IASC FOUNDATION MONITORING BOARD

Statement of the Monitoring Board for the International Accounting Standards Committee Foundation on Principles for Accounting Standards and Standard Setting

22 September 2009

The International Accounting Standards Committee Foundation Monitoring Board is composed of securities regulators from both larger and emerging markets. As authorities responsible for deciding upon the accounting standards to be used for financial reporting in our respective jurisdictions, we established the Monitoring Board to discharge more effectively our mandates regarding investor protection, market integrity, and capital formation. Our belief that the quality of financial information issuers provide is essential to the confidence of capital providers in making investment decisions is derived from these mandates. In this light, we feel it appropriate to ensure that the fundamental principles on which accounting standards are based and under which the standard setting process operates remain front of mind as areas identified during the financial crisis as needing improvement are addressed.

Accounting standard setters, both nationally and internationally, are currently considering how accounting standards can be improved in light of the recent credit crisis. We strongly support these efforts and agree that the credit crisis offers important lessons for how accounting standards can be improved to offer greater transparency in times of market stress, to the benefit of both investors and market stability.

Financial standards and regulations created or modified in the midst of any crisis should be considered carefully. This is particularly true with regard to the current review of accounting standards because these standards play an important role in public company financial disclosures, and these financial disclosures, in turn, are an important part of the foundation upon which fair and efficient capital markets are based. Financial crises have historically sparked panics in capital markets, and regulators and standard setters recognise that market panics should not be allowed to evolve into regulatory panics, where important regulatory fundamentals are inadvertently undermined in an effort to respond quickly to the symptoms – rather than the root causes – of a market crisis.

For this reason, we believe that the future strength and integrity of our capital markets depends on both regulators and accounting standard setters reaffirming, at this critical juncture, their commitment to certain fundamental first principles about the purposes that accounting standards serve and the process by which the standards are determined. The quality of financial reporting, and, by extension, the health and integrity of our capital markets, depends upon vigilant attentiveness to these fundamental principles, and expedience should not be permitted to undermine the objectives these principles describe. Consequently, we also believe a reiteration of these principles, and an explanation for why they are so important, is a valuable exercise given that there have been calls from some quarters for accounting standards to be reformed in ways that could decrease the transparency of public company financial statements, particularly with regard to disclosures of certain types of financial assets made by financial institutions that sell their shares to the public.

While we recognise that some observers have claimed that certain current accounting standards impose *procyclical* burdens on some financial institutions that have publicly traded shares by requiring that these issuers use market-based or otherwise objective and verifiable measures to report to investors the current value of the assets they hold, we believe this claim focuses on a symptom of a problem rather than the problem itself. Public capital markets are, first and foremost, vehicles in which millions of investors make decisions about investment opportunities as a cost-efficient and effective tool by which they invest and save for the future. Public capital markets are also mechanisms by which issuers can seek efficiently priced and liquid capital that they can use to hire new workers, build new factories, and fuel the future growth of our economies. Public capital markets, however, are predicated on trust and transparency. Investors trust that an issuer's disclosure statements, and the accounting standards on which they are based, provide them with a complete, unbiased, fair and comparable view of the issuer's performance. If that trust is undermined through promulgation of new accounting standards that offer less transparency (for example, by indicating that an investment involves less risk than actually exists), or that are established through a process that deviates from fundamental principles guiding the standard setter's decisions, investor confidence in our capital markets will suffer, with strong and weak issuers alike facing concomitantly greater capital costs.

Principles underpinning accounting standards

The International Accounting Standards Board (IASB) in its *Framework* and the U.S. Financial Accounting Standards Board (FASB) in its *Statements of Financial Accounting Concepts* provide objectives of financial reporting and describe the characteristics of accounting standards that support those objectives. These collectively form the foundation on which individual standards are developed. They are universal in that they apply to financial reporting for businesses of all sizes, across all industries. Though each standard setter has presented these objectives and characteristics in its own way, consistent principles can be readily identified. We view the primary objective of financial reporting as being to provide information on an entity's financial performance in a way that is useful for decision-making for present and potential investors. To be considered decision-useful, information provided through the application of the accounting standards must, at a minimum, be relevant, reliable, understandable and comparable.

Relevant: Financial information must be relevant to the decision being evaluated. For purposes of capital markets participants, relevance depends on whether the information enables the user to evaluate past and present events, such that the user can draw inferences regarding future events.

Further, information is relevant if it provides the user a basis against which to assess past evaluations.

Reliable: Information should be reliable in the sense of providing a faithful representation of the events on which it purports to be reporting. This requires the information to be neutral and to depict fairly the reported transactions. Reliability does not necessarily equate with certainty, as judgment, for example for some measurements or estimates of future outcomes, is an inherent aspect of financial reporting.

Understandable: Financial information is intended to provide a tool for decision-making. It therefore should be developed and presented in a way that, with reasonable effort, can be understood and adapted by users into their decision-making processes.

Comparable: Information used in decision-making is generally evaluated within a context, rather than statically. To facilitate its use, financial information should be prepared and presented with sufficient consistency to enable comparison of the reporting entity's performance over time and against other reporting entities.

These attributes are not controversial and enjoy broad support. The report of the Financial Crisis Advisory Group recognised that "financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses." The Basel Committee on Banking Supervision recently acknowledged the importance of decision usefulness and relevance of financial reporting, and asserted that information is useful if, among other things, it enables users to assess amounts, timing and uncertainty of future cash flows of the reporting entity. In our desire to set economic recovery on a strong course, we must not compromise on the time-tested principles underpinning financial reporting.

Principles underpinning accounting standard setting

In addition to the principles guiding the standards themselves, the process by which accounting standards are set must embody certain attributes. Confidence in the quality and integrity of the standards depends upon independence and transparency in the standard setter's due process.

Independence: Deliberations and, in particular, conclusion on positions in an independent fashion rely on a number of factors. First, the individuals composing the standard setting body must demonstrate professional competency in matters of financial reporting. Further, members with a decision-making role in the standard setting organisation should collectively be reasonably representative of the constituents whose interests the standards seek to address. Finally, the process should remain free of undue pressures from political and corporate interests.

Transparency: Visibility into the standard setting process should be sufficient to enable users to trace the evolution of the standard from thoughtful consideration of alternatives to final positions. Interested parties must be afforded the opportunity to provide input to inform the standard setter's evaluation of pertinent issues.

The IASB and FASB have benefitted from informative input into their financial instruments and fair value measurement standard setting initiatives from a broad range of stakeholders. The recommendations of some constituencies often contradict the strongly held views of others, reflecting the diversity of uses for and desired outcomes of financial reporting. As above, robust participation of interested parties is an essential element of a standard setter's transparent due process. Equipped with this input, it is the responsibility of the standard setters to evaluate the knowledge they have gained against the overarching objectives of financial reporting and the principles that reinforce those objectives, in a manner engendering independent decision-making.

While it is useful to consider the intersection of banking supervision and financial reporting in light of the recent banking crisis, accounting standards should not be allowed to become a surrogate for robust bank risk management or effective bank supervision. Accessing public capital markets is a choice issuers make, and but one of many choices open to financial institutions. As securities market regulators, we believe it would be a mistake to attempt to rectify today's banking crisis by placing a burden on the investors in our public capital markets. Accounting standards must be designed to provide investors with information to assist them in efficiently allocating their hard-earned investment money. It is in this context that accounting standards are designed to contribute to a sound, prosperous and more stable financial standard of living.

Independent standard setting and adherence to the fundamental objectives of financial reporting remain essential components in the development of high quality, global accounting standards. The Monitoring Board is strongly committed to guarding the independence and accountability of the standard setting process.

Note for Editors:

1. The members of the Monitoring Board are, at this moment, the Chairman of the Emerging Markets Committee of the International Organization of Securities Commissions (IOSCO), the Vice-Chairman of the Technical Committee of IOSCO, the Commissioner of the Financial Services Agency of Japan (JFSA), and the Chairman of the US Securities and Exchange Commission (SEC). The Monitoring Board charter was drafted with the participation of the European Commission (EC) and with the expectation that the EC would be a member of the Monitoring Board. We understand that the EC's internal discussions regarding its membership are ongoing.

Press contact:
Ms. Imre de Roo.
The Netherlands Authority for the Financial Markets
Phone: + 31 20 797 2073,
Email: imre.de.roo@afm.nl