS 39 in the fall of 2009, this timetable was noticeably sped up by the EU actions during the fall of 2008 (Bischof, Brüggemann, and Daske). A review of a standard of this magnitude would normally take months to achieve, involving a full due process according to the IFRS Foundation’s bylaws; however, Tweedie was told that he had four days to make the desired amendments before the EU passed their revised version of IAS 39 (Kessler).

Interpreting the EU's actions as what he called "a blunt threat to blow the organization away," Tweedie and the IASB decided to rework the standard within this timetable (Bischof, Brüggemann, and Daske). But, before this could happen, the IFRS Trustees needed to intervene to allow for the IASB to formally issue standards on such a short notice and bypass the organization's usual due process. One day after McCreevy's address to the European Parliament, the Trustees publicly stated that the IASB was permitted to suspend normal due process to avoid lengthy deliberations and public comments before adopting fair value reclassifications (Bischof, Brüggemann, and Daske). 11 of 13 IASB members voted in favor of this revision the following day, stressing that it was "consistent with the request made by European leaders and finance ministers" (Bischof, Brüggemann, and Daske). According to Moody's, the IASB's new standards allow banks to "cherry pick" assets and "distort economic reality," a technique used by Deutsche Bank to shift $32 billion in assets.

Despite the widely accepted notion that the original IAS 39 was flawed, the IASB's actions in this case again revealed some serious issues impairing its independence. As a Moody's vice president, J.F. Tremblay, stated, "The measure does not make much sense in the first place. But the fact that a board can be influenced like that is not good news" (Kessler). In this case, not only did the IASB prove willing to continue to submit to the will of EU politicians, but it also showed that it is willing to do almost anything to remain the accepted standards-setter of the EU by entirely bypassing their due process when issuing their alteration to IAS 39. The IASB's statement that this standard is consistent with requests from European officials that accompanied their issuance completely contradicts the political separation that is desired in an independent accounting standards board.

With over 100 nations choosing to adopt IFRS since the creation of the reformed IASB in 2001, the Board's willingness to allow European interests greatly detracts from its newly acquired credibility. IASB Chairman Tweedie acknowledged this by stating in 2008 that the Board requires further protection from political interests in order to become the global gold standard (Kessler). It is not hard to imagine that the further use and threat of the carve-out by the EU will kill the global experiment (French Want More IASB Influence). It is important to note that the only two members to vote against this change were James Leisenring, the American liaison to the FASB, and John Smith, another American. These individuals are quite aware of the IASB's need for independence if there is hope of future global convergence. As former FASB Chairman Robert Denham stated in the wake of the IASB's change to IAS 39, "Right now, there is no credibility. If we are going to have global accounting standards, my view is that is not going to work if the IASB is going to be jerked around by the European Commission" (Kessler).

Organizational Changes 2001-Present

As previously discussed, the IASC decided to undergo an entire organizational restructuring in the 1990s, culminating in the formation of the IFRS Foundation and the newly restructured IASB in 2001. After such reorganization, Europe controlled five of the initial fourteen spots on the IASB. However, this large representation was not satisfactory to the EU as they were confused as to why countries who had not committed to adoption of IFRS, such as the U.S., had representation on the Board (Bruce). Although the EU lost out on its arguments for implementing a 21-member IASB and establishing geographical representation as the principal criterion for Board selection, European officials did not stop pressuring the IFRS Trustees for organizational changes into the new millennium. In 2005, the Trustees decided to alter the language in its constitution that describes IASB member selection criterion from the "foremost qualification" being "technical expertise" to the "main qualifications" being "professional competence and practical experience" (Zeff, "IFRS" 280). Also added in 2005 was the phrase that members should represent the "best available combination of technical expertise and diversity of international business and market experience" (Zeff, "IFRS" 280). This was the first appearance of geographic diversity in the IASB's Constitution and not coincidentally occurred shortly after the EU officially adopted IFRS. There was no question after this alteration that technical expertise was demoted as the criterion for selection (Zeff, "IFRS" 280).

In February 2008, the European Committee on Economic and Monetary Affairs declared that the EU should move from a reactive to proactive attitude towards the IASB and also declared that more members from the EU should be on the international standards-setting body (Zeff, "IFRS" 280). Not surprisingly, the IFRS Foundation once again adjusted its organizational structure with the creation of the Monitoring Board. As discussed in Chapter 1, the members of the Monitoring Board were the "responsible member of the European Commission," the chair of the IOSCO Emerging Markets Committee, the chair of the IOSCO Technical Committee, the commissioner of the Japan Financial Services Agency, and the chair of the SEC ("Constitution"). The IASB's relative autonomy (and that of its predecessor, the IASC) has been declining since the 1990s. The addition of the Monitoring Board is merely the "latest and most visible manifestation of this trend" (Posner 648). Although the mandate of the Monitoring Board is to safeguard the bylaws without "impairing the independence of the standards-setting process," this seems a contradictory and impossible task as the increased injection of governmental influence on the IFRS Foundation seems to only result in decreased independence (Leone, "SEC").

The Monitoring Board did not only increase European influence, but that of the United States as well. Despite the fact that the United States still did not agree to adopt IFRS, it was still afforded significant representation on this newly created oversight committee. Possessing the largest economy, securities exchange, and most respected accounting regulations, the U.S. has an undeniably large influence on the International Organization of Securities Commissions (IOSCO). As such, the inclusion of the SEC and the Technical and Emerging Markets Committees of the IOSCO as members gave this country a large amount of influence on the Monitoring Board. The Monitoring Board is charged with overseeing the Trustees and has the responsibility to approve the appointment of Trustees, who in turn select IASB members.

The latest significant organizational changes for the IASB were the expansion to 16 members and the establishment of recommended specific global representation in 2009. The current IFRS Foundation's Constitution suggests the following IASB member distribution: four from Asia/Oceania, four from Europe, four from North America, one from Africa, and one from South America ("Constitution"). Although this was in line with European requests for the incorporation of geographic criteria into the IASB member selection process, if these guidelines are followed then the overall European presence on the IASB would decrease as there were six and five members from Europe as of the year-ends of 2008 and 2009, respectively. By instituting geographic requirements for IASB composition, the board runs the risk of containing lesser qualified individuals and moving further away from the SEC's wish that "technical expertise" be the main criterion for IASB appointment. Although de-emphasizing the importance of European control is an indication of resistance of towards the EU's attempts to dominate the Board, it is unlikely to have a large impact due to the continued existence of the EU's IAS Regulation and continued presence among the Trustees and Monitoring Board. The current IASB contains five members from Europe, with both the chairman and vice-chairman hailing from this region.

CHAPTER 3

Independence Analysis - FAF

Governmental Influence

In contrast to the IASB's lack of legal authority and right to issue authoritative accounting standards, regulations issued by the FASB carry the full weight of the law within the U.S. As discussed earlier, the SEC is the organization in the United States charged with accounting standard regulation. However, as reinforced most recently though the Sarbanes-Oxley Act of 2002 with its requirement for the SEC to establish a private standards-setting body, this authority has been delegated to the FASB. The delegation of power to this private organization has enabled the SEC to maintain significant influence over the FASB. Throughout the history of this relationship, the SEC has "applied substantial pressure on the FASB in the standard setting process and has not adopted a position of benign neglect" (Palmon, Peytcheva, and Yezegel 165).

The actual delegation of power and relationship between the FASB and SEC is critical to understanding the influence that the SEC has on the FASB in setting its agenda and making decisions. In contrast to the EU, whose motivation to accept IFRS seems to be primarily motivated by their inability to organize and create an effective and efficient European accounting standard-setting body, the SEC's reasoning for delegating authority to the FASB seems to be quite different. Federal agencies that are directly responsible for regulation have historically been heavily criticized for succumbing to the special interests of the companies that they are regulating (Palmon, Peytcheva, and Yezegel 167). By delegating this responsibility to the FASB, the SEC is able to deflect such criticism to this private organization and avoid allegations that it caters to special interest groups or industries. (Palmon, Peytcheva, and Yezegel 167).

Although the SEC has delegated this responsibility to the FASB, allowing this organization to receive the brunt of the criticism for unfavorable rulings, it still maintains an effective veto power over all FASB pronouncements. Since authoritative power over accounting regulation still remains with the SEC, it has the right and ability to overrule the FASB if it chooses. Other researchers have argued that their power over the FASB and involvement in the decision making of the Board are much stronger than that (Palmon, Peytcheva, and Yezegel 167). Behavioral studies examining the behavior of both parties when an entity with decision-making power delegates this authority to a third party also indicate certain actions that would be beneficial to the SEC. A 1989 article by Calvert, McCubbins, and Weingast in the *American Journal of Political Science* shows that although the agents to whom decision-making power is delegated are the active policymakers, policy choices are reflective of those who originally delegated the power, not those making the decisions (Palmon, Peytcheva, and Yezegel 168).

The IASB is considered to be largely influenced by the EU due to its ability to carve-out or ignore provisions in the IFRS as passed by the IASB that it does not agree with. However, the EU is limited to only those abilities prescribed within the IAS Regulation (Camfferman and Zeff 302). Congress faces no such restrictions as it has the ability to pass any law or provision it pleases in relation to accounting regulation as the SEC is ultimately under its control. If the EU were to act on its threat of entirely carving out IFRS from its commercial code, it lacks the ability to set up an effective standard-setting body as this was one of the main reasons for the initial adoption of IFRS. Congress, on the other hand, has the ability to simply set this function under the control of the SEC and maintain full authority over these standards. Thus, while the

EU is limited by the practicality of their ability to completely carve-out IFRS, Congress has the full ability to make such a change. While it does not possess the power to instruct the FASB, a private standard setter, to issue or not issue certain regulations, it does have the power to instruct the SEC to either require or not require a certain accounting treatment for listed companies (Camfferman and Zeff 302).

As will be discussed at length later in this section, this is precisely what Congress threatened to do regarding FASB's treatment of stock options in FAS 123 with the proposed Stock Option Accounting Reform Act. Congress' disagreement with the FASB's treatment of stock options led them to propose a bill in the House of Representatives that would instruct the SEC to require listed companies to follow a different treatment for stock options than the one dictated by the FASB. The Big Four public accounting firms strongly opposed this standard, citing the large independence concern that would be created by overriding the existing FASB standard (Cheney 1). Although this bill never came to fruition, the threat of government intervention forced the FASB to alter its position. After the FASB changed its position, then-Chairman Beresford expressed his exasperation, "No matter how hard we tried to convince people of the correctness of our stand, there simply was not enough support" (McEnroe and Martens 129).

In the wake of the recent financial crisis, Congress again tried to take action against the authority granted to the FASB to issue pronouncements used by listed domestic companies. However, in this instance the politicians wishing to influence domestic accounting standards did not directly attack certain provisions or policies enacted by the FASB, but wished to create an entirely new accounting standard structure in the U.S. As such, in 2009, the House of Representatives introduced the Federal Accounting Oversight Board Act of 2009, a bill that would end the SEC's statutory authority over accounting standards (Barlas, "House" 22). If passed, this bill would have created a new Federal Accounting Oversight Board, which would have been responsible for setting U.S. accounting standards (Barlas, "House" 22). In effect, Congress was trying to replace the FASB with this new government-operated organization and thus directly provide governmental control over accounting regulation. Although this bill failed to pass, it is illustrative of the overall control concerning accounting regulation that the government desires.

The Sarbanes-Oxley Act of 2002 also significantly altered the governmental influence on the FASB. As discussed in Chapter 1, this act requires all companies registered with the SEC to pay annual accounting support fees that go to fund the operations of the Financial Accounting Foundation (FAF). This created a stable and reliable funding stream that on the surface greatly enhanced the independence of the FASB. However, an additional part of the Sarbanes-Oxley Act of 2002 was the provision that granted the SEC the right to approve or disapprove the FASB's budget (Palmon, Peytcheva, and Yezegel 181). Thus, while the institution of a reliable funding stream for the FASB seemed to greatly enhance the independence of this organization, it was simply a tradeoff for allowing the SEC final authority over its spending. Not satisfied with control over the FASB's budget, the SEC used this provision to increase its influence on this private standards board in 2007 as it refused to sign off on the FASB's budget unless the FAF agreed to allow the SEC to nominate, interview, and review potential Board members and FAF trustees (Rappeport and Leone). According to then-SEC spokesman Jeff Nester, "The Sarbanes-Oxley Act requires us to certify the standards-setter's capacity and capability to do their job" (Rappeport and Leone). Such increased government participation in the selection of members of a supposed private body certainly appears to impair the independence of this organization.

Former FASB Chairman Edmund Jenkins echoed this notion, calling it a "step in the wrong direction" (Palmon, Peytcheva, and Yezegel 181).

As illustrated through each of these attempts, both successful and unsuccessful, by the government to gain increased influence over the FASB, it is evident that the intention of U.S. politicians and the SEC is to dictate the actions of the FASB. The following case analyses will further examine the government's influence over this body, as well as that of other stakeholders.

Stock Options

Stock options have been one of the most debated and controversial topics for the last forty years. When initially created in the 1970's, the APB ruled in Opinion No. 25, *Accounting for Stock Issued to Employees*, that stock options given to employees as compensation would not be recognized as a compensation expense (Levine). Instead, the intrinsic value method, where compensation expense equaled the excess of the stock price at the measurement date over the option exercise price, was to be utilized (Apostolou and Crumbley). The main reason for this treatment was that no reliable method existed to value these compensation instruments at the time (Levine). Ironically, the Black-Scholes formula would be published during the following year (Levine).

When the FASB was created, they decided to adopt the treatment of stock options as determined by the APB. As such, the provisions created in Opinion No. 25 were the authoritative treatment of stock options for over two decades. However, increased popularity of stock options in the 1980s and early 1990s forced the FASB to revisit this issue. According to a 1993 study conducted by Merril Lynch, expensing stock options for high-tech companies would have lowered profits by 60 percent, on average ("Congress and the Accounting Wars"). In June of

1993, the FASB attempted to create a treatment for these compensation mechanisms that would represent their true economic reality with FAS 123 (Apostolou and Crumbley). When the FASB released its exposure draft concerning this standard, their intention was the creation of a standard that would supersede Opinion No. 25 (Cocco and Vent). Intense government pressure, however, would alter these plans.

The proposed SFAS 123 stated that total compensation expense was to be based on the "fair value of the options expected to vest on the grant date" (Apostolou and Crumbley). But, intense pressure from both regulators and corporate executives, the most vocal coming from the high-tech sector, caused the FASB to alter their proposed treatment. Since high-tech startup firms did not have a great deal of earnings and wealth for which to pay their employees, they heavily utilized stock options in order to attract the best talent. As such, these corporations believed that this proposed standard was unfairly targeted towards them and infringed on their ability to compete with larger, wealthier firms in attracting talented employees. Additionally, these firms felt that the excess expense cause by this treatment would adversely affect their stock prices and that they would be put at a disadvantage as larger corporations would be better able to absorb these large compensation expenses (Apostolou and Crumbley).

Regulators, led by Senator Joseph Lieberman, sided with the corporations as they introduced a bill that would mandate the SEC to require that no compensation expense relating to stock options be reported on the income statement (Apostolou and Crumbley). After this non-binding resolution passed with a vote of 88-9, this bill threatened to significantly impair the FASB's independence in a manner similar to when the EU carved out specific provisions of IAS 39 ("Congress and the Accounting Wars"). As James Leisenring, vice chairman of the FASB from 1988 to 2000, stated:

> "It wasn't an accounting debate. We switched from talking about, 'Have we accurately measured the option?' or, 'Have we expensed the option on the proper date?' to things like, 'Western civilization will not exist without stock options,' or, 'There won't be jobs anymore for people without stock options.' ... People tried to take the argument away from the accounting to be just plainly a political argument" ("Congress and the Accounting Wars").

James Hooton, Arthur Andersen's chief of worldwide accounting at the time, continued:

> "It was the first time that accounting principles had become very, very much influenced by commercial interest and political interest. If you move accounting and accounting standards into the political environment, then you've lost control over whether those standards are the best standards" (Congress and the Accounting Wars").

Such political and corporate pressure caused the FASB to alter their initial position and issue a revised final version of its proposed standard. In October of 1995, the FASB released *FAS 123, Accounting for Stock-Based Compensation*, under which the FASB "encourages" all firms to use fair value accounting for employee stock option accounting, but still permitted the use of the intrinsic value method (Levine). The one definitive change is that if a firm chooses to use the intrinsic value method, then they must disclose in their footnotes what the compensation cost would have been using the fair value method on a pro-forma basis (Levine). Not surprisingly, most firms chose to continue their use of the intrinsic value method.

Following accounting scandals in the early 2000s featuring firms such as Enron and Tyco, increased pressure to revise existing financial accounting regulation caused the FASB to revisit the issue of stock option accounting. In December of 2004, the FASB issued SFAS 123(R), a revision to their previously issued FAS 123 that would require all public and non-public companies with calendar fiscal year-ends to report stock-based compensation beginning in 2006 (Apostolou and Crumbley). This proposed standard does not specify what model should be used to imply the fair value method, but the same six inputs that are used in the Black-Sholes formula are given as the six components that must be taken into account by the FASB (Apostolou and Crumbley). However, this standard fell under heavy criticism once again.

The FASB stated four primary reasons for the issuance of this standard: addressing the concerns of users and others, improving comparability of reported financial information, simplifying US GAAP by establishing a single treatment of stock options, and international convergence (Apostolou and Crumbley). In a paper examining the corporate response to the FASB's new stock option expensing policy, Aaron Alsheimer noted the FASB's desire to ensure financial statements more accurately reflected economic reality as an additional rationale (47). Proponents to this legislation included such prominent figures as Alan Greenspan, Warren Buffet, and the Big Four public accounting firms. In the 1998 annual report for Buffet's Berkshire Hathaway, he labeled the present stock option accounting regulation as "outrageous" and an "egregious flaw in accounting" (Apostolou and Crumbley). He further stated that he was often forced to adjust EPS figures by five to ten percent when making his portfolio decisions based on this treatment (Apostolou and Crumbley). In a study on stock option accounting, Nicholas G. Apostolou and D. Larry Crumbley found similar results as they tested the 2003 annual reports of 20 companies and found that the difference in earning "substantially exceeds 10%," with Yahoo and Adobe having differences of 86% and 70%, respectively (Apostolou and Crumbley). In a letter addressed to Representative Baker, the chairman of the

House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, the Big Four public accounting firms stated their belief that the fair value of stock options should be treated as compensation expense and they noted their strong belief in the importance of an independent FASB for effective capital markets to exist ("Expensing Stock Options: Can FASB Prevail?").

Critics to the FASB's proposal listed the following main concerns with this standard: the negative impact on recently started business, the negative impact on the economy caused by its discouragement of U.S. job creation, the failure to achieve the results desired by stock option expensing supporters, and the encouragement of class action lawsuits against U.S. companies (Alsheimer 48). Representative Baker stated that he was "significantly disappointed" in the FASB's decision and stated that he planned to launch a congressional investigation into this accounting treatment ("Expensing Stock Options: Can FASB Prevail?"). This came to fruition with the Broad-Based Stock Option Plan Transparency Act introduced by Representative Eshoo in February of 2005. If passed, this legislation would have prohibited regulators from recognizing accounting standards that require the expensing of employee stock options (Schneider). This bill threatened to once again impair the FASB's independence as it would represent a direct intervention by the government in setting accounting standards, a duty supposedly delegated to a "private" standards body.

Although the majority of legislators were in agreement in their opposition against the proposed FASB standard, not all were strongly against this change. Richard Shelby, chairman of the Senate Banking Committee, prevented the bill from reaching the Senate floor and made it clear that he would do whatever he could to prevent the current congressional session from intervening in the FASB's decision making (Waters). SEC Chairman Donaldson also provided his full support for the fair value treatment of the employee stock options (Waters). As such, the SEC has rejected all other alternatives that run counter to the FASB proposal (Alsheimer 60).

Despite FASB member Ed Trott saying, "We continue to get a clear message…that this information is needed as soon as possible," FASB decided to push back the originally planned vote date six months (Waters). Companies, auditors, and the SEC all argued that more time was needed before this standard was passed due to the present complications posed by the recently passed Sarbanes-Oxley Act (Waters). This delay allowed politicians and all stakeholders the ability to lobby the FASB in opposition to their proposed treatment of stock options; however, such attempts were unsuccessful. The final passed version of FAS 123(R) did not give into political and corporate pressure to eliminate the fair value treatment of options, instead forcing all public and non-public companies to expense equity compensation to employees at the fair value expected on the grant date (Levine).

Leases

When initially faced with determining the treatment of capital leases, the FASB was challenged with a deciding how each lease should be viewed. On one hand, equal treatment could be required for all capital leases, regardless of their conditions. Conversely, leases could be viewed on a case by case basis, with the specific conditions of each agreement determining their final accounting treatment. Recognizing that not all lease agreements are the same in both their purpose and their specific requirements, the FASB opted for the second choice. The decision then became not how to treat all leases, but how should the distinction be made between different leases and how many possible treatments would be available to corporations. The FASB's decision became evident in 1973 with the issuance of SFAS 13 and the creation of the now widely known and understood operating and capital lease classes.

The FASB decided that four criteria would be used to determine the difference between these two classes. If any of the following conditions were present, the lease would be classified as a capital lease, with the asset and a related obligation going on the balance sheet: the present value of the minimum lease payments is equal to 90 percent of the fair value of the asset, a bargain purchase option exists, the leased asset reverts to the lessee at the end of the lease, or the lease term is greater than 75% of the estimated useful economic life of the asset. However, by requiring treatment based on concrete conditions, leases deliberately constructed to avoid ending up on corporate balance sheets were the logical next step. Thus, leases which differed very little in economic substance were receiving very different treatment on corporate financial statements. As Miller and Bahnson wrote in a July 2011 article in *Accounting Today*, with SFAS 13 the FASB also created two different lease classes, "those with legitimate purposes; and those designed to produce misleading financial statements" (24).

This treatment of leases has not only been the subject of criticism since its inception, but SFAS 13 has also been largely considered the "poster child for rules-based accounting" due to its detailed list of criteria for determining treatment (Agoglia, Doupnik, and Tsakumis 750). As such, it serves as a good illustration of the ability to manipulate accounting treatments by altering the conditions of a transaction only slightly. Although the FASB issued several small updates on lease accounting over the past 30 years, SFAS 13's establishment of two separate lease classes continued to be the authoritative treatment on leases until the FASB, as well as the IASB, seriously revisited the issue in 2010.

In 2010, the FASB and IASB announced that later in the year they would release exposure drafts on lease accounting. As part of these updates, the two boards agreed to pursue a "right-to-use" concept model for which all lease transactions would be evident on the balance sheet and operating leases would be eliminated (Whitehouse). Additionally, the lease term was to change from the fixed, non-cancellable period which is "reasonably assured" to the longest period of time which is "more likely than not" to occur and the rental payments would include contingent payments that are "expected" to occur ("FASB Eyes Possible 'Big Bang' Implementation of New Standards"). Although these proposed changes would largely lessen the extent to which the FASB's lease treatment was based on a formulaic, rules-based methodology, it would also introduce a large amount of subjectivity. With the "more likely than not" provision large questions arose as to who will assess this likelihood and what will be used as evidence for this determination? This will undoubtedly create a difficult situation for both auditors and financial statement users in evaluation of the actual economic substance of the transaction.

In May of 2011, the volume of operating leases in the U.S. was estimated at over $1 trillion (Mattson-Teig 62). Also during the summer of 2011, in response to a survey of companies conducted by Deloitte regarding proposed lease changes, 45% said that it would affect existing debt covenants, 40% said they would have trouble acquiring additional financing, and 30% said that they would be more likely to purchase rather than lease ("New Lease Accounting Standards Present Challenges, Opportunity" 100). Accordingly, after the release of their proposed changes, the FASB's main opposition was not the federal government and politicians, but the countless corporations which would be largely affected by these alterations. After receiving nearly 800 public comment letters, the FASB responded to these pressures by drastically changing their initial proposal.

First, the FASB pushed back the tentative effective date of these changes to January 1, 2015, two years later than originally planned (Mattson-Teig 63). Next, the FASB decided to recognize that once again all leases are not the same and decided to create two classes of leases once again, "financing" and "other-than-financing" leases. Financing leases would be treated like an installment sale with an asset and a related liability that would be paid off over time on the balance sheet (Whitehouse). "Other-than-finance" leases would be put on the balance sheet but their impact on the income statement would be nearly identical to modern operating leases (Whitehouse). Another change was the FASB's decision to allow all leases with terms lasting under 12 months to remain off of the balance sheet (Miller and Bahnson 24). Additionally, the FASB decided to eliminate the proposed use of renewal options being included in the calculation of the net rental obligation (Mattson-Teig 63). This decision eliminated the "more likely than not" provision and stated that the renewal option would only be included if there was an economic incentive to extend the lease (Whitehouse).

While the purpose of due process is to allow all stakeholders to have a say in the ultimate standard-issuing process, these changes show the susceptibility of the FASB to corporate influence. While the introduction of new leasing treatments would be a large change to corporations throughout the U.S., if given a reasonable timetable for implantation, such change is feasible. Even though the FASB should take into account the input provided by corporations and other stakeholders, the purpose of this organization is to produce reliable accounting standards that accurately reflect the economic substance of business transactions in corporate financial statements, not to cave to the whims and desires of Corporate America. The decision to allow leases that are less than 12 months in duration to remain off of the balance sheet clearly illustrates the FASB succumbing to corporate pressure as it would still allow companies to largely avoid such obligations on their balance sheet. For example, a company could create a large portfolio of 12-month leases, creating billions of dollars of debt, without ever reflecting this borrowing on the balance sheet (Miller and Bahnson 24). The two newly created “financing” and “other-than-financing” lease classes also closely mirror the pre-existing capital and operating leases. Financing leases would be almost identical to the current capital leases and the only difference between the current operating leases and “other-than-financing” leases would be the placement of the later on the balance sheet, something that could easily be avoided as previously discussed. Lastly, the requirement to include a renewal option if there was an economic incentive closely parallels the original requirement of the period “reasonably assured” as corporations would be reasonably assured to make use of this option if it provided an economic incentive.

Economic Crisis

In September of 2006, the FASB issued *FAS 157, Fair Value Measurements*, establishing a single definition for fair value (Jaggi, Winder, and Lee 473). This standard defines fair value as the “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date,” and states that “exit” prices were to be used instead of “entry” prices for valuation purposes (Jaggi, Winder, and Lee 473). Furthermore, FAS 157 stipulates that asset value should be mark-to-market, and not representative of some theoretical value or model of predicted cash flows (Jaggi, Winder, and Lee 474). One additional important component of this standard is the requirement that the fair value of liabilities take into account the risk of not meeting that obligation, including a company's credit risk. An interesting consequence of this provision is the write-down in a liability, effectively a gain, for a borrower when its credit worthiness declines (Jaggi, Winder, and Lee 474). However, by the start of the economic crisis in 2008, the FASB was forced to readdress fair value issues after intense government and corporate pressure.

By 2008, only 27% of the total assets of the S&P 500 companies that had adopted FAS 157 were reported at fair value; those operating in the financial sector had a higher amount at 39% (Casabona and Shoaf 21). However, despite these moderate percentages, FAS 157 is largely blamed for at least contributing to, and in many cases causing, the financial crisis in the fall of 2008. In an attempt to halt the ongoing economic collapse, on October 3, 2008 Congress enacted the Emergency Economic Stabilization Act (EESA) of 2008, commonly referred to as the bailout of the U.S. financial system. In addition to the widely publicized authorization provided to the Secretary of the Treasury to purchase distressed assets and inject capital into banks up to the amount of $700 billion, this act also took direct aim at the FASB as it required the SEC to conduct a study of mark-to-market accounting and granted them the authority to suspend FAS 157 (Casabona and Shoaf 22). Required in this study was the examination of the impact of accounting regulation on bank failures, the process used by the FASB in developing accounting standards, and possible modifications and alternatives to existing standards (Casabona and Shoaf 22).

Although the SEC technically had this authority in the first place, since it is granted the power to set accounting regulation for U.S. securities exchanges, Congress' decision to outwardly express such concern for the FASB's ruling shows a direct attempt by the government to intervene with accounting regulation. In addition to this bailout provision, SEC Chairman Cox also received a letter from 65 members of Congress asking that "mark-to-market" be replaced with "mark-to-value" (Barlas, "SEC Guidance" 24). It is also important to note that Federal Reserve Chairman Ben Bernanke also displayed concern for the effects of FAS 157 by stating that "we will review regulatory policies and accounting rules to ensure that they do not induce excessive [swings in the financial system and economy]" (Jaggi, Winder, and Lee 478). On October 10, 2008, the FASB issued additional guidance on FAS 157, called FAS 157-3, that provided additional detail on how to apply fair value accounting in distressed markets. This standard was largely referred to as a softening of the existing language and provided increased flexibility to financial managers. One such component of this ruling was the indication to banks that they don't have to use market prices in distressed markets (Whittall 83).

In December of 2008, the SEC completed their study and reaffirmed their commitment to the importance of mark-to-market accounting. However, the SEC did state that the FASB must revisit FAS 157, should develop a model through which credit losses would be illustrated in other comprehensive income, and should provide guidance regarding determining fair values in illiquid or inactive market conditions (Jaggi, Winder, and Lee 478). In March of 2009, a bill was introduced in the House of Representatives that would strip the SEC of its accounting regulation powers and create a Federal Accounting Oversight Board (FAOB), consisting of the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the SEC, the chairman of the FDIC, and the Chairman of the PCAOB. As part of this bill, if any of these agencies determine that an accounting rule has an adverse effect on the health of the U.S. economy then the FAOB would review such a standard and determine whether it should continue to be applied or be removed on a temporary or permanent basis (Casabona and Shoaf 23). Thankfully, this law never gained traction. In April of 2009, the FASB released staff positions FAS 115-2 and FAS 124-2, which were both aimed at providing additional guidance regarding the treatment of other-than-temporary impairment losses on debt and equity securities. However, FAS 157-4 brought forth a multitude of issues and was easily the most controversial of these updates.

FAS 157-4 addresses three key and controversial topics. First, it notes that even though many factors should be considered in determining if the market for a certain asset is inactive, when there is a significant decrease in the trading volume of orderly transactions for a specific asset these transactions can be treated as “not ordinary transactions” (Jaggi, Winder, and Lee 479). In these cases, without comparable transactions or quoted prices, alternative valuation methods, such as projected cash flow models, are permitted for fair value purposes (Jaggi, Winder, and Lee 479). This allowance grants corporations the power to not only determine that their assets are trading in an illiquid market without strong evidence, but also to develop and utilize beneficial valuation techniques for these assets. FAS 157-4 also reinforces the required incorporation of non-performance risk when valuing liabilities (Jaggi, Winder, and Lee 480). Lastly, this staff position established the idea of Level 1, 2, and 3 fair value measurements. Level 1 measurements reflect quoted prices in an active market of the asset, Level 2 measurements reflect quoted prices in active markets of comparable assets, and Level 3 measurements reflect models or alternative methods of fair value estimation in the absence of the first two methods. The creation of Level 3 measurements is a continuation of the FASB’s allowance of alternative fair value estimations during illiquid markets discussed earlier in this staff position and grants additional leeway to corporations during these situations.

Despite these efforts to revise their fair value treatment to please corporate desires, Congress still attempted to pass a bill, H.R. 3996, that would subject the FASB to a new oversight body in November 2009. The House Financial Services Committee attempted to create a federal council of risk regulators that would have the ability to override accounting standards during periods of financial distress (Casabona and Shoaf 24). This bill was later modified to allow for the creation of a Financial Services Oversight Committee that has the power to only recommend, not mandate, certain changes to the SEC.

The alterations of FAS 157 by the FASB in the wake of the economic crisis reveal a great deal about the overall independence of this standards-setter. First, by relenting on the recently issued standard several times in order to meet both market and governmental demands, the FASB once again illustrated its susceptibility to political and lobbyist pressure. As the CFA Institute detailed in a letter to FASB Chairman Herz in April of 2009, modifying their mark-to-market accounting rules damages the credibility of both the FASB and U.S. standards (Jaggi, Winder, and Lee 481). By softening their stance on fair value accounting, creating loopholes for banks to take advantage of in times of distress, and allowing companies to move material losses off of the income statement and into other comprehensive income, the FASB's actions go directly against its intended purpose of creating standards that provide timely and accurate information to financial statement users. Thus, many organizations such as the CFA Institute were highly critical of the FASB as they do not wish accounting regulations to become tools to cover up the effect of bad business decisions (Jaggi, Winder, and Lee 482). The Investors Technical Advisory Committee was also critical of the FASB as their alterations to FAS 157 in the face of political and corporate pressure make the reporting of losses more heavily intent on managers' intent, reduce the transparency of current financial reporting, and show signs of abandoning neutrality in financial reporting (Jaggi, Winder, and Lee 482).

The aftermath of the economic crisis also clearly illustrated the continued intent of politicians to gain increased control over accounting regulations. By ordering the SEC to study the value and practice of mark-to-market accounting, requesting the implementation of mark-to-value accounting instead of mark-to-market, attempting to create the Federal Accounting Oversight Board (FAOB), and proposing the creation of a council that could overrule the FASB during economic distress, the government's desired influence over the supposed independent FASB was made quite clear. Politicians and corporations were quick to blame the FASB and existing accounting regulation for the economic collapse of 2008, causing this organization to alter their standards in favor of banks and distressed corporations in the financial sector. However, by applying such pressure, all these individuals accomplished was the passage of accounting regulation that allows for the further manipulation of financial statements by providing increased management discretion to determine accounting treatments and valuation methods. As such, rather than place the blame correctly on the institutions who engaged in senseless and irresponsible lending, the government and lobbyists further impaired the FASB's independence and could potentially create a crisis that would truly be the product of poor accounting guidance.

CHAPTER 4

Independence Analysis - GASC

The IASB is a standards-setting body that is legally recognized as the authoritative source of accounting regulation in a number of different nations but which isn't under the jurisdiction of any sovereign state or group of nations. The FASB is a standards-setting body that has the full authority to set accounting regulation for securities exchanges in a single nation as formally delegated to it by the governmental agency given the legal right to set these conditions. The German Accounting Standards Committee (GASC) is similar to the FASB in that its issuances relate to a single nation, but in contrast to both organizations, the GASC is not provided legal authority to issue accounting regulation. As noted in Chapter 1, the agreement between the Ministry of Justice and the GASC instructs the latter to complete the following four tasks: develop recommendations for accounting principles for consolidated financial reporting, advise the Federal Ministry of Justice on planned legislation on accounting regulations, represent Germany on international standard-setting bodies, and develop interpretations of IFRS utilizing the German Commercial Code ("Annual Report 2010"). Notably absent in this agreement is the responsibility to develop authoritative accounting regulation for German public or private corporations. Also evident is that the GASC is only extended the ability to "recommend" changes for "consolidated" financial reporting. Once GAS are developed, they are only assumed to be authoritative once published by the Ministry of Justice (Previts, Gary, Peter Walton, and Peter Wolnizer 78). Thus, similar to the IAS Regulation, which requires the European Commission to approve the adoption of all newly issued IFRS for them to become authoritative in the Eurozone, the German government has veto power on all GASC issued standards. Lastly, the GASC is only provided informative, and not interpretative, power over accounting standards, meaning it can't issue additional guidance concerning the application and use of its pronouncements (Previts, Gary, Peter Walton, and Peter Wolnizer 78).

Not only are the powers extended to the GASC significantly lacking compared to the FASB, but the adoption of IFRS by the EU significantly impaired the power of the GASC even further as all corporations listed on stock exchanges within Europe are required to follow these international standards. As a result, GASC duties are primarily limited to participation in the due process of the IASB to make German interests known, consultative work with the EFRAG, and issuance of recommendations on accounting regulation for private domestic companies under the supervision of the German government. A 2008 survey by the Dr. Bernhard Pellens, Dr. Nils Crasselt, and Thomas Kemper of German auditors, company representatives, academics, and financial analysts reveals the lack of influence of the GASC. First, this study found that GAS are only "little-known among representatives of non-listed companies," the group most affected by the GASC. Secondly, although the recommendations provided by the GASC to the Ministry of Justice are regarded as important, the actual influence of this organization is considered to "only of medium intensity" (Pellens, Crasselt, and Kemper). It is also important to note that these conclusions are made despite the fact that Dr. Bernhard Pennels is a member of the GASC's Executive Board. Thus, although this organization serves as an important case study and example, as it illustrates an attempt to act as an independent standards-setter, mimic the organizational structures of the FASB and the IASB, and create meaningful accounting guidance for German corporations, it lacks independence from the German government in both appearance and operation. Therefore, further discussion of the independence of this organization is unnecessary.

CHAPTER 5

Conclusions and Proposed / Revised Organizational Structure

From examining the overall organizational structures of the IFRS Foundation, the FAF, and the GASC, as seen in Figures 2, 3, and 5, striking similarities are evident between the three organizations. For example, both the FAF and the IFRS Foundation have Trustees that are responsible for selecting the members of their respective decision-making Boards, the FASB and IASB. Additionally, they both have advisory councils selected by the Trustees that set their own agenda and help the standard-issuing bodies make informed decisions. These similar structures make sense since the restructured IFRS Foundation was modeled after the FAF in 2001. The overall structures of the GASC and the IFRS Foundation are also quite comparable. Illustrating this point, the Board of Directors for the GASC and the Trustees for the IFRS Foundation are quite similar in both number of members, 20 versus 22, and purpose, appointment and oversight of the decision-making bodies of the organizations. The main differences between the three organizations are the amount of power afforded to them by national governments to set authoritative accounting standards; the criteria used to select members of the Boards and other committees; the power given to oversight bodies to intervene in the decision-making process; the true level of separation between the Board and the governments of the nations that utilize their accounting standards; the manner in which they interact with political organizations, government agencies, and special interest groups; and the funding streams.

The first step in any reorganization or restructuring process is recognition of the constraints in which the organization must operate. As was discussed earlier, a primary limitation of the IASB's independence is the fact that no legal enforcement mechanism exists to require compliance with its standards "as issued by the IASB." Instead, the national governments of the nations that utilize IFRS have the ability to adopt, alter, or exclude rulings as determined by the IASB as they see fit, as illustrated through the "carve out" of IAS 39 by the EU. Since the national government of each of these nations ultimately has responsibility for the development of its own accounting standards, this fact can't be changed and additional legal authority can't be given to the IASB without legislative change being enacted by these nations. As such, any reorganization efforts concerning the IASB can't alter this fact as the Board must continue to operate in a situation where all issued standards are subject to legislative review, and possible alteration, after issuance.

An equally important limitation also exists concerning this organization's funding. Historically, the IFRS Foundation's heavy reliance on private donations for funding and lack of a reliable source of financing has been one of the main criticisms concerning the IASB's independence. But, just as the IASB has no legal authority to ensure that its users comply with IFRS, this organization has no power to require companies, special interest groups, or national governments to provide any level of monetary support. Thus, other than revenues generated from the sale of its own standards and subscriptions to its services, all other money provided to the IFRS Foundation is done on a voluntary basis. As such, any alterations or improvements of this organization's funding stream must be done within this constraint.

This chapter will utilize the historical analysis of the FAF, IFRS Foundation, and GASC as conduced in Chapter 1 and the existing independence concerns as discussed in Chapters 2-4 to create a restructured IFRS Foundation that will enhance the independence of the IASB, as well as improve its ability to effectively issue accounting standards that accurately address the economic reality of business transactions. Fully recognizing the constraints detailed above and the analysis conducted in the preceding chapters, the following sections will detail suggested improvements and alterations to the organizational structure of the IFRS Foundation.

The existing IFRS Foundation consists of five main committees or groups: the Monitoring Board, the IFRS Trustees, the IASB, the IFRS Advisory Council, and the IFRS Interpretations Committee. In this section, each group will be evaluated separately, with alterations or improvements suggested as is necessary. There will be no changes to the current structure of the IFRS Interpretations Committee and the IFRS Advisory Council and thus they will not be discussed.

Monitoring Board

The Monitoring Board provides the highest level of oversight within the IFRS Foundation as it is the body responsible for the appointment of Trustees and the safeguarding of the bylaws. Members of this group represent the offices of governmental agencies, such as the SEC and European Commission, or private groups with an interest in financial reporting, such as the IOSCO Emerging Markets Committee. No such committee exists within the FAF as, although Trustee nominations are provided by an "array of domestic and international investor, accounting, and business organizations; financial and capital markets participants; accounting and business academicians; consumer groups; regulatory organizations" and the Trustees themselves, the Trustees have final say over appointments ("By-Laws of the Financial Accounting Foundation"). The Board of Directors for the GASC, which operates similarly to the Trustees, is selected by the General Meeting, a group made up of individuals, companies, and organizations which pay annual memberships to act in such a capacity.

Since the Trustees are responsible for securing financing and selecting the members of the respective decision making boards, Trustee appointment is of critical importance to both the operation of and effectiveness of the Boards. The fact that the SEC has ultimate oversight over the FASB makes the institution of a group such as the Monitoring Board unnecessary within the FAF. Although the SEC does not directly intervene in Trustee appointment, its presence serves to make the Trustees accountable as the FASB only has power as delegated by the SEC. In contrast, as the IFRS Foundation does not have a similar enforcement mechanism to legitimize its standards, the institution of governmental influence on the appointment of Trustees ultimately brings the organization more in line with its American counterpart. The German model is an intriguing option for the IFRS Foundation as it removes the governmental influence posed by the SEC, EC, Japan Financial Services Agency, and the two IOSCO committees and would also represent a way to increase revenue for the organization. However, as of 2010 only 69.8% of corporate members of the General Meeting were publicly traded companies, down from the 84.5% of corporate members that were publicly traded companies in 2005 (*Deutsches Rechnungslegungs Standards Committee e.V*). As discussed earlier, the role of the GASC diminished over this five year period from dealing with the implementation of IFRS in Germany to predominantly dealing with non-listed companies, suggesting that membership in the General Meeting is motivated by potential influence over the decision-making process. Thus, instituting such a system for the IFRS Foundation might result in decreased governmental influence, but would only exacerbate its financing issue as memberships would serve as de facto donations to the organization.

Some researchers deemed the establishment of the Monitoring Board as yet another example of the declining autonomy of the IASB since the mid-1990s (Posner 648). However, even though the Trustees have the power to alter the by-laws and eliminate this group, this may not be the most advantageous decision to the overall organization as the presence of a body overseeing the Trustees ensures the accountability of these individuals, as well as those on the IASB. Therefore, the proposed change is not an elimination of this group, but a restructuring of its composition. As discussed at length in Chapter 2, the EU and U.S. governments have shown that they have both the intent and the ability to influence the IASB. The Monitoring Board, with the SEC, EU, and the IOSCO Technical Committee, which as of 2012 contains 9 of its 20 representatives from the U.S. or Europe, only extends this influence. A Monitoring Board that will both establish the desired accountability and limit governmental influence would be composed of organizations with no legal ties to national governments. Instead of geographical or national interests, the members should represent the different industries affected by accounting standards. For example, the proposed Monitoring Board would consist of the following organizations and their respective industries: the Basel Committee on Banking Supervision, banking; CFA Institute, industry; ICAEW, accounting; International Association for Accounting Education and Research (IAAER) academic; and the World Bank, monetary regulation.

Trustees

The Trustees play an extremely important role within the IFRS Foundation by selecting the members of the IASB and securing the funding necessary to operate the organization. However, judging the effectiveness of a given group of individuals in accomplishing these tasks is extremely difficult due to the subjective nature of these duties. For example, even though the number of IASB members from each region is recommended by the IFRS Foundation's Constitution, the Trustees are provided a great deal of autonomy to select IASB members. When the eventual selections are made, it is quite difficult to judge how each of the selections has performed. On the surface, analyzing voting records would seem an apt way to judge these members, but then the question arises as to what was the "correct" vote. Another possibility would be to evaluate Board's as a collective unit and then compare similarities and differences between the given groups to develop an understanding of the best possible composition. However, with the IASB's main task being the development of global accounting standards, how would one judge the correct treatment for a given transaction? Industry and national responses could not be used since standards are not meant to reflect the desires of these stakeholders but represent the economic reality of the situation. Similarly, responses to comment letters could not be used since the IASB must gently walk the fine line of incorporating feedback received from its stakeholders into its standards while not completely bending to their will.

There are currently 22 Trustees, with the following national representation mandated by the organization's constitution: six from Europe, six from North America, six from Asia/Oceania, one from Africa, one from South America, and two from any other country. The only other explicit criterion for selection is the rough recommendation that two be from public accounting firms ("Constitution"). The FAF Trustees consist of anywhere from 14 to 18 members, the majority must not be associated with public accounting firms, and three must have extensive experience as either financial officers or elected officials of state and local entities ("By-Laws of the Financial Accounting Foundation"). The Board of Directors in the GASC is made of 20 members, with a set number coming from specific pre-determined sectors as discussed in Chapter 1.

While the sectors used by the GASC and the sectors represented by the FAF and IFRSF Trustees can't be compared due to the historical use of financial reporting for equity markets in the U.S. and Europe versus financial reporting for creditors in Germany, as well as the large market of SMEs in Germany, the FAF and IFRS Foundation Trustees can be compared. The main difference between the Trustees of the two organizations is found in the respective representatives from the public accounting and banking industries. As of 2012, 4 of the 22 IFRS Trustees are either employed by banks or their last employer before retirement was a bank; the FAF has one such individual (*IFRS*) (*FAF*). Even though the FAF does not have as many Trustees, this still illustrates the large influence of banking industry among the IFRS Foundation Trustees. Also as of 2012, 3 of the 14 FAF Trustees are from or were employed just before retirement in the public accounting industry; the IFRS Trustees have one such individual. Thus, even though limitations exist concerning the extent of influence from this industry allowed among the FAF Trustees, this sector still has a larger influence on the FASB than the IASB. A conceivable rationale for this difference could be that a single set of accounting standards and a single set of auditing standards in the U.S., as opposed to national and regional differences and traditions among the nations utilizing IFRS, have led to a more established auditing industry in the U.S. Despite these differences, the difficulty in determining the effectiveness of Trustees from different nations and industries in making appointments and raising capital require that the current composition of the Trustees be kept and the changes in the Monitoring Board and the changes in the IASB discussed in the next section be depended on to establish the necessary independence in the IFRS Foundation.

IASB

The next group within the IFRS Foundation's structure, the IASB, is the body actually charged with the issuance of IFRS. As mentioned in Chapter 1, the IFRS Foundation Trustees voted to expand this board to 16 members by the end of 2012; however, the IASB currently contains 14 members. As of December 2011, the IASB had 15 members, but Elke König stepped down after being named President of the German Federal Financial Supervisory Authority. Wishing to establish global representation among the board, the IFRS Constitution states that the IASB members should "normally" be distributed as follows: four from Asia/Oceania, four members from Europe, four from North America, one from Africa, one from South America, and two from anywhere "subject to maintaining geographic balance" ("Constitution"). It is further noted no IASB decision would be ruled invalid without such a composition ("Constitution"). Although the Trustees are under no obligation to follow these guidelines, the current IASB exactly mirrors this geographic balance.

The IASB's original composition after restructuring in 2001 differed greatly from the current model as 7 of the 14 members were from the U.S. and UK, effectively giving these nations control over the decision-making process. **Appendix G** illustrates these differences by showing membership by nation on the original restructured IASB in 2001 and the current IASB. Since the EU had not yet decided to adopt IFRS as the required accounting standards for all listed companies within its jurisdiction, the decision to cater to the U.S. and British interests on the IASB was most likely an attempt to gain access to the largest stock exchange in the world, the New York Stock Exchange (NYSE), and the largest one in Europe, the London Stock Exchange. The fact that the IASB was based in London and the beliefs that US GAAP was the gold standard of accounting regulation and that the IASB would need the support of the SEC if it ever hoped to become accepted for use within the U.S probably further contributed to such concessions. In the years following the initial IASB selections, the shift of power was much more heavily slanted towards Asia and continental Europe. **Appendix G** illustrates this change as Asia/Oceania's representation on the board increased from two members in 2001 to four in 2012. This increase was a response to the growing influence of nations from Asia/Oceania on the global economy, evidenced by the fact that GDP growth rates for China, India, and Indonesia from 2002-2006 were 10.64%, 7.82%, 5.1%, respectively, and these nations each had GDPs ranked within the 15 highest in the world in 2006 (*The World Bank*). Similarly, as two representatives were from the UK and one each from France, Switzerland, and Germany in 2001, only 2 members were from the Eurozone on 2001. In 2012, this number increased to three, and would have been four had Elke König not stepped down at the end of 2011.

IASB restructuring has historically focused on national and regional representation as the only alterations to the organization's constitution made by the Trustees was the recommended geographic distribution discussed above and a change from "technical expertise" being the "foremost qualification" for IASB membership to requiring that the Board consist of "the best available combination of technical expertise and diversity of international business and market experience" in 2005 (Zeff, "IFRS" 280). European leaders have argued for geographic representation since the IASB's restructuring efforts in the late 1990s, stating that those who have committed to use of IFRS long-term should have the dominant vote on the Board (Zeff, "IFRS" 280). But, the true intention of IFRS are not to represent accounting standards as seen by various nations or to incorporate historical national accounting traditions, but most accurately reflect the essence of business transactions so that financial statement users have the most accurate information possible. Echoing this concept, the FASB lobbied hard for, and achieved to a certain extent since the original IFRS Foundation Constitution stipulated that technical expertise was the "foremost qualification" for IASB membership, that knowledge and experience be the sole criteria for member selection (Zeff, "IFRS" 280).

May and Sundem argue in a May 1976 article in the *Accounting Review* that accounting regulation can be considered to be a social policy decision due to its ability to impact the value of securities portfolios, and in extension wealth distribution among individuals, and investor decisions, ultimately influencing the structure of security prices (749). Accounting research has traditionally used this idea to support the notion that politicians, individuals experienced in making social policy decisions and dealing with the associated pressures, should play a role in accounting regulation. However, as has been illustrated throughout this paper, it is precisely this experience in catering to special interest groups and governmental factions that should be avoided when structuring the IASB. This concept applies equally to regional and national interests as an effective ruling board must take into account the various interests of all of its users, in this case users across the globe, but qualities such as expertise and experience should far outweigh any desires to appease different interests. As stated by a regulator in response to a question posed about the loss of UK influence over accounting regulation following the EU's decision to adopt IFRS, "If we have the right views, those views should prevail anyway" (Fearnley and Hines).

Examining the historical composition of the IASB, it is evident that membership has changed drastically since 2001. As seen in **Appendix I**, in 2001 there were six members whose previous employer or current employer was a national accounting standards-setting body and zero members from financial services corporations or government agencies. In 2012, members from these sectors were one, three, and three, respectively. Such reliance on individuals with experience setting accounting standards is easily understood on the original board, but the change towards increased influence of those from government agencies and financial services firms requires further examination. Of the three members who were previously employed by government agencies, it is interesting that two of them were from European agencies and were appointed after the adoption of IFRS in Europe. These actions could potentially indicate increased influence of the EU in the appointment process, an example of governmental pressure which this new organizational structure attempts to combat. It is also worth noting that two of the three members from financial services companies were added following the financial crisis, perhaps indicating that the Trustees wished to avoid future debacles such as the one concerning IAS 39 during the financial crisis. Although a member was also added with experience at a central bank, Amaro Luiz de Oliveira Gomes of Brazil, 20% of the voting power was still delegated to the financial services sector as seen in **Appendix I.**

Although the current FASB represents a much more balanced representation of economic sectors, its composition has also changed greatly over the last decade. From 2001 to 2012, representatives from public accounting firms have decreased from three to one, members from public companies decreased from two to zero, one member was added from a private company, and two members were added from financial or accounting consulting groups as illustrated in **Appendix H**. The decrease in influence of the public accounting and public company sectors is undoubtedly a product of the prevalent accounting scandals in Corporate America in the early 2000s and the subsequent Sarbanes-Oxley Act. Although the only formal effects on the FAF organizational structure of this act were the addition of a reliable funding stream and the requirement that the majority of the Trustees not be from public accounting firms, the perception of these sectors can be inferred to have impacted these appointment decisions. The addition of consulting members has no obvious implication on the FASB's decision-making, but the new member from a private company illustrates the realization by the Trustees of the importance of accounting for SMEs and private entities, especially during the upcoming accounting conversion. The GASB makeup has stayed consistent throughout the same time period as the only change was the removal of a member from an accounting standards-setter and the addition of a member from a law firm, as seen in **Appendix D**.

The proposed reorganization of the IASB demands the composition favor the FASB model of using technical expertise as the sole criteria. However, realizing that the IASB should recognize the interests of all financial statement users, specific numbers of members will be required to represent various economic sectors, similar to the GASC model for the Board of Directors. The problem then becomes which sectors should be represented and how much influence should be given to each on the IASB. Chapter 2 illustrated that the two primary threats to the IASB's independence over the last ten years have been governmental influences, most notably the EU, and banks. Thus, voting power afforded to individuals with employment backgrounds in these sectors should be limited to maximize independence. Individuals whose previous employer was a governmental agency will not be permitted to serve on the IASB and only one member whose previous employer was in the financial services industry will be allowed to serve on the Board. However, in order to avoid isolation of the European legislators from the due process of standard-setting and allow the EC to understand the thought process behind standards issued by the IASB, the EFRAG will be established as an observer to the Board. Additionally, recognizing the importance of establishing a workable set of accounting standards for private companies and SMEs and the importance of good working relationships with universities and researchers, among the IASB members there must be at least one member from a private corporation and one whose previous position was either at an accredited academic institution or a financial or accounting research organization. Although there has been a large amount of criticism towards the influence of public accounting firms over accounting regulators, few other corporations operate in an industry that has clients throughout the entire world that require such an intense level of knowledge over accounting differences in separate nations. As such, international public accounting firms should have a strong presence on the newly restructured IASB, with the stipulation that the representatives must have served in at least two nations during his tenure and one can't have been in the EU. This allows for the addition of representatives who understand the difficulties and challenged facing different nations and the EU stipulation ensures that the differences are large enough to bring a knowledgeable perspective on these differences. Lastly, since public companies are the organizations that actually utilize IFRS and release financial statements, one representative from a public company whose role required financial statement preparation should be on the new IASB.

Before the number of representatives per sector can be determined, the ideal size of the IASB must be established. This was a primary issue when the IFRS Foundation was created in 2001 as European regulators and stakeholders advocated for a 21-member board while the SEC lobbied strongly for a seven-member board, matching the makeup of the FASB (Zeff, "IFRS" 80). The eventual compromise was for 14 members. But, where did these numbers of 21, 14, and seven come from? The original report from the Wheat Committee in 1972 chose seven members for the original FASB because it seemed "to be small enough to be efficient and large enough to provide for a variety of views and backgrounds" (Watts, et al). The obvious tradeoff between large and small board sizes is the added efficiency from a small number of members versus the diversity in knowledge and experiences gained from a large board size. Delving deeper into this topic, current research is quite varied on the ideal size of a board for a non-profit organization. An April 2012 study in the *Journal of Accounting and Economics* found evidence that board size of non-profit organizations is positively related to organizational performance (Aggarwal, Evans, Nanda). Additionally, this study also found a positive correlation between board size and the number of projects taken on. (Aggarwal, Evans, Nanda). Since the IASB is already overwhelmed and its ability to meet user demands is already heavily questioned, taking on additional projects is not the ideal change and could lead to a drop in the overall quality of its standards. However, the “board” in the typical non-profit organization acts more similarly to the Trustees in the IFRS Foundation as these individuals don’t carry out the day-to-day operations of the firm and issue the organization’s primary services. Thus, the IASB must be treated differently.

There are two pre-dominant theories concerning the optimum size for a committee, the “Neutral Judges Perspective” and the Median Voter Theory. The first of these theories assumes that all members of a committee are neutral participants that seek to determine the optimal outcome and that more members, the more likely they are to reach the correct decision. The second theory is predicated on the belief that committee members have pre-existing influences and beliefs. As such, the preferences of a committee will be arranged on a continuum and thus the outcome of a vote will represent the median of these preferences. According to the Median Voter Theory, if there is a core group of voters, adding and subtracting voters will have no effect on the median if these preferences are evenly distributed on both sides. For the case of the FASB, the institutional design is made on the assumption that the “Neutral Judges Perspective” holds true as all members have identical bases of accounting knowledge (Watts, et al). However, whether or not this concept holds true for the FASB, it certainly does not for the IASB as the simple suggestion by the Trustees that the IASB have geographic balance shows that these individuals do possess regional and national preferences. Thus, the IASB lends itself more towards the Median Voter Theory, and especially more so after the reorganized IASB will be formed on the basis of differing industry backgrounds.

The trouble with the application of this theory is in recognizing or establishing the core group of voters. Obviously each of the IASB members will possess the necessary accounting knowledge and background to make informed decisions concerning accounting regulation. To solve this problem and correspond with the conclusions concerning board representation noted above, the newly proposed IASB will have a core group composed of two members from public accounting firms, one member from an academic institution or accounting research group, one from a private corporation, and two from public corporations. Supplementing this group will be representatives from sectors that have vastly different perspectives on financial accounting, financial services and accounting regulators. Thus, in order to both include important stakeholders in the decision-making process and balance national and industry opinions, one member will be from the financial services industry while one will be from a national standards-setting body located outside of the U.S. or EU. Due process will remain the same with this newly restructured IASB, but in order to allow for the Board to quickly respond to developing accounting issues and concerns, only a simple majority will be necessary to pass a standard.

SME Committee

As shown throughout this paper, the IASB has been tremendously influenced by U.S. and UK accounting traditions, which have primarily focused on accounting for equity markets, and the adoption of IFRS by the EU. As a consequence, IFRS have been largely tailored towards financial accounting for public companies and SMEs and private companies have ultimately been largely ignored by the IASB. Although the IASB did release an IFRS for SMEs draft, as was discussed previously, it was rejected by such nations as Germany. Therefore, the reorganized structure of the IFRS Foundation should include a committee designed to meet the needs of these stakeholders, the Small-and-Medium Entity Committee (SMEC). Structured similarly to the IFRS Interpretations Committee, this group would feature 14 members from private companies, banks, financial statement preparers and users, and any organization with an interest in financial reporting for SMEs and would be chaired by the member of the IASB from the private company sector. This group would be granted equal powers as the IFRS Interpretations Committee concerning issues dealing with SMEs and private companies.

Fast-Track Due Process

The last proposed alteration to the IFRS Foundation's structure is the establishment of a fast-track due-process that would be available to the IASB in times of emergency. Hoping to avoid the need for constitutional changes to enable the issuance of accounting standards, as seen during the economic crisis, without the full due process being completed, this provision would allow the IASB to issue standards quickly to respond to quickly developing accounting issues. In order to assure that this power is not abused and that the full due process is utilized by the Board during normal occurrences this will only be allowed to occur following a supermajority vote by the IASB, 5 of 7 votes required, and an additional vote of confidence by Trustees, 13 of 22 votes required. Lastly, if a standard or revision of an existing standard is issued in this manner, it will be considered as a "Provisional IFRS as Issued by the FASB," which will be authoritative for a period of 120 days before expiring. During this time the normal due process will occur and the IASB will have the ability to reaffirm the provisional standard or alter it in any way that it sees fit after 60 days have passed.

Appendix A – Historical Makeup of IASB

Time Period	Number of Board Members	Member Nations	Required Votes
January 1983 – December 1983	12	United States, United Kingdom/Ireland, Netherlands, Canada, Australia, Japan, Germany, France, Mexico, Nigeria, South Africa, Italy	9
January 1984 – December 1985	13	United States, United Kingdom/Ireland, Netherlands, Canada, Australia, Japan, Germany, France, Mexico, Nigeria, South Africa, Italy, Taiwan	10
January 1986 – June 1995	14	United States, United Kingdom/Ireland, Netherlands, Canada, Australia, Japan, Germany, France, Mexico (Jordan starting 1988), Nigeria (Nordic Federation starting 1988), South Africa, Italy, Taiwan (Korea starting 1988, India starting 1993), International Coordinating Committee of Financial Analysts Associations	11
July 1995 – December 1995	15	United States, United Kingdom/Ireland, Netherlands, Canada, Australia, Japan, Germany, France, Mexico, Nordic Federation, South Africa/Zimbabwe, Malaysia, India/Sri Lanka, International Coordinating Committee of Financial Analysts Associations, Federation of Swiss Holding Companies	12
January 1996 – March 2001	16	United States, United Kingdom/Ireland, Netherlands, Canada, Australia, Japan, Germany, France, Mexico, Nigeria, South Africa/Zimbabwe, Malaysia, India/Sri Lanka, International Coordinating Committee of Financial Analysts Associations, Federation of Swiss Holding Companies, International Association of Financial Executives	12

Source: *IAS Plus*

Appendix B – IFRS Foundation Long-term Financing Commitments (2010)

*****Based on the following exchange rates as of February 1, 2010**:**

1 USD = 0.71771 Euros

0.62643 Pounds

1.06081 Canadian Dollars

1.41004 New Zealand Dollars

Financing Source	**Contribution Total ($)***	**Percentage of Overall Contributions**
Private companies/organizations	7,482,503	38.23%
National governments	3,750,623	19.16%
Levies on individual companies	5,589,045	28.56%
Central Banks/International Organizations	500,000	2.55%
Public accounting firms	2,250,000	11.50%
National Accounting Standards Boards	300,000	1.53%
Overall Total	**19,572,171**	**100%**

Source: IFRS Foundation, 2009 Annual Report

Appendix C – FAF Revenue Sources

***** Prior to the passage of the Sarbanes-Oxley Act (2002), equity and investor company issuers were not charged these fees by the SEC. During this period, funding received from companies and organizations was voluntary and classified as donations.

Year	Accounting Support Fees (% of Total)	Publications/Subscriptions (% of Total)	Contributions (as % of Total)
2000	*	66	34
2001	*	67	33
2002	*	69	31
2003	57	37	6
2004	62	32	6
2005	57	37	6
2006	60	34	6
2007	67	27	5
2008	67	28	5
2009	75	21	4
2010	69	28	3

Source: FAF, 2000-2010 Annual Reports

Appendix D – Current Employer or Employer Previous to GASB

NOTE: Table values represent the number of members that worked at each type of entity while serving on the GASB or prior to Board service

*Indicates President
**Both member were from the same bank (Deutsche Bank AG)

Year	Public Accounting Firm	Bank	Law Firm	Public Company	Accounting Standards Body	Limited Liability Company (SE)
2005	2*	2 **	1	1	0	1
2006	2*	2 **	1	1	0	1
2007	2	2	0	1	1*	1
2008	2	2	0	1	1*	1
2009	2	2	0	1	1*	1
2010	2	2	0	1	1*	1

Source: GASC, 2005-2010 Annual Reports

Appendix E – GASC Revenue Breakdown

NOTE: 2005 was the first year that public companies in Germany were required to report under IFRS per the Regulation of IAS

Year	Membership Fees and Donations (as % of Total)	Collected IFRSF Contributions (as % of Total)	Activity-Specific Donations (as % of Total)	Collected EFRAG Donations (as % of Total)	Other Income (as % of Total)
2005	94	0 *	0	0	6
2006	60	39	0	0	1
2007	71	28	0	0	1
2008	67	27	0	5	1
2009	68	26	5	0	1
2010	56	34	5	0	5

Source: GASC, 2005-2010 Annual Reports

Appendix F – GASC Membership Fee Structure

NOTE: These fees are as of July 20, 2011

Corporation/Firm/Organization	**Fee (in Euros)**
Corporations:	
DAX	50,000
MDAX	20,000
Other	10,000
Corporations (only debt issuing) (in Euros):	
Outstanding Debt > 10 billion	50,000
2 billion < = Outstanding Debt < = 10 billion	20,000
Outstanding Debt < 2 billion	10,000
Accounting & Auditing Firms (in Euros):	
Audit Revenue > 200 million	50,000
50 million < =Audit Revenue < = 200 million	25,000
Audit Revenue < 50 million	10,000
Organizations	20,000

Source:

"Membership Fee Structure of the Accounting Standards Committee of Germany e.V"

Appendix G – IASB Global Representation

***** Indicates chairman
** Indicates vice-chairman
*** Elke König was a member of the IASB (increasing the Board to 15 members) July 2010 – December 2011 before stepping down to become President of the German Federal Financial Supervisory Authority.

Country of Origin	IASB (2012)	IASB (2008)	(IASB 2001)
North America			
United States	4	4**	5**
Canada	0		1
Europe			
UK	1	2*	2*
France	1	2	1
Sweden	1	1	0
Switzerland	0	0	1
Germany	0***	0	1
Netherlands	1*	0	0
Asia/Oceania			
Japan	1	1	1
Australia/New Zealand	1*	1	1
India	1	1	0
China	1	1	0
South America (Brazil)	1	0	0
Africa (South Africa)	1	1	1

Source: *IAS Plus*

Appendix H – FASB by Former Sector of Employment

***** Indicates chairman

Sector	FASB (2012)	Voting %	FASB (2001)	Voting %
Public Accounting	1	14%	3*	43%
Public Company	0	0%	2	29%
Financial Services	0	0%	1	14%
FAF staff	1	14%	0	0%
Academic	1	14%	1	14%
Consulting	2*	29%	0	0%
Private Company	1	14%	0	0%

Source: *FAF*

Appendix I – IASB by Current/Former Sector of Employment

* Indicates chairman
** Indicates vice-chairman

Sector	IASB (2012)	Voting %	IASB (2001)	Voting %
Public Accounting	3	21%	2	14%
Government Agency	3*	21%	0	0%
Public Company	2	14%	3	21%
Accounting Standards-Setter	1**	7%	6*	43%
Financial Services	3	21%	0	0%
IASB Executive Committee	0	0%	1**	7%
Academic	0	0%	1	7%
Consulting	0	0%	1	7%
Central Bank	1	7%	0	0%
Organization with Interest in Financial Reporting	1	7%	0	0%

Source: *IFRS*

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The Pennsylvania State University**,** University Park, PA
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Bachelor of Science in Accounting
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RESEARCH:

Honors Thesis: Achieving IASB Independence: Creating an independent IASB through the examination and comparison of the organizational structures and funding streams of the IASB, FASB, and GASC
Thesis Supervisor: Karl A. Muller
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WORK EXPERIENCE:

PricewaterhouseCoopers McLean, VA
Assurance Intern 6/11 – 8/11

- Worked on 3 year-end audits, one quarterly review, and one pension benefit plan audit
- Completed numerous audit workpapers, interacting one-on-one with client executives
- Helped budget staff hours, researched accounting treatments, extensively used firm audit software
- Accepted full-time offer, starting September 2012

HONORS:

Dean's List all semesters at Penn State University
Penn State President's Freshman Award, 2008
President Sparks Award, 2009
Evan Pugh Junior Award, 2011
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PICPA Multi-year Scholarship, 2009-2012

ACTIVITIES:

Events co-chair, South Halls Residence Association (SHRA), 2008

Teaching Assistant for BA 303, 2011
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Study Abroad (Milan, Italy), Spring 2011