

IV. Selected Issues In Financial Governance

1. Introduction

This chapter identifies and examines selected financial management and governance issues that are relevant to the participating countries. The chapter is structured as follows. Section two describes moves to develop international guidelines and to monitor country compliance with these guidelines. Sections three and four examine International Accounting Standards (IASs) and accounting-standard-setting processes. International Standards on Auditing (ISAs) and responsibilities for setting accounting standards are discussed in sections five and six. Some guidelines for assessing the essential components of a professional accountancy body are provided in section seven. Section eight examines education and training guidelines, and the recent release of International Public Sector Accounting Standards (IPSASs) is discussed in section nine. The chapter concludes with section ten.

2. International Guidelines and Surveillance

The international community is supporting the development of guidelines, standards, and codes to assess financial management and governance practices (Table 4 refers).

ADB is also developing a governance “scorecard” which is based upon a checklist of governance indicators. These guidelines, standards, and codes – to varying extents – all involve accounting and auditing arrangements. Furthermore, in an attempt to identify and avoid potential crises before they occur, the IMF and the World Bank have together embarked on a series of experimental *Reports on the Observance of Standards and Codes (ROSCs)*. These reports summarize the extent to which countries observe certain internationally-recognized standards.²⁵ While ROSCs are intended to be voluntary, the information provided by each country (or not provided, as the case may be) is likely to influence country dealings with International Financial Institutions, and the level of confidence that the international financial community has in a country.

²⁵ International Monetary Fund. 2000 September. *Experimental Reports on Observance of Standards and Codes (ROSCs)*. www.imf.org/external/np/rosoc

Table 4. Selected International Guidelines, Standards and Codes

International Guideline, Standard or Code	Promulgated By
• Principles of Corporate Governance	Organization for Economic Cooperation and Development (OECD)
• Code of Good Practices on Fiscal Transparency	International Monetary Fund (IMF)
• Code of Good Practices on Transparency of Monetary and Financial Policies	International Monetary Fund (IMF)
• Implementation of the Objectives and Principles for Securities Regulation assessment surveys	International Organization of Securities Commissions (IOSCO)
• International Accounting Standards (IASs)	International Accounting Standards Committee (IASC)
• International Public Sector Accounting Standards (IPSASs)	International Federation of Accountants (IFAC)
• International Standards on Auditing (ISAs)	IFAC
• Draft Banking Supervision Guidelines	Basel Committee

3. International Accounting Standards

Introduction

Differences in financial reporting practices and accounting standards can be significant between countries. The factors that influence the development of accounting practices and the differences between countries in terms of these practices, include: the nature of a country's legal system, the prevalent providers of finance, the influence of taxation, and the strength of the accountancy profession.

IASs have been developed to reduce national differences in accounting and financial reporting practices. The International Accounting Standards Committee (IASC), which was established in 1973, develops and issues IASs. Its objective is to achieve uniformity in the accounting principles that businesses and other organisations around the world use for financial reporting. The IASC's intention is to

improve the ability of investors, creditors, governments, and others to make informed resource allocation and policy decisions.

Thirty-four IASs were effective at 30 September 2000 (Appendix 1 refers) and more are being developed (Appendix 2 refers). In recent years, many countries have either adopted IASs completely or have modified IASs to suit their particular national requirements. A 1996 survey examined the extent to which countries use IASs – the survey results, which have been updated for the countries involved in this study, are presented in Table 5. Sixty of the 71 countries, or 85 percent, listed in Table 5 use IAS to some extent.²⁶ The remainder of this section examines why so many countries are ‘harmonizing’ with IAS and the criticisms of this move.

Table 5. Use of International Accounting Standards²⁷

Use of IASs	Countries
IASs Used Directly	
<ul style="list-style-type: none"> • IASs used directly as national standards and explanatory material is added. 	Croatia, Cyprus, Kuwait, Latvia, Malta, Oman, Pakistan , Trinidad & Tobago.
<ul style="list-style-type: none"> • IASs used directly. National standards are developed for topics not covered by IAS and explanatory material added. 	Malaysia, Papua New Guinea .
<ul style="list-style-type: none"> • IASs are used directly as national accounting standards but, in some cases, may be modified for local conditions and circumstances. 	Albania, Bangladesh, Barbados, Colombia, Jamaica, Jordan, Kenya, Mongolia , Poland, Sudan, Swaziland, Thailand, Uruguay, Zambia, Zimbabwe. (25 countries)
National Standards Based On IASs	
<ul style="list-style-type: none"> • National accounting standards are separately developed but are based on, and are similar to, the relevant IAS. National accounting standards generally provide additional explanatory only. 	People’s Republic of China , Iran, Philippines, Slovenia, Tunisia, Uzbekistan .

²⁶ Seven of the other 11 countries, which are European Union members, will be required to harmonize their accounting standards with IAS by 2005.

²⁷ International Accounting Standards Committee (IASC). October 1997. *IAS Insight*.

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Use of IASs	Countries
<ul style="list-style-type: none"> National accounting standards are separately developed but are based on, and are similar to the relevant IAS, in most cases. However, some standards may provide more or less choice than IASs. National accounting standards are separately developed but are based on, and are similar to the relevant IAS, in most cases. Each standard includes a statement that compares the national standard to IASs. 	<p>Brazil, Czech Republic, France, India, Ireland, Lithuania, Mauritius, Mexico, Namibia, Netherlands, Norway, Portugal, Singapore, Slovak Republic, South Africa, Switzerland, Turkey.</p> <p>Australia, Denmark, Hong Kong, Italy, New Zealand, Sweden, Yugoslavia.</p> <p>(30 countries)</p>
<p>IASs Used Informally</p> <ul style="list-style-type: none"> National accounting standards may or may not exist, but IASs, while not formally adopted, is usually used for private sector reporting. 	<p>Botswana, Cambodia, Lesotho, Romania, Viet Nam.</p> <p>(5 countries)</p>
<p>National Accounting Standards are Separately Developed</p>	<p>Austria, Belgium, Canada, Finland, Germany, Japan, Korea, Luxembourg, Spain, United Kingdom, United States.</p> <p>(11 countries)</p>

The Global Trend towards International Accounting Standards

"I became convinced that international standards were necessary. I used not to think so, but I now speak with total conviction that they are necessary. A Japanese aircraft is approaching John F Kennedy airport in New York in fog. Should the pilot proceed by his own rules and should he attempt to converse with the ground staff in Japanese? (I deliberately introduced fog into the analogy because finding one's way through some financial statements I have seen is like groping through a fog). Business, like everything else, has to be conducted by reference to certain rules and regulations, or else chaos reigns. If a multinational company is raising money on world markets there must surely be some international standards by which its operations are judged."

– Lord Henry Benson, Initiator and first Chairman of the IASC²⁸

²⁸ Walton, Peter. 1998 June. Accountancy – the Most Exciting Profession in the World: An "Interview" with Lord Benson. *Accounting & Business*.

The forces of globalization, combined with an assessment of the causes of the 1997-1998 Asian financial crisis, are driving a worldwide trend to harmonize accounting and auditing standards. For instance, the first objective listed in the Confederation of Asian and Pacific Accountants' mission statement is to "enhance the standards and development of the profession by promoting harmonization through the adoption of IFAC and IASC pronouncements."²⁹ Appendix 3 recounts the history of the development of IASs. The following reasons are given for harmonizing accounting standards:³⁰

- Comparability – The basis for preparing financial reports can vary widely from country to country, and sometimes even within a country. This is unsatisfactory from the point of view of company management, because: (i) it can increase the costs of preparing financial reports (a multinational company may have to prepare different reports on its operations for use in different countries); and (ii) businesses must have a uniform system for assessing the financial performance of their operations in different countries.
- Usefulness – IASs are useful for countries that do not have a national standard setting body or do not have the resources to undertake the full process of preparing accounting standards. The preparation of accounting standards involves considerable cost and, quite apart from the advantages of uniformity, it would not be economic for each country to have a separate process.

Criticisms of International Accounting Standards

Three criticisms are commonly made of IASs. First, some commentators criticize IASs for being insufficiently detailed. This means that accountants and auditors have to exercise professional judgment. In response, an accounting standard "should be clear enough so as to leave no doubt as to what is intended and sufficiently precise so that users can understand what has been done in preparing the financial statements. Excessive details should be avoided, as this is likely to be counter-productive. The two qualities which are essential to any accountant if he is going to succeed in the pursuit of his profession are judgment and common sense and both should be brought fully into play in writing international standards."³¹

²⁹ Confederation of Asian and Pacific Accountants (CAPA). 2000. *Mission Statement*.

³⁰ International Accounting Standards Committee (IASC). 2000. www.iasc.org.uk

³¹ Walton, Peter. 1998 June. Accountancy – The Most Exciting Profession in the World: An "Interview" with Lord Benson. *Accounting & Business*.

Second, some people argue that accounting rules should not be formulated to cater to the needs of a small number of firms that are already listed (or will be listed) on foreign stock exchanges. They also argue that an accounting environment characterized by a lack of an independent auditing profession is unsuitable for IASs.³² The second point has some validity when taken together with the previous paragraph. In particular, it means that countries adopting International Accounting Standards must pay attention to the creation of a strong, independent accounting and auditing profession.

Third, some people say that IASs have an Anglo-Saxon bias. There is a natural fear in every country that, in preparing international accounting standards, the views or practices of one country will be given undue emphasis to the exclusion of those in other countries. In practice, however, IASC goes to great pains to try to secure balanced standards that do not place improper emphasis in any direction.³³

Moving to International Accounting Standards

Until quite recently, accounting and auditing practices have varied significantly between countries. By identifying commonalities, it is easier to understand the common issues that the seven participating countries are facing as they move towards adopting IASs. In this respect, Table 6 classifies 44 countries, including the seven study participants, into two broad accounting systems, and five accounting models.

All seven participating countries have either moved, or are moving, to an IAS-type framework. Of the options presented in Table 6, the authors support the direct or modified use of IASs for three reasons. First, countries can only claim that they are using IASs if they use them directly. Second, the rate at which IASs are issued in the next five years will increase dramatically. Those countries that have opted to modify IASs will incur significant costs as they absorb the impacts of these additional standards.

³² See, for instance, Xiang, Bing. 1998 April. *Institutional Factors Influencing China's Accounting Reforms and Standards*. Hong Kong University of Science and Technology: Paper presented at 21st EAA Congress: Accounting in Times of Transition. Antwerp.

³³ See, for instance, Walton, Peter. 1998 June. Accountancy – The Most Exciting Profession in the World: An "Interview" with Lord Benson. *Accounting & Business*.

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Table 6. Accounting Practices Classified by Country Grouping³⁴

Accounting System	Accounting Model	Features	Countries
Uniform Accounting Plans	Soviet Union	<ul style="list-style-type: none"> Government driven Dominated by statistics and taxation requirements Accounting practices are statute-based Accountancy profession not required 	People's Republic of China, Mongolia Russia, Uzbekistan.
	Continental European	<ul style="list-style-type: none"> Government driven Dominated by taxation requirements Accounting practices are statute-based 	Belgium, Cambodia , France, Germany, Italy, Spain, Sweden, Switzerland, Viet Nam , Venezuela.
	Latin American	<ul style="list-style-type: none"> "Castilian model" Very similar to continental European model. 	Argentina, Bolivia, Chile, Colombia, Ethiopia, Paraguay, Peru, Uruguay.
Standards Based Accounting	British Commonwealth	<ul style="list-style-type: none"> Commercially driven Overriding rule is that financial statements show a 'fair' picture. Accounting practices reflect, and develop with, business practices Professional regulation dominates. 	Australia, Bahamas, Ireland, Fiji, India, Jamaica, Kenya, Netherlands, New Zealand, Pakistan , Papua New Guinea , Zimbabwe, Singapore, South Africa, Trinidad & Tobago, United Kingdom.
	United States	<p>Same as Commonwealth Model except that:</p> <ul style="list-style-type: none"> Professional regulation coexists with extensive regulated disclosures. 	Canada, Japan, Mexico, Panama, Philippines, United States.

³⁴ Modified from, Nobes, Christopher and Robert Parker. 1995. *Comparative International Accounting* Fourth Edition: Prentice Hall. p. 67.

Third, in general, the analyses of the accounting standards of each country that participated in this study identified minor deviations from IASs. In most cases, these deviations were due to accounting policy choices being restricted. These restrictions could have been applied through separate regulations rather than by modifying the IASs themselves.

4. Accounting Standard-Setting Processes

There are five standard-setting phases:³⁵ (i) Design – a particular aspect of accounting is identified and researched and an exposure draft prepared; (ii) Approval – the draft is subjected to review and, if it survives, it is approved as a standard; (iii) Education – financial statement users and preparers are educated in the impacts and implementation of the new standard; (iv) Implementation – the requirements of the new standard are implemented by financial statement preparers; and (v) Enforcement – compliance is monitored and, if necessary, appropriate remedial action is taken.

Those countries that adopt IAS directly need only bother with the latter three stages. The process for setting accounting and auditing standards should be:

- **Transparent** Interested parties should be kept informed of developments.
- **Orderly** A process and timetable should be designed and communicated to interested parties.
- **Inclusive** Interested parties should have the opportunity to make their views known. The process of reconciling alternative views should be transparent.

Appendix 4 describes the IASC process for developing an IAS (for reference purposes).

5. International Standards on Auditing

Auditing is a systematic process involving steps such as; accepting and agreeing the terms of audit engagement, planning, gathering audit evidence, and reporting. IFAC's International Auditing Practices

³⁵ Nobes and Parker (1995) identify only three phases: design, approval and enforcement. In the Authors' opinion, particularly in developing countries, education and implementation are also important phases (Nobes, Christopher and Robert Parker. 1995. *Comparative International Accounting* Fourth Edition: Prentice Hall. pp. 108–114).

Committee (IAPC) works to improve the degree of uniformity of auditing practices and related services throughout the world by issuing pronouncements on auditing issues and promoting their acceptance worldwide. Its key pronouncements are International Standards on Auditing (ISAs) and International Auditing Practice Statements (IAPSS). The list of ISAs and IAPSS that were effective at 30 September 2000 is provided as Appendix 5.

National standards on auditing and related services that have been published in many countries differ in form and content. The IAPC recognizes these documents and differences and, in the light of this knowledge, issues ISAs which are intended for international acceptance. ISAs are to be applied in the audit of financial statements. ISAs are also to be applied, adapted as necessary, to the audit of other information and to related services. These standards outline basic responsibilities for auditors, help them cope with increased and changing demands for financial statement information, and provide guidance in specialized areas, such as auditing computer information systems. They are codified and available in a bound volume or through an electronic subscription service. IAPSS provide practical assistance to auditors in implementing the standards or on related subjects and promote good practice. These statements are not intended to have the authority of standards.

6. Responsibility for Setting Accounting Standards

The issue of whether accounting standard setting should be a government or private sector function is a common one for many countries. Three factors influence the assignment of this. First, the role that the central government plays in the economy.³⁶ Second, the status of the legal system – in European countries, where the legal system's status is considered to be paramount (e.g., Germany and France), financial reporting requirements are codified in laws. Third, the influence of historical factors – for instance, accounting standards in Anglo-Saxon countries were traditionally developed by professional organizations, such as the Financial Accounting Standards Board (FASB) in the US, and the Accounting Standards Committee in the UK.

Institutional structures are largely the product of a country's historical and cultural environment. Given the pace of change in developing countries (and particularly in transitional countries), there is

³⁶ Zeff, Stephen. 1987 December. Setting Accounting Standards: Some Lessons from the US Experience. *Accountant's Magazine*, p. 27.

no time for the organic development of institutions. Hence, institutional structures are often borrowed directly from other countries.

Internationally, the institutional arrangements for accounting standard-setting are tending towards the American model, whereby a semi-independent body sets accounting standards, which then have legal status. Countries where accounting standard-setting was a core government responsibility (such as those in the European Union) are moving towards this model, as are countries where accounting standard-setting was previously the responsibility of professional organizations (e.g., Australia and New Zealand).

Transitional and developing countries tend to assign accounting standard-setting responsibilities to government organizations, such as the Finance Ministry. Along with historical reasons, a transitional lack of capacity in the accounting profession is cited as a reason for this approach. This approach is risky for the following reasons: (i) accounting standards tend to be prescriptive rules rather than standards *per se*; (ii) accounting practices can become driven by taxation concerns; (iii) this top-down approach does not consider the needs of the users of financial statements; (iv) little importance is placed on the importance of external information, and (v) the accounting and auditing profession tends to remain undeveloped.³⁷

Furthermore, the IFAC President stated that “a reason why the 142 member bodies have in some cases found it difficult to ensure that the international standards are introduced, despite their best endeavors, may be that the standard setters are not within their control. There are many countries where the standards on accounting and auditing are outside the control of the accounting profession – although the accounting profession may still play a significant part in the development of the national standards. Member bodies may well be trying to persuade the national standard setters to follow the international standards but the power to mandate them lies elsewhere.”³⁸

³⁷ See, for instance, Armstrong, Mikael and Katerina Hellström. 1998 April. *A Case Study of the Czech Republic*. Stockholm School of Economics: Paper presented at 21st EAA Congress: Accounting in Times of Transition. Antwerp.

³⁸ Harding, Frank. 1999. IFAC President: *Corporate Credibility – Why a Harmonized Global Accountancy Framework Matters*: International Federation of Accountants.

7. Strength of the Accounting Profession

In 1998, the Confederation of Asian and Pacific Accountants (CAPA) issued the *Guide on the Essential Components of a Professional Accountancy Body*, which covers ten components as follows:³⁹

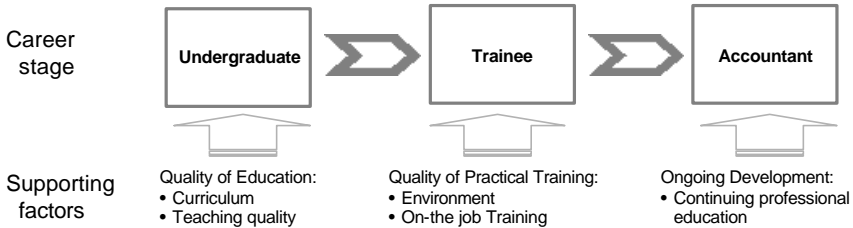
- (i) Admission / Advancement Standards (entry level membership admission requirements, and professional program).
- (ii) Full Membership Requirements (educational requirements; professional program requirements; experience requirements; fees payable; professional body, statutory or registration requirements; and permitted activities).
- (iii) Continuing Professional Education (mandatory and voluntary requirements, continuing professional education provision; compliance reporting by member; and noncompliance penalties).
- (iv) Technical Standards (setting and usage of national accounting standards and their status; and the setting and usage of national auditing standards; status of International Accounting Standards, status of International Standards on Auditing adopted; involvement in the standard-setting process (national and international); and standards prescribed in legislation).
- (v) Quality Assurance / Peer Review Program (program in place; compliance requirements; and penalties for noncompliance).
- (vi) Registration as Accountant / Auditor (activities covered - public accountancy, corporate audit, taxation; practice requirements; professional body requirements; and noncompliance penalties).
- (vii) Disciplinary Rules (existence of disciplinary rules; enforcement procedures are in place and are published; involvement of nonmembers in disciplinary hearings; and penalties and appeals processes in place).
- (viii) Management and Administrative Structures (mission statement and objectives; and business plan in place).
- (ix) Governance (type of entity; governing body; composition, duties and responsibilities, election by members; governance structure including committees, divisions and branches; voting rights of members; involvement in accounting and auditing standard setting process; and strategic plan and budget in place).
- (x) External Affiliations / Memberships (national, international and regional).

³⁹ Confederation of Asian and Pacific Accountants (CAPA). 1998. *Guide on the Essential Components of a Professional Accountancy Body*.

8. Accounting Education and Training

In order to develop competent accounting graduates, the trainers themselves must be thoroughly conversant with modern-day practices and trends. The quality of undergraduate teachers is a key factor in developing competent accountants (Figure 2 refers).

Figure 2. Education and the Competence of Accountants



The issue of competence and its assessment has become a major issue within the accounting profession. Unfortunately, there is a lot of confusion related to it, since the term "competence" is commonly used to mean different things in an everyday context as well as in academic discussions. Moreover, what one deems desirable may not be deemed desirable by another, and what is considered to be acceptable performance by one may not be acceptable to another.

In order to clarify these issues, both IFAC and the United Nations Conference on Trade and Development (UNCTAD) have issued Guidelines and Standards on accounting education and professional competence. These are discussed in the following sub-sections. Furthermore, UNCTAD has initiated a project to assess the competence of accountants. The objective of the project is to rate professional accounting qualifications from around the world and, in doing so, create impetus for improvements and support international skill transferability.

UNCTAD Guidelines on Accounting Qualifications

In February 1999, UNCTAD issued a report on accounting education and qualifications.⁴⁰ The report provides a very useful set of benchmarks in respect of these issues, in particular:

- Guideline for a Global Accounting Curriculum and Other Qualification Requirements (Includes the requirements for the

⁴⁰ UNCTAD. 1999. *International Accounting and Reporting Issues: 1999 Review*. United Nations.

qualifications of professional accountants, and the guideline for national systems for the qualifications of professional accountants)

- Global Curriculum for the Professional Education of Professional Accountants (Includes organizational and business knowledge; information technology; and accounting and accounting-related knowledge).

IFAC Education Standards and Guidelines

The Education Committee of the International Federation of Accountants (IFAC) has also issued a series of International Education Standards (IESs) and International Education Guidelines (IEGs). The IESs are intended to establish the essential elements on which education and training programs, both pre-qualification and post-qualification, for all accountants should be founded. Although they cannot override authoritative local pronouncements, they are essentially prescriptive in nature. The IEGs promote good practice and or provide good advice. They are based on careful study of the best practices and most effective methods for dealing with the issues being addressed.

9. International Public Sector Accounting Standards

Government accounting took a big step forward on 24 May 2000, when IFAC issued the first set of international public sector accounting standards (IPSASs). Appendix 6 summarizes these IPSASs.

Most countries are progressively harmonizing their private sector accounting standards with IASs. They aim to improve the quality and comparability of corporate financial information. In contrast, the financial reports of public sector organizations vary significantly across the world. First, while most countries require businesses to prepare and publish balance sheets, few require this discipline of public sector organizations. Second, up until May 2000, there were no international accounting standards for preparing public sector financial information.

In early 1996, the Public Sector Committee (PSC) of IFAC initiated a project to prepare a set of IPSASs. The benefits of improved governmental financial reporting and the corresponding improvement in transparency were recognized by international and regional organizations, including ADB, the World Bank, the IMF, and the UNDP, all of which provided funding for the public sector accounting standards project.

On 24 May 2000, IFAC formally released the first eight IPSASs. The standards are the first set of accounting standards applicable to

public sector reporting and are intended to meet the needs of governments, ministers, taxpayers, and credit-rating agencies. The standards apply to all levels of government and will provide governments with a platform on which to base improvements in their financial management and reporting practices. Further IPSASs are currently being developed, with another six draft IPSASs published for comment in July 2000. The PSC recognizes that many governments may not yet be in a position to adopt the accrual-based IPSASs. To assist these governments, the PSC has also developed an exposure draft ED-9 *Financial Reporting under the Cash Basis of Accounting*. ED-9 sets out the requirements for the presentation of the primary financial statement under the cash basis of accounting, as well as the statement's structure and minimum content requirements. The requirements that are likely to emerge in this standard should lead to transparency where governments remain on the cash basis of reporting.

The case for adopting IASs in the private sector is clear. But, why should countries adopt international standards for public sector reporting? The prime users of government financial reports include taxpayers, voters, financial institutions, international development institutions and credit-rating agencies (such as Moodys and Standard & Poors). The latter three groups look very closely at government financial information. They compare this information with international benchmarks. Their opinions move country interest rates and currency levels. When a country's government financial information is poor, this will be reflected in base interest rates. So, on the basis that national public sector accounting standards will be trusted less than international standards, countries that develop and apply their own government accounting policies will pay higher interest rates.

10. Conclusion

The selected issues that were reviewed in this chapter are all relevant to the seven participating countries. For instance, the gradual introduction of Reports on the Observance of Standards and Codes (ROSCs) is going to place countries under pressure to conform to international standards and codes.