

The importance of an independent standard-setting process

A paper written for the INTOSAI Subcommittee on Accounting and Reporting

Introduction

Governments must be held accountable for the collection of taxes and other revenues and the level, quality, and cost of services they provide. To do this, governments must prepare financial statements that are transparent and that meet the needs of a wide range of users. While legislatures want to assess the government's performance and stewardship of resources, resource providers and recipients of services also want to know how the government's resources are being used.

To achieve a successful accountability relationship and to have their informational needs met, users of government financial statements need the assurance that government financial statements are credible and have been prepared using accounting standards that are unbiased and transparent.

For financial statements to be credible they must be prepared following a set of understandable, enforceable, and objective principles that are not subject to the individual preference of the individual who is preparing them. The development of such standards cannot be accomplished, in our view, without an independent standard-setting process.

Due process in standard-setting

A successful standard-setting due process produces high-quality standards that yield relevant, reliable, neutral, consistent, and comparable financial statements that meet the needs of users. To achieve this goal, the standard-setting process must be rigorous, transparent, objective, and participatory, but most important, it must be carried out by an independent standard-setting body. If those who set the standards are not independent from those who prepare the financial statements, the standards could be arbitrarily changed to suit the preferences of

the current management and could result in inconsistent or misleading financial statements.

Standard setters should be free from undue funding pressures. They should not be dependent on political or corporate largesse and they should not be unduly influenced by special interest groups or significant economic players that want to paint a particular financial picture. However, independence does not mean the absence of accountability. A standard setter must be accountable for the timely maintenance of standards, for transparency in standard setting, and for meeting the public's needs.

Stakeholders' acceptance of the standard-setting process is important. Financial information users must be confident that, when the accounting standards are drafted, input is sought from all stakeholders, including preparers of financial statements, auditors, regulators, and other stakeholders. Ongoing discussion among stakeholders about the various implementation issues they encounter is important. If accounting standards are to have continuing relevance and use, stakeholders need to learn from each others' experiences, and different points of view must be discussed and dealt with sensibly.

The recognized process for independent standard setting is as follows:

- Exposure drafts of new or revised standards are usually developed with input from a task force and from subject-matter experts.
- All interested stakeholders are encouraged to comment on the draft standards, which are widely distributed and publicly available.
- Comments are reviewed and the exposure draft is revised, as appropriate. If the revisions are substantive, a re-exposure draft may be issued.
- Once approved, the new or revised standards are officially issued.

Other common elements of an effective, independent accounting standard-setting body and supporting staff include

- a process for the selection of independent members of the standard-setting body and for monitoring their performance and a conflict of interest policy;
- public meetings;
- an oversight process for the body in support of the public interest;
- adequate resources and sufficient technical expertise, skills, and experience; and
- a transparent process to identify and prioritize changes to the standards.

Also, the standard-setting body must be independent in both fact and appearance.

The current landscape

Many countries have independent standard-setting bodies to develop and establish standards, and related guidance, for governing financial accounting and reporting. Canada and the United States have separate independent bodies to establish standards for the public sector and the private sector.

At the international level, there are two independent standard-setting bodies established to issue high-quality, global accounting and reporting standards for the public and private sectors. The International Accounting Standards Board (IASB) was established by the International Accounting Standards Committee Foundation in 2001 to issue accounting and reporting standards for the private sector or publicly accountable profit-oriented enterprises. The International Federation of Accountants established the International Public Sector Accounting Standards Board (IPSASB) to set the standards for the public sector.

The INTOSAI Subcommittee on Accounting and Reporting conducted a survey in the spring of 2009 to identify the accounting standards used by each INTOSAI member country for reporting financial results. Respondents were allowed to select more than one choice.

The survey revealed the following:

- 22 percent of countries used IPSAS Accrual Basis.
- 24 percent used IPSAS Cash Basis.
- 24 percent used IFRS.
- 36 percent used the national standards established by their country's standard-setting body.
- 34 percent used other standards.

Of the respondents who indicated that their government used at least one non-international accounting standard, 45 percent indicated that their government has no plans to move to a set of international standards, while 55 percent indicated that their government was planning to move to one of the following three sets of international standards (respondents were allowed to select more than one choice):

- IPSAS Accrual Basis (76 percent of respondents),
- IPSAS Cash Basis (37 percent of respondents), and
- IFRS (34 percent of respondents).

As a result of the recent financial crisis, there has been an increased need for transparent and reliable financial reporting. Many national accounting bodies have made significant progress in bringing their national accounting standards in line with international accounting standards.

Independent standard-setting bodies, national and international, engage in similar activities and strive for the same outcome: well informed readers of credible financial statements.

Case studies

Canada. Between the late 1970s and the end of the 1980s, the credibility of the Canadian government's financial statements was brought into question because there were no independent accounting standards to which both the government and the auditors could refer. At the time, during debates in the House of Commons, the government often described the situation as an "honest division of opinion" between two experts on technical accounting matters. It said that it could "list a number of accountants who will argue one side of this issue and a number who would argue the other side." Nobody was well served by this situation.

Fortunately, since that time, the Public Sector Accounting Board (PSAB) of The Canadian Institute of Chartered Accountants developed objective accounting standards for governments, and the Canadian government brought its accounting policies in line with PSAB standards. The government's stated accounting policies are not significantly different from Canadian generally accepted accounting principles. For 11 consecutive years, the Canadian government has received unqualified audit opinions on its summary financial statements.

Denmark. In 2008, the government of Denmark established an advisory committee, on the suggestion of the National Audit Office of Denmark, to advise the Minister of Finance on the development and maintenance of governmental accounting. The National Audit Office had come to realize that government accounting standards had to be updated in a more systematic and professional manner. For example, the existing process did not involve all relevant users. More profound discussions of new accounting rules and principles were needed to improve the quality of government accounting information. In the last three decades, the development of accounting principles used by the government had been inspired more or less by management accounting principles, supplemented

in the last decade by introducing capitalization and depreciation of assets. The National Audit Office recognized the importance of seeking inspiration from the international accounting standards for developing its national standards for public sector accounting.

The main tasks of the advisory committee are threefold:

- Study the evolution and applicability of public international accounting standards for use in national governmental accounting.
- Monitor developments in private sector accounting rules and assess their applicability to the public sector.
- Advise the Minister of Finance on questions relating to the development and maintenance of cost-based and expenditure-based accounting in government.

The advisory committee, composed of representatives of the National Audit Office of Denmark and ministries, meets every six months. The committee has discussed issues such as new standards from IPSASB, accounting principles for infrastructure, a pension scheme for civil servants and accounting principles for units outside the grant-funded state account. These discussions are seen as instrumental in the Ministry of Finance's decision making process regarding accounting principles for state accounts.

Conclusion

The setting of standards is not new. For decades, many countries have delivered high-quality, authoritative standards, through their own independent standard-setting bodies. In the public sector, financial statements are important documents that measure the government's stewardship of public funds. Independent and objective financial reporting standards are crucial to the accountability of public sector entities as they set the requirements for preparing their financial statements.

Some countries will choose to continue using their national standards, while others may adapt their national standards to international ones or adopt the international standards outright. Whatever the course they decide to follow, countries must ensure that they have a truly independent standard setter and a transparent, high-quality standard-setting process, which will ensure the credibility and usefulness of government financial reports.

We encourage the INTOSAI Congress to recognize and endorse the importance of an independent standard-setting process, internationally and for each of the INTOSAI member countries. It is through such independent processes that users of financial information—in the public and private sectors—have the assurance that the financial statements they rely on to make important economic decisions or to hold public entities to account are credible and have been prepared without undue influence.