CHAPTER 8

Global Accounting and Auditing Standards

Efforts to "harmonize" accounting around the world began even before the creation of the International Accounting Standards Committee (IASC) in 1973.[1] Companies seeking capital outside of their home markets and investors attempting to diversify their investments internationally faced increasing problems resulting from national differences in accounting measurement, disclosure, and auditing. International accounting harmonization efforts accelerated during the 1990s, matching the growing globalization of international business and securities markets, and the increased cross-listings by companies. The harmonization efforts involved accounting standard setters, securities market regulators, stock exchanges, and those who prepare or use financial statements. The substantial differences in financial reporting requirements and practices around the world, and the increasing need of financial statement users to compare information of companies from different countries, were, and continue to be, the driving forces behind the movement to harmonize accounting.

Harmonized standards are compatible, that is, they do not contain conflicts. The term *convergence* is associated with the International Accounting Standards Board (IASB), discussed later in this chapter. As envisioned by the IASB, the convergence of international and national accounting standards involves the gradual elimination of differences through the cooperative efforts of the IASB, national standard setters, and other groups seeking best solutions to accounting and reporting issues. Thus, the notions behind harmonization and convergence are closely aligned. However, harmonization was generally taken to mean the elimination of differences between existing accounting standards, while convergence might also involve coming up with a new accounting treatment not in any current standard. *Convergence* is now the term most commonly used, and *harmonization* is used much less. It is important to note that neither

[1] The IASC was the predecessor body to the International Accounting Standards Board (IASB).

process necessarily implies replacing national standards with international ones; national and international accounting standards can coexist.[2]

Accounting convergence includes the convergence of (1) accounting standards (which deal with measurement and disclosure), (2) disclosures made by publicly traded companies in connection with securities offerings and stock exchange listings, and (3) auditing standards.[3]

A SURVEY OF INTERNATIONAL CONVERGENCE

Advantages of International Convergence

Proponents of international convergence claim that it has many advantages. Donald T. Nicolaisen, former chief accountant of the U.S. Securities and Exchange Commission, said the following in September 2004:

> At a conceptual level, supporting convergence is easy. An accounting treatment that transparently reflects the economics of a transaction to readers of financial statements in the U.K., will also do so for readers in France, Japan, the U.S. or any other country. Similarly, the auditing requirements and procedures that are the most effective are likely to be the same in the U.S., Canada, China, or Germany. Disclosures relevant to investors in Italy, Greece or the Middle East, are likely to be just as useful to investors in the U.S. and elsewhere. Having high-quality standards for accounting, auditing, and disclosure benefits investors and reduces the cost of accessing the capital markets around the world. In short, convergence is good business and good for investors.[4]

In April 2005, Nicolaisen wrote the following:

> Key forces favoring a single set of globally accepted accounting standards are the continued strong expansion of the capital markets across national borders and the desire by countries to achieve strong, stable and liquid capital markets to fuel economic growth. A thriving capital market requires a high degree of investor understanding and confidence. Converging with or embracing a common set of high quality accounting standards contributes immensely to this investor understanding and confidence.
>
> If a company's financial statements are prepared using accounting standards which are not viewed as being of high quality or with which the investor is unfamiliar, then investors may not be able to fully understand a company's prospects and thus may insist on a risk premium for an

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[2] Thus, one should distinguish between convergence and adoption. Some countries, such as the United States and China discussed in Chapter 4, are converging their national GAAP with International Financial Reporting Standards (IFRS). Other countries, such as those of the European Union discussed in Chapter 3 are adopting IFRS. Some people use the term standardization interchangeably with harmonization and convergence. However, standardization generally means imposing a rigid and narrow set of rules—a one-size-fits-all approach. Harmonization and convergence are more flexible approaches to achieving compatibility.

[3] This is just a partial listing. For example, efforts are also under way to converge auditor education and requirements for offering and listing securities on stock markets.

[4] D. T. Nicolaisen, "Remarks Before the IASB Meeting with World Standard-Setters" (September 28, 2004), www.sec.gov/news/speech/spch092804dtn.htm.

> investment in that company. The relative cost of obtaining capital will thereby increase for those companies. And, at the extreme, if as a result of companies using weak or incomplete accounting standards it becomes excessively time-consuming or difficult for investors to distinguish good investment opportunities from bad, investors may choose instead to invest in what they consider to be safer opportunities rather than in particular securities which may actually offer greater reward.
>
> Financial statements prepared using a common set of accounting standards help investors better understand investment opportunities as opposed to financial statements prepared under differing sets of national accounting standards. Without common standards, global investors must incur the time and effort to understand and convert the financial statements so that they can confidently compare opportunities. This process is time-consuming and can be difficult, sometimes causing investors to resort to educated guesses as to content and comparability. Additionally, if investors are presented with financial information that varies substantially depending on which accounting standards are employed, that can cause investors to have doubt about the actual financial results of a company, resulting in a correspondingly adverse effect on investor confidence. . . .
>
> Embracing a common set of accounting standards can also lower costs for issuers. When companies access capital markets beyond their home jurisdiction, they incur additional costs of preparing financial statements using different sets of accounting standards. These include the costs for company personnel and auditors to learn, keep current with and comply with the requirements of multiple jurisdictions. Similarly, use of resources dedicated to standards writing could potentially be optimized if fewer separate accounting models are pursued.[5]

Finally, a recent paper argued for "global GAAP." Among the benefits cited are:

- High-quality financial reporting standards that are used consistently around the world improve the efficiency with which capital is allocated. The cost of capital will be reduced.
- Investors can make better investment decisions. Portfolios are more diverse and financial risk is reduced. There is more transparency and comparability between competitors in the global markets.
- Companies can improve their strategic decision-making in the merger and acquisition area.
- Accounting knowledge and skills can be transferred seamlessly around the world.
- The best ideas arising from national standard-setting activities can be leveraged in developing global standards of the highest quality.[6]

To summarize, most arguments for accounting convergence relate in one way or another to increasing the operational and allocational efficiency of capital markets.

[5] D. T. Nicolaisen, "A Securities Regulator Looks at Convergence," *Northwestern University Journal of International Law and Business* (April 2005), www.sec.gov/news/speech/spch040605dtn.htm.

[6] PricewaterhouseCoopers, *Global GAAP: The Future of Corporate Reporting* (2003), www.pwcglobal.com.

Criticisms of International Standards

The internationalization of accounting standards has also had critics. As early as 1971 (before the IASC was formed), some said that international standards were too simple a solution for a complex problem. Arguing that accounting, as a social science, has built-in flexibility, critics maintained that the ability to adapt to widely different situations is one of its most important values. They doubted that international standards could be flexible enough to handle differences in national backgrounds, traditions, and economic environments, and some thought that internationalization would be a politically unacceptable challenge to national sovereignty. Many of these doubts and fears continue to be expressed today.

Critics also question whether comparability is the right goal of financial reporting. They worry that reflecting the underlying reality of a company's performance and financial position (that is, achieving a fair presentation) may be sacrificed in pursuit of achieving comparability. They also fear that a global monopoly standard-setter will inhibit innovation and the development of better quality standards. Finally, there are questions about whether comparability can be achieved without proper enforcement and as long as firms' reporting incentives differ across countries.[7]

Other observers claim that large international accounting service firms are using international accounting standards as a tool with which to expand their markets. Multinational accounting firms, they say, are indispensable to apply international standards in national environments where such standards might seem distant and complex. As international financial institutions and international markets insist on the use of international standards, only large international accounting firms will be able to meet the demand.

Finally, some critics maintain that international standards are not suitable for small and medium-sized companies, particularly unlisted ones with no public accountability. Standards written to meet the needs of users in the world's capital markets are unnecessarily complex and require too much detailed disclosure for these types of companies. In such firms, there is often no separation between ownership and management, and shares change hands infrequently—perhaps only on succession in a family business.[8]

Reconciliation and Mutual Recognition

As international equity issuance and trading grow, problems related to distributing financial statements in nondomestic jurisdictions become more important. As already noted, supporters argue that international convergence will help resolve problems associated with filings of cross-border financial statements.

Two other approaches have been advanced as possible solutions to the problems related to cross-border financial statement filings: (1) reconciliation, and (2) mutual recognition (also known as "reciprocity"). With reconciliation, foreign firms can prepare financial statements using home-country accounting standards, but also must provide a reconciliation between critical accounting measures of the home country and the

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[7] For example, institutional differences as discussed in Chapters 2, 3, and 4 shape financial reporting incentives such as meeting earnings forecasts, underreporting liabilities, and smoothing earnings.

[8] See B. Shearer, "In Support of a GAAP Gap," *Accountancy Magazine* (September 2005): 96–97. "Big GAAP/little GAAP" is a familiar theme in accounting. Here, it means international standards for global companies and simplified standards for the others. As noted later in this chapter, *IFRS for SMEs* was issued in 2009 in response to this concern.

country where the financial statements are being filed. For example, the U.S. Securities and Exchange Commission (SEC) permits foreign registrants to file their financial statements using another comprehensive body of accounting principles besides U.S. GAAP or International Financial Reporting Standards (IFRS). However, companies that do so must reconcile net income, shareholders' equity, and earnings per share to U.S. GAAP, if materially different. Reconciliations are less costly than preparing a full set of financial statements under a different set of accounting principles. However, they only provide a summary, not the full picture of the enterprise.

Mutual recognition exists when regulators outside the home country accept a foreign firm's financial statements based on home-country principles. For example, the London Stock Exchange accepts U.S. GAAP-based financial statements in filings made by foreign companies. Reciprocity does not improve the cross-country comparability of financial statements and can create an "unlevel playing field" in that it may allow foreign companies to apply standards less rigorous than those that apply to domestic companies.

Evaluation

The harmonization/convergence debate may never be completely settled. Some arguments against harmonization have merit. However, increasing evidence shows that the goal of international harmonization of accounting, disclosure, and auditing has been so widely accepted that the trend toward international convergence will continue or even accelerate. Debates aside, all dimensions of accounting *are* becoming harmonized worldwide. Many companies are voluntarily adopting International Financial Reporting Standards (IFRS). Growing numbers of countries have adopted IFRS in their entirety, base their national standards on IFRS, or allow the use of IFRS. Leading international organizations and standard-setting bodies throughout the world (the European Commission, World Trade Organization, and Organization for Economic Cooperation and Development, among others) endorse the goals of the International Accounting Standards Board (IASB). Progress in harmonizing disclosure and auditing has been impressive.

Finally, national differences in the underlying factors that lead to variation in accounting, disclosure, and auditing practice are narrowing as capital and product markets become more integrated. As already mentioned, many companies have voluntarily adopted IFRS. They have done so because they see economic benefit in adopting accounting and disclosure standards that are credible internationally. Moreover, as discussed in Chapter 5, companies are voluntarily expanding their disclosures in line with IFRS in response to demand from institutional investors and other financial statement users. The success of recent convergence efforts by international organizations may indicate that convergence is happening as a natural response to economic forces.

SOME SIGNIFICANT EVENTS IN THE HISTORY OF INTERNATIONAL ACCOUNTING STANDARD SETTING

1959—Jacob Kraayenhof, founding partner of a major European firm of independent accountants, urges that work on international accounting standards begin.

1961—Groupe d'Etudes, consisting of practicing accounting professionals, is established in Europe to advise European Union authorities on matters concerning accounting.

1966—Accountants International Study Group is formed by professional institutes in Canada, United Kingdom, and United States.

1973—International Accounting Standards Committee (IASC) is created.

1976—Organization for Economic Cooperation and Development (OECD) issues Declaration on Investment in Multinational Enterprises containing guidelines on "Disclosure of Information."

1977—International Federation of Accountants (IFAC) is founded.

1977—Group of Experts appointed by United Nations Economic and Social Council issues four-part report on *International Standards of Accounting and Reporting for Transnational Corporations.*

1978—Commission of European Community issues Fourth Directive as first move toward European accounting harmonization.

1981—IASC establishes consultative group of nonmember organizations to widen input to international standard setting.

1984—London Stock Exchange states that listed companies not incorporated in United Kingdom or Ireland are to comply with international accounting standards.

1987—International Organization of Securities Commissions (IOSCO) resolves at annual conference to promote use of common standards in accounting and auditing practices.

1989—IASC issues Exposure Draft 32 on comparability of financial statements and publishes *Framework for the Preparation and Presentation of Financial Statements.*

1995—IASC Board and IOSCO Technical Committee agree on work plan whose successful completion will result in IAS forming a comprehensive core set of standards. Successful completion of these standards will allow IOSCO Technical Committee to recommend endorsement of IAS for cross-border capital raising and listing purposes in all global markets.

1995—European Commission adopts new approach to accounting harmonization that allows use of IAS by companies listing on international capital markets.

1996—U.S. Securities and Exchange Commission (SEC) announces that it "supports the IASC's objective to develop, as expeditiously as possible, accounting standards that could be used for preparing financial statements that could be used in cross-border offerings."

1998—IOSCO publishes "International Disclosure Standards for Cross Border Offerings and Initial Listings by Foreign Issuers."

2000—IOSCO accepts all 40 core standards prepared by IASC in response to IOSCO's 1993 wish list.

2000—European Commission proposes regulation requiring all EU companies listed on regulated markets to prepare consolidated accounts in accordance with IAS by 2005.

2001—International Accounting Standards Board (IASB) succeeds IASC and assumes its responsibilities. IASB standards, designated International Financial Reporting Standards (IFRS), include IAS issued by the IASC.

2002—European Parliament endorses Commission proposal that virtually all EU listed companies must follow IASB standards starting no later than 2005 in their consolidated financial statements. Member states may extend requirement to nonlisted companies and to individual company statements. European Council later adopts enabling regulation.

2002—IASB and FASB sign the "Norwalk Agreement" committing them to convergence of international and U.S. accounting standards.

2003—European Council approves amended EU Fourth and Seventh Directives removing inconsistencies between old directives and IFRS.

2004—Australian Accounting Standards Board announces intent to adopt IFRS as Australian accounting standards.

2005—SEC proposes "roadmap" to eliminate requirement for reconciliation between IFRS and U.S. GAAP. SEC and EU Commission later agree on roadmap to eliminate requirement no later than 2009.

2005—Chinese Ministry of Finance commits to converging Chinese accounting standards to IFRS by 2007. Canadian Accounting Standards Board proposes eliminating Canadian GAAP in favor of IFRS by 2011. IASB and Accounting Standards Board of Japan launch convergence project.

2006—FASB and IASB sign memorandum of understanding setting out milestones the two boards must reach in order to demonstrate acceptable level of convergence between U.S. GAAP and IFRS to SEC and EU Commission.

2006—IASB publishes statement on its working relationships with other accounting standard setters.

2006—EU issues Statutory Audit Directive, replacing the Eighth Directive.

2007—Accounting Standards Board of Japan and IASB sign the "Tokyo Agreement" committing them to convergence of Japanese GAAP and IFRS.

2007—SEC eliminates reconciliation requirement for companies using IFRS as promulgated by IASB.

2008—SEC proposes "roadmap" outlining milestones that, if achieved, could lead to mandatory transition to IFRS by U.S. issuers starting in 2014, later changed to 2015.

OVERVIEW OF MAJOR INTERNATIONAL ORGANIZATIONS PROMOTING ACCOUNTING CONVERGENCE

Six organizations have been key players in setting international accounting standards and in promoting international accounting harmonization:

1. International Accounting Standards Board (IASB)
2. Commission of the European Union (EU)
3. International Organization of Securities Commissions (IOSCO)
4. International Federation of Accountants (IFAC)

5. United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), part of United Nations Conference on Trade and Development (UNCTAD)
6. Organization for Economic Cooperation and Development Working Group on Accounting Standards (OECD Working Group)

The IASB represents private-sector interests and organizations. The EU Commission, referred to as the European Commission (EC), the OECD Working Group, and the ISAR are political entities that derive their powers from international agreements. IFAC's main activities include issuing technical and professional guidance and promoting the adoption of IFAC and IASB pronouncements. IOSCO promotes high standards of regulation, including harmonized accounting and disclosure standards for cross-border capital raising and trading.

Also important is the World Federation of Exchanges (WFE), the trade organization for regulated securities and derivative markets worldwide. The WFE promotes the professional business development of financial markets. One of the WFE's goals is to establish harmonized standards for business processes (including financial reporting and disclosure) in cross-border trading in securities, including cross-border public offerings.

Many regional accounting organizations (e.g., the ASEAN Federation of Accountants, the Nordic Federation of Accountants) participate in cross-country standard setting within their respective regions. The Fédération des Experts Comptables Européens (FEE: Federation of European Accountants) represents national accounting bodies in Europe. Other regional organizations include the Fédération des Bourses Européennes (FESE: Federation of European Securities Exchanges) and the Committee of European Securities Regulators (CESR), consisting of securities market regulators from EU member nations.

Refer to Exhibit 8-1 for Web sites offering information about major international organizations. Exhibit 8-2 presents the Web site addresses of national regulatory and accountancy organizations, many of which are actively involved in accounting convergence activities.

INTERNATIONAL ACCOUNTING STANDARDS BOARD

The International Accounting Standards Board (IASB), formerly the IASC, is an independent private-sector standard-setting body founded in 1973 by professional accounting organizations in nine countries and restructured in 2001. (The restructuring made IASC into an umbrella organization under which the IASB carries out its work.)[9] Before the restructuring, the IASC issued 41 International Accounting Standards (IAS) and a Framework for the Preparation and Presentation of Financial Statements. The IASB's objectives are:

1. To develop, in the public interest, a single set of high-quality, understandable, and enforceable global accounting standards that require high-quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions.
2. To promote the use and rigorous application of those standards.

[9] The IASC Foundation will be renamed the International Financial Reporting Standards Foundation sometime during 2010.

EXHIBIT 8-1 Web Sites Offering Information about Major International Organizations and International Convergence Activities

Organization	Web Site Address
Bank for International Settlements	www.bis.org
Committee of European Securities Regulators	www.cesr-eu.org
Confederation of Asian & Pacific Accountants (CAPA)	capa.com.my
Deloitte IAS Plus Web site	www.iasplus.com
European Union (EU)	europa.eu
European Commission—Internal Market and Financial Services	ec.europa.eu/internal_market/index_en.htm
Fédération des Experts Comptables Européens (FEE) a/k/a European Federation of Accountants	www.fee.be
Federation of European Securities Exchanges a/k/a Fédération des Bourses Européennes (FESE)	www.fese.be/en/
International Accounting Standards Board (IASB)	www.iasb.org
International Federation of Accountants (IFAC)	www.ifac.org
International Monetary Fund (IMF)	www.imf.org
International Organization of Securities Commissions (IOSCO)	www.iosco.org
Organization for Economic Cooperation and Development (OECD)	www.oecd.org
United Nations Conference on Trade and Development (UNCTAD)	www.unctad.org
World Bank	www.worldbank.org
World Federation of Exchanges (WFE)	www.world-exchanges.org
World Trade Organization (WTO)	www.wto.org

Note: These listings were correct when this book went to press.

3. In fulfilling the objectives associated with (1) and (2), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies.
4. To bring about convergence of national accounting standards, and International Accounting Standards and International Financial Reporting Standards to high-quality solutions.[10]

The IASB represents accounting organizations from every part of the world. With a remarkably broad base of support, the IASB is the driving force in international accounting standard setting. Exhibit 8-3 lists the current IASB standards (as of April

[10] See the IASB Web site (www.iasb.org).

EXHIBIT 8-2 Web Site Addresses of Selected Regulatory and Accountancy Organizations

Organization	Web Site Address
Government and Regulatory Organizations	
U.K. Financial Services Authority (FSA)	www.fsa.gov.uk
U.S. Public Company Accounting Oversight Board	www.pcaobus.org
U.S. Securities and Exchange Commission (SEC)	www.sec.gov
U.S. Securities and Exchange Commission (SEC) Edgar Database	www.sec.gov/edgar.shtml
French Autorité des Marché Financiers (AMF)	www.amf-france.org
National Professional Accountancy Organizations	
Argentina—Federación Argentina de Consejos Profesionales de Ciencias Económicas	www.facpce.org.ar
Barbados—Institute of Chartered Accountants of Barbados	www.icab.bb
Belgium—Institut des Experts Comptables	www.accountancy.be
Belgium—Institut des Réviseurs d'Entreprises	www.accountancy.be
Canada—Society of Management Accountants of Canada	www.cma-canada.org
Canada—Chartered Accountants of Canada	www.cica.ca
Canada—Certified General Accountants Association of Canada	www.cga-canada.org
China—Chinese Institute of Certified Public Accountants	www.cicpa.org.cn
Cyprus—Institute of Certified Public Accountants of Cyprus	www.icpac.org.cy
Czech Republic—Union of Accountants of the Czech Republic	www.svaz-ucetnich.cz
France—Conseil Supérieur de l'Ordre des Experts-Comptables	www.experts-comptables.com
Georgia—Georgian Federation of Professional Accountants and Auditors	www.gfpaa.ge
Germany—Institut der Wirtschaftsprüfer in Deutschland	www.idw.de
Hong Kong—Hong Kong Institute of Certified Public Accountants	www.hksa.org.hk
Hong Kong—Hong Kong Institute of Accredited Accounting Technicians	www.hkaat.org.hk
India—Institute of Chartered Accountants of India	www.icai.org
Ireland—Institute of Chartered Accountants in Ireland	www.icai.ie
Japan—Japanese Institute of Certified Public Accountants	www.hp.jicpa.or.jp
Jordan—Arab Society of Certified Accountants	www.ascasociety.org
Kenya—Institute of Certified Public Accountants of Kenya	www.icpak.com
Korea—Korean Institute of Certified Public Accountants	www.kicpa.or.kr
Malaysia—Malaysian Institute of Accountants	www.mia.org.my
Malta—Malta Institute of Accountants	www.miamalta.org
Mexico—Instituto Mexicano de Contadores Públicos	www.imcp.org.mx
Nepal—Institute of Chartered Accountants of Nepal	www.ican.org.np
Netherlands—Koninklijk Nederlands Instituut van Registeraccountants	www.nivra.nl

(continued)

EXHIBIT 8-2 Web Site Addresses of Selected Regulatory and Accountancy Organizations (Continued)

Organization	Web Site Address
New Zealand—Institute of Chartered Accountants of New Zealand	www.nzica.com
Nigeria—Institute of Chartered Accountants of Nigeria	www.ican-ngr.org
Norway—Den norske Revisorforeningen (DnR)	www.revisorforeningen.no
Pakistan—Institute of Cost and Management Accountants of Pakistan	www.icmap.com.pk
Pakistan—Institute of Chartered Accountants of Pakistan	www.icap.org.pk
Philippines—Philippine Institute of Certified Public Accountants	www.picpa.com.ph
Romania—Corpul Expertilor Contabili si Contabililor Autorizati din Romania	www.ceccar.ro
Singapore—Institute of Certified Public Accountants of Singapore	www.accountants.org.sg
South Africa—South African Institute of Chartered Accountants (SAICA)	www.saica.co.za
South Africa—South African Institute of Professional Accountants	www.saipa.co.za
Sri Lanka—Institute of Chartered Accountants of Sri Lanka	www.icasrilanka.com
Sweden—Branchorganisationen för revisorer och rådgivare	www.farsrs.se
U.K.— Institute of Chartered Accountants in England & Wales	www.icaew.com
U.K.—Chartered Institute of Management Accountants	www.cimaglobal.com
U.K.—Association of Chartered Certified Accountants	www.acca.org.uk
U.K.—Chartered Institute of Public Finance and Accountancy	www.cipfa.org.uk
U.K.—Institute of Chartered Accountants of Scotland	www.icas.org.uk
U.K.—Association of Accounting Technicians	www.taaieem.org
U.S.—American Institute of Certified Public Accountants	www.aicpa.org
U.S.—National Association of State Boards of Accountancy	www.nasba.org
U.S.—Institute of Management Accountants	www.imanet.org
U.S.— Institute of Internal Auditors	www.theiia.org
Zimbabwe—Institute of Chartered Accountants of Zimbabwe	www.icaz.org.zw
Accounting Standard-Setting Bodies	
Australia—Australian Accounting Standards Board (AASB)	www.aasb.com.au
Canada—Accounting Standards Board (ASB)	www.acsbcanada.org
France—Conseil National de la Comptabilité (CNC)	www.minefi.gouv.fr/directions_services/CNCompta
Germany—German Accounting Standards Committee (GASC)	www.drsc.de
Japan—Accounting Standards Board (ASBJ)	www.asb.or.jp
Netherlands— Dutch Accounting Standards Board	www.rjnet.nl
New Zealand—Accounting Standards Review Board	www.asrb.co.nz
United Kingdom—Accounting Standards Board (ASB)	www.frc.org.uk/asb
United States—Financial Accounting Standards Board (FASB)	www.fasb.org

Note: These listings were correct when this book went to press.

EXHIBIT 8-3 Current IASB Standards

Standard	Description
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 3	No longer effective. Replaced by IAS 27 and IAS 28.
IAS 4	No longer effective. Replaced by IAS 16, 22, and IAS 38.
IAS 5	No longer effective. Replaced by IAS 1.
IAS 6	No longer effective. Replaced by IAS 15.
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 9	No longer effective. Replaced by IAS 38.
IAS 10	Events Occurring after the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 13	No longer effective. Replaced by IAS 1.
IAS 14	No longer effective. Replaced by IFRS 8.
IAS 15	No longer effective. Withdrawn December 2003.
IAS 16	Property, Plant, and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 22	No longer effective. Replaced by IFRS 3.
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 25	No longer effective. Replaced by IAS 39 and IAS 40.
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	No longer effective. Replaced by IFRS 7.
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Disclosures and Presentation
IAS 33	Earnings Per Share
IAS 34	Interim Financial Reporting
IAS 35	No longer effective. Replaced by IFRS 5.
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities, and Contingent Assets

(continued)

EXHIBIT 8-3 Current IASB Standards (Continued)

Standard	Description
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement. Partially replaced by IFRS 9.
IAS 40	Investment Property
IAS 41	Agriculture
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-Based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-Current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosure
IFRS 8	Operating Segments IFRS 9 Financial Instruments

Note: As of April 2010. Consult IASB Web site, www.iasb.org, for current list.

2010).[11] The IASB Web site (www.iasb.org) makes IASB standards freely available to registered users. IASB standards follow the principles of fair presentation and full disclosure (see Chapter 2). Financial reporting and accounting measurement principles are described in Chapter 3. Simplified reporting standards have been issued for small and medium-sized entities.[12]

During the first decade of the IASC, international accounting standards were more descriptive than prescriptive. These early standards codified similar national practices and excluded outlier practices. The IASC began to address more difficult issues during its second 10 years and responded to concerns that its standards included too many alternative accounting treatments and were not rigorous enough.

IASC's Core Standards and the IOSCO Agreement

The IASB (like the former IASC) has been striving to develop accounting standards that will be accepted by securities regulators around the world. As part of this effort, the IASC adopted a work plan to produce a comprehensive core set of high-quality standards. In July 1995, the IOSCO Technical Committee stated its agreement with the work

[11] Standards issued by the IASB are referred to as International Financial Reporting Standards (IFRS); those issued by the IASC are called International Accounting Standards (IAS). The IASB has adopted all previously issued IAS. All references to IFRS include IAS.

[12] Issued in 2009, *IFRS for SMEs* simplifies recognition and measurement requirements. For example, (a) property, plant, and equipment and intangibles are valued at historical cost—the revaluation option is removed; (b) all intangible assets, including goodwill, are presumed to have a ten-year life and are amortized over that period; (c) development costs are expensed; and (d) the cost model is permitted for investments in associates and joint ventures. Disclosure requirements are also reduced. For example, the disclosure of earnings per share and operating segment reporting are not required. The volume of accounting guidance is reduced by more than 85 percent compared to full IASB standards.

plan. The Core Standards were completed with the approval of IAS 39 in December 1998. IOSCO's review of the Core Standards began in 1999, and in 2000 it endorsed the use of IASC Standards for cross-border offerings and listings.

The IASB Structure

The IASC board formed a Strategy Working Party (SWP) to consider what the IASC's strategy and structure should be after completion of the core standards work program. In 1998, the SWP approved a discussion paper, "Shaping IASC for the Future," to encourage and focus discussion. In 1999, the IASC board unanimously approved a resolution supporting a proposed new structure with the following main features: (1) IASC would be established as an independent organization; (2) the organization would have two main bodies, the trustees and the board, as well as a Standing Interpretations Committee (now called the International Financial Reporting Interpretations Committee) and a Standards Advisory Council (now called the IFRS Advisory Council); and (3) the trustees would appoint the board members, exercise oversight, and raise the funds needed, whereas the board would have sole responsibility for setting accounting standards. A monitoring board of securities market regulators was established in 2009 to oversee the activities of the trustees.

The IASB includes the following bodies.[13]

1. ***Trustees.*** The IASB has 22 trustees: six from North America, six from Europe, six from the Asia/Oceania region, and four from any area ("subject to establishing overall geographic balance").[14] The trustees appoint the members of the board, the International Financial Reporting Interpretations Committee, and the IFRS Advisory Council. The trustees are responsible for raising funds, and supervise and review the priorities and operations of the IASB.
2. ***Monitoring Board.*** The Monitoring Board was recently established to provide a formal link between the trustees and capital market authorities. The Monitoring Board has one representative from the European Commission, two from the International Organization of Securities Commissions, one from the Japanese Financial Services Agency, and one from the U.S. Securities and Exchange Commission. There is also an observer, representing the Basel Committee on Banking Supervision.[15] The Monitoring Board appoints the trustees and provides oversight over their activities.
3. ***IASB Board.*** The board establishes and improves standards of financial accounting and reporting for businesses. Its responsibilities include "complete responsibility for all IASB technical matters including the preparation and issuing of International Accounting Standards, International Financial Reporting Standards, and exposure drafts . . . and final approval of Interpretations by the

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[13] Much of this section is based on information published on the IASB Web site (www.iasb.org). The IASB structure is modeled after the U.S. accounting standard-setting structure, as described in Chapter 4.
[14] All direct quotations in this section are from the IASB constitution (revised February 2009), found on its Web site (www.iasb.org).
[15] The European Commission and the International Organization of Securities Commissions are discussed later in this chapter. The Japanese Financial Services Agency and the U.S. Securities and Exchange Commission are discussed in Chapter 4.

International Financial Reporting Interpretations Committee," and approving the technical agenda and the conduct of its work. The board consists of 15 members, appointed by the trustees to provide "the best available combination of technical expertise and diversity of international business and market experience."[16] All board members are paid IASB employees. Up to three members may be part-time; the rest are full-time. To ensure geographic diversity, the board will normally have four members from North America, four from Europe, four from the Asia/Oceania region, one from Africa, one from South America, and the rest from any area ("subject to maintaining overall geographic balance"). The board maintains liaison with national standard setters and other official bodies concerned with standard setting. (The purpose is to partner with these national bodies to achieve the convergence of national and international accounting standards.)[17] Members are appointed for a five-year term, renewable once.

4. ***International Financial Reporting Interpretations Committee (IFRIC).*** The IFRIC consists of 14 members appointed by the trustees. The IFRIC interprets "the application of International Accounting Standards and International Financial Reporting Standards and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of IASB's Framework," publishes draft interpretations and reviews public comments on them, and obtains board approval for final interpretations.
5. ***IFRS Advisory Council.*** The IFRS Advisory Council, appointed by the trustees, is made up of "thirty or more members, having a diversity of geographic and professional backgrounds, appointed for renewable terms of three years." The council was reconstituted in 2009 so that it is made up of individuals representing a wide range of investor groups relevant to the accounting standard-setting process.[18] The IFRS Advisory Council normally meets three times each year. Its responsibilities are to give the board advice on its agenda and priorities, inform the board of the views "of the organizations and individuals on the council on major standard setting projects," and give "other advice" to the board or the trustees.

The IASB follows due process in setting accounting standards. For each standard, the board normally publishes a discussion paper that sets out the possible requirements for the standard and the arguments for and against each one. Subsequently, the board publishes an exposure draft for public comment, and it then examines the arguments put forward in the comment process before deciding on the final form of the standard. An exposure draft and final standard can be issued only when nine members of the board have voted in favor of doing so.[19]

[16] By July 1, 2012, there will be 16 IASB Board members.
[17] The IASB has formal liaison relationships with standard setters in Australia and New Zealand, Canada, France, Germany, Japan, the United Kingdom, the United States, and the Technical Expert Group of the European Financial Reporting Advisory Group (EFRAG, discussed later in this chapter).
[18] For example, there are representatives from the major accounting firms, the World Bank, the International Monetary Fund, Financial Executives International, Committee of European Securities Regulators, and the International Organization of Securities Commissions. A complete list of SAC members is available on the IASB Web site, www.iasb.org.
[19] The number increases to ten when the board becomes 16 members.

Recognition and Support for the IASB

International Financial Reporting Standards are now widely accepted around the world. They are (1) used by many countries as the basis for national accounting requirements or are adopted entirely; (2) accepted by many stock exchanges and regulators that allow foreign or domestic companies to file financial statements prepared in conformance with IFRS; and (3) recognized by the EC and other supranational bodies. In 1995, the EC endorsed IFRS. Rather than amend existing directives, the EC determined that the EU should associate with IASC/IASB and IOSCO efforts toward a broader international harmonization of accounting standards. EU companies listed on recognized stock exchanges now use IFRS in preparing consolidated financial statements.

The signing of the 2002 "Norwalk Agreement" by the IASB and U.S. Financial Accounting Standards Board symbolized the commitment of national standard setters to converge toward a single set of international accounting standards worldwide. The Australian Accounting Standards Board has adopted IFRS as Australia's accounting standards. China and Japan have committed to converging their respective national accounting standards to IFRS. The Canadian Accounting Standards Board will replace Canadian accounting standards with IFRS in 2011. Standard setters from Australia/New Zealand, Canada, France, Germany, Japan, the United Kingdom, and the United States actively partner with the IASB in its standard-setting activities.

U.S. Securities and Exchange Commission Response to IFRS

During the 1990s, the SEC came under increasing pressure to make U.S. capital markets more accessible to non-U.S. issuers. At the time, the SEC expressed support for the IASB's objective to develop accounting standards for use in financial statements used in cross-border offerings. However, the SEC also stated that three conditions must be met for it to accept IASB standards.[20]

1. The standards must include a core set of accounting pronouncements that constitutes a comprehensive, generally accepted basis of accounting.
2. The standards must be of high quality—they must result in comparability and transparency, and they must provide for full disclosure.
3. The standards must be rigorously interpreted and applied.

Later, senior officials of the SEC indicated that if the IASB and FASB make sufficient progress in converging their standards, and if sufficient progress is made in creating an infrastructure for interpreting and enforcing accounting standards, the SEC would consider allowing foreign registrants to file in the United States using IFRS without reconciling to U.S. GAAP.

In 2005, the SEC issued a "roadmap" setting out the steps for eliminating the requirement to reconcile IFRS to U.S. GAAP. The SEC roadmap reaffirmed that sufficient convergence must have been achieved between the two sets of standards and that the SEC has confidence in auditing and enforcement practices. The SEC and the EU Commission (discussed next) signed an agreement on the roadmap later that same year. In 2006, the FASB and IASB signed a memorandum of understanding on how they will achieve convergence

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[20] U.S. Securities and Exchange Commission, "News Release—SEC Statement Regarding International Accounting Standards" (Washington, DC: U.S. Securities and Exchange Commission, April 11, 1996).

between U.S. GAAP and IFRS in order for the SEC to eliminate the reconciliation requirement. This memorandum of understanding is essentially their own roadmap containing a "to do" list and milestones for achieving equivalence between the two sets of standards. In 2007, the SEC eliminated the reconciliation requirement for companies using IFRS. The SEC's decision indicates confidence in the quality and application of IFRS and in the convergence process between the FASB and IASB. The FASB/IASB memorandum of understanding was updated in 2008, setting out major convergence goals to be achieved by 2011.

The SEC is currently studying whether to allow, or even require, U.S. companies to use IFRS. Opponents of the idea question whether principles-based IFRS would be workable in the litigious U.S. environment. Opponents believe that U.S. interests are best served by keeping U.S. GAAP for U.S. companies and continuing the effort to converge U.S. GAAP and IFRS. They worry about accounting standards that are not "made in America." However, proponents argue that a single set of high-quality global standards is the right goal. They argue that IFRS will continue to improve over time and that the convergence process—already long, difficult, and costly—is unlikely to be wholly successful in eliminating differences between U.S. GAAP and IFRS. An SEC proposal issued in 2008 could eventually lead to the mandatory transition to IFRS by U.S. registrants. (The originally proposed start date of 2014 was later changed to 2015.)

EUROPEAN UNION (EU)

The Treaty of Rome established the European Economic Community (EEC, later called the European Community) in 1957, with the goal of harmonizing the legal and economic systems of its member states. The EEC was absorbed into the European Union (EU) when it came into existence in 1993, as a result of the (1992) Maastricht Treaty. The EU now comprises 27 member countries (Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom). In contrast to the IASB, which has no authority to require implementation of its accounting standards, the European Commission (EC, the governing body of the EU) has full enforcement powers for its accounting directives throughout the member states.

One of the EU's goals is to achieve integration of European financial markets. Toward this end, the EC has introduced directives and undertaken major initiatives to achieve a single market for:

- raising capital on an EU-wide basis
- establishing a common legal framework for integrated securities and derivatives markets
- achieving a single set of accounting standards for listed companies

The EC embarked on a major program of company law harmonization soon after it was formed.[21] EC directives now cover all aspects of company law. Several have a

[21] EU directives become the law of member states through a complex, lengthy process. Preliminary work leads to the issuance of a draft directive (i.e., exposure draft) by the EU. When a draft directive is broadly acceptable (after hearings and other evaluation procedures), it is submitted to the member states for ratification after approval from the European Council. After the EU adopts a directive, each member state adopts and implements it. Directives are binding on member states, but the method of implementation is left to the discretion of national authorities.

direct bearing on accounting. Many observers consider the Fourth, Seventh, and Eighth Directives to be historically and substantively the most important.

Fourth, Seventh, and Eighth Directives

The EU's Fourth Directive, issued in 1978, is the broadest and most comprehensive set of accounting rules within the EU framework. Both public and private companies above certain minimum size criteria must comply. Fourth Directive requirements apply to individual company accounts and include format rules for financial statements, disclosure requirements, and valuation rules. The true and fair view is the overriding requirement and holds for footnote disclosures just as it does for financial statements. The Fourth Directive also requires that financial statements be audited. It aims to ensure that European companies disclose comparable and equivalent information in their financial statements.

The Seventh Directive, issued in 1983, addresses the issue of consolidated financial statements. At the time, consolidated financial statements were the exception rather than the rule. They were the norm in Ireland, the Netherlands, and the United Kingdom, and Germany required consolidation of German subsidiaries (only). Elsewhere in Europe consolidated statements were rare. The Seventh Directive requires consolidation for groups of companies above a certain size, specifies disclosures in notes and the directors' report, and requires an audit. Because of the newness of consolidations as a legal requirement, member states were given wide latitude and many options for incorporating the Seventh Directive into their individual national company laws.

The Eighth Directive, issued in 1984, addresses various aspects of the qualifications of professionals authorized to carry out legally required (statutory) audits. Essentially, this directive lays down minimum qualifications for auditors. It covers requirements for the education and training of auditors and independence. The Eighth Directive was substantially amended in 2006 and is now referred to as the Statutory Audit Directive. The new directive is a response to accounting scandals involving European companies such as Parmalat, the Italian dairy company, and Ahold, the Dutch grocery chain, as well as to the American accounting scandals involving WorldCom, Global Crossing, and Enron, and others. It includes requirements for the appointment and removal of auditors, audit standards, continuing professional education, auditor rotation, and public oversight. It requires that all statutory audits in the EU observe International Standards on Auditing (discussed later). Among its more important provisions is one requiring each member state to establish a public oversight body for the audit profession and the establishment of the European Group of Auditors' Oversight Bodies (EGAOB) to coordinate their activities. Exhibit 8-4 compares certain features of the Statutory Audit Directive to the U.S. Sarbanes-Oxley Act (see Chapter 4).

Transparency Directive

The 2007 Transparency Directive harmonized certain requirements for annual and interim reporting for listed companies. Among the provisions are requirements that the annual report must be released no later than four months after year-end and the half-yearly (financial) report must be released within two months of the half-year date. Both reports must contain a "responsibility statement" by which the board of directors confirms that the financial statements give a true and fair view. A narrative management

EXHIBIT 8-4 Comparison of EU Statutory Audit Directive and U.S. Sarbanes-Oxley Act

Issue	EU Statutory Audit Directive	U.S. Sarbanes-Oxley Act
Audit committees	Required for listed companies. Appoints or dismisses the auditor. At least one member must be independent. At least one member must have financial expertise.	Required for listed companies. Appoints or dismisses the auditor. Committee must be independent. At least one member must have financial expertise. Also requires procedures for complaints from whistleblowers.
Internal controls	Audit firm must report on key matters that arise from the audit, especially weaknesses in internal controls.	Same. Requirements are more detailed.
Public oversight of auditors	Each member state must appoint an oversight body for auditors.	Public Company Accounting Oversight Board (PCAOB) oversees audit of public companies, establishes standards for auditing, quality control, ethics, and independence of audit firms.
Firm vs. partner rotation	Key audit partner rotation every seven years, with member-state option of rotation of audit firm.	Lead audit partner must rotate every five years.
Auditing standards	International Standards on Auditing.	PCAOB standards.

report discussing the company's material evens and transactions, performance, and financial position must be released quarterly.

Have EU Harmonization Efforts Been Successful?

The Fourth and Seventh Directives had a dramatic impact on financial reporting throughout the EU, bringing accounting in all the member states up to a good and reasonably uniform level. It harmonized the presentation of the profit and loss account (income statement) and balance sheet and added minimum supplementary information in the notes, in particular a disclosure of the impact of tax regulations on reported results. It accelerated accounting development in many EU countries and also influenced accounting in neighboring, non-EU countries.

However, the success of EU harmonization efforts has been debated. For example, member states generally did not scrap their existing accounting rules when adopting EU directives. Instead, they adapted the new rules to their existing ones. Another issue is the extent to which member states enforced compliance with the directives. Thus, some question whether the directives harmonized accounting as much as had been intended when they were issued.[22]

[22] Peter Walton, "European Harmonization," in *International Finance and Accounting Handbook*, ed. Frederick D. S. Choi, 3rd ed. (New York: John Wiley, 2003).

Karel van Hulle, former head of the accounting and audit unit at the European Commission, described some of the difficulties.

> It must be admitted that the comparability achieved through the harmonisation process is far from perfect. First of all, the Accounting Directives contain primarily minimum rules. They are *not* dealing with a number of important accounting issues. Secondly, the provisions of the Directives are not always interpreted in the same way by Member States. A number of questions relating to the interpretation of the Directives have been dealt with by the Contact Committee on the Accounting Directives.[23] Other questions have remained on the table. It has been difficult to arrive at an agreed position on these questions because the text of the Directives often leaves much scope for interpretation and Member States were not prepared to compromise on the interpretation. The general wording of some of the provisions in the Accounting Directives has been an important reason why the Commission has not brought some of these questions before the European Court of Justice for a final ruling.[24]

The EU's New Approach and the Integration of European Financial Markets

In 1995, the EC adopted a new approach to accounting harmonization, referred to as the New Accounting Strategy. The commission announced that the EU needed to move promptly in order to give a clear signal that companies seeking listings in the United States and other world markets will be able to remain within the EU accounting framework. The EC also stressed that the EU needed to strengthen its commitment to the international standard-setting process that offers the most efficient and rapid solution for the problems of companies operating on an international scale.

In 2000, the EC adopted a new financial reporting strategy. The cornerstone of this strategy was a proposed regulation that all EU companies listed on regulated markets, including banks, insurance companies, and SMEs (small and medium-sized companies), prepare consolidated accounts in accordance with IFRS. (Unlisted SMEs are not covered, but may find it in their interest to adopt IFRS voluntarily, especially if they seek international capital.) The EU Parliament endorsed this proposal, and the EU Council adopted the necessary enabling legislation in 2002.[25]

This regulation affected some 7,000 listed EU companies (compared with nearly 300 listed EU companies that used IFRS in 2001). It is designed "to encourage cross-border trade in financial services and so create a fully-integrated market, by helping to make financial information more transparent and easily comparable."[26]

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[23] European Commission Contact Committee on the Accounting Directives, *The Accounting Harmonisation* in the European Community: *Problems of Applying the Fourth Directive on the Annual Accounts of Limited Companies* (Luxembourg: Office for Official Publications of the European Communities, 1990).

[24] Karel van Hulle, "International Harmonisation of Accounting Principles: A European Perspective," *Wirtschaftsprüferkammer—Mitteilungen,* special edition (June 1997): 44–50.

[25] Regulation (EC) No. 1606/2002. Member states may extend this requirement to all companies, not just listed ones, including individual company accounts.

[26] "International Accounting Standards: Mandatory for Listed Companies by 2005," *Single Market News*, no. 25 (March 2001): 18–19.

To become legally binding, IFRS must be adopted by the EC. Included in the above regulation is a two-tiered "endorsement mechanism" and the establishment of the Accounting Regulatory Committee (ARC), an EU body with representatives from member states. An IFRS is first given a technical review and opinion by the European Financial Reporting Advisory Group (EFRAG), a private-sector organization of auditors, preparers, national standard setters, and others.[27] The Standards Advice Review Group, an EU body of independent experts and representatives of national standard setters, next assesses whether EFRAG's endorsement advice is well balanced and objective. Then the ARC recommends that the IFRS be endorsed (or not) based on whether it is compatible with European directives and conducive to the European public good. EC endorsement completes the process. The entire endorsement process normally takes around 10 months. To date, all IFRS have been endorsed, with the exception of one "carve-out" to IAS 39.[28] The Fourth and Seventh Directives were also amended in 2003 to remove inconsistencies between the old directives and IFRS. Auditor's reports refer to IFRS "as adopted by the European Union."

Finally, there have been developments designed to strengthen enforcement of IRFS in Europe. In 2003, the Committee of European Securities Regulators adopted Standard 1 on Financial Information. This standard contains 21 principles aimed at developing and implementing a common approach to the enforcement of IFRS throughout the EU.[29] Standard 2 on Financial Information Coordination and Enforcement Activities was issued to provide a framework for coordinating enforcement in the EU.[30]

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

The International Organization of Securities Commissions (IOSCO) consists of securities regulators from more than 100 countries. The objectives of IOSCO's member agencies are:

- To cooperate together to promote high standards of regulation in order to maintain just, efficient, and sound markets
- To exchange information on their respective experiences in order to promote the development of domestic markets
- To unite their efforts to establish standards and an effective surveillance of international securities transactions
- To provide mutual assistance to promote the integrity of the markets by a rigorous application of the standards and by effective enforcement against offenses

Together, IOSCO members are responsible for regulating more than 90 percent of global securities markets. As financial markets have become increasingly global,

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[27] The EFRAG Web site is www.efrag.org.

[28] A carve-out is an exception to one or more provisions of a particular standard. The EC has endorsed IAS 39 with the exception of its provisions on hedge accounting. This carve-out allows entities to use hedge accounting in circumstances that are not permitted by IAS 39.

[29] *Standard No. 1 on Financial Information: Enforcement of Standards on Financial Information in Europe*, CESR 03–073 (March 12, 2003). CESR was established in 2001 as an EC advisory group on securities market regulation. Its Web site is www.cesr-eu.org.

[30] *Standard No. 2 on Financial Information Coordination and Enforcement Activities* CESR 03-317c (April 2004).

cross-border cooperation among securities regulators has become an increasingly important objective for the organization.

IOSCO has worked extensively on international disclosure and accounting standards to facilitate the ability of companies to raise capital efficiently in global securities markets. In 1998, IOSCO published a set of nonfinancial disclosure standards that may eventually enable companies to use a single prospectus to offer or list shares on any of the world's major capital markets. Securities regulators worldwide are increasingly adopting these standards.

An IOSCO technical committee focuses on multinational disclosure and accounting. Its main objective is to facilitate the process whereby world-class issuers can raise capital in the most effective and efficient way on all capital markets where investor demand exists. It cooperates with the IASB by, among other activities, providing input on IASB projects. It has endorsed IFRS for cross-border securities offerings. A working-party study completed in 1998 presented recommendations for facilitating multinational equity offerings. The report recommended "that regulators be encouraged, where consistent with their legal mandate and the goal of investor protection, to facilitate the use of single disclosure documents, whether by harmonisation of standards, reciprocity or otherwise."[31]

Exhibit 8-5 presents a brief summary of the 10 disclosure standards. The summary is important because it indicates the comprehensiveness proposed by the working party. The disclosure standards proposed are also highly detailed.

In 2002, a companion disclosure document for ongoing disclosures was published. Excerpts from this document are reproduced in Exhibit 8-6.

EXHIBIT 8-5 **Summary of International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers**

1. **Identity of Directors, Senior Management, and Advisers and Responsibility Statement**
   This standard identifies the company representatives and other individuals involved in the company's listing or registration, and indicates the persons responsible. The definition of the persons covered by this standard may vary in each country and would be determined by host country law.
2. **Offer Statistics and Expected Timetable**
   This standard provides key information regarding the conduct of any offering and the identification of important dates relating to the offering. It is understood that listings do not always involve offerings.
3. **Key Information**
   This standard summarizes key information about the company's financial condition, capitalization, and risk factors.
4. **Information on the Company**
   This standard provides information about the company's business operations, the products it makes or the services it provides, and the factors that affect the business.
5. **Operating and Financial Review and Prospects**
   This standard provides management's explanation of factors that have affected the company's financial condition and results of operations, and management's assessment of factors and trends

(continued)

[31] International Organization of Securities Commissions, *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Firms*, 1998.

EXHIBIT 8-5 Summary of International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers (Continued)

that are anticipated to have a material effect on the company's financial condition and results of operations in future periods. In some countries, a forecast or statement of the company's prospects for the current year and/or other future periods may be required.

6. **Directors and Officers**

   This standard provides information concerning the company's directors and managers that will allow investors to assess their experience, qualifications, and levels of compensation, as well as their relationship with the company. The definition of the persons covered by this disclosure standard may vary in each country and would be determined by host country law. Information is also required concerning the company's employees.

7. **Major Shareholders and Related-Party Transactions**

   This standard provides information regarding the major shareholders and others that control or may control the company. The standard also provides information regarding transactions the company has entered into with persons affiliated with the company and whether the terms of such transactions are fair to the company.

8. **Financial Information**

   This standard specifies which financial statements must be included in the document, as well as the periods to be covered, the age of the financial statements, and other information of a financial nature. The country in which the company is listed (or is applying for listing) will determine the comprehensive bodies of accounting and auditing principles that will be accepted for use in preparation and audit of the financial statements.

9. **The Offer**

   This standard provides information regarding the offer of securities, the plan for distribution of the securities, and related matters.

10. **Additional Information**

    This standard provides information, most of it of a statutory nature, that is not covered elsewhere in the document.

Source: International Organization of Securities Commissions (IOSCO), *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers,* 1998 (public document).

EXHIBIT 8-6 Principles for Ongoing Disclosure and Reporting of Material Developments

1. **The Key Elements of an Ongoing Disclosure Obligation**

   Listed entities should have an ongoing disclosure obligation requiring disclosure of all information that would be material to an investor's investment decision.

2. **Timeliness**

   The listed entity shall disclose ongoing information on a timely basis, which could require disclosure on:

   a. an immediate basis for disclosure of material developments, where such a term could be defined as "as soon as possible" or prescribed as a maximum of specified days; and

   b. a periodic basis, prescribed by law or listing rules, such as quarterly or annual reports. Such information would also include management discussion and analysis (MD&A), where required, which can be disclosed in a separate report or included in a periodic report.

(continued)

EXHIBIT 8-6 Principles for Ongoing Disclosure and Reporting of Material Developments (Continued)

The disclosure obligation may require disclosure of relevant information on an immediate basis even when it belongs to periodic reporting.

3. **Simultaneous and Identical Disclosure**

   If the entity is listed in more than one jurisdiction, the information released under the ongoing disclosure obligation of one jurisdiction where it is listed should be released on an identical basis and simultaneously in all the other jurisdictions where it is listed. This obligation should not be dependent on where the listed entity is principally listed.

4. **Dissemination of Information**

   Under the ongoing disclosure obligation, listed entities should ensure that full information is promptly made available to the market by using efficient, effective, and timely means of dissemination.

5. **Disclosure Criteria**

   Ongoing disclosure of information should be fairly presented, not be misleading or deceptive, and contain no material omission of information.

6. **Equal Treatment of Disclosure**

   The information to be disclosed in compliance with the ongoing disclosure obligation should not be disclosed to selected investors or other interested parties before it is released to the public. Certain narrow exceptions may be permitted to this principle to allow communications with advisers and rating agencies or, in the ordinary course of business, communications with persons with whom the listed entity is negotiating, or intends to negotiate, a commercial, financial, or investment transaction or representatives of its employees or trade unions acting on their behalf. In all these cases, the recipients have a duty to keep the information confidential.

Source: International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities: A Statement of the Technical Committee*, October 2002 (public document).

INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

High-quality auditing standards are necessary to ensure that accounting standards are rigorously interpreted and applied. Auditors validate and add credibility to external financial reports. Credible financial reporting is at the core of the efficient functioning of capital markets. International accounting and auditing standards are interrelated. Accounting standards define what is useful accounting information. Auditing standards guide the auditor in determining whether the information is reliable. Useful and reliable accounting information puts investors, creditors, and others in a position to make better decisions. It therefore makes sense that the development of international accounting and auditing standards should be aligned.

External auditing in 10 countries of Europe, the Americas, and Asia was discussed in Chapters 3 and 4. From this discussion, the following points about (independent, external) auditing may be discerned:

1. The main purpose of an external audit varies around the world. For example,
   a. In the United States, auditors attest to whether financial statements "present fairly" a company's financial position and results. The test of fair presentation is compliance with (U.S.) GAAP.

   b. In the United Kingdom, auditors attest to whether financial statements present a "true and fair view" of a company's financial position and results. There is a "true and fair override" of U.K. GAAP.
   c. In Germany, auditors primarily attest to whether financial statements comply with the law.

2. Auditor responsibility varies around the world. For example,
   a. In France, auditors must report criminal acts they become aware of to the state prosecutor, in addition to their other responsibilities.
   b. In Germany, auditors must provide a private report to the company's managing board of directors and supervisory board on the company's future prospects, in addition to their other responsibilities.

3. Who can conduct an audit varies around the world. For example,
   a. In the United States, only certified public accountants may do so.
   b. In the United Kingdom, members of four professional associations are allowed to do so: chartered accountants in England and Wales, chartered accountants in Scotland, chartered accountants in Ireland, and chartered certified accountants.
   c. In the Netherlands, administrative accountants may audit smaller companies, while *registeraccountants* may audit all companies.
   d. In Germany, sworn book examiners audit small and medium-sized companies, while *wirtschaftsprüfer* may audit all companies.

4. Nations have taken steps to tighten control over the auditing profession. Recently established oversight bodies include:
   a. The Public Company Accounting Oversight Board in the United States. It is a government agency established as a result of the Sarbanes-Oxley Act.
   b. The Haut Counseil du Commissariat aux Comptes (High Council of External Auditors) in France. It is overseen by the Ministry of Justice.
   c. The Professional Oversight Board in the United Kingdom. It is overseen by the Financial Reporting Council, an independent private-sector body.
   d. The Certified Public Accountant and Auditing Oversight Board in Japan. It is overseen by the Financial Services Agency, a government agency.

5. Auditors are facing increasing responsibility for improving corporate governance. For example,
   a. In the United States, auditors express an opinion on internal controls (for listed companies).
   b. In Japan, auditors express an opinion on management's assessment of the internal controls (for listed companies).

The rationale for converging accounting standards was made earlier in this chapter. Comparability is necessary so that investors can make "apples to apples" comparisons. The reason for converging auditing standards is subtler. Fundamentally, an audit assures users that they can trust the information communicated by the financial statements. However, if auditors around the world are not comparably trained or do not observe comparable standards, then their work varies in quality. As a result, the inherent reliability of financial statements also varies. (See Chapter 9 for further discussion on international auditing issues, both internal and external.)

IFAC is a worldwide organization with 157 members and associates in 123 countries, representing more than 2.5 million accountants. Organized in 1977, its mission is "to strengthen the accountancy profession worldwide and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant."[32]

IFAC is governed by the IFAC Council, which is made up of one representative from each member organization. The council elects the IFAC board, which is responsible for setting policy and overseeing IFAC operations, the implementation of programs, and the work of IFAC's standard-setting groups and committees. The Public Interest Oversight Board (PIOB) is an independent body that provides additional oversight. Day-to-day administration is provided by the IFAC chief executive located in New York, which is staffed by accounting professionals from around the world.

IFAC's professional work is done through its standard-setting boards and standing committees. The IFAC standard-setting boards are:

- International Accounting Education Standards Board
- International Auditing and Assurance Standards Board
- International Ethics Standards Board for Accountants
- International Public Sector Accounting Standards Board

The IFAC standing committees are the following:

- Compliance Advisory Panel
- Developing Nations Committee
- Nominating Committee
- Professional Accountants in Business Committee
- Small and Medium Practices Committee
- Transnational Auditors Committee

IFAC's International Auditing and Assurance Standards Board issues International Standards on Auditing (ISA), which are organized into the following groups:

- General Principles and Responsibilities
- Risk Assessment and Response to Assessed Risk
- Audit Evidence
- Using Work of Others
- Audit Conclusions and Reporting
- Specialized Areas[33]

IFAC has close ties with other international organizations, such as IASB and IOSCO. The financial statements of an increasing number of companies are being audited in conformity with IFAC's International Standards on Auditing. As noted earlier, all financial statement audits in the EU must follow ISA.

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[32] IFAC 2008 Annual Report (www.ifac.org).
[33] The *Handbook of International Standards on Auditing and Quality Control* is available at the IFAC Web site (www.ifac.org).

UNITED NATIONS INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING (ISAR)

ISAR was created in 1982 and is the only intergovernmental working group devoted to accounting and auditing at the corporate level. "ISAR assists developing countries and economies in transition to implement best practices in corporate transparency and accounting in order to facilitate investment flows and economic development. ISAR achieves this through an integrated process of research, intergovernmental consensus building, information dissemination, and technical cooperation."[34] ISAR discusses and publishes best practices, including those recommended by the IASB.

ISAR was an early proponent of environmental reporting, and recent initiatives have focused on IFRS implementation, corporate governance, disclosure, corporate responsibility reporting, and accounting by small and medium-sized enterprises. It has also conducted technical assistance projects in a number of areas, such as accounting reform and retraining in the Russian Federation, Azerbaijan, and Uzbekistan, and designing and developing a long-distance learning program in accountancy for French-speaking Africa. Its *ISAR Update* is published twice a year.

ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

The OECD is the international organization of 30 (mostly industrialized) market-economy countries. It functions through its governing body, the OECD Council, and its network of about 200 committees and working groups. Its journal *Financial Market Trends,* issued twice a year, assesses trends and prospects in the international and major domestic financial markets of the OECD area. Descriptions and analyses of the structure and regulation of securities markets are often published either as OECD publications or as special features in *Financial Market Trends.* An important activity is promoting good governance in the public and private sectors. (See Chapter 5 for a discussion of *OECD Principles of Corporate Governance*.) With its membership consisting of mostly larger, industrialized countries, the OECD is often a counterweight to other bodies (such as the United Nations and the International Trade Union Confederation) that have built-in tendencies to act contrary to the interests of its members.[35]

CONCLUSION

Most people now believe that international convergence is necessary to reduce the regulatory barriers to cross-border capital-raising efforts. The debate is no longer *whether* to converge, nor even *how* to converge. Although national differences in environmental factors that affect accounting development (such as systems of corporate governance and finance) will persist for some time, financial reporting systems are converging

[34] ISAR Web site (www.unctad.org/Templates/Startpage.asp?intItemID=2531&lang=1), June 2009.
[35] From the OECD Web site (www.oecd.org), April 1, 1998.

as international capital markets become more investor oriented. The International Accounting Standards Board is at the center of this movement. These days it is impossible to address capital market and stock exchange regulatory issues without considering international convergence of accounting principles, disclosure, and auditing.

Discussion Questions

1. Distinguish between the terms "harmonization" and "convergence" as they apply to accounting standards.
2. Compare and contrast the following proposed approaches for dealing with international differences in accounting, disclosure, and auditing standards: (1) reciprocity, (2) reconciliation, and (3) international standards.
3. What are the key rationales that support the development and widespread application of International Financial Reporting Standards?
4. What are the key rationales *against* the development and widespread application of International Financial Reporting Standards?
5. What evidence is there that International Financial Reporting Standards are becoming widely accepted around the world? Do you believe that worldwide convergence of accounting standards will end investor concerns about cross-national differences in accounting practices? Why or why not?
6. Describe the structure of the International Accounting Standards Board and how it sets International Financial Reporting Standards.
7. What is the purpose of accounting harmonization in the European Union (EU)? Why did the EU abandon its approach to harmonization via directives to one favoring the IASB?
8. Why is the concept of auditing convergence important? Will international harmonization of auditing standards be more or less difficult to achieve than international harmonization of accounting principles? Describe IFAC's work on converging auditing standards.
9. Describe IOSCO's work on harmonizing disclosure standards for cross-border offerings and initial listings by foreign issuers. Why is this work important to securities regulators around the world?
10. What role do the United Nations and the Organization for Economic Cooperation and Development play in harmonizing accounting and auditing standards?

Exercises

1. Three solutions have been proposed for resolving the problems associated with filing financial statements across national borders: (1) reciprocity (also known as mutual recognition), (2) reconciliation, and (3) use of international standards.

   Required: Present a complete but concise evaluation of each of the three approaches. What do you expect would be the preferred approach from the perspective of each of the following: (1) investors, (2) company management, (3) regulatory authorities, (4) stock exchanges, and (5) professional associations? Discuss your reasons for each response. Which approach do you predict will eventually prevail?

2. Exhibit 8-1 presents the Web site addresses of many major international organizations involved in international accounting harmonization. Consider the following three: the International Federation of Accountants (IFAC), the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR), and the Organization for Economic Cooperation and Development (OECD).

   Required: For each of these three organizations, describe its membership, its organizational focus, and why it is concerned with international financial accounting standard setting.

3. Exhibit 8-2 presents the Web site addresses of national accountancy organizations, many of which are involved in international accounting standard-setting and convergence activities.

Required: Select one of the accounting organizations and search its Web site for information about its involvement in international accounting standard setting and convergence. Describe the organization's activities in these areas.

4. The text discusses the many organizations involved with international convergence activities, including the IASB, EU, and IFAC.

Required:

a. Compare and contrast these three organizations in terms of their standard-setting procedures.
b. At what types and sizes of enterprises are their standards *primarily* directed?
c. Briefly critique the following statement: "Acceptance of international accounting standards (accounting principles, disclosures, and auditing), as far as it has come and is likely to come in the near future, is significantly centered in companies operating in multiple countries."

5. The chapter contains a chronology of some significant events in the history of international accounting standard setting.

Required: Consider the 1995 European Commission adoption of a new approach to accounting harmonization. Consult some literature references about this event; prepare a short essay describing it and indicating why it is deemed significant.

6. Exhibit 8-3 identifies current IASB standards and their respective titles.

Required: Using information on the IASB Web site (www.iasb.org) or other available information, prepare an updated list of IASB standards.

7. The biographies of current IASB board members are on the IASB Web site (www.iasb.org).

Required: Identify the current board members (including the chair and vice-chair). Note each member's home country and prior affiliation(s). Which board members have previously served on national accounting standard-setting bodies?

8. Chapter 3 discusses financial reporting and accounting measurements under International Financial Reporting Standards (IFRS). Chapter 4 discusses the same issues for U.S. GAAP and Exhibit 4-2 summarizes some of the significant differences between IFRS and U.S. GAAP.

Required: How would each difference affect the balance sheet and income statement? How would each difference affect the following financial ratios used by analysts?

a. Liquidity*: current ratio*
b. Solvency*: debt to equity; debt to assets*
c. Profitability*: return on assets; return on equity*

9. The U.S. Securities and Exchange Commission (SEC) roadmap issued in 2008 may eventually move U.S. issuers to report under International Financial Reporting Standards (IFRS). Consider the following critical questions of such a move:

a. IFRS lack detailed rules when compared to U.S. GAAP. Shouldn't IFRS be further developed and improved before mandating them?
b. An effort is already under way to converge U.S. GAAP and IFRS. Why not just keep converging?
c. How will U.S. interests be protected if standard setting is the responsibility of a non-U.S. organization?

Required: As one who believes that U.S. companies should use IFRS instead of U.S. GAAP in their financial statement filings with the SEC, how would you answer each of the above critical questions?

10. The IASB Web site (www.iasb.org) summarizes each of the current International Financial Reporting Standards.

Required: Answer each of the following questions.

a. In measuring inventories at the lower of cost or net realizable value, does net realizable value mean:
   i. estimated replacement cost, or
   ii. estimated selling price less estimated costs to complete and sell the inventory?
b. Under International Financial Reporting Standards, which of the following methods is (or are) acceptable to account for an investment in a joint venture?
   i. cost method
   ii. equity method

iii. proportionate consolidation
iv. consolidation

c. Which of the following would be classified as an extraordinary item?
   i. loss from settlement of a product liability lawsuit
   ii. claims paid by an airline as a result of a plane crash
   iii. destruction of a communications satellite during launch
   iv. none of the above

d. In Year 1, an enterprise accrued its warranty obligation based on its best estimate of the expected cost to repair defective products during the three-year warranty coverage period. During Year 2, warranty claims were significantly more than expected due to unrecognized quality-control problems in Year 1. Is it appropriate to restate the financial statements for Year 1 to reflect the revised estimate of the warranty obligation?

e. True or false: An enterprise with a December 31 year-end declares a dividend on its common shares on January 5. The dividend is recognized as a liability at year-end.

f. After initial recognition, which of the following financial assets is (are) not remeasured at fair value?
   i. options on unquoted equity securities
   ii. marketable securities (equities)
   iii. derivative financial instruments that are financial assets
   iv. fixed maturity instruments the enterprise intends to hold to maturity

g. Which of the following is true? An enterprise that follows the policy of revaluing its property, plant, and equipment may apply that policy:
   i. to all assets within a single country on a country-by-country basis
   ii. to all assets within a single broad class, such as to land and buildings
   iii. to all assets of a certain age, such as all assets 10 years old or older.

h. True or false: Interest costs on funds borrowed by an enterprise to finance the construction of a new building must be capitalized as part of the cost of the building.

CASES

Case 8-1

PetroChina Company Limited

PetroChina Company Limited (PetroChina) was established as a joint stock company under the company law of the People's Republic of China in 1999 as part of the restructuring of China National Petroleum Corporation. PetroChina is an integrated oil and gas company with operations in virtually every aspect of China's oil and gas industry, including exploration and production, refining and marketing, natural gas transmission, and petrochemicals. PetroChina manages some 70 percent of China's oil and gas reserves and 45 percent of its oil-refining capacity. Its shares were listed on the Hong Kong and New York Stock Exchanges in 2000.

You are an equity research analyst and have been asked to prepare a research report on PetroChina. Your business strategy analysis indicates that PetroChina's sales growth and financial performance can probably be sustained. However, although your qualitative analysis has yielded promising results, you are concerned that your financial analysis will be difficult due to accounting and audit-quality issues.

You start your analysis by becoming familiar with the accounting principles used to prepare PetroChina's financial statements filed with the U.S. Securities and Exchange Commission. You are encouraged that the company states that its financial statements conform to IASB standards, but realize that how accounting standards are applied is as important as the standards themselves.

Required

PetroChina's financial statements filed with the U.S. Securities and Exchange Commission may be found at www.petrochina.com.cn/resource/EngPdf/annual/20-f_2008.pdf. Examine PetroChina's Note 3, "Summary of Principal Accounting Policies," and read about the IASB Standards on the IASB Web site (www.iasb.org) and the IAS Plus Web site (www.iasplus.com).

1. As much as possible, assess the extent to which PetroChina's accounting principles conform to IASB standards.
2. How reliable is your assessment?
3. What further information would help your assessment?
4. Does the auditor's report provide information useful in your assessment? Explain.

Case 8-2

Whither The Withering Standard Setters?

Sir David Tweedie, chairman of the International Accounting Standards Board, is quoted as saying that the IASB and the FASB will eventually merge. "U.S. standards and ours will become so close that it will be senseless having two boards, and they will merge eventually. . . . Ultimately, it doesn't make sense having two standard setters producing the same standards."[36]

Required

1. Go to the Web sites of the International Accounting Standards Board (www.iasb.org) and the U.S. Financial Accounting Standards Board (www.fasb.org). Compare and contrast the two boards in terms of their composition and standard-setting processes.
2. Why is so much attention paid to convergence between International Financial Reporting Standards (IFRS) and U.S. GAAP and not to convergence between IFRS and other national accounting standards? What evidence is there of the direction of convergence: Is U.S. GAAP converging to IFRS, are IFRS converging to U.S. GAAP, or are they converging toward each other?
3. U.S. companies must use U.S. GAAP in their financial statements, not IFRS. Why should U.S. accountants, analysts, and others involved in financial reporting need to know about IFRS?
4. Will the IASB and FASB eventually merge, or will they remain separate accounting standard-setting bodies? Why do you say so?

[36] L. Bolton, "IASB and FASB Will Eventually Merge, Says Tweedie," *Accountancy Magazine* (October 2005): 6.