UNITED
NATIONS

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Economic and Social Council

Distr.
GENERAL

E/C.10/AC.3/1994/2
11 January 1994

ORIGINAL: ENGLISH

COMMISSION ON TRANSNATIONAL CORPORATIONS
Intergovernmental Working Group of
Experts on International Standards
of Accounting and Reporting
Twelfth session
Geneva, 7-15 March 1994
Item 3 of the provisional agenda*

REVIEW OF IMPORTANT CURRENT DEVELOPMENTS AT THE GLOBAL LEVEL IN THE FIELD OF ACCOUNTING AND REPORTING BY TRANSNATIONAL CORPORATIONS

Report of the UNCTAD secretariat

SUMMARY

The purpose of this report is to review developments that promote the harmonization of accounting standards worldwide and the comparability of financial statements. Vigorous efforts have been under way in the past few years to reduce the options in international standards and to increase their use by the regulators of securities markets and international trade. A significant event during 1993 was the endorsement by the International Organization of Securities Commissions (IOSCO) of the international standards on auditing that are promulgated by the International Federation of Accountants (IFAC). Governments in central and eastern Europe are rewriting or adopting new commercial legislation, including accounting and auditing laws and regulations, to promote the transition to market economies. Indications are that harmonization will grow significantly throughout the world in this decade. The report also examines some specific problems: accounting and reporting in the commercial banking industry, accounting for financial instruments, duties and responsibilities of the board of directors, litigation against accountants and environmental accounting. Lastly, the activities of international and regional bodies active in the field are summarized.

* E/C.10/AC.3/1994/1.

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I. THE ADVANCEMENT OF INTERNATIONAL ACCOUNTING STANDARDS

1. The adoption of international standards of accounting and reporting by transnational corporations was rather slow during the 1980s. Although there has been considerable research, discussions and other activities on the importance of the harmonization of accounting and reporting standards in the world, the speed of adoption of harmonized standards, in particular in the major developed countries, has been sluggish. The rate of harmonization has not kept up with the globalization and expansion of international business activities and capital markets.

2. According to an article by Emmanuel Enenyonu and Sidney Gray that appeared in the 2 July 1993 edition of the Financial Times:

> "... progress towards harmonization over the last 20 years has been mixed. Taken overall, it has been very modest with and an increase in the average harmony index score from a moderate level of 0.6230 to only 0.6903. This is an average increase in international accounting harmonization of only 10.8 per cent from 1971-72 to 1991-92. ...
>
> "There were only 14 issues showing an increase in harmonization. In 12 cases there was in fact a reduction in harmonization or a higher level of accounting diversity ... Despite 20 years of effort, clearly there are substantial continuing problems facing those promoting international accounting harmonization."

3. This situation has occurred because of many factors, particularly different legal and taxation systems and cultural differences in various countries and regions of the world. A major divergence of opinions exists between the financial leaders of those countries that believe in the so-called "prudence principle" of reporting and their counterparts in other countries that promote the "matching concept" as being a more appropriate conceptual basis for financial reporting. The foundation for most discussions of these divergent principles is the determination of whether the primary users of the financial statements are investors or lenders (creditors), and which of the two concepts of accounting should override others. Thus, some maintain that current period fluctuations in operating results should be promptly reported to investors, and others believe that it is in the best interests of management, creditors and long-term investors if more conservative accounting methods are followed, such as the use of reserves to smooth out peaks and valleys in financial performance over several reporting periods. The Organisation for Economic Cooperation and Development's (OECD) Working Group on Accounting Standards has been particularly active in studying these issues and how the two conceptual bases are applied in its member countries. The OECD convened a meeting on the subject in Paris during May 1993.

4. However, the need for financial reporting which is transparent and which meets the needs of a very wide range of users of such information has been growing in geometric proportions. According to a recent study by the United Nations Conference on Trade and Development:

> "The universe of transnational corporations is large, diverse, and expanding. By the early 1990s, there were 37,000 transnational corporations in the world, with over 170,000 foreign affiliates. Of these, 24,000 transnational corporations were based in 14 major home developed economies, up from 7,000 in 1970." 1/

5. As the number of transnational corporations has increased in recent years, the number and the aggregate amount of international equity and debt offerings have also increased significantly. The globalization of business activities has resulted in greater demand for financing economic growth and diversification. In 1982, the 32 developing country stock markets surveyed by the International Finance Corporation had a combined market capitalization of about US$ 67 billion for about 7,300 listed companies. By the end of 1992, the emerging stock markets had increased their market capitalization about 11 times to $770 billion, and nearly tripled their share of world equity market capitalization, from 2.5 per cent to 7 per cent. The number of listed companies in these markets now represents about 40 per cent of the 30,000 listed companies in the world. 2/

6. Another factor contributing to the need for harmonization has been the significant increase in privatization transactions in not only developed and developing countries of the world but also in the countries in eastern and central Europe that are in transition to a market economy. Their domestic markets have not been able to provide all of the financing that has been required for their expansion in capital requirements.

7. With this growth in international business has come an increase in the need for useful, transparent financial information for investors and creditors. At the speed that international business is transacted in the age of rapidly increasing data processing and communications technology, financial information must be timely and meet the needs of many users from many different countries.

8. Financial leaders in some countries have advanced the position that there should be mutual recognition by governmental authorities and securities exchange regulators of the national accounting and reporting standards of other countries. It was pointed out that mutual recognition would facilitate investments in many more transnational corporations than were currently listed in capital markets outside of their home country and this would promote greater foreign direct investment. Also, this would allow non-local enterprises a source of capital and visibility in many different financial markets of the world. It is noted, in particular, that the United States Securities and Exchange Commission (SEC) does not accept this position for foreign offerings in spite of the requests of the New York Stock Exchange (NYSE) and non-United States enterprises for a relaxation in SEC rules and regulations. Some financial leaders feel that SEC rules and regulations are excessively detailed, and compliance with the requirements for disclosures result in significant effort and costs for enterprises to produce. In addition, the information disclosed in SEC filings would be greatly different than is being circulated in the home country.

9. These positions have been rejected by the SEC because it feels that United States investors are put at a disadvantage if they are not able to read and

analyse financial statements from domestic and foreign countries that are prepared according to a single set of accounting and reporting rules, or are reconcilable to such rules.

10. It should be noted that in 1993 a leading German enterprise, Daimler-Benz, agreed to comply with the SEC requirements and listed its shares for trading on the NYSE. This significant event is described in a later section of this report.

11. Noting the trends, the International Accounting Standards Committee (IASC) in the late 1980s began a project to reduce the number of acceptable alternatives that exist in the International Accounting Standards (IAS) that they promulgate. The effort that has been continuing since that time is referred to as their "Comparability/Improvements Project". A description of the new and revised IASs that have been issued in the last two years by the IASC is contained in a later section of this report.

12. An important stimulus to the adoption of international standards by transnational corporations has come from efforts being made in the last few years by the International Organization of Securities Commissions (IOSCO) to evaluate the acceptability of international standards for cross-border securities offerings to public investors. IOSCO has concluded that the use of different standards of accounting by enterprises that trade their securities on their national exchanges represent the greatest impediment to transnational securities offerings. This is because investors and their analysts have difficulty in evaluating the financial statements of enterprises whose accounting standards are not harmonized. As an illustration of this situation, the Financial Times of London on 10 October 1992 quoted the Chairman of Gartmore Investment Management as saying that, "... under UK accounting, pharmaceutical company SmithKline Beecham has negative net worth of 300 million pounds while under US accounting rules its shareholder funds are 3.5 billion pounds. This is nonsense and something has to be done about it". Representatives of IOSCO have been meeting regularly with the IASC on accounting standards and with the International Federation of Accountants (IFAC) on auditing standards. In October 1992, IOSCO agreed that the auditing standards promulgated by IFAC constitute the minimum requirements for multinational securities offerings and they could be relied upon by securities regulators. This event represents a very significant stimulus to the harmonization of international standards.

13. The Technical Committee of IOSCO has also developed what it considers to be the elements of a comprehensive set of accounting standards for the preparation of financial statements for cross-border securities offerings. The IASC, working closely with the representatives of IOSCO, believes that by the end of 1994 its Comparability/Improvements Project will be sufficiently completed so that IOSCO can consider endorsing the use of the IASs for international offerings of securities. Two of the leading stock exchanges, the London and the Hong Kong Stock Exchanges, currently accept international accounting standards in addition to the accounting principles that are generally accepted in their countries.

14. In related developments, another committee of IOSCO in October 1992 approved minimum general disclosure requirements for multinational securities offerings, and the committee is drafting a model offering prospectus.

15. In the United States, the Financial Accounting Standards Board (FASB), the primary United States financial accounting standards setter, in conjunction with the international objective of its mission statement, has identified a number of initiatives in the international arena which it has been implementing in varying degrees over the last several years. These initiatives include:

(a) Consideration of foreign and International Accounting Standards Committee (IASC) standards in conjunction with all domestically oriented projects. Over the last three years, the FASB has included an international section in a number of its discussion memoranda;

(b) Enhancement of FASB staff capabilities in international matters;

(c) Reconsideration of a United States standard when a corresponding foreign national or international standard has been judged by due process to be superior to the United States standard;

(d) Engaging in joint multinational standards-setting projects.

16. SEC is actively supporting greater convergence in global accounting and auditing standards. To this end, it has:

(a) Participated actively in IOSCO efforts to facilitate cross-border securities filings using documents prepared in accordance with domestic securities laws;

(b) Devoted considerable staff time to the oversight of IASC efforts to improve existing international accounting standards and achieve international comparability of financial statements;

(c) Issued a United States-Canadian multi-jurisdictional rule to permit certain United States and Canadian companies to file documents prepared in accordance with their own domestic accounting rules with the securities commission of the other country;

(d) Entered into agreements with the securities commissions of other countries to promote consultation and cooperation in the administration and the enforcement of the United States and other countries’ securities laws;

(e) Participated as an observer in the activities of the Group.

17. The American Institute of Certified Public Accountants (AICPA) is also attempting to promote international harmonization by participating as a member of IASC in efforts to improve existing international accounting standards and achieve international comparability of financial statements.

II. SIGNIFICANT RECENT DEVELOPMENTS AND KEY ISSUES IN INTERNATIONAL ACCOUNTING

18. The present section reviews progress being made on key issues or problems in international accounting. Many of these issues are complex and agreement on proper accounting and reporting treatments are difficult to obtain. The topics discussed are Daimler-Benz's listing of its shares for trading on the New York Stock Exchange, accounting and reporting in the commercial banking industry, accounting for financial instruments, duties and responsibilities of the board of directors, litigation against auditors, environmental accounting and research on the effect of future events on accounting.

A. The New York Stock Exchange Listing of Daimler-Benz shares for trading

19. As referred to in the previous section of this report, the debate in the global financial community about the mutual recognition of national accounting standards by governmental authorities and capital markets regulators has been ongoing. The Government of the United States has been particularly opposed to this view for its domestic capital markets, as referred to above.

20. The Chief Executive Officer of the NYSE, Mr. William Donaldson, has been outspoken in the press about his views. He has stated that such a position has resulted in the diminution of the importance of the NYSE as a global capital market, although it is still the largest stock exchange in the world. American investors can buy shares of stock in leading multi-national enterprises by making purchases on the London, Tokyo and other non-United States exchanges even though such enterprises do not disclose information that is similar and comparable to what is required of American enterprises. Cross-border investments are occurring in spite of the increased risks, because of the perceived opportunity for diversification and profitability.

21. Supporting the NYSE position, some leading non-United States enterprises seeking to increase their global liquidity and visibility feel that they are being excluded from participating in the largest capital market in the world. It has been particularly noted that no German enterprise has been willing to comply with the very extensive requirements of SEC, although Germany is one of the world's largest free-market economies.

22. Much recent publicity has recently occurred about the largest industrial enterprise in Germany, Daimler-Benz, seeking to broaden its source of financing. Only one third of its capital shares are publicly traded and the remainder are held by institutional investors, such as Deutsche Bank, Germany's largest bank. Daimler-Benz has had its shares traded in Germany and Switzerland for many years, and it listed its shares on the London and Tokyo stock exchanges in 1990 and on the Paris and Vienna exchanges in 1991. It has also declared its intention to list its shares in Singapore and possibly in Shanghai in 1994, and has been considering a NYSE listing, which is particularly important for a world-class enterprise. It was further recognized that such a listing would increase its capital base and enhance shareholder value at a time when the competition for capital in the world has become increasingly intense.

23. The management of Daimler-Benz held extensive meetings with Mr. Donaldson and with the Chairman of the SEC concerning listing requirements. However, while both the NYSE and the SEC were interested in making the listing, the position of the SEC was that German accounting standards were not designed to provide the public capital markets in the United States with a high enough level of information concerning financial results, cash flows and rates of return which investors need to be able to make comparisons among alternative investments in enterprises in the United States and foreign countries. Further, the practice in Germany of allowing enterprises to have hidden reserves gives their management the opportunity to manipulate enterprise profits, if they so desire, and investors will not know currently what the real trend is in operations.

24. Finally, in March 1993 the financial management of Daimler-Benz reached a negotiated agreement with the SEC. The agreement requires the company to disclose a truer picture of its financial position and results of operations on a consolidated enterprise basis although the group did not have to compile and disclose some of the information required of other companies whose shares are publicly traded in the United States. As part of the agreed-upon disclosures, in March 1993 Daimler-Benz announced that it was going to report for its 1992 financial year an extraordinary gain of DM 4 billion as a result of applying uniform valuation procedures throughout its group of companies. Also, an accounting change would be required for the amortization of goodwill from acquisitions against the profits of future years. As referred to in the previous section of this report, Daimler-Benz shares began trading on the NYSE in October 1993.

25. To illustrate the effect of the difference in accounting standards in Germany and in the United States, the Financial Times reported on 23 September 1993 that Daimler-Benz had a loss of DM 949 million for the first half of 1993 under United States generally accepted accounting principles and a profit of DM 168 million under German accounting rules. This difference is mainly attributable to the release of provisions made to accumulated reserves in previous years.

26. The SEC and the NYSE hope that other German enterprises will follow the leadership of Daimler-Benz and apply for the listing of their shares on the United States stock exchanges, in spite of the increased disclosures required by United States standards. However, according to the World Accounting Report (May 1993), other German enterprises resent the agreement reached with the SEC because they feel that it weakens their case for getting United States regulators to agree to the mutual recognition of accounting standards among countries.

B. Accounting and reporting in the commercial banking industry

27. As a result of the widely publicized events surrounding the Bank of Credit and Commerce (BCCI) bankruptcy, there is considerable interest and concern being expressed by Governments and leaders in the financial world's communities about the adequacy of financial controls over commercial banks, and particularly over banks with substantial international operations.

28. The newspaper USA Today (6 November 1993) reported on a symposium that was recently sponsored by Temple University on the experiences of the BCCI bankruptcy. Investigators, prosecutors, defence lawyers and bank officials participated in the meeting. A United States Senate investigator who worked for two years on BCCI matters was quoted as saying, "What you have is a nineteenth century regulatory system trying to deal with twenty-first century crime". A professor of criminal justice at the university stated that "the system that brought about BCCI is still in place. The networks of business relationships and partnerships are promiscuous and ongoing".

29. Compounding this situation is the growth in the volume and different types of new financial instruments that are being proliferated by very sophisticated investment and banking communities. (See the following section of this report.) The Financial Times (29 September 1993), in reporting on a seminar sponsored by the Group of Thirty banks, quoted the Executive Director of the Bank of England as stating that "... the rapid growth of [financial] derivatives [instruments] could be leading to credit risk problems similar to less developed country debt ... The growth of banks seeking to enter the market could outstrip the number of traders expert enough to handle derivatives ...". At the same seminar, the President of the New York Federal Reserve Bank said that "it appeared that credit risk was not fully reflected in the pricing of derivatives".

30. In the commodities industry, the economic role played by speculators in facilitating the transfer of price risks by providing liquidity to futures, options and other derivatives markets is important. However, in some segments of the banking industry, activities are seen solely as speculative activities. 3/

31. These events have significant implications for those persons responsible for setting accounting and reporting standards for financial institutions and auditing their operations. Another article in the Financial Times dated 24 September 1993 reported on an International Monetary Fund study about risks in the derivatives markets for future contracts and currency and interest rate swaps and stated that "... many transactions are not fully understood by the senior managers of banks and securities houses." A particularly difficult area is the ability to net or offset asset and liability transactions.

32. A recent article in the Financial Times (4 November 1993) reported on an interview with the Vice-President of the Deutsche Bundesbank on the subject of derivatives. He called for international guidelines and greater transparency because of the globalization of markets. He said that "annual reports by German banks offer essentially no description of an institution's activities in the derivatives market".

33. If the experts in the industry do not fully understand the transactions, the ability of accounting standard setters to deal with the issues is certainly compounded.

34. The Group may wish to study these matters in detail at a future session.

C. Accounting for financial instruments

35. With the increased globalization of the world's economy there has developed what the World Accounting Report (August/September 1993) calls "the age of financial engineering". Prior to the 1980s, the primary financial instruments which were thought to be sophisticated were convertible securities and options. Convertible securities are typically debt or preference shares that are convertible into different other debt or equity securities - usually common shares. Options are sold for many different purposes, but primarily for commodity, stock price and foreign currency risk exposures.

36. In the most recent years, the number and quantity of new financial instruments has increased exponentially, so that the only limitations on the creation and distribution of new financial instruments seem to be the identification and quantification of financial needs and the imagination and skills of investment and financial advisers. The most common new financial instruments in circulation are referred to as "derivatives". Derivatives are financial contracts that are valued based upon underlying assets or financial measurements thereof, such as foreign currency exchange rates, interest rates, share prices and indices.

37. To put the importance of these instruments in perspective, the market for derivatives was estimated to aggregate approximately $8,000 billion as of the end of 1993. 4/

38. Financial instruments are generally defined to include monetary assets and liabilities - cash, receivables, payables, equity securities and derivative instruments (such as forwards, futures, options and swaps that are meant to hedge virtually any type of balance sheet exposure). Most derivatives have maturities within one to three years, but maturities can go as far out as 20 years. The risks associated with the new financial instruments may be classified as the credit risks relating to the capital that is financing enterprises, the legal risks for moving monies across international borders, and the delivery risks (liquidity risks) that might occur if transactions are defaulted. 5/ Financial difficulties experienced by a major participant in the derivatives market could endanger the liquidity of the entire financial system.

39. As foreign direct investments are expanding, so are the markets for trading financial instruments. Emerging capital markets in developing countries are experiencing demands for ways to manage currency and interest rate risks of investors and borrowers.

40. From an accounting viewpoint the most important issues are: on- versus off-balance sheet financing; recording transactions on both the assets and liabilities side of the balance sheet or reporting them on a net basis; the classification of financial assets as current operating (or trading) assets or as long-term assets or investments that are intended to be held to maturity; and the current valuation and recording of assets (called marking-to-market) versus continuing to report assets at their historical carrying values.

41. A major study was recently conducted by the Group of Thirty banks. 6/ The Group recommended that "Financial statements of dealers and end-users [of

financial instruments] should contain sufficient information about their use of derivatives to provide an understanding of the purposes for which transactions are undertaken, the extent of transactions, the degree of risk involved, and how the transactions have been accounted for ... Accounting standards-setting bodies in each country should, as a matter of priority, provide comprehensive guidance on accounting and reporting of transactions in financial instruments, including derivatives, and should work toward international harmonization of standards on this subject. Also, the International Accounting Standards Committee should finalize its accounting standard on Financial Instruments".

42. The subjects of valuation and accounting for financial instruments is described in more detail in the report of the Secretary-General (E/C.10/AC.3/1994/5).

D. Duties and responsibilities of the board of directors

43. For reasons including recent famous, or infamous, failures of enterprises, there has been an increased focus on the subject of corporate governance. The board of directors of an enterprise must accept the primary responsibility for failures that occur even though audit failure may also occur. The highest level of responsibility rests with the board of directors with respect to business practices and operating and financial strategies. This includes the responsibility for the enterprise's failure to continue as a going concern, and to have to enter bankruptcy proceedings.

44. In the United Kingdom, a special study was conducted by a group called the "Cadbury Committee", named after its chairman, Sir Adrian Cadbury. Some of its recommendations have implications for the world's accountancy profession as to what may be expected to be a trend in business practices in the future.

45. First, the Committee repeated the call for there to be an audit committee of the board of directors for each publicly held company. This Committee is to include only non-management directors, and is charged with the appointment of the auditor for the company and for review of the results of the auditor's work. The audit committee is particularly interested in any disagreements that might have occurred during the audit between the management of the company and the auditor concerning controversial accounting matters, and any dishonesty or fraud that came to the attention of the auditor during his or her examination. The establishment and use of audit committees has been the practice in many countries for some years now and is not particularly new thinking, but increased emphasis.

46. There is a new recommendation that the board of directors should be charged with the responsibility to monitor the internal controls of their company, in addition to the expectation that the auditor has reviewed and checked on important controls. The Cadbury Committee also recommended that the board of directors report annually on whether or not they believe that their company is a going concern and therefore is expected to continue in operation for the next year, at least. The auditor should always independently reach his own conclusion as to whether or not he or she believes that the company is a going

concern, and appropriately indicate in his or her report any significant uncertainties that exist.

47. Thus, it is the view of many that the directors of a company, as the elected representatives of the shareholders, are able to get whatever information they require to properly represent the interests of the shareholders, lenders and creditors, and government authorities, and they are in a position to replace the senior management for failure to properly operate the enterprise. The directors are responsible for the highest levels of planning and direction of the company.

48. In a related matter, concerns are being expressed about the rights of the shareholders and creditors of a transnational enterprise when a bankruptcy has occurred. At issue is whether or not it is in the interests of all concerned to have international bankruptcy laws that will better protect such rights. This discussion in the international community is just beginning, and it is a very difficult issue to deal with. It is not a new issue, but one whose time may have come.

E. Litigation against accountancy firms

49. Few trends have had a more significant impact on the accountancy profession in recent years than client fraud and dishonesty. In an article in the Financial Times of London (4 December 1992), Mr. John Roques, the Chief Executive of Touche Ross & Co. in the United Kingdom, stated:

> "... there has undoubtedly been a crisis of confidence during the past two years. The public and the media frequently equate corporate failure with audit failure, and forget that it is by the very nature of business that some companies succeed and others fail."

50. This "crisis of confidence" has led to the so-called "expectations gap" between what the users of professional auditing services think that they are getting and what professionals believe are their responsibilities and what they can reasonably deliver. Auditors maintain that it is very difficult, and in many cases, virtually impossible to detect fraud committed by the management of enterprises. Most frauds cannot be uncovered by auditors during the typical examination of financial statements because the scope of the engagement does not provide for detailed reviews of all or most transactions. To do so would be cost prohibitive, unless an auditor has a specific engagement to perform a fraud examination. Nevertheless, in many cases, this expectations gap may be self-inflicted on the profession. Independent auditing is, essentially, a zero-defect business, and auditing failures will occur.

51. Some years ago, the American Institute of Certified Public Accountants (AICPA) organized a self-regulatory group for the accountancy profession in the United States that is called the Public Oversight Board. One of its first activities was to set up a programme called "peer review". This programme provides for a quality control review of the administrative and technical accounting and auditing activities of public accountancy firms. The report of the accountancy firm making the review is given to the Public Oversight Board,

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and detailed results of the review and recommendations for improvements are discussed with the firm of accountants being reviewed. This programme has been useful in assuring both participating firms and the public about the quality standards and practices of the professional firms, particularly the largest firms.

52. A major issue being debated in the United States is the responsibility of an auditor for reporting the discovery of fraud during an audit examination. Under current practice, the auditor has an obligation to report the discovery of fraud to his client at the appropriate higher level of the organization, which could be to a member of the management, to the chairman of the audit committee, if there is one, or to the board of directors, depending on the seriousness and level of the organization at which the fraud was committed. In 1993, proposed legislation came before the United States Congress entitled, "The Financial Fraud Detection and Disclosure Act". The major accountancy firms in the United States and the AICPA have endorsed this legislation. If passed as drafted, the law will require auditors to notify specified government agencies of possible illegal activities discovered during an audit if senior management and the board of directors fail to take timely and appropriate remedial actions. The law will also codify existing auditing standards for detecting illegal acts, identifying related party transactions, and evaluating whether there is a substantial doubt about the ability of an enterprise to continue as a going concern.

53. This legislation is meant to strengthen public confidence in the nations's financial reporting system by requiring auditors to provide earlier public notification of possible misconduct and management fraud. It should be noted that the primary responsibility for setting auditing standards will stay in the private sector with the AICPA. The draft law includes a "safe harbour" provision that would protect auditors from liability in private legal actions for any findings, conclusions or statements made pursuant to the direct reporting provisions of the law.

54. Because of litigation exposure and increased costs of lawsuits, there is increasing concern among the leaders of the profession about how to deal with such trends. According to a recent article in the Financial Times of London (11 October 1993), aggregate claims against auditors at that time were approximately $30 billion, and litigation costs for the six largest international accountancy firms were approximately $600 million for the year, or approximately 11 per cent of fees collected from their clients. Professional liability insurance premiums have increased by 300 per cent since 1985. This is leading many members of the accountancy profession to believe that, among other strategies, they should be more selective in accepting and retaining clients. The well-publicized losses that Lloyd's of London has incurred recently further concerns professional accountants. Lloyd's is the largest provider of professional indemnity insurance for most firms. Many professional accountants are reviewing their client lists and investigating potentially new clients with increased scepticism. Professional relationships are being terminated and more new client engagements are being turned down because the risks of financial losses are too great for the reward of fees to be earned.

55. The public must be protected from fraud and misconduct, and auditors must be responsible for the performance of their duties with a high degree of

professional standards and competence. However, the public cannot be properly served unless there is a reform of national tort laws to provide some reasonable limitation on the amount of a person's professional liabilities. The current situation in many countries of unlimited liability for the performance of professional accountancy services may restrict a person's ability to practise in a cost-effective manner in providing the services demanded and needed by clients and other users of financial information. The world's capital markets particularly need the services of auditors as an element in the efficient flow of capital and investments.

56. In the United Kingdom, the Accounting Practices Board, in October 1993, issued a draft guideline on the responsibilities of auditors for detecting and reporting client fraud. The draft, entitled SAS 110, Fraud and Error, states that it is reasonable to expect that a professionally performed audit should detect that financial statements contain material misstatements because of fraudulent acts by management. If such a situation has occurred, the auditor has an obligation to report the matter to the board of directors, and, in severe situations, to appropriate authorities.

F. Environmental accounting

57. In May 1993, the United Nations convened a group of experts to discuss a case study on accounting for sustainable development. A research case study project had been undertaken by Mr. Daniel Rubenstein of the Government of Canada's Office of the Auditor General.

58. The report prepared by Mr. Rubenstein presented arguments for adopting a more environmental friendly approach to forestry and milling and the costs and consequences thereof. The experts discussed the manner in which enterprises can implement the concept of sustainable development and modify methods and techniques of operations. The consequential impact upon profitability was also considered.

59. It is argued that in the long-run, enterprises which do take up environmental accounting and accounting for sustainable development now will have the competitive edge, because they will have modified their corporate behaviour over time rather than having to comply with more stringent environmental regulations quickly, which would be more costly. But even more importantly, these enterprises will be economically viable because they are also environmentally viable.

60. The most commonly accepted definition of sustainable development is one which meets the needs of the present generation without compromising the ability of future generations to meet their own needs. This means that human requirements should be met via environmentally sustainable production or production which is clean and equitable. The concept of "What gets measured, gets managed" must be adopted to avoid the squander of this planet's finite resources. Traditional corporate practices, which have evolved within the framework of western intellectual tradition, tend to undervalue natural resources. Capital includes critical and natural capital, other sustainable natural capital and artificial capital. Critical capital must not be touched

and if natural capital declines, it must be replaced or a substitute obtained. Sustainability requires that an enterprise maintain its total capital intact and only consume its income.

61. In practice this concept at the enterprise level could be implemented in three ways:

(a) The inventory approach;

(b) The sustainable cost approach;

(c) The resource flow-through, input-output approach.

62. This case study could be classified as the "inventory approach". The paper develops a conceptual framework for estimating environmental costs, which is then applied to a fictitious forestry, pulp and paper milling company located in Ontario, Canada. Current accounting is criticized because the underlying resources do not have an inherent value in the accounting model.

63. The case study demonstrates that accountants can play a significant role, working within a multi-disciplinary team whose objective is to help produce new information for informed decision making. Furthermore, enterprises can begin to integrate environmental, economic, and business information. Accountants can begin to compute the costs of converting to sustainable development once management and internal experts and scientists have determined which industry practices will have to change under a regime of sustainable development.

64. In 1993, the Fédération des experts comptables européens (FEE) published a study entitled, "Environmental Accounting and Auditing: Survey of Current Developments". This is described in the section on the activities of FEE that follows later in this report. The report of FEE was presented and discussed at an OECD round-table meeting on environmental accounting and auditing that was held in May 1993. The meeting is described in a later section of this report on the activities of OECD.

G. The effect of future events on accounting

65. Standard-setting bodies in Australia, Canada, the United States and the United Kingdom in 1992 organized a study group to consider the effect that future events should have on decisions that have to be made currently to recognize and measure the values of the assets and liabilities of an enterprise. Instances in which future events should possibly be considered are in the valuation of receivables and inventories and in the recognition of deferred income taxes. The research group expects to formulate general principles for the guidance of standards setters in formulating future accounting rules.

H. Accounting reform in the newly independent States

66. UNCTAD, in cooperation with OECD and the World Bank, organized a conference on accounting reform in the newly independent States (NIS) in Kiev, Ukraine, in

July 1992. The meeting helped NIS accounting experts from eight republics (Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Turkmenistan, Ukraine and Uzbekistan) to identify the most pressing issues of accounting reform and ways of optimizing western technical assistance through coordinated efforts in legislative reform and accounting training. A Coordinating Council on Accounting Methodology was created to propose changes for the modernization of accounting practices on a harmonized basis among the eight republics.

67. The Council held meetings in November 1992 and May 1993. All NIS members are in the process of drafting new accounting legislation and designing systems for setting supplementary accounting standards. Recognizing the importance of a skilled accounting profession, member Governments are embarking on substantial retraining programmes.

68. UNCTAD cooperated with other international organizations in establishing an International Advisory Board on Accounting and Auditing for the Russian Federation. An organization meeting held in July 1992 set the programme of work and methodology for the task of drafting accounting legislation and standards. The Board's priorities include revising the chart of accounts for the Federation and drafting a new accounting law, reviewing draft auditing legislation, and creating a standard-setting system.

III. ACTIVITIES OF INTERNATIONAL AND REGIONAL ORGANIZATIONS

69. The following section is a review of the activities of international and regional organizations in the area of standard-setting and accountancy development.

A. World Congress of Accountants

70. Over 3,000 accountants from all over the globe attended the Fourteenth World Congress of Accountants from 11 to 14 October 1992 in Washington, D.C. The Congress was sponsored by the International Federation of Accountants, which has 110 member bodies in 80 countries representing 1.2 million accountants. The host organizations included the American Institute of Certified Public Accountants, the Institute of Internal Auditors and the Institute of Management Accountants. The participants heard a number of outstanding economists speak on the Accountant's Role in the Global Economy during the plenary sessions. Some of these included Pehr Gyllenhammar, CEO, Volvo; Enrique Iglesias, President, Interamerican Development Bank; Kiminmasa Tarumizu, President, Asian Development Bank; and Laurence Summers, Senior Economist, World Bank.

71. Mr. Gyllenhammar called the 1990s "the hung over decade" in that the world economy is still paying for the excesses of the 1980s. In addition to dealing with "a financial party that got out of hand" economists and accountants also have to deal with environmental concerns and the break-up of the former "command economies". He said that, unfortunately, international leadership is in short supply and a leaderless, global economy is likely to be highly accident prone, putting at stake our institutions and our future stability.

72. He advised his audience:

> "Don't believe that the market can solve everything. It was only a couple of years ago when we were told that there would never again be a shortage of capital; now banks hardly lend money ... We need to be more strict in our attitudes to what we call the market. We need effective ground rules to limit the excesses and the mistakes which have been serious enough to call into question our integrity and our ethics (especially that of accountants). This distinguished and important gathering could assist, for example, the drive and commitment to uniform accounting standards. We need to start now with the rules of the game for making the global business community more transparent and for reducing some of the uncertainties which act as a brake on investment and growth. Getting the fundamental rules into shape is the best way to create jobs, savings, political and institutional stability."

73. In addition to the plenary sessions, there were 18 technical sessions: the most interesting and heavily attended were those on environmental accounting and newly industrialized and developing countries. In this latter session, it was noted that most of the technical assistance in accounting is going to central and eastern Europe rather than to developing countries.

74. During the Congress, professors from the Russian Federation and Uzbekistan who were attending the Congress gave a seminar on current developments in the new independent States.

B. International Accounting Standards Committee

The comparability/improvements project

75. The most important part of the work of IASC during the past two years has been its project to reduce the number of options in its existing standards. Exposure draft 32, Comparability of Financial Statements (1989), contained 29 proposals that were designed to eliminate most of the choices of accounting treatment for like transactions and events permitted by international standards.

76. The Board of IASC approved the following revised standards at its November 1993 meeting:

(a) International Accounting Standards (IAS) 2: Inventories (formerly Accounting for Inventories in the Context of the Historical Cost System). The weighted-average cost formula or the first-in, first-out formula (FIFO) are designated as the benchmark accounting methods. The last-in, first-out (LIFO) method is also allowed. The base stock method may not be used.

(b) IAS 8: Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies (formerly Unusual and Prior Period Items and Changes in Accounting Policies). A benchmark treatment is prescribed for the correction of charges or credits that arise in the current accounting period as a result of errors or omissions in the preparation of the financial statements of prior periods (called fundamental errors). Such errors are to be adjusted by correcting the beginning retained earnings balance for the current reporting period and appropriately restating comparative financial statement information that is presented. The reporting of fundamental errors in the current period financial statements is allowed as an alternative.

(c) IAS 9: Research and Development Activities (formerly Accounting for Research and Development Activities). The new standard states that research and development costs should be recognized as an expense when incurred (benchmark treatment) but if certain development costs meet the criteria for asset recognition, they must be capitalized.

(d) IAS 11: Construction Contracts (formerly Accounting for Construction Contracts). The revised standard requires the use of the percentage of completion method of accounting for long-term construction-type contracts.

(e) IAS 16: Property, Plant and Equipment (formerly Accounting for Property, Plant and Equipment). The revised IAS establishes historical costs as the benchmark for valuing property but permits the revaluation of carrying values after the initial acquisition has been recorded. Methods of accounting for property items obtained in non-monetary exchanges are also prescribed.

(f) IAS 18: Revenue (formerly Revenue Recognition). The revised standard requires the use of the percentage of completion method of accounting for services. As a general principle, all items of revenue should be measured at the fair value of the consideration that has been received or is to be received.

(g) IAS 19: Retirement Benefit Costs (formerly Accounting for Retirement Benefits in the Financial Statements of Employers). The benchmark treatment for calculating the periodic cost of retirement benefits is the accrued benefit valuation method. An allowed alternative is the projected benefit valuation method. Past service costs and revisions of estimates and adjustments should be amortized over the period of time that the workers are expected to be employed in the enterprise.

(h) IAS 21: The Effects of Changes in Foreign Exchange Rates (formerly Accounting for the Effects of Changes in Foreign Exchange Rates). The new standard does not permit the deferral and amortization of exchange differences on long-term monetary items and from the translation of the financial statements of enterprises whose operations are integrated with the reporting company. Also, the income statements of foreign entities must be translated using the exchange rates that existed on the dates when the transactions occurred. As a practical matter, except for large and unusual items, averages of exchange rates will be used for translating most transactions. Financial statements prepared for foreign operating entities in hyperinflationary economies must be restated in accordance with IAS 29, Financial Reporting in Hyperinflationary Economies, before translation into the currency of the reporting entity.

(i) IAS 22: Business Combinations (formerly Accounting for Business Combinations). Both the purchase and the pooling-of-interests methods are allowed in accounting for business combinations. Goodwill arising in a business combination should be amortized into income over a five-year period unless it can be demonstrated that a longer period is more appropriate. In these circumstances, the amortization period can range up to 20 years. The benchmark treatment for negative goodwill is to first allocate amounts to non-current assets and record the remainder as deferred income. As an alternative, negative goodwill is allowed to be amortized in the same manner as positive goodwill.

(j) IAS 23: Borrowing Costs (formerly Accounting for Borrowing Costs). The benchmark treatment for borrowing costs is to expense the costs as incurred. However, if the costs incurred relate directly to the acquisition, construction or production of an asset, they meet the asset recognition test and may be capitalized.

Other technical pronouncements

77. The Board of IASC has also approved a standard (IAS 7) on Cash Flow Statements that will be effective for 1994. The new IAS replaces IAS 7, Statement of Changes in Financial Position. The standard states that enterprises should present a cash flow statement in place of a statement of changes in financial position. The cash flow statement should report the inflows and outflows of cash and cash equivalents during the accounting period. These cash flows should be classified as operating, investing and financing activities. The new IAS encourages users to report cash flows from operating activities using the direct method in which an enterprise reports the gross cash receipt or payments arising from each operating activity. An enterprise should also report separately major classes of gross cash receipts and gross cash payments arising from investing activities. However, gross reporting is not relevant for some activities of financial institutions.

78. Investing and financing transactions that do not require the use of cash and cash equivalents, such as the conversion of debt to equity, should be disclosed outside of the cash flow statement.

79. The new IAS requires the disclosure of the components of cash and cash equivalents and a reconciliation of these amounts with the equivalent items in the balance sheet. There are specific classification and disclosure requirements for unusual items, interest and dividends, taxes on income, and acquisitions and disposal of subsidiaries or other businesses.

Other projects in process

80. The Board of IASC has approved a revised exposure draft (E48) on Financial Instruments based on the previous exposure draft (E40) and comments received. The draft applies to financial assets and liabilities of financial as well as non-financial institutions and the rules propose that such assets and liabilities from operating activities be fair valued at the end of an accounting period. General principles are prescribed for recognizing, measuring, and reporting financial assets and liabilities and for the related supplementary disclosures to the financial statements.

81. The Board has also agreed on the substance of a proposed revision of the standard on Income Taxes (IAS 12). The proposal is to adopt an assets and liabilities valuation approach for deferred income taxes by the recognition of timing differences between the carrying amount of assets and liabilities for

financial statement purposes and their values for income tax purposes. Exceptions are allowed for positive goodwill and unallocated negative goodwill arising from business combinations, earnings of affiliated companies that probably will not be distributed to the enterprise and therefore will not enter into the investor’s taxable income and timing differences arising from unrealized profits on intragroup transactions.

82. There is a draft statement of principles on the subject of Earnings per Share. The draft proposes that enterprises with publicly traded ordinary shares should disclose "basic net profit per share" and "fully diluted net profit per share", as defined in the draft statement of principles. Definitions of earnings, ordinary shares outstanding and potential ordinary shares are given, as well as guidance on the calculations of both basic and fully diluted earnings per share.

83. A draft statement of principles has also been issued on Intangible Assets. The proposed new standard is not meant to replace the requirements of other IASs, such as IAS 9 (Research and Development Activities), IAS 17 (Accounting for Leases), and IAS 22 (Business Combinations). The draft specifies criteria for determining if control over an asset exists and if future economic benefits will result from the use of the asset. Other matters covered include criteria for recognition and initial measurement of the value of an intangible asset, timing for the recognition of expenses, the allowed fair revaluation of assets, amortization, impairment of carrying values, retirements and disposals, and standards of disclosure.

84. IASC is also reviewing IAS 14, Reporting Financial Information by Segment, to determine if revisions should be made to that standard. A Steering Committee has been formed and research is in progress.

C. International Federation of Accountants

85. The recurring work programme of IFAC is carried out by its Council, its five major standing committees (International Auditing Practices, Education, Ethics, Financial and Management Accounting, and Public Sector), and a series of Ad Hoc Task Forces. IFAC is also a member of the International Capital Markets Group (ICMG), and the current President of IFAC is also the current chairman of the ICMG. ICMG is a private-sector group that seeks to promote a system of efficient capital markets throughout the world.

86. In August 1992, the Council of IFAC issued a Statement of Policy on "Assuring the Quality of Audit and Related Services". This document addresses the very serious concerns being expressed in many countries about business failures and the responsibilities of auditors. Recommendations are made on ways to develop quality review programmes for the profession. In 1993, IFAC also published a significant report entitled, "Impact of Information Technology (IT) on the Accountancy Profession". The report describes IT trends and developments that will affect accountants in the next decade, such as reduced acquisition and operating costs for data processing and data communications, transformation of organizations and accounting services and information technology. The report

also makes recommendations for actions to be taken in response to these developments.

87. In February 1992, the International Auditing Practices Committee (IAPC) released a second addendum to International Standard of Accounting (ISA) 8 (Audit Evidence) on "Additional Guidance on Long-Term Investments and Segment Information". In October 1992 IAPC issued ISA 6 (Risk Assessment and Internal Control). The addendum is entitled, "Audit Considerations Relating to Entities Using Service Organizations". Also in February 1992 a revision was issued of ISA 14, "Other Information in Documents Containing Audited Financial Statements".

88. New ISAs promulgated by IFAC are ISA 30, "Knowledge of the Business" and ISA 31, "Consideration of Laws and Regulations in an Audit of Financial Statements". ISA 30 provides a description of important elements of business enterprises and the market sectors in which they operate that must be understood by an auditor, and how he/she should use such information. Sources for information are also suggested. ISA 31 is concerned with the procedures that an auditor should follow to determine that a client has complied with national laws and regulations and how the auditor should deal with illegal acts, for whatever reason they have occurred, that would result in the material misstatement of financial statements. The IAPC is also working on a codification of the existing standards to refine and update the content and present them in a more user-friendly format.

89. Supplementing its Code of Ethics for Professional Accountants, the Education Committee issued IEG 10, "Professional Ethics for Accountants: The Educational Challenge and Practical Application". The Code of Ethics was revised in July 1992. The Committee also released discussion papers on "Specialization in the Accounting Profession" and "Minimum Skill Levels in Information Technology for Professional Accountants".

90. The Financial and Management Committee has promulgated Statement on International Management Accounting Practices No. 5, "Managing Quality Improvements" (March 1993). The Statement describes the role of the accountant in Total Quality Management (TQM) programmes. The Public Sector Committee released International Public Sector Guideline No. 3, "Applicability of International Standards on Auditing to the Audit of Financial Statements of Governments and Other Non-Business Public Sector Entities" (January 1992) and Study No. 2, "Elements of the Financial Statements of National Governments" (July 1993). The latter study should be helpful in the development of public sector accounting standards that are more compatible with private sector accounting standards.

91. ICMG is composed of three member organizations - IFAC, the International Bar Association and the Fédération International des Bourses de Valeurs (FIBV). The Group works towards promoting efficient global capital markets to enhance the confidence of investors. Each of the three organizations works on projects in its area of specialization and interest and the results are reviewed and discussed with the other members of the Group. In 1992, the Group published a report entitled, "Harmonization of International Standards" which describes efforts being made, problems that have occurred and achievements attained.

92. IFAC has adopted a strategic plan entitled, "Towards the 21st Century: Strategic Directions for the Accountancy Profession". The purpose of the plan is to clearly define the mission of IFAC, what its objectives should be, and activities the organization should undertake to achieve these objectives. Since IFAC is the international representative organization for the profession, it intends to increasingly assert itself on global issues, continue to enhance the technical and professional development of its members, foster a strong and cohesive profession, assist formation of national and regional organizations, promote the profession’s role, responsibilities and achievements and contribute to the development of capital markets and international trade.

93. To this end, the Executive Committee of IFAC has recently established a Developing Nations Task Force which had its first meeting in November 1993. UNCTAD has been invited to participate in the work of this group. The Task Force is researching the needs of developing countries and of their accounting professions in order to identify ways in which practical assistance can be offered to satisfy such needs.

94. As referred to earlier in this report, in October 1992 IOSCO endorsed international auditing standards of IFAC as being the minimum requirements that should be acceptable for securities offerings by corporations on exchanges other than in the home country of the offeree.

D. Arab Society of Certified Accountants

95. In April 1993, the Arab Society of Certified Accountants (ASCA) sponsored the Third International Arab Accounting Conference in Bahrain. The theme of the conference was "Challenges Facing Arab Accountants", and the presentations highlighted the globalization of international business and the need for the harmonization of national standards of accounting and reporting with international standards. A representative of UNCTAD made a presentation entitled "Professional Changes Under the New World Order", which discussed the effects of the globalization of business on accountants, recent developments in corporate governance policies, litigation against accountants, and the activities of the Intergovernmental Working Group. Other presentations discussed litigation and professional indemnity insurance issues, conflicts of interest situations for accountants and consultants, and the domestic and international qualification of professional accountants.

96. Some of the recommendations that were made at the conference were that professional accountancy bodies should work more closely with educators; they should publicize their contributions of accounting and auditing services to the efficient conduct of world trade and investment; and individual accountants should strive to raise their professional standards to the highest levels. Universities and other educational institutions were encouraged to review their curricula for relevance with the rapidly changing events and technology in the world.

97. Immediately following the Conference, UNCTAD and ASCA conducted a workshop on accounting standards setting for government and professional accountants representing countries in the Gulf region. Topics presented were: the current

status of accounting standard setting in the countries of the Gulf region; the work of the Intergovernmental Working Group and other international organizations on standard setting; the role of conceptual frameworks in setting accounting standards; and, institutional arrangements for standard setting. Recommendations were adopted at the end of the workshop for actions to be taken, including the establishment of regional and local standard setting bodies and for a UNCTAD-sponsored workshop on accounting education in the region.

E. European Community

98. The European Community Seventh Directive on consolidated accounts has become one of the most important steps in the process of harmonizing accounting practices in Europe. The Directive, which was adopted in 1983, has now been implemented in all European Community member States. The requirements of the Directive will also have to be implemented in the six European Free Trade Area (EFTA) countries that will be joining the European Economic Area, and the requirements will serve as the basis for many of the legislative reforms currently under way in the central and eastern European countries in transition to a market economy.

99. The Commission of the European Communities has proposed to increase the thresholds (balance sheet total; net turnover) for the definition of small and medium-sized companies, taking into account the economic and monetary developments in the Community since 1990. It is expected that the proposed change in the Accounting Directives will be adopted by the Council of Ministers before the end of 1993. This change will allow a larger number of small and medium-sized companies to be exempted from audit and disclosure requirements of certain accounting information in their consolidated financial statements.

100. The Commission is also examining to what extent the existing Accounting Directives should be modified so that they properly apply to the growing number of financial conglomerates (groups that include both banking and insurance enterprises).

101. The European Community has recently established an Accounting Advisory Forum composed of preparers and users of financial information and representatives from accounting standards setting bodies in the Community. To date, the members of the Forum have indicated reluctance to eliminate alternative methods of accounting that are currently available. The Forum recently adopted a paper on accounting for government grants which states that both the gross and the net methods of accounting are acceptable. Where the net method is used, it is recommended to include additional information in the notes to the financial statements to allow a comparison with the accounts of companies that use the gross method of accounting.

102. At its October 1993 meeting the Forum discussed draft papers on foreign currency translation and on accounting for leases. Rather than advocate the use of a single method for leases, the Forum expressed a preference for allowing the two methods that are used in European Community member States. However, when a finance lease has not been capitalized by the lessee, it is recommended that the

lessee include certain information in the notes to the financial statements to disclose the liabilities under the lease contract.

103. Another subject which the Forum addressed at its October meeting was environmental accounting. FEE prepared a background paper on the issues for discussion at the meeting.

104. The European Community 1986 Directive on accounting for financial institutions has now been implemented by all member States and should normally apply for the first time to 1993 annual financial statements (including consolidated financial statements).

F. Fédération des experts comptables européens

105. FEE is the representative organization for the accountancy profession in Europe. It is not a standard-setting body; however, it is closely involved in the work of the European Community Accounting Advisory Forum, IASC, and the OECD Working Group on Accounting Standards. FEE also undertakes an active research programme on financial reporting issues in Europe and elsewhere and publishes reports that are directed towards the harmonization and comparability of financial statements.

106. FEE recently published a study entitled "Seventh Directive Options and their Implementation", which examines how the directive has been implemented in each member State and how Seventh Directive options have been incorporated into national legislation. It covers all European Community member States as well as Austria, Norway, Sweden and Switzerland. Beginning with the background of the Seventh Directive and its contents, the study also discusses those areas most affected, such as harmonization, equivalence and mutual recognition. After a comparative overview of developments in the European Free Trade Area (EFTA) countries, the study concludes with a summary of the effects of the directive across Europe.

107. Another study just published is entitled "Environmental Accounting and Auditing: Survey of Current Developments". The survey presents the current situation on environmental accounting and auditing in each of the European Community countries as well as in Austria, Finland, Iceland, Norway, Sweden and Switzerland. It further provides insight on the Fifth Action Programme on the Environment, "Towards Sustainability", which the Commission of the European Communities published in March 1992, as well as on the Community-wide Eco-Management and Audit Scheme (the so-called Eco-audit), as adopted in March 1993. The study discusses how "green" accounts should be.

108. Work is progressing on FEE’s comprehensive survey of pension accounting in Europe. The objective is to develop a more profound understanding of the details of the pension regimes in different countries (state funded, private sector, pay-as-you-go, fully funded, etc.) so that any recommendations for the harmonization of accounting treatments will actually lead to like transactions being accounted for in a like manner, and fundamentally different transactions being accounted for differently. The project should also assist in making more

transparent the extent of any problems of substantial unfunded pension liabilities, especially in state-run schemes.

109. Having published several surveys of financial statements, including the 1991 Survey of Published Accounts and the 1992 FEE Analysis of European Accounting and Disclosure Practices, FEE has now entered into a new project entitled "1994 Investigation of Emerging Accounting Areas". The investigation explores the following areas: valuation of joint-ventures and associated companies, capitalized intangibles, provisions for guarantees and product liability and disclosure issues (such as environmental issues and the true and fair view override). The investigation covers 16 countries and should be published in the summer of 1994.

110. FEE is about to finalize its survey on the involvement of the auditor in the prudential control of banks by supervisory authorities, and expects the survey to be published in late 1993. The survey will discuss the role of a bank's auditor in relation to the supervisory authorities and will address the initiatives of IFAC and the European Community Commission in this area. The survey has become a topical issue after the collapse of BCCI.

111. At the request of the Commission of the European Communities, FEE is developing draft proposals for the approach to be followed when preparing consolidated financial statements of financial conglomerates, i.e. groups comprising banking, insurance and, sometimes, other commercial activities. At present, three separate European Community directives impact such consolidated financial statements: the Seventh Directive for mainstream commercial activities, the Bank Accounts Directive for banking activities and the Insurance Accounts Directive for insurance activities. This has given rise to widely different accounting treatments in practice, especially as far as balance sheet and income statement presentations and formats are concerned. FEE hopes to present its recommendations to the European Community by the end of 1993.

112. FEE has issued two discussion memoranda dealing with financial instruments. One is on the subject of valuation of instruments and the other is on disclosure in financial statements. A third memorandum on recognition will be issued later.

113. Another project in the area of financial institutions that FEE is about to undertake is a study on the interaction between the IASC's international accounting standards and the European Community Accounting Directives, with an emphasis on accounting for financial instruments.

114. FEE believes that there is an urgent priority for the European Community to deal with the issues of the mutual recognition of accountancy firms and the cross-border provision of regulated accountancy services. Progress in these areas has been more slow than expected because of the reluctance of some countries to accept any liberalization of the current rules governing the profession and its activities.

115. FEE held its third Congress in September 1993. At the meeting discussions were held on the important issues facing the accountancy profession in Europe, including harmonization of financial reporting, the erosion of confidence in

professional audits, increasing litigation against accountants and environmental auditing.

G. <u>Fédération internationale des experts-comptables francophones</u>

116. During 1992 and 1993, the members of FIDEF continued to be engaged in a number of activities that are designed to promote the development of the accountancy profession in their respective countries. The December 1992 meeting of FIDEF in Paris dealt with economic restructuring and privatization and the contributions made by financial, accounting and management information systems to the processes.

117. Accounting professionals in the "Maghreb" Arab countries have signed a declaration of intent to organize a regional association of professional organizations. The purpose of the association is to develop cooperation among accountants in the areas of professional practice, accounting standardization, and basic and advanced training, and to provide joint representation within international professional bodies to increase the influence of the accounting professionals in the Maghreb countries. Another regional organizational organization, the African Accounting Council, is collaborating with the United Nations Industrial Development Organization (UNIDO) to organize a meeting of cost accounting specialists by the end of 1993. The specialists will prepare a cost accounting manual for small and medium-sized enterprises in Africa. Some activities in the member countries represented in FIDEF are described in the following paragraphs.

118. In Algeria, Decree No. 92-20 dated 13 January 1992 now sets forth the operating procedures of the Algerian Ordre des experts comptables des commissaires et des comptables agrées. A meeting to establish the Ordre was held in April 1992 and its governing Council will now undertake an appraisal of the profession in Algeria and define the broad aims of the Ordre. Technical, juridical and socio-professional rules appropriate to meeting the objectives of the Ordre are being developed.

119. In Côte d'Ivoire a bill dated 27 March 1992 established a professional body for enterprise accountants and professional accountants. An Ordre des experts comptables is being established, and is expected to be constituted by the end of 1993.

120. In Zaire, a group of accountants in 1992 established the Institut des réviseurs comptables (IRC). Its new members have been chartered by a special commission that was established for the purpose.

H. <u>Organisation for Economic Cooperation and Development Working Group on Accounting Standards</u>

121. The OECD Working Group on Accounting Standards addresses issues aimed at promoting the international harmonization of accounting and practices among its member countries. Since 1990, it has also been actively involved in providing

technical assistance and advice on accounting reform to central and eastern European countries in transition to market economies.

122. The reform of accounting systems in central and eastern Europe is of crucial importance for the transition to a market economy, and in particular to the restructuring and privatization of enterprises, the promotion of investment and the creation of capital markets. In 1992-93, the OECD's Working Group on Accounting Standards, in cooperation with the Centre for Cooperation with European Economies in Transition (CCEET), has been extending technical assistance to these countries in a number of ways.

123. Following a conference on Accounting, Financial Reporting and Auditing issues in Estonia, Latvia and Lithuania which was held in April 1992, a newly created Joint Working Group on Accounting Reform for the Baltic States held its first meeting in Riga last November. At this meeting, recent accounting developments in the three Baltic States was discussed, including experiences with the drafting and implementation of accounting legislation. The Group is an important step in helping the Baltic countries to develop a coordinated approach to accounting legislation and practices and to cooperate in the building of accountancy professions.

124. See section II. H above for a description of other activities of OECD in accounting reforms in the newly independent States.

125. Recognizing that a growing private sector in the CCEET countries requires the services of well-trained and experienced accountants and auditors, the OECD has been actively involved in developing training programmes for these countries designed to provide a basic understanding of accounting, the ability to analyse and interpret financial statements from commercial entities, and a general understanding of the mechanics of the accounting process. This activity is carried out in cooperation with international accounting organizations, consulting firms, and other international institutions in order to combine resources effectively and to avoid unnecessary duplication.

126. An accounting training model has been developed for use as part of the Centre's training activities which are carried out in different OECD tax training centres. Courses have been given at both the Vienna and Copenhagen tax training centres. The training module is flexible enough to be used as part of the training of tax administrators or as a basis for courses to be given to a wider audience such as enterprise accountants and government officials in charge of implementing accounting legislation. The module was used for a course given with the Academy of National Economy in Russia in January 1993.

127. The difficulty encountered in these activities is the lack of readily available high quality teaching materials, including textbooks. It is important to disseminate as widely as possible accounting and auditing training information so as to provide these countries with the tools necessary to understand western accounting principles.

128. The OECD publishes the proceedings of the meetings of the Coordinating Council for the NIS and the Joint Group on Accounting Reform for the Baltics which will also be made available in the Russian language.

129. In its work on promoting harmonization of accounting standards, the Working Group organized a Roundtable in May 1993 on Environmental Accounting and Auditing. Representatives from Governments and standard-setting organizations in the OECD countries, central European countries and Mexico attended the meeting. Participants exchanged views on various issues, including the disclosure of environmental expenditures and liabilities and specific environmental reporting by enterprises, user needs for independent audits of environmental matters and the relationship between financial auditors, certification bodies and environmental auditors. The Roundtable did not attempt to draw conclusions in this area which participants agreed is rapidly evolving. However, there was some consensus that major changes to the accounting framework are not needed to deal with the special nature of environmental costs and liabilities already included in financial accounts, although there is room for guidance on implementation to achieve proper and consistent application.

130. The Working Group has also been looking at current practices regarding the manner in which training activities by enterprises and the skills and competencies of the work force are taken into account and how this is reflected in systems of financial accounting and reporting. This work is being carried out in cooperation with the OECD’s Committee on Education, Employment, Labour and Social Affairs.

131. Work on the analysis of the prudence and the matching principles as they are applied in OECD member countries is also under way and will be taken up by the Group at its May 1994 meeting.

132. The Group has also been considering the accounting treatment of new financial instruments since 1990 and is planning to take up this issue again in 1994 to discuss member countries’ views on Exposure Draft No. 40, "Financial Instruments" that was issued by the International Accounting Standards Committee in September 1991.

I. North American Research Group

133. Members of accounting standards setting bodies in Canada, Mexico and the United States have recently joined together to study the similarities and differences in the standards of their countries with a view towards harmonization. The project involves examining the existing standard setting processes, conceptual frameworks utilized and differences in specific standards. The research group will also compare their standards with IASC standards to identify differences and similarities. This work is then expected to form the basis for specific efforts to improve the comparability of accounting standards of the three countries involved in the project.

IV. MEETING OF WORLD ACCOUNTING STANDARD SETTING BODIES

134. A meeting of representatives from standard setting bodies was hosted by the United States Financial Accounting Standards Board in the last quarter of 1992. The purpose of the meeting was to discuss the processes for setting standards in the countries represented and important issues that each body is currently

addressing. The representatives also discussed the globalization of business and how national and international groups could work towards the harmonization of standards. As reported above, the FASB has been showing an increased interest in the harmonization of United States standards with standards in other countries of the world.

V. PROPOSAL TO DEVELOP A GLOBAL ACCOUNTING QUALIFICATION

135. During its eleventh session, the Group of Experts considered how accounting education could be improved so that accountants and auditors can better meet their global responsibilities. It noted the growing educational gap between the developed and developing countries. While a high level of accountancy has been achieved in many countries, there is no common guaranteed level world-wide. That poses problems for accountants from developing countries and countries in transition, as they are not accorded equal status.

136. The European Community has recently addressed the issue of the qualification of professionals across national boundaries within the community, and has taken actions for mutual recognition of educational qualifications for licensing. This action, obviously, is a regional solution, and not an international solution.

137. During the eleventh session experts from developing countries and countries in transition described how difficult it is for them to obtain an accounting or auditing credential that is recognized worldwide. Without properly educated accountants and auditors, accountability in neither the public nor the private sector is likely to improve. Moreover, given the lack of fully qualified accountants, it is impossible for developing countries and countries in transition to set up standard-setting bodies which could provide the regulatory framework to increase accountability and provide for transparency and comparability in financial statements.

138. Therefore, a logical first step in improving accountability and promoting standard-setting would be to improve the quality of accounting education and to close the educational gap. The Group recommended the development of global accounting and auditing qualifications. Since the International Federation of Accountants (IFAC) is devoted to the strengthening of the profession and since it has already issued minimum guidelines for accounting education, ISAR adopted a resolution at the eleventh session which gave the task of developing such global qualifications to IFAC. The Group recommended the following terms of reference for consideration by IFAC (see E/C.10/AC.3/1993/12):

1. To develop global qualification standards for accountants and auditors to be endorsed by the United Nations;

2. To develop a professional accreditation system based on the global qualification standards;

3. To develop a multilingual world dictionary of accountancy;

4. To take into account the different environments that exist in the world by involving the regional bodies of the International Federation of Accountants;

5. To start with the qualifications for accountants as the suggested order in developing the global qualification standards;

6. To liaise with the World Bank and other international bodies, where appropriate;

7. To consult with the Bureau of the Intergovernmental Working Group and to report to it at its twelfth session in 1994.

139. The Governing Council of IFAC considered the above recommendations at one of its meetings during 1993 and referred the matter to IFAC's Education Committee for study. No actions have been taken as of October 1993 on this matter.

VI. CONCLUSIONS

140. With the current level of internationalization of the world's economies and the rapid changes in information technology and communications, the needs for continued improvements in the harmonization and transparency of accounting and financial reporting are correspondingly increasing. The Intergovernmental Working Group serves as the truly international forum for the consideration of issues to improve the availability and comparability of information disclosed by transnational corporations. In particular, the Group participates in the work of other international organizations and identifies areas which are not being examined by them or which merit a broader perspective than other organizations can offer. Its work in environmental accounting and accounting for sustainable development has been particularly regarded as important by United Nations Member States. It is important that ISAR continue to undertake empirical studies and sponsor conferences that promote its historical mission as described above.

141. The eleventh session of the Group made a significant contribution by identifying the needs of developing countries and countries in transition to a market economy for accounting education and training and for the qualification and recognition of professional accountants. Technical assistance projects need to be undertaken in Member States that have requested assistance to meet these needs.

Notes

1/ United Nations, World Investment Report (New York, 1993).

2/ Emerging Stock Markets Factbook. Washington, D.C., The International Finance Corporation, June 1993.

3/ Phillips, Susan M., "Derivatives Markets - Challenges and Regulatory Issues", World of Banking, vol. 12 (March/April 1993).

4/ Fraser, K. Michael, "Forex Derivatives Take a Wild Ride", Global Finance, vol. 6 (November 1992).

5/ Anonymous, "Derivatives: Part of the Solution to Global Risk", Global Finance, vol. 6 (October 1992).

6/ Global Derivatives Study Group, Derivatives: Practices and Principles. Washington, D.C.: Group of Thirty, July 1993.
