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#### Capacity-building framework for high-quality corporate reporting

## Challenges and issues: Assessment questionnaire and measurement methodology for high-quality corporate reporting

Note by the UNCTAD secretariat

### *Executive summary*

Over the last two years, UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been working towards developing a guiding tool on capacity-building for high-quality corporate reporting. The two main components of this tool are (a) a capacity-building framework; and (b) a capacity assessment questionnaire.

The capacity-building framework is contained in documents TD/B/C.II/ISAR/56 and its addendum TD/B/C.II/ISAR/56/Add.1. It was discussed at the twenty-seventh session of ISAR, which found it useful for the capacity-building needs of member States. The assessment methodology is explained in document TD/B/C.II/ISAR/59. A core element of the methodology is a questionnaire which consists of detailed questions on essential elements that need to be in place in a country in order to ensure that high-quality corporate reports are prepared in accordance with international benchmarks and good practices.

This note outlines key issues that were identified in developing the assessment methodology during the preparatory process for the twenty-eighth session of ISAR. It is structured around the main pillars of the capacity-building framework, namely the legal and regulatory framework, the institutional framework, human capacity-building, and the capacity-building process. These issues will be discussed further during the current session, in order to finalize the assessment tool to be used by member States to identify gaps and priorities, and to measure and benchmark their progress on building capacity for high-quality corporate reporting.

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## I. Introduction and background

1. A strong corporate reporting infrastructure is key to improving transparency, fostering investor confidence, facilitating the mobilization of domestic and international financial resources, and promoting financial stability. Over the last decade, a series of international corporate reporting standards and codes have been developed. The increasing pace of globalization and international economic integration has strongly encouraged the application of such standards and codes worldwide. Nevertheless, the effective adoption and implementation of such standards and codes remains a challenge for many countries. Many developing countries, particularly least developed countries (LDCs), lack critical elements of a corporate reporting infrastructure and the capacity to meet the financial and non-financial information needs of users of both public- and private-sector reports. In the face of these challenges, there is a need for a coherent approach to capacity-building in this area.

2. Responding to these capacity-building needs of member States, ISAR, at its twenty-seventh session, deliberated on the essential components of a capacity-building framework for high-quality corporate reporting (see TD/B/C.II/ISAR/56 and its addendum TD/B/C.II/ISAR/56/Add.1). This debate reflected the efforts made in the wake of the financial crisis – at global level and by member States – towards strengthening the international financial architecture and improving the quality of corporate reporting, based on convergence with a common set of international reporting standards. It also emphasized the importance of developing tools to measure and benchmark progress and to identify priorities in the capacity-building process. In accordance with the agreed conclusions of the twenty-seventh session of ISAR, the UNCTAD secretariat has begun development of such a measurement tool.

3. The primary objective of this tool is to assist policymakers in identifying gaps and priorities, and also in measuring and benchmarking the progress made on building capacity for high-quality corporate reporting. Where relevant, the tool could also help to identify country needs for technical assistance, and to measure the impact of such assistance over time.

4. The tool consists of an assessment methodology and the related questionnaire, which are contained and explained separately in document TD/B/C.II/ISAR/59. The current note should be considered in conjunction with document TD/B/C.II/ISAR/59.

5. In developing the assessment methodology, UNCTAD sought expertise and views from its ISAR network – for example, at the meeting of the Consultative Group on Capacity-Building held in Geneva in January 2011; and at the Accountancy Education Forum held in March 2011, which was organized jointly by UNCTAD and the International Accounting Education Standards Board. As part of the development process for the assessment methodology, UNCTAD organized country-level roundtables with the support of the United Kingdom's Association of Certified Chartered Accountants. These took place in Brazil (hosted by the Federal Accounting Council), Croatia (hosted by the Ministry of Finance), South Africa (hosted the South African Institute of Certified Accountants, and Viet Nam (hosted by the Ministry of Finance), with the participation of high-level stakeholders including regulators, standard-setters, report preparers and users, staff from academia and training institutions, and other relevant stakeholders in the area of accounting and reporting. Additional input was received from Mexico.

6. The main objectives of the roundtables were to test the usefulness and validity of the questions in the questionnaire, to test the practicability and usefulness of the assessment methodology, and to identify areas for improvement in terms of substance, clarity and objectivity. The roundtables also helped to raise awareness of accountancy capacity-building challenges. Furthermore, they highlighted the usefulness of the methodology, and of the

discussion process itself, by bringing together key stakeholders and deliberating on a road map towards capacity-building.

7. The questionnaire has also benefited from the Accountancy Development Index Project, which was carried out by USAID's Benchmarking International Standards of Transparency and Accountability (BISTA) project, and from the Statements of Membership Obligations developed by the International Federation of Accountants' Compliance Programme.

8. It is important to note that the questionnaire will be constantly updated and improved, and therefore will be subject to modifications as new standards are issued and other developments arise.

9. This note deals with challenges and issues related to the assessment methodology, and presents the questionnaire, and the measurement approach for high-quality reporting.

## **II. Challenges and cross-cutting issues**

10. Throughout the development of the methodology, a number of challenges and cross-cutting issues were identified and discussed. The following issues were raised in most of the debates.

11. As a tool to guide policy, the assessment questionnaire is designed to be used by all member States, in order for gaps to be identified and priority areas for capacity-building determined in a comparable manner. In this regard, the development of a tool that could be relevant for any country has been the main challenge encountered, due to the variety of the corporate reporting infrastructures and systems in place in different countries. In this regard, the questionnaire provides a global perspective on elements and aspects of the capacity needed for high-quality reporting, to allow for international benchmarking. It is not aimed at or even capable of reflecting areas of specific concern to a particular country. However, the proposed methodology allows stakeholders at the national level to adapt the questionnaire in order to identify needs and developments specific to the country in question.

12. In order to facilitate consistent interpretation across respondents, the questionnaire seeks to avoid the use of subjective language. In the context of institutions, where subjective terms such as "properly" were necessary, the questionnaire includes additional questions to define the terms and clarify their meaning. To the same end, the questionnaire includes a glossary of definitions, as formulated by relevant international bodies.

13. Another challenge was defining the scope of the questionnaire and deciding whether it should take a comprehensive approach and evaluate all areas of reporting in a country, or whether it should adopt a more specific approach and focus only on certain areas. There are areas of reporting that are more recent, not fully developed, or have been adopted only in certain areas of the world – such as standards on environmental, social and corporate governance reporting, and standards for public-sector financial reporting. Based on the observations and discussions of the Consultative Group on Capacity-Building, the UNCTAD secretariat included all areas of financial and non-financial reporting in the questionnaire. The reason for this was to obtain a comprehensive picture reflecting good practices available around the globe, which can serve as a basis from which countries can select areas that they regard as priorities in the context of their national strategies.

14. The relevance of public-sector entities was highlighted during discussions encouraging UNCTAD to further develop the section of the questionnaire that assesses capacity needs, to improve reporting by public-sector entities. The current version of the questionnaire takes into account this feedback. However, at present, the questions covering public-sector entities are limited to adoption of the International Public Sector Reporting Standards (IPSAS) formulated

by the International Federation of Accountants (IFAC), and to auditing standards issued by the International Organization of Supreme Audit Institutions. Further work on other matters related to capacity-building for high-quality reporting for public-sector entities will be needed in order to identify international benchmarks and good practices as they relate to IPSAS implementation, monitoring, quality control, and other aspects of capacity-building in this important area in a manner that is consistent with the framework used for corporate reporting.

15. Another challenge was determining which standards would be used as benchmarks in the assessment exercise. Key references were identified depending on the subject area, and the questionnaire refers to a range of international standards and widely accepted benchmarks on financial and non-financial reporting. Suggestions were also made to use some regional and national codes and guidance. However, it was felt that, at a global level, for the purposes of international harmonization, existing international benchmarks would be more appropriate, unless some national requirements of a particular country's financial markets had such significance and scope that they could usefully be referred to as "good practice" to be considered in national capacity-building efforts.

16. In addition to the approach where implementation issues are addressed by questions related to enforcement, monitoring and compliance, views were expressed indicating the need for clear differentiation in the questionnaire of the indicators related to adoption of standards and codes from activities dealing with implementation. In this regard, it was noted that it would be difficult to objectively measure implementation levels – other than via surveys or other studies to be carried out by respondents, which could become costly and time-consuming. A related challenge was addressed, regarding how to reflect the transitional nature of accounting systems in some countries, as well as countries' ongoing efforts towards implementation of international standards that have not yet yielded measurable results but could do so at some point in the future. In this regard, it was stated that the objective of the exercise was to assess progress over time. Such progress will inevitably be reflected when the assessment is carried out on an ongoing basis.

17. The statistical methodology employs a simple and clear statistical formula, in order to provide a user-friendly approach, avoid inconsistencies, and obtain a fair measurement of the relative progress of countries in their efforts to develop corporate reporting capacity. In an effort to be as objective as possible, and to provide a common framework at a global level, the questionnaire uses a binary yes/no style of questions based on observable facts about a country's capacity in the area of corporate reporting. No open-ended questions are used, because it was considered that these could introduce subjectivity into the results, reducing the tool's usefulness in providing comparable measurements of progress over time. The questionnaire also contains a column for explanatory notes and comments, allowing the binary findings to be put into the appropriate context. It should be noted that the final quantitative assessment, or "score", derived from the questionnaire is intended solely to provide guidance to countries on their relative progress over time in building capacity within each pillar, and to highlight areas for further development. For this reason, the statistical formula and the structure of the questionnaire are designed in such a way that where comparatively greater capacity in corporate reporting exists, the tool will always reflect a higher assessment.

18. Another issue discussed was the weighting of the pillars. The measurement approach gives equal weight for pillars A, B and C. It was stated that since the number of questions and checklists in each pillar varies, it may be inadequate to assign the same value (weight) to each pillar, as this mechanism might distort the assessment of capacity. It was felt by some that certain questions were more relevant than others and should therefore have a bigger impact on the result. However, it was noted that different countries, and different stakeholders within countries, may have very different views on what is more relevant and how questions should be weighted. This is a common challenge which is faced by many international benchmarks.

Whereas agreement by all stakeholders on an appropriate variable weighting scheme presents practical difficulties, an equal weighting scheme achieves the purpose of demonstrating progress over time and does so without the complexities of a variable weighting scheme. As noted above, keeping the assessment methodology as straightforward as possible is considered important for facilitating the understandability and user-friendliness of the tool. It was noted, for example, that the assessment methodology of the Public Expenditure and Financial Accountability (PEFA) programme had adopted a similar approach, again due to practicality considerations with respect to weighting at an international level.

19. In addition, there was discussion on how fair feedback could be ensured when there are multiple respondents for a certain section. One way to address this issue may be to invite all of the possible respondents to complete the questionnaire and then to average the score of their answers. Alternatively, the country could decide which one of the institutions involved is the most competent, taking different aspects into consideration. For example, a professional accounting organization may take into consideration aspects such as size of membership, IFAC membership, regional association membership, and certification programmes.

20. One of the key aspects discussed was the need to ensure that a wide range of experts responds to the questionnaire when the actual assessment exercise takes place. As the questionnaire covers a wide range of knowledge areas, a variety of respondents will be required in order to fill out the questionnaire properly. Therefore, one of the main concerns highlighted was the need for a respondents' profile description.

21. The questionnaire is based on the capacity-building framework and is built on its four interrelated pillars:

- Pillar A: Legal and regulatory framework;
- Pillar B: Institutional framework;
- Pillar C: Human capacity-building;
- Pillar D: The capacity-building process.

### **III. Pillar A: Legal and regulatory framework**

22. Pillar A, on the legal and regulatory framework, includes the following nine indicators:

- (a) A.1 – Financial reporting and disclosure;
- (b) A.2 – Public-sector financial reporting, disclosure and auditing;
- (c) A.3 – Audit;
- (d) A.4 – Environmental, social and governance reporting;
- (e) A.5 – Enforcement, monitoring of implementation, and compliance on corporate reporting requirements;
- (f) A.6 – Licensing of auditors;
- (g) A.7 – Corporate governance;
- (h) A.8 – Ethics; and
- (i) A.9 – Investigation, discipline and appeals.

23. Based on existing good practices, the questionnaire identifies different types of entities (e.g. listed and non-listed companies, small and medium-sized enterprises (SMEs), public interest entities etc.) to which the legal and regulatory framework applies. For example, the requirements for listed companies are usually more stringent than the requirements for privately owned companies. This distinction was included in the questionnaire, with a view to more accurately assessing the corporate reporting infrastructure in a country as it applies to different types of entities. The questionnaire has been designed taking into consideration the different approaches that countries have been taking towards implementing International Financial Reporting Standards (IFRS). For example, in some countries, the requirement for full IFRS applies only to listed companies, while the remaining entities use another set of

standards but may be permitted to use full IFRS if they wish to do so. Some countries apply IFRS to consolidated financial statements only. Others also apply them in the case of separate financial statements. In certain countries, IFRS are not required for listed companies, however entities are permitted to apply them. The relevance of IFRS and of IFRS for SMEs has been questioned, depending on the relative economic development of a country; the same concerns may apply to International Standards of Auditing (ISA). The questionnaire is designed to accommodate a variety of scenarios, in order to lead to fair benchmarking where harmonization towards the international requirements for high-quality corporate reporting is concerned.

24. The concept of “public interest entities” is included in the questionnaire, with a view to enquiring not only about the situation in countries with regard to listed companies, but also about the situation with regard to other entities of significant public relevance such as banks and insurance companies, as well as entities of major national interest because of the nature of their business, their impact on the economy, their size, or their number of employees. The questionnaire provides a definition of “public interest entity”, since some countries do not have a national definition of the term.

25. When referring to a particular standard, the questionnaire makes reference to the most recent version of that standard. There were suggestions that stating the specific version for each standard would improve the clarity of the tool. However, the questionnaire is intended to be used in several evaluations in order to assess progress over time; this implies that the questions would need to be modified each time a standard is issued. Given that the respondent group is intended to be composed of specialists from all areas covered in the questionnaire, it is reasonable to assume that they will be aware of the current version of the standards to be used for their respective areas of specialization.

#### **IV. Pillar B: Institutional framework**

26. Pillar B consists of the following four indicators:

- (a) B.1 – Institutional responsibilities;
- (b) B.2 – Coordination;
- (c) B.3 – Funding; and
- (d) B.4 – Professional accounting organizations.

27. Due to the variety of institutional frameworks in place in countries around the world, it was decided to avoid making explicit references to specific institutions in the questionnaire. Instead, the questions are focused on the existence of key functions/activities required along the reporting chain to ensure high-quality corporate reporting, and on clarity of related responsibilities.

28. The questionnaire includes a definition of the term “independence” as it concerns institutions. In this context, “independence” means that the institutions are able to keep their objectivity and perform their duties without being forced to take a certain approach or to benefit a certain party. One possible way of assessing independence could be by considering the institution’s sources of funding and any conflict of interest on the part of those organizations or persons providing the funding.

## V. Pillar C: Human capacity-building

29. Pillar C encompasses the following eight indicators:

- (a) C.1 – General assessment;
- (b) C.2 – Professional education and training;
- (c) C.3 – Professional skills;
- (d) C.4 – Assessment of accountancy capabilities and competencies;
- (e) C.5 – Practical experience requirements;
- (f) C.6 – Continuing professional development;
- (g) C.7 – Specialized training; and
- (h) C.8 – Requirements for accounting technicians.

30. As discussed in earlier paragraphs, there are some issues with regard to accounting education programmes. For instance, countries usually have many institutions providing university courses, and this fact makes it very difficult to decide which one of the institutions should be selected to respond to the questionnaire.

31. When considered necessary, the questionnaire makes a distinction between accountants and auditors, despite the fact that in many countries such a distinction is not made and an auditor has to be an accountant. The process that must be followed in order to become an accountant or an auditor varies from country to country: in some countries, a degree in accountancy at university level is required; in others, the qualification of “accountant” is reached at advanced (i.e. master’s) level; and in yet other countries, qualification requirements are fulfilled through enrolment in a professional accountancy organization without any need to attend university courses. In addition, IFAC refers to the accountancy profession in general, without differentiating between accountants and auditors. For instance, the Code of Ethics is applicable to all professional accountants; the term “professional accountant” is defined according to IFAC as “an individual who is a member of an IFAC member body.” The questionnaire allows countries to reflect on such differences and still to respond in a consistent and a comparable manner.

32. It was felt that, since the questionnaire measures capacity, the issue of supply and demand of accountants and auditors needed to be addressed. However, it remains difficult to assess whether the number of accountants and auditors available in the country is adequate to fulfil the demand. It is not clear how to measure the size of the demand or the supply, or how to establish whether the supply is sufficient to satisfy the demand. The idea behind the supply/demand question was to find out whether the number of accountants graduating in the country is sufficient to fill all the positions required by the different entities participating in the reporting chain. One possible solution that was suggested with regard to this issue could be to obtain estimates from recruitment organizations operating in the countries. Another option is to exclude the question altogether – if the assessment cannot be conducted in a satisfactory manner.

## VI. Pillar D: The capacity-building process

33. This pillar was not considered for measurement, because the questionnaire is intended to evaluate the current status of the country, whereas this pillar deals with the strategy and action plan to be carried out at national level in order to improve the corporate reporting infrastructure. National stakeholders need to coordinate among themselves, and decide on priorities and time frames, human resources, and financial resources, in order to better tackle adoption and implementation of standards and codes. However, this section remains as part of the questionnaire, in order to emphasize this area’s importance in building capacity for high-quality corporate reporting.



## VII. Conclusions

34. Development of a quantitative measurement tool is a challenging exercise, particularly at a global level. It is challenging to find a common international denominator for all the diverse and complex national systems of corporate reporting. However, another challenging issue is the need to measure progress towards harmonization in accordance with international requirements in a consistent and comparable manner. Therefore, the quantitative analysis resulting from the assessment exercise should complement other projects that look at the qualitative aspects of accounting reforms and improvements, together with the related surveys and discussions.

35. Delegates at the twenty-eighth session of ISAR may wish to consider the issues outlined in the current note. They may also wish to consider the following conceptual aspects:

- (a) How could a global benchmark be established for assessment of a country's capacity for financial reporting, in view of the different approaches towards their convergence with the IFRS?
- (b) Should the capacity-building framework and the questionnaire include public-sector entities and IPSAS as benchmarks for their reporting?
- (c) Should measurement be carried out only as an internal, country-level exercise, or would international benchmarking be useful and contribute towards capacity-building for high-quality corporate reporting?
- (d) What could the next steps be in developing the measurement methodology, and would pilot assessment exercises be useful in this regard?
- (e) If pilot assessments take place, what kind of due process needs to be in place to ensure a fair reflection of the capacity of an individual country?
- (f) Would this measurement tool be useful for technical cooperation and assistance towards high-quality corporate reporting?

36. Delegates may also wish to adopt the questionnaire, after incorporating suggestions and comments, with a view to performing an actual assessment exercise with selected countries during the next inter-session period. The results of the actual evaluation process could be shared at the next ISAR session in 2012, with a view to further refining the assessment methodology and the questionnaire.