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# Report of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting on its Nineteenth Session

Held at the Palais des Nations, Geneva,
from 25 to 27 September 2002

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## INTRODUCTION

1. The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) held its nineteenth session at the Palais des Nations, Geneva, from 25 to 27 September 2002. In the course of its session, it held two plenary meetings and six informal meetings.

1.

# Chapter I

# AGREED CONCLUSIONS

## A. Transparency and disclosure requirements for corporate governance

2. The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) recalls that during its eighteenth session it proposed to discuss corporate governance at the nineteenth session of ISAR, with the specific topic selected by the Commission on Investment, Technology and Related Financial Issues at its sixth session (held in January 2002). There it was agreed that, in light of ISAR's mandate to promote transparency and disclosure, it should consider how it could assist developing countries and countries with economies in transition in identifying and implementing best corporate governance practices to achieve better transparency, financial disclosure and accountability.

3. At its nineteenth session, ISAR discussed the report submitted by the secretariat on transparency and disclosure requirements for corporate governance (TD/B/COM.2/ISAR/15).[1] It welcomed the report's objective to assist developing countries and countries with economies in transition in developing their own guidelines for applying global principles of corporate governance and the fact that the report provided a valuable illustration of the convergence of opinion on the content of corporate governance disclosures.

4. ISAR agreed that further work was needed in the area of transparency and disclosure requirements for corporate governance, including field case studies that could be useful as an input towards a practical tool kit for corporate governance. ISAR recognizes the need to cooperate closely with other multilateral and regional initiatives in this area.

## B. Accounting by small and medium-sized enterprises

5. At its seventeenth session, ISAR recognized the need for a user-friendly, understandable and flexible financial accounting and reporting system that accommodates the needs of small and medium-sized enterprises (SMEs) at various stages in their development in order to enable them to maintain accounting records and generate meaningful financial information.

6. At its eighteenth session, ISAR agreed on approaches to accomplish the above objectives. It also recognized that the outcome of such an exercise would be voluntary technical aid tools for member States and that it was up to each country to determine the appropriate definition for the term "small and medium-sized enterprises" in accordance with its national economic environment.

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[1] This report is also available at *www.unctad.org/isar*.

7. At its nineteenth session, ISAR considered the proposed guidelines submitted by the ad hoc consultative group on accounting by SMEs for Levels 2 and 3. It found the proposals acceptable and commended the ad hoc group for its work.

8. ISAR invited session participants who had provided comments to confirm their input by communicating their suggestions to the UNCTAD secretariat in writing by 31 October 2002 at the latest. It requested representatives of the ad hoc consultative group, under the authority of the chairperson of the nineteenth session, to incorporate the comments, where considered appropriate, into the proposed guidelines as necessary.

9. ISAR agreed that the proposed guidelines for Level 2 could benefit from wider consultations. It requested the secretariat to circulate the draft guidelines widely for a period of about three months to such organizations as national and regional standard setters, professional organizations and other entities with an interest in the proposed guidelines, and to make feedback received from consultations available to the ad hoc consultative group for its review.

10. ISAR also agreed that the proposed guidelines for Level 2 and particularly Level 3 could benefit from feedback through field-testing. It encouraged the UNCTAD secretariat, under the authority of the chairperson of the session, to provide necessary cooperation to international, regional and national organizations, agencies and others interested in field-testing the proposed guidelines for Levels 2 and 3. ISAR encouraged the secretariat to compile feedback obtained from field-testing and make it available for eventual review.

11. ISAR agreed that comments received through the wider consultations, as well as any other necessary updates to the proposed guidelines, would be incorporated into the guidelines by the ad hoc consultative group. ISAR also recognized the possible need for a person-to-person meeting of the consultative group in order to finalize the proposed guidelines.

12. ISAR agreed that the documents should be released as finalized documents under the authority of the chairperson of the session.

13. ISAR agreed to provide the International Accounting Standards Board with the final output for Level 2 SMEs and to extend all necessary cooperation to the IASB in its project on accounting by SMEs. ISAR reiterates its request to the IASB to give priority to completing its project.

14. ISAR recognized that the finalized guidelines would need reviewing and updating at appropriate intervals.

## C. Follow-up from the fifteenth session

**Environmental accounting**

15. ISAR reviewed its work in the area of environmental accounting and eco-efficiency indicators. It agreed to proceed with wider consultations on the eco-efficiency guidelines, and

to continue to develop, drawing on available extra-budgetary funds, training materials and their dissemination, including through distance learning.

### D. Follow-up from the sixteenth session

**Assessment of professional qualifications**

16. Taking into account the positive and recognized contribution that the guideline on national requirements for the qualification of professional accountants that ISAR adopted at its sixteenth session is making towards the goal of enhancing the level of professional qualifications, ISAR recommends that the UNCTAD secretariat continue to cooperate with international, regional and national organizations and professional bodies to strengthen accounting education and professional qualification. The group of experts reviewed its activities in the area and recommended that ISAR continue its efforts in close cooperation with the Steering Committee on Professional Qualifications.

## Chapter II

## OPENING STATEMENTS

17. In his opening statement, the **Deputy Secretary-General of UNCTAD** highlighted the timeliness of the deliberations of ISAR on corporate governance transparency and disclosure, given the state of affairs that prevailed in world capital markets. While it was true that the issues were being discussed in other forums, what made ISAR as a forum unique was the fact that it was all-inclusive and experts from member States at all levels of economic development were there at the session to tackle the issue from different perspectives. Only inclusive discussions could produce consensus that would endure over time.

18. While the individual output of small and medium-sized enterprises (SMEs) seemed very small in comparison to that of larger corporations, the aggregate contribution of this sector to the economies of all member States did not need more emphasis. They employed most of the labour force, generated most of the gross domestic product and paid most of the taxes; thus, their contribution was very significant. He made reference to research and earlier deliberations by ISAR indicating that the SME sector suffered from lack of adequate financing. Many lenders required collateral or properly prepared financial reports in order to provide funds to SMEs. Lack of funds and a number of other factors had contributed to the bankruptcy and ultimate collapse of many SMEs.

19. With respect to the general state of affairs in corporate financial reporting and the role of ISAR, the Deputy Secretary-General stated that since the previous session of ISAR less than a year ago, many people had been struggling to come to terms with the sad reality of corporate financial fraud. Dramatic developments had taken place in world capital markets, and mega-corporations had collapsed. Market capitalization of staggering proportions had been wiped out. The lifetime savings of many employees and other stakeholders had been lost. Serious doubts had been cast on the integrity of corporate executives, boards of directors and independent accountants. Investors had lost confidence in the financial markets.

20. He concluded his remarks by urging ISAR to keep in mind that the issues it was dealing with were of major significance in the context of the economic and social development agenda of the United Nations as a whole. He encouraged ISAR to look ahead and address issues in its collective expertise in a proactive manner.

21. The outgoing **Chairman of the eighteenth session of ISAR** stated that during the intersession period many activities aimed at advancing the work of ISAR had been undertaken. These included further work on the project on accounting by SMEs and consultations conducted with a view to identifying a specific area of study in the area of corporate governance and developing materials on the topic for discussion at the nineteenth session.

## Chapter III

## CHAIRPERSON'S SUMMARY OF INFORMAL DISCUSSIONS

### A. Transparency and disclosure requirements for corporate governance

(Agenda item 3)

22. An UNCTAD resource person, introducing the item, recalled that at the tenth quadrennial conference (in Bangkok in February 2000), member States had requested UNCTAD to “promote increased transparency and financial disclosure by encouraging the use of internationally recognized accounting, reporting and auditing standards and improved corporate governance”.

23. In concluding the eighteenth session and adopting the provisional agenda for the nineteenth session, ISAR proposed to work on issues related to corporate governance in order to assist developing countries and countries with economies in transition in identifying and implementing best corporate governance practices. Through informal consultations conducted in a two-day workshop on 13–14 September 2001 and via e-mail and fax communications thereafter, it was agreed to focus the work on disclosure requirements on corporate governance, with a view to developing guidelines.

24. The UNCTAD resource person indicated that most delegates considered this specific topic one that was consistent with ISAR’s mandate to promote better transparency and disclosure and that would add value to existing initiatives. The following considerations were also instrumental in the choice:

- Transparency and disclosure have been recognized as the major elements of a sound corporate governance system by most codes and rating models of corporate governance.
- Recent events in financial markets reveal the need to implement these codes or translate them into practical action according to the particular business environment.
- Disclosure requirements on corporate governance, although outlined as an important issue, have not yet been specifically and comprehensively addressed by any intergovernmental organization.
- Focusing on such a specific topic would be consistent with ISAR’s expertise in providing guidance on international best practices in reporting and disclosure.
- Such guidance on implementation might be particularly useful for developing countries and for countries with economies in transition.

25. The report prepared by the Ad Hoc Consultative Group of Experts on Corporate Governance Disclosures, which was contained in document TD/B/COM.2/ISAR/15, was introduced by two representatives of that group. The report represented the deliberations of the ad hoc group during a meeting held in April 2002 in Geneva, as well as electronic

communications that followed the meeting. The report covered both financial and non-financial disclosures on corporate governance.

26. In the discussions that followed, the Group of Experts reviewed and deliberated on the report prepared by the ad hoc consultative group. Most delegates expressed appreciation for the high quality of the report and emphasized the importance of ISAR's work on corporate governance disclosure, especially since the International Accounting Standards Board seemed to regard corporate governance disclosure as being beyond its mandate. It was noted that this work of ISAR was an important contribution to efforts to achieve the Millennium development Goals[2] by conquering poverty and integrating developing countries and countries with economies in transition into the global economy.

27. Most of the questions raised by delegates related to the scope of application of the recommendations included in the report, the relationship between transparency and disclosure, details of some of the financial and non-financial disclosures, the location of disclosure on corporate governance in published reports to shareholders and other stakeholders, and further steps that ISAR should take in this area.

28. In particular, some delegates felt that there should be a separate corporate governance report in addition to the financial report. Other delegates, however, expressed concern that doing this could lead to repetition of information, especially in relation to financial information, that had already been disclosed in an enterprise’s financial report. Some of the delegates stated that the level of detail required by the report might be more appropriate for inclusion in the Management’s Discussion and Analysis (MD&A), rather than in a separate report on corporate governance.

29. The ad hoc group representatives pointed out that the purpose of financial disclosure in relation to corporate governance was to provide explanations for and draw the attention of shareholders and other stakeholders to key issues that might not be immediately understood by users lacking specific expertise in the area of finance and accounting. They emphasized that the disclosed information should be clear to all users. Since most users are not accountants, it would be important to explain to them the major transactions and events underlying the figures that are important for decision-making.

30. It was noted that the location of such disclosures, although worth debating for the sake of harmonization, was not as important as the disclosures themselves. Possible options, based on the ad hoc group’s recommendations, were to include a reference to some of the financial information already provided in the notes to the financial statements, to put all such

[2] The Millennium Development Goals (MDGs) are contained in a resolution adopted by the Fifty-fifth session of the General Assembly of the United Nations (6–8 September 2000, New York). The resolution outlines the UN goals for improving living conditions in developing countries. Among other targets, it includes further development of an open trading and financial system that is rule-based, predictable and non-discriminatory, which implies a commitment to good governance, development and poverty reduction. For further details on the MDGs, see *www.un.org*.

disclosures in a separate section of the annual report, and to provide a stand-alone corporate governance report.

31. There was discussion of who should apply the proposed recommendations. To what types of enterprises should they apply – listed companies only, or others as well? Should they be extended to SMEs (which might create an additional burden for such enterprises)?

32. One delegate suggested that the proposed recommendations should apply to publicly listed companies, including mutual funds and financial institutions, but that individual jurisdictions should decide whether they should apply to non-listed companies and, if so, how they should be applied to them. A number of delegates felt that the recommendations should be limited to listed companies only. Other delegates felt that all entities of pubic interest should apply the recommendations. Several delegates stated that, although corporate governance disclosures should be provided by all enterprises, this did not mean that the proposed recommendations should be applied equally to them. The level of detail proposed by the ad hoc group should apply only to listed companies, but smaller companies should not be completely excluded. In support of this position, several delegates noted that many developing countries depended on small enterprises for their economic growth, and that, therefore, limiting disclosure requirements to listed companies would not allow these countries to achieve the goal of poverty reduction in developing countries, which is one of the objectives of improved transparency and reporting. It was also noted in the debate that, although the detailed disclosures might not be required of certain enterprises, all enterprises should be made aware of them.

33. In responding to this debate, the UNCTAD resource person indicated that the recommendations in the report were not exclusive. He drew the delegates' attention to the statement in the report indicating that "this work would be relevant to enterprises eager to attract domestic as well as foreign investment regardless of their legal form and size. The purpose of the work was to highlight the major concerns of international institutional and other investors and creditors and how they might be reassured by disclosures on corporate governance. What organizations disclose and how they do it will depend considerably on local laws and customs."

34. Some delegates indicated that the report should have contained more explanations regarding differences between corporate governance disclosure requirements for listed companies and those for SMEs. It was suggested that ISAR's work on corporate governance disclosure should also be tied into its current work on accounting by SMEs, and that the issue of corporate governance disclosure by SMEs should be addressed in ISAR's forthcoming guidance on accounting by SMEs. It was also suggested that state-owned enterprises' different needs regarding corporate governance disclosure be addressed.

35. One delegate suggested that, besides the principle of transparency, the report should also cover other principles of corporate governance, and that public governance and best practices in the area of governing structures should also be considered. Another delegate noted, however, that, at present, several organizations were working on a number of aspects of corporate governance, and that, although ISAR needed to work in cooperation with them

in this regard, the area in which ISAR could most valuably contribute was that of transparency and disclosure.

36. It was also noted that other issues suggested by some delegates for inclusion in the report – such as intellectual property, requirements for auditor rotation and criteria for auditor independence – were, although undoubtedly important, outside the purview of the ad hoc consultative group and therefore outside the scope of the report.

37. Delegates debated the issue of transparency and its relationship to disclosure. One delegate suggested that there should be some clarification (maybe a paragraph) of the concept of transparency (i.e. a definition and main elements). He maintained that transparency was broader than disclosure and should be dealt with separately from disclosure, especially since it was separately mentioned in the title of the report. Transparency could cover corporate policy, rules and regulations of the enterprise, processes and procedures, specific actions of management and employees, and other issues. The ad hoc group representative responded that disclosure in itself constituted transparency and that those who disclosed things properly were transparent. Another delegate, however, maintained that, in the case of Enron, even though issues were disclosed in notes to financial statements, the company was not perceived as being transparent to its shareholders.

38. In relation to this debate, some delegates noted that transparency as part of corporate governance included not only external reporting but also internal reporting to the board of directors. Therefore, reporting and disclosure requirements inside the enterprise itself, as well as related issues concerning the responsibilities of directors and external and internal auditors, should be addressed.

39. Delegates also discussed the overall detailedness of the corporate governance disclosure requirements outlined in the report. One delegate maintained that the extensive list of disclosures presented in the report could become a good starting point for defining priorities in corporate governance disclosures. Some delegates felt that such detailed requirements would be disadvantageous to enterprises, and that the language of the report was too prescriptive. Too much disclosure could conflict with confidentiality and could discourage companies from getting listed.

40. One of the delegates said that the duty of the board was to promote the success of the enterprise, and if an enterprise provided too extensive a disclosure of its risks, it could risk damaging its business. He said that an enterprise should be required to disclose material information in good faith, but that what was material should be decided by the directors and not by outside bodies. Otherwise, a conflict could occur between the enterprise's duty to its shareholders and its duty to disclose. Investors could make their own judgements. Another delegate noted that, although it was important to ensure that the interests of shareholders were respected and to observe the principle of confidentiality, the danger of undermining them as a result of corporate governance disclosures was exaggerated since, in reality, the commercial secrets related to technological processes, which were not part of financial reporting.

41. This delegate maintained that in light of the recent increase in crimes in the area of corporate finance and reporting, it was important to improve the system outlining the responsibilities of managers for the financial information they provide and their accountability related to corporate governance, including the quality of corporate governance disclosure. This should include matters relating to improving the quality of audits, what kind of training is needed for auditors (considering the increased demand on auditors), how to strengthen penalties for inappropriate financial behaviour by management, and how to improve the methodology of financial reporting. It was noted in the debate that in making disclosures, the principles of cost-benefit effectiveness should be observed. Another delegate indicated that the burden and risk of providing corporate governance disclosures should be weighed against the risk and cost of nondisclosure. An opinion was also expressed that confidentiality should be respected, but should be balanced with accountability: one cannot be accountable without being transparent.

42. Regarding the level of detail of corporate governance disclosure, one of the delegates maintained that the more general guidance outlined by the Organisation for Economic Co-operation and Development (OECD) corporate governance principles would be a more appropriate reference point for corporate governance disclosures, since it had been developed in broader terms to avoid placing unreasonable costs on, or damaging the competitive position of, an enterprise. More detailed elaboration of these principles might be dangerous and might impose an additional burden on businesses. Although the OECD principles are to be revised, they are cast in sufficiently broad terms to allow developing countries to require the sorts of disclosures that will give investors the confidence to invest in their countries. This viewpoint was supported by another delegate, who maintained that the OECD principles did not, and should not, call for greater disclosure than did the existing standard practices in developed countries, maybe with the exception of disclosure of corporate objectives, which is required by the OECD but is not a common corporate practice.

43. Another delegate agreed that the OECD principles should be the required point of reference, but felt that being too general and too broad would undermine the effort of developing countries that used certain rules of good governance. He further suggested that it would be useful to have a benchmark of best practices that would allow each enterprise to position itself vis-à-vis these practices without being required to apply them. Enterprises could then at least identify the gaps that existed in this regard. A representative of the ad hoc group indicated that the goal of the report was to emphasize the convergence of messages in leading codes on corporate governance disclosure requirements and to draw attention to prevailing best practices in this area. Another delegate stated that the economic future of developing countries depended on the ability of their inhabitants to invest, but that the lack of trust in directors was growing. Lack of disclosure requirements was, in his opinion, one reason why directors were not being punished for their fraudulent activities. The report called for nothing more than for the directors to confirm that they had acted in a good faith, that they had the required competencies and skills, that they had operated within certain parameters, and that they knew the enterprise that they were working for.

44. Another delegate, having agreed that ISAR should use the OECD principles on corporate governance as a reference point, suggested that referring just to the OECD principles might not be sufficient for accepting or rejecting specific corporate governance disclosures in light of current corporate failures, changes in corporate governance requirements since those principles were issued, and upcoming revisions of those principles.

45. Another delegate suggested that ISAR should provide input into the OECD principles when they were next revised. It was pointed out that ISAR and UNCTAD had a critical and important role to play in reviewing and proposing revisions to the OECD principles, and in helping to provide the basic tool kit from which developing countries could select what was most appropriate for them in the implementation of transparency and disclosure principles.

46. Delegates also debated on who would be the users of the proposed corporate governance disclosure requirements. One delegate felt that developing countries would not have sufficient demand for such disclosures, since there were not many investors and stock analysts in these countries. Another delegate felt that providers of capital would be very interested in this type of information. It was also suggested that the input from capital providers reflected in the report should be enhanced and bank representatives should also be consulted. Another delegate noted that the requirements set out in the report were primarily important for citizens of developing countries rather than for foreign investors.

47. One of the delegates noted that the position of capital providers was reflected in the recent McKinsey survey, which indicated that 71 per cent of 200 institutional investors in 31 countries, collectively responsible for US$2 trillion of assets under their management, rated accounting disclosures as the most important factor among 10 factors in their decision-making.

48. One delegate noted that accounting and disclosure issues were not problems just for developing countries, and that therefore the issue had to be seen in a broader context. Some of the developing countries, especially those in the Middle East, had huge investments in developed countries, and these investors had a right to know what the state of affairs was in these countries. Despite the pressure on regulators and appropriate bodies to address issues related to the recent corporate failures, there were no answers yet on whether those failures were caused by accounting issues, problems in financial markets or shortcomings in corporate governance.

49. A number of delegates felt that it was important to consider the interests of all stakeholders, not just those of capital markets. In this regard, one delegate emphasized the importance of the fact that the report addressed the issues of environmental and social stewardship and placed them in the broader context of corporate governance. Corporate social responsibility could have serious financial implications, and the disclosure of corporate policy on this matter was important. In this regard, the importance of coordination with other requirements, such as those of the Global Reporting Initiative and the OECD principles for multinational corporations, was mentioned.

50. Delegates also discussed issues regarding independent verification of corporate governance information, and related disclosures. It was emphasized that, as recommended in the report, there should be a statement about what information had been verified and how it had been verified.

51. A number of delegates raised issues relating to disclosures on particular financial matters. Some delegates felt that the report's section on financial disclosure should be shortened, with the explanatory parts taken out, since these issues were addressed in standards issued by the International Accounting Standards Board. One delegate suggested that a corporate governance report should just encourage companies to follow accounting principles and that more emphasis should be put on internal control systems to ensure proper financial disclosure. Another delegate felt that transitional economies were still experiencing a lack of guidance on financial disclosure in the context of corporate governance, and other delegates requested that more guidance be provided, especially on the materiality concept, related parties, fair value and other issues requiring professional judgement.

52. In concluding the debate, ISAR agreed that the report provided useful information and a convergence of views on corporate governance disclosure. It had also anticipated some of the new requirements contained in the Sarbanes-Oxley Act of 2002, by the New York Stock Exchange (NYSE), and by the National Association of Securities Dealers Automated Quotations (NASDAQ). One of the delegates said that ISAR had a vital role in continuing this work. A number of delegates suggested that the recommendations in the report be tested quickly with institutional and other investors, and that they be supplemented with examples of best practices. Further work in this area should include development of local case studies and implementation guidance.

53. A delegate suggested that case studies in developing countries include practical examples of how to implement transparency and disclosure requirements on corporate governance, what institutions are needed, what training is required (including that for company directors), and what the implications are for the accounting profession and other professions. Another delegate suggested that, in producing case studies, different countries could concentrate on their most prevalent types of enterprises (e.g. family companies, SMEs). A number of delegates noted that this work should be done in coordination with other global forums and groups, such as the Global Corporate Governance Forum.

## B. Accounting by small and medium-sized enterprises

(Agenda item 4)

54. In introducing the agenda item, the chairperson stated that ISAR's eighteenth session had asked the ad hoc consultative group to further refine the draft guidelines on accounting by SMEs taking into account the recommendations of the eighteenth session. The ad hoc consultative group had also been requested to elaborate on the guidance for Level 3 entities so that interim guidance could be developed as soon as possible. During the intersession period, the ad hoc consultative group had exchanged views by electronic mail as well as at a

meeting in Geneva in April 2002. The chairperson drew delegates' attention to the relevant documentation on the agenda item, namely documents TD/B/COM.2/ISAR/16 and addenda 1 through 4.

55. The chairperson reminded delegates that the International Accounting Standards (IAS) issued by the International Accounting Standards Board (IASB) had been used as a basis for the preparation of the proposed guidelines. However, neither members of the IASB nor its staff had endorsed the proposed guidelines.

56. The chairperson drew the attention of participants to the report of ISAR on its eighteenth session (TD/B/COM.2/ISAR/13). He reviewed other important points on which the eighteenth session had reached consensus and also recalled tasks that the eighteenth session had asked the ad hoc consultative group on accounting by SMEs to perform. He said that the urgent need for guidance on accounting by SMEs and the three-tiered approach had been reconfirmed. He also reminded participants that the proposed guidance was not a standard but rather a voluntary technical aid for member States that might wish to use it.

57. Following his introductory remarks, the chairperson invited the representative of the IASB, who was also an observer in the ad hoc consultative group on accounting by SMEs, to provide an update on activities at the IASB regarding its project on accounting by SMEs, and to provide his personal estimate on when the IASB would issue an exposure draft on this subject. The representative from the IASB stated that in May 2002 the IASB had added an "active research project" to its agenda. He stated that the purpose of this active research project was to evaluate various alternatives available for addressing the needs of SMEs and make a formal proposal to the Board. The alternatives the representative mentioned included systems used in Canada, New Zealand, the United Kingdom and the United States as well as recent proposals from Hong Kong (China).

58. The IASB would be forming an advisory panel of experts to advise it on the various alternatives for formulating a formal proposal. The representative stated that, according to his personal estimate, formal proposals would be presented to the IASB in about 12 months or longer. He also stated that the IASB was aware of the requirements in the European Union for listed companies to adopt IAS by 2005 and also the desire of the European Commission that its member States have the opportunity to extend the IASs to SMEs. The IASB's timetable took these facts into consideration, and it intended to make available proposals by that time.

59. The chairman thanked members of the ad hoc consultative group on accounting by SMEs for their contributions to the project. He then invited the two representatives of the ad hoc consultative group to introduce the proposed guidelines for accounting by SMEs for Levels 2 and 3 respectively.

60. The ad hoc consultative group representative who introduced the proposed guidelines for Level 2 SMEs stated that the guidelines were based on a set of IAS that SMEs were likely to encounter. The text in the proposed guidelines was primarily composed of the "black italicized letter" text of the IAS selected. Where amplification was felt to be appropriate,

however, the ad hoc consultative group had done so. Standards that were relevant only to a specialized area, as well as complex standards, had been excluded from the proposed guidelines. If SMEs in Level 2 were to encounter transactions that could not be addressed within the proposed guidelines, they would refer to the full IAS for guidance. Compliance with the proposed guidelines did not mean compliance with the IAS. He indicated that the IAS on which the guidelines were based were listed in appendix 3 of addendum 3 (TD/B/COM.2/ISAR/16). The ad hoc group representative also emphasized that the proposed guidelines were made as simple as possible in view of the fact that the implementation of the guidelines was going to require extensive communication and education tasks to familiarize preparers and users of accounts. He mentioned the IASB's improvements project and the possibility that some of the text of the proposed guidelines would change as a result of the project. He drew attention to the need to update the proposed guidelines in view of this fact. He also stated that the proposed guidelines could eventually be superseded by guidance from the IASB.

61. The ad hoc consultative group representative who introduced the proposed guidelines for Level 3 SMEs (contained in addendum 4 of document TD/B/COM.2/ISAR/16) discussed various elaborations that had been made on the proposals presented at the eighteenth session. The proposals included an accounting and reporting framework, basic requirements and model financial statements consisting of an income statement and a balance sheet. The ad hoc consultative group had taken the position that cash flow information was important for managing SMEs, and it recommended that owner-managers keep cash records that would be sources for primary entry for the financial statements. However, if a cash flow statement was necessary for a particular SME, then the preparer would refer to the requirements for Level 2 SMEs for guidance. This would also be the case for all other events or transactions that were not addressed in the proposed guidelines for Level 3. In discussing the link between the guidelines for Level 3 and those for Level 2 and IAS, the ad hoc consultative group representative stated that the relationship would be a top-down approach from IAS to Level 2 and then to Level 3. This was different from the proposal discussed at the eighteenth session that suggested a bottom-up approach from Level 3 to Level 2 systems. In elaborating on the application of simple accruals in Level 3, the ad hoc group representative cited the case for lease payments deriving from operating as well as finance leases or hire purchase contracts and explained that these would be recognized as expenses on a cash basis, as opposed to accruals. He also discussed a format for a Level 3 income statement as well as model financial statements, including the rationale for the presentation.

62. In concluding their introductory remarks, the two ad hoc group representatives asked participants to comment on how helpful they thought the guidelines were, whether there were ways to make them more practical, and whether there should be wider formal consultations on the drafts.

63. Many participants, including some from developed economies,said that they found the draft guidelines to be very useful in their countries. One delegate stated that these documents would be useful for SMEs and micro-finance institutions. They could be used to generate financial information for taxation purposes as well, and his country’s chamber of commerce

would be interested in them. Another delegate cited consultations conducted in his country that reaffirmed the need to provide less burdensome accounting and reporting systems for SMEs, rather than requiring them to comply with full IAS. Still another delegate said that the approaches used in his country were similar to those in the draft guidelines, with certain adaptations to the local environment. His Government was providing lower-level SMEs with free accounting software. A delegate shared his observations on a multi-tiered accounting system that was being implemented in his region and that resembled the draft guidelines, and he stated that feedback from the implementation exercises in his region had been encouraging.

64. Many delegates were of the view that since many of the IAS on which the draft guidelines were based were being looked at by the IASB as part of its "improvements" project, and since amendments of varying degrees were likely on these IAS, the draft guidelines needed to be revised to incorporate the relevant expected amendments. On the other hand, several delegates expressed the view that IAS would be undergoing improvements constantly and that it would not be wise to wait for the completion of the IASB "improvements" project before issuing the guidelines under discussion. Some delegates stated that issuing the guidelines as they were, rather than delaying them, would result in more benefits than costs.

65. Certain delegates were of the view that the draft guidelines were not specific enough in defining the dividing line between levels, particularly between SMEs in Level 2 and those in Level 3. There were also questions regarding the varying intensity of labour utilized by SMEs in different sectors and the validity of number of employees as a criterion for classifying SMEs. There were a few interventions regarding reporting periods that were shorter or longer than 12 months. There was a general understanding that the guidelines should indicate the general approaches to these issues while leaving the specifics for member States to decide.

66. Some delegates expressed a view that the draft guidelines seemed to be geared mainly toward financial reporting by SMEs, without regard to their needs for fiscal reporting and national statistics. There were also concerns that the guidelines did not include charts of accounts that were traditional in certain reporting regimes. Other delegates found that it would not be realistic to try and accommodate all these suggestions in the proposed guidelines. Member States could adapt the guidelines to meet their specific requirements.

67. Some delegates expressed concern that the conceptual framework contained in the draft guidelines was not detailed enough and did not incorporate all the elements contained in the IASB framework. However, there was general agreement that the guidelines for SMEs needed to be fairly succinct. As a result, many components of the guidelines were presented in an abridged form. One delegate questioned the ad hoc consultative group's decision to simplify the standard on impairment of assets. A representative of the ad hoc consultative group explained that, because of the highly complex nature of that particular standard, simplification was considered necessary. Some delegates questioned the need for SMEs to state their accounting policies as set out in the draft guidelines, and asked whether it would not be sufficient for them just to state that they were in compliance with the guidelines for

Level 2 or 3, as the case might be. A similar question was also asked regarding the auditing of financial reports prepared under the proposed guidelines. There was general agreement that SMEs needed to state the basis on which the financial statements had been prepared. This would be helpful for auditing purposes as well. In addition to specifying the basis of accounting, SMEs were also required to state significant accounting policies that they had applied in generating their financial statements. One delegate felt that requiring SMEs to provide explanatory notes would be too burdensome.

68. There were several exchanges of views on the ad hoc consultative group's decision to incorporate only the segment of the IAS 8 "improvements" exposure draft that dealt with the hierarchy of the IAS. A number of delegates felt that proposed "improvements" to other IAS should have been incorporated. A representative of the ad hoc consultative group clarified its position by stating that it felt the hierarchy element and hence its inclusion was particularly important. Because of the time constraints under which the consultative group was operating, it was not feasible for it to incorporate other proposed "improvements". It was also noted that these "improvements" had yet to be finalized by the IASB and that a number of them could be reversed or modified.

69. One delegate pointed out that the draft guidelines retained many of the alternatives contained in the IAS, and felt that, in view of the lack of adequate training of accountants in developing countries, it would be preferable to eliminate alternatives that required significant professional judgement. It was noted, however, that eliminating alternatives offered by IAS for listed companies would mean that SMEs would have to comply with requirements that would be more stringent than those for Level 1 enterprises; this could be viewed as defeating the main objective of the whole exercise.

70. There were several interventions regarding the exclusion from the draft guidelines of items such as consolidations or group accounting, accounting in inflationary economies, discontinuing operations and extraordinary items. The general consensus seemed to be that these particular items did not occur frequently in an SME environment. However, if they were to occur, then SMEs would consult the full IAS for guidance.

71. A delegate noted that the proposed guidelines did not include guidance for SMEs transitioning from their former systems to implementing the guidelines that were being proposed. The ad hoc consultative group, however, had felt that providing guidance on first-time application was not within its mandate. Nevertheless, there was a general view that SMEs in such a circumstance could refer for guidance to the IFRS that would be issued on first-time application.

72. A number of editorial comments were raised. These will be taken into consideration in preparing the draft guidelines that will be circulated for wider consultations.

73. Several delegates commented on the draft model income statement and balance sheet for Level 3 enterprises that were contained in the draft guidelines. It was suggested that including owner's drawings in the income statement as well as the balance sheet did not add value to users. Other delegates did not see any harm in providing such information, since it

was considered helpful in gauging the amount of profits retained in the business. The point was made that as one worked towards providing useful information for institutions such as micro-credit agencies, one moved further away from most conventional presentations in order to cater to their specific needs. There were also questions regarding consistency in the use of terminology (e.g. *profit* and *earnings*). One delegate pointed out that the draft guidelines for Level 3 SMEs allowed the recording of lease payments on cash basis, which he considered to be inconsistent with the definition of liabilities that was provided in the proposed guidance.

74. Some delegates were concerned that the proposed guidelines for Level 3 SMEs did not include guidance on preparing a cash flow statement. There was a view that, even though at this level an enterprise was not likely to be engaged in financing or investing activities, a cash flow statement could be useful for understanding the nature of its activities and its cash generating capacity. Other delegates felt that, since such SMEs conducted almost all their operations on a cash basis, an income statement would be enough to indicate the cash flow of the firm. One delegate stated that, since Level 3 SMEs rarely engaged in borrowing, providing guidance on preparing tax reports would be sufficient.

75. The chairperson requested participants at the session who had provided suggestions to confirm their input by sending written comments to the secretariat. Representatives of the ad hoc consultative group would then review the drafts and make amendments, including editorial ones, as considered necessary.

76. Delegates exchanged views on the need for wider consultations and for field-testing the proposed guidelines. Many were of the view that the guidelines could benefit from such consultations and field-testing. There were discussions regarding who would be conducting field tests. A representative from one accounting organization indicated that her association would be willing to coordinate field tests of the Level 3 guidance among its members. It was generally agreed that all interested entities would be welcome to conduct field tests; the more feedback received, the better the resulting guidance would be.

77. Delegates also noted the work that the IASB was going to conduct on accounting by SMEs. A number of delegates suggested that the final version of the guidelines for Level 2 SMEs be passed along to the IASB. A number of delegates also felt that the guidelines on accounting by SMEs issued by ISAR could provide an interim solution until a standard on accounting by SMEs was finally issued by the IASB.

78. There was some discussion on whether the guidance provided by ISAR could remain in effect once the IASB had issued guidance on accounting by SMEs. The chairperson noted that the purpose of ISAR's work was to provide a voluntary technical tool for accounting by SMEs. This tool should be consistent with the framework of the IFRS and should ensure a harmonized approach among member States and regional and international organizations in implementing standards issued by the IASB. Accordingly, the ISAR guidance on accounting by SMEs would be reviewed by taking into consideration developments at the IASB.

## C. Other Business

(Agenda item 5)

### 1. Follow-up on previous sessions

***Fifteenth session – Update on environmental accounting***

*Guideline on eco-efficiency indicators*

79. An UNCTAD resource person provided an update on a manual that he was co-authoring for UNCTAD and ISAR on eco-efficiency indicators for preparers and users of financial statements. The indicators cover water use, energy use, global warming, ozone-depleting substances and waste. The financial items that are relevant to eco-efficiency indicators include value added, revenue, purchased goods and services, and consolidation. These tools would help financial analysts, bankers, and other stakeholders to more precisely link environmental performance with financial performance and would promote comparability between different industrial sectors. It is now possible to link financial performance to environmental performance. But, more importantly, the environmental performance of different companies and sectors can be compared. UNCTAD will organize a meeting with the Global Reporting Initiative (GRI) to discuss collaboration on and implementation of the guidelines.

*Distance learning*

80. A professor from the University of Geneva presented to the Group a joint UNCTAD–University of Geneva project on distance learning. The course would be offered either 100 per cent via the Internet or in a mixed environment where classroom meetings would complement the learning process.

81. The pedagogical objective of the module was to give information and guidance on environmental accounting issues and environmental performance indicators, and to identify best practices that could be considered by national standard setters in the development of their own accounting standards, rules and regulations.

***Sixteenth session – Update on assessment of professional qualification requirements***

82. The secretariat provided background information on the work of ISAR that had led to the development and adoption in February 1999 of the guideline on the requirements for the qualification of professional accountants, which included a model curriculum. The secretariat also provided interim results on a survey that was being conducted on the awareness and use of the guideline on professional requirements and the model curriculum developed by ISAR.

83. The secretariat updated participants on a meeting of the Steering Committee on Professional Qualifications that had taken place in Geneva in June. The Committee discussed the need to address the issue of professional qualifications in continuously globalizing financial markets and in light of the current corporate failures and suggested either the

twentieth session of ISAR or a special workshop as possible venues for further deliberations on the issue. It highlighted the need for strategic alliances with other development and professional organizations and agreed to continue with the benchmarking project. The Steering Committee discussed the need for updating the model curriculum of the group of experts and suggested that the secretariat perform research and present the results to the nineteenth session.

84. An UNCTAD resource person presented the results of a study on the need for updating the ISAR model curriculum as suggested by the Steering Committee on Professional Qualifications at its meeting in June. He discussed three alternative courses of action for revising the model curriculum. The alternatives were a minimum revision, a supplemental project to develop guidelines on minimum content targets for teaching the material, and a systemic approach for the design, respectively. He discussed in detail various sections of the model curriculum that he thought would need revision. The resource person indicated that the revision of the curriculum would require a systemic, eclectic and participatory approach with considerable international financial and technical assistance throughout the development process. He requested comments from delegates on the proposals. As part of his follow-up steps, the resource person stated that he would incorporate forthcoming comments on the draft proposal. The updated report has been sent to the Steering Committee and a semi-final report to the secretariat.

### 2. Updates by international and regional organizations on recent developments in accounting and financial reporting

85. A representative of the **European Commission** updated the session on many developments in financial reporting, auditing, corporate governance and related subject areas that had various implications for listed and, to some extent, non-listed companies registered in financial markets regulated by the European Union. An important development was the approval by the Council of Ministers for the International Financial Reporting Standards to become Community law by 2005. The representative discussed the roles of the Committee of European Securities Regulators, professional accounting bodies, the Accounting Regulatory Committee, the European Financial Reporting Advisory Group and the endorsement mechanism for IFRS. He provided updates on activities leading towards the modernization of the Eighth Directive and guidelines on auditor independence that the Commission had adopted in May 2002. The guidelines on auditor independence recommend, *inter alia*, mandatory rotation of key audit partners and a cooling-off period of two years for audit partners before they join former clients as employees.

86. A representative of the **Asian Development Bank** shared with delegates several activities in which his organization had been engaged in order to improve transparency and financial disclosure in its member countries. He discussed various projects under way on issues such as guidelines for financial governance and management, harmonization of guidelines and policies among the World Bank and regional development banks, diagnostic studies conducted in five member countries, and various projects aimed at capacity building in the private as well as the public sector.

87. The representative from the **International Accounting Standards Board** (IASB) informed the session about various developments in his organization. He updated participants on the status of several IASB projects. The preface to the International Financial Reporting Standards (IFRS) and amendments to International Accounting Standard 19, Employee Benefits, were completed. He enumerated several projects for which exposure drafts either had been issued or were due to be issued within a few months, as well as active projects on the IASB agenda and active research projects, including the project on accounting by SMEs and in emerging and transition economies. He discussed the close cooperation between the IASB and the European Financial Reporting Advisory Group in light of final approval by the Council of Ministers of the European Union, in June 2002, of the decision to require listed companies in the European Union to present their consolidated financial reports on the basis of IFRS. While most of the companies would be required to comply by 2005, some had until 2007 to do so. The Australian Financial Reporting Council had decided that listed companies in Australia would be required to comply with IFRS beginning on 1 July 2005. The representative also discussed changes in the IASB membership and its constitution, as well as the restructuring of its interpretations committee.

88. The Chief Executive of the **Eastern Central and Southern African Federation of Accountants** (ECSAFA) presented several initiatives that his organization was undertaking to strengthen the accounting profession in his region. He said that his organization had distributed 1,700 copies of the 2002 edition of the *International Accounting Standards* to its members at a significantly reduced price. He also apprised participants on the fifth congress of his organization, which had taken place in July, its work on corporate governance and efforts underway to establish an independent review scheme for accountants and accounting firms in the ECSAFA region.

89. The representative of the **European Federation of Accountants** (FEE) updated participants on various developments at her organization. FEE consisted of 38 member organizations in 26 countries. She discussed the role of FEE in the European Financial Reporting Council. She also discussed various initiatives as well as publications and discussion papers that FEE had issued on topics such as financial reporting, market regulation and enforcement, auditing, corporate governance and ethics.

90. The representative of the **Fédération internationale des experts comptables francophones** (FIDEF) recalled the active participation of the Federation in the work of ISAR during the past many years, including ISAR’s conference in Dakar (Senegal) in 1991. He stated that the Federation supported the work that ISAR was considering at the session. He said that the Federation was organizing a conference in Beirut in October.

91. A representative from the **South Asian Federation of Accountants** (SAFA) updated participants on developments in his organization. He discussed centres of excellence that SAFA had established in various areas, its Best Presented Corporate Accounts Award and co-operation among its members on issues such as education and mutual recognition of qualifications. In the post-Enron environment, SAFA was developing guidelines on auditors' independence and was also preparing a model code of ethics for its region.

# Chapter IV

# ORGANIZATIONAL MATTERS

## A. Opening of the session

92. Mr. Carlos Fortin, Deputy Secretary-General of UNCTAD, opened the session on Wednesday, 25 September 2002.

## B. Election of officers

93. At its opening plenary meeting, on Wednesday, 25 September 2002, the Intergovernmental Working Group elected the following as officers:

| | |
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| Chairperson: | Mr. David Moore (Canada) |
| Vice-Chairperson-cum-Rapporteur: | Mr. Abbas Mirza (United Arab Emirates) |

## C. Adoption of the agenda and organization of work

94. At its opening plenary, the Intergovernmental Working Group adopted the provisional agenda for the session (contained in TD/B/COM.2/ISAR/14). The agenda was thus as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Transparency and disclosure requirements for corporate governance
4. Accounting by small and medium-sized enterprises
5. Other business
6. Provisional agenda for the twentieth session
7. Adoption of the report of the Intergovernmental Working Group on its nineteenth session

## D. Transparency and disclosure requirements for corporate governance and accounting by small and medium-sized enterprises

95. At its closing plenary meeting, on Friday, 27 September 2002, the Intergovernmental Working Group adopted its agreed conclusions on these agenda items (see chapter I). It also agreed that the chairperson should summarize the informal discussions on these agenda items (see chapter III).

### E. Adoption of the report of the Intergovernmental Working Group on its nineteenth session

96. At its closing plenary meeting on 27 September 2002, the Intergovernmental Working Group authorized the Vice-Chairperson-cum-Rapporteur, under the authority of the Chairperson, to finalize the report after the conclusion of the meeting.

## Annex I

## PROVISIONAL AGENDA FOR THE TWENTIETH SESSION

1. Election of officers
2. Adoption of the agenda and organization of work
3. Transparency and disclosure in corporate governance: a review of the field case studies and consideration of ISAR’s contribution to the practical toolkit for corporate governance
4. Other business
5. Provisional agenda for the twenty-first session
6. Adoption of the report

## Annex

## ATTENDANCE *

1. Experts from the following States members of UNCTAD attended the Meeting:

Angola
Bangladesh
Benin
Brazil
Canada
China
Czech Republic
Democratic People's Republic of Korea
Democratic People's Republic of the Congo
Djibouti
Egypt
El Salvador
Ethiopia
Germany
Greece
Hungary
India
Iran (Islamic Republic of)
Italy
Jordan
Lao People's Democratic Republic
Malta
Mexico
Morocco
Namibia
Netherlands
Pakistan
Panama
Paraguay
Peru
Poland
Portugal
Romania
Russian Federation
Rwanda
Saint Lucia
Saudi Arabia
Senegal
Slovakia
Spain
Sri Lanka
Switzerland
Thailand
Tunisia
Turkey
Ukraine
United Kingdom of Great Britain and Northern Ireland
United Republic of Tanzania
Yemen
Yugoslavia

2. The following intergovernmental organizations were represented at the Meeting:

European Commission
League of Arab States

3. The following specialized agencies were represented at the Meeting:

Economic Commission for Europe
Department of Economic and Social Affairs

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* For the list of participants, see TD/B/COM.2/ISAR/INF.5.

4. The following non-governmental organizations were represented at the Meeting:

*General Category*

International Confederation of Free Trade Unions

5. The following special invitees attended the Meeting:

Asian Development Bank
Association of Accountants and Auditors of Republika Serpska
Association of Accounting Technicians
Association of Chartered Certified Accountants
Association of International Accountants
Compagnie Nationale des Commissaires aux Comptes
Central Organization for Control and Auditing, Yemen
Chulalongkorn University, Thailand
Conseil National de la Comptabilité, France
Deloitte & Touche
Eastern, Central and Southern African Federation of Accountants
Fédération des Experts Comptables Européens
Fédération Internationale des Experts Comptables Francophones
Institute of Chartered Accountants of Bangladesh
Institute of Certified Public Accountants
Institute of Certified Accountants and Auditors of Thailand
Institute of Chartered Secretaries and Administrators
Institute of Chartered Accountants of India
Institute of Directors
Institut Tunisien des Experts Comptables
International Accounting Standards Board
KPMG
Lebanese Association of Certified Public Accountants
London Metropolitan University
Ma Quader Kabir & Co.
National Economic University of Kiev
Ninsuvan Co. Ltd.
Saudi Fund for Development
South Eastern European Partnership on Accountancy Development
Sudan Council of Certified Accountants
Thammasat University, Thailand
Universidad Federal do Rio de Janeiro
Université de Lausanne, Switzerland