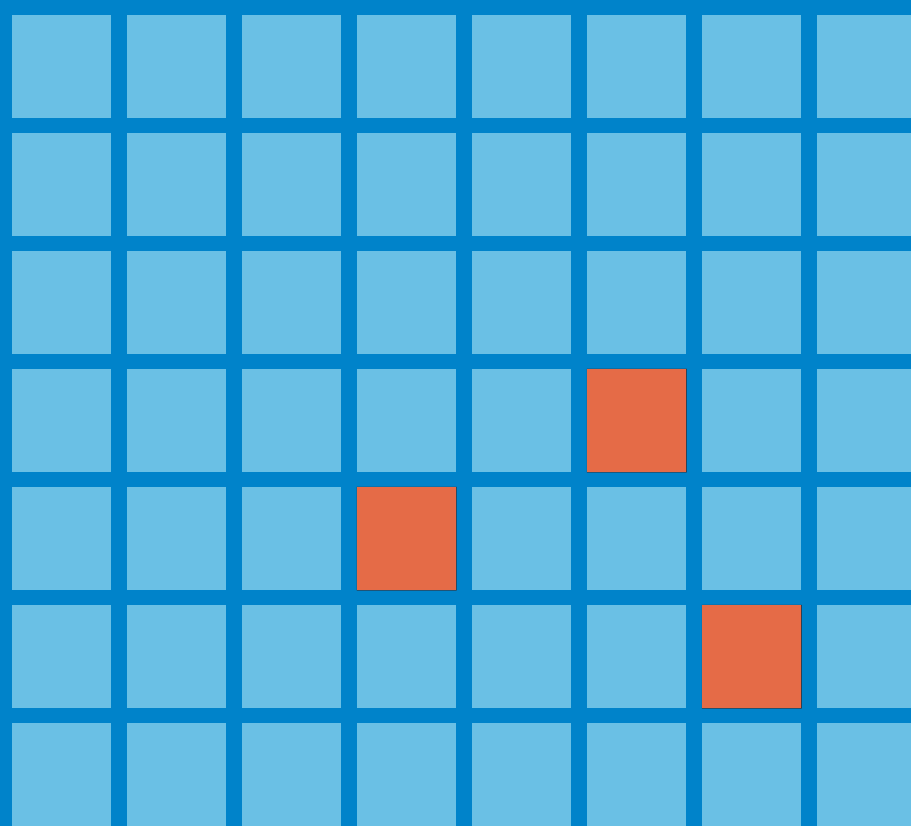




# INTERNATIONAL ACCOUNTING and REPORTING ISSUES



# 2012 Review



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**INTERNATIONAL  
ACCOUNTING  
AND  
REPORTING ISSUES**

**Review 2012**

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## Preface

In the aftermath of the financial crisis of 2007–2008, continued efforts are being made towards improving the quality of corporate reporting as an essential part of measures towards strengthening the international financial architecture. High-quality corporate reporting is key to improving transparency, facilitating the mobilization of domestic and international investment, creating a sound investment environment, fostering investor confidence and promoting financial stability. A strong and internationally comparable reporting system facilitates international flows of financial resources while at the same time helping to reduce corruption and mismanagement of resources. It also strengthens the international competitiveness of enterprises by attracting external financing and benefiting from international market opportunities.

The implementation and consistent application of internationally recognized standards, codes and good practices in the area of corporate reporting has been strongly encouraged. However, the effective adoption of such standards and codes remains a challenge for many developing countries and economies in transition, as they lack some of the critical elements of corporate reporting infrastructure, from weaknesses in their legal and regulatory frameworks to a lack of human capacity and relevant institutional arrangements.

The objective of this publication is to assist national policymakers and other stakeholders in formulating appropriate policies and regulations that lead to the implementation and enforcement of corporate reporting requirements in a consistent manner to promote high-quality and internationally comparable reporting.



## Introduction

This publication provides an overview of major trends and challenges in corporate financial and non-financial reporting with regard to recent developments on building relevant regulatory and institutional arrangements as well as enhancing required professional qualifications, and presents some selected case studies to share good practices in these areas.

The first part provides a general overview of recent major trends and challenges in regulatory and institutional developments at global, regional and national levels. It highlights such trends as the strengthening of institutional settings at a global level and the growing role of reporting standards in international financial architecture, the increasing role of international bodies not only in standard formulation but also in the areas of enforcement and implementation, the increasing role of national State regulations and institutions and the growing role of regional organizations. It also discusses some of the major challenges in regulatory and institutional building, such as a need to develop mechanisms to ensure the consistent application of international standards and monitoring of compliance, a higher demand for non-financial reporting, a greater pressure for stakeholder coordination at all levels, a need for a coherent strategic approach towards building national regulatory and institutional capacity and issues of sustainability of accounting reforms. It also outlines the main updates in the activities of major international bodies in the areas of accounting and reporting during 2012.

The second, third and fourth parts of this publication provide selected case studies to illustrate the issues and updates from both international and national perspectives.

The second part is dedicated to financial reporting. The case studies are on Romania and Turkey.

The case study on Romania was written by CN Albu and N Albu from the Bucharest Academy of Economic Studies. Romania, an ex-communist country, has been a member of the European Union since 2007. After the communist period (1947–1989), Romania underwent a continuous reformation process of its financial reporting model with the country's political objective being the accession to the European Union. Therefore, Western accounting systems were considered as models for reforming the one of Romania. Financial reporting regulations in Romania prove a strong orientation towards IFRS but significant differences remain and efforts are being made for the adoption of the same. The study gives a detailed account of the steps taken by regulatory instructions towards the same. It also emphasizes the roles played by international organizations such as the International Monetary Fund, the World Bank and OECD in reforming the accounting and management system.

The case study on Turkey was written by R Pekdemir from the Istanbul University School of Business and is dedicated to the laws and regulations governing corporate reporting in Turkey. Over the years, Turkey has undertaken broad stabilization and structural reforms to open up isolated and uncompetitive industries to international competition, which led to structural changes in different fields of economic life. Turkey is the fastest growing economy in Europe and one of the fastest growing economies in the world, with real GDP growth rates of 9.2 per cent in 2010 and 8.5 per cent in 2011. As one of the top 10 emerging markets, it is also a member of G20. The study gives an account of the laws and regulations governing corporate reporting in Turkey by explaining the financial and non-financial reporting codes and standards to be followed, the auditing standards to be met and the professional qualifications required. It also gives an account of institutions supporting the implementation and enforcement of laws and regulations, explaining the roles of the Capital Market Board of Turkey, Istanbul Stock Exchange, professional accountancy organizations and audit public oversight board.

The third part provides information on non-financial reporting. The case studies are on Romania, corporate climate change-related reporting, disclosure guidelines in Japan and the role of stock exchanges in reporting developments.

The case study on Romania was written by I Jianu and I Janu from the Bucharest University of Economic Studies and I Gusatu from the Bucharest University of Medicine and Pharmacy Carol Davila. It provides a discussion on major trends and issues in non-financial disclosure in the country, with a focus on environmental aspects.

L Guthrie, Executive Director of the Climate Disclosure Standards Board, contributed to the second case study on corporate climate change-related reporting codes and standards. Climate change-related disclosure represents an evolution of reporting from the introduction of formal financial reporting. The gradual accretion of corporate governance, environmental and social information over time has led to the development of more recent connected or integrated reporting of financial and non-financial information. The study provides an overview of institutions developing corporate climate change-related reporting requirements, types of provisions such as legal requirements, standards, protocols and Government-sponsored guidance requiring climate change-related reporting and also the content of climate change-related reporting. National examples of approaches to climate change-related reporting from Australia, Brazil, Denmark, France, Japan, South Africa, the United Kingdom of Great Britain and Northern Ireland and the United States of America provide an understanding of the current status of and practices in climate change-related disclosure in countries.

The case study on Japan was written by T Sumita, Executive Director of Japan Machinery Centre for Trade and Investment in the Brussels office and T Tatano from the Chicago Harris School. It focuses on requirements in the area of non-financial disclosure and gives an account of non-financial disclosure guidelines issued by the Government of Japan. The study touches upon constituent features to be incorporated in a possible globally-accepted framework for the disclosure of non-financial information. More importantly, the study touches upon the most recent approach of integrated reporting proposed by the International Integrated Reporting Council (IIRC), established mainly by Accounting for Sustainability (A4S) and GRI.

The case study on the role of stock exchanges in promoting transparency and disclosure was written by A Amico, a member of the OECD Corporate Affairs Division responsible for the Organization's work on corporate governance. The study highlights the important roles of stock exchanges and provides examples of good regulatory frameworks put in place by stock exchanges worldwide for higher governance standards.

The final part covers human capacity. The case studies are on the training of professional accountants and professional accounting qualification systems.

The case study on a global approach to the training of professional accountants by M Walsh of the Association of Chartered and Certified Accountants (ACCA) sets out the rationale for a global approach to professional training and discusses the requirements of a global qualification set of competences required and the limitations of this approach. It also offers some comparisons of the missions of six leading global bodies and the goals they intend to achieve, as well as the progress made by these bodies towards meeting the criteria for a global body.

C Aggestam, associate professor of the Department of Accounting and Auditing at Copenhagen Business School, contributed to the case study providing an overview of professional accounting qualification systems in five selected countries. The study reports on the regulatory arrangements for certification and licensing (qualification) requirements for professional accountants that exist as of December 2011 in five countries, namely Mexico, Canada, Japan, Denmark and South Africa, limited to considering the arrangements for the highest level of certification for professional accountants. The study helps to gain a better understanding of the similarities and differences between existing educational and qualification systems for professional accountants in the selected countries.

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# Part One: Major trends and challenges

## I. Introduction

This part provides an overview of regulatory and institutional development challenges in 2012 and of the main activities of international bodies in the areas of accounting and reporting. It presents updates on financial reporting standards, non-financial reporting standards and codes, auditing standards, professional qualifications, compliance and regulatory oversight and the implementation and enforcement of accounting and reporting standards.

## II. Developments at the global level

One of the major trends since the financial crisis is that accountancy development policies and policies affecting accounting and audit regulations are being increasingly developed by international groups. What the crisis of 2007–2008 showed beyond any doubt is that the financial system is truly global. It is evident that the financial situation in one country is driven by what happens in others, and it follows that the financial regulations of one country can affect all others. This has underlined the need for far greater coordination among regulators on a global basis in order to avert future worldwide economic disasters.

The financial crisis has brought into sharp focus the reality that the regulation of corporate reporting is just one piece of a larger regulatory configuration, and that forces are at play that would subjugate accounting standard setting to broader regulatory demands. Today, financial accounting standard setting finds itself drawn into the orbit of complex political processes focused on restructuring the regulation of the world's financial markets. Proposals abound for how the regulation of financial markets and financial institutions should be changed to mitigate the potential for such large-scale financial meltdowns in the future. The crisis has energized politicians, regulators and economists to scrutinize financial accounting standards as never before, creating significant pressure for change.

In 2012, countries progressed in the acceptance of IFRS as global accounting standards. From 2012, IFRS are required or permitted for use by more than 100 countries, and half of all Fortune Global 500 companies report using IFRS. Among the G20 countries, IFRS was required for use for the first time during 2012 in Argentina, Mexico and the Russian Federation, while Saudi Arabia made further steps towards IFRS adoption.<sup>1</sup>

**Table 1**  
**Current use of IFRS in G20<sup>2</sup>**

	<b>Status for listed companies as of December 2012</b>
Argentina	Required for fiscal years beginning on or after 1 January 2012
Australia	Required for all private sector reporting entities and as the basis for public sector reporting since 2005
Brazil	Required for consolidated financial statements of banks and listed companies from 31 December 2010 and for individual company accounts progressively since January 2008
Canada	Required from 1 January 2011 for all listed entities and permitted for private sector entities, including not-for-profit organizations

<sup>1</sup> Available at <http://www.ifrs.org/The-organisation/Governance-and-accountability/Annual-reports/Documents/2012-IFRS-Foundation-Annual-Report.pdf>.

<sup>2</sup> Available at <http://www.ifrs.org/The-organisation/Documents/2013/Who-We-Are-English-2013.pdf>.

China	Substantially converged national standards
France	Required via European Union adoption and implementation process since 2005
Germany	Required via European Union adoption and implementation process since 2005
India	Convergence with IFRS. Data to be confirmed
Indonesia	Convergence process ongoing
Italy	Required via European Union adoption and implementation process since 2005
Japan	Permitted from 2010 for a number of international companies
Mexico	Required from 2012
Republic of Korea	Required from 2011
Russian Federation	Required from 2012
Saudi Arabia	Required for banking and insurance companies. Full convergence with IFRS currently under consideration
South Africa	Required for listed entities since 2005
Turkey	Required for listed entities since 2005
United Kingdom	Required via European Union adoption and implementation process since 2005
United States	Allowed for foreign issuers in the United States since 2007
European Union	All European Union member States required to use IFRS as adopted by the European Union for listed companies since 2005

IFRS are developed and published by the International Accounting Standards Board (IASB), an independent standard-setting body of the IFRS Foundation. In 2012, the IASB focused its activities on completing the projects it agreed to work on jointly with the Financial Accounting Standards Board of the United States (FASB) under their memorandum of understanding (MoU) as well as other joint projects such as insurance contracts. In the third quarter of 2012, the remaining issues of the MoU and joint projects on the IASB agenda were financial instruments, leasing, revenue recognition and insurance. During the first half of the year, IASB and FASB worked on arriving at a consensus with respect to impairment accounting, classification and measurement. The Boards expect completion of the new impairment requirements in the first half of 2013. The IFRS on general hedge accounting is due for completion by the end of 2012 or in early 2013. An exposure draft on macrohedge accounting is targeted for publication in the autumn of 2012. The proposed standard on revenue recognition was reexposed for comment and a final standard is expected by early 2013. A final standard on leases is also expected in mid-2013. In relation to insurance, the IASB will reexpose the draft standard in the last quarter of 2012.

With regard to the development of international audit standards in 2012, the IAASB unanimously approved and released a milestone consultation document in its work to enhance, on a global basis, the communicative value of the auditor's report on financial statements. The IAASB "Invitation to Comment (ITC) on Improving the Auditor's Report" sets out the indicative direction of the Board's future standard-setting proposals to improve how and what auditors report in accordance with international standards on auditing (ISAs).

Another important trend is a growing understanding that a regulatory system is not just about standard setting but also about the implementation, enforcement and monitoring of the consistent application of such standards and compliance with requirements.

In this regard, it is important to note that in 2012 a new structure, the Accounting Standards Advisory Forum (ASAF), was created. Proposals to the IASB to create a new advisory group were published for public comment. The group is known as ASAF and will provide technical advice and feedback to the IASB. The ASAF consists of national accounting standard setters and regional bodies with an interest in financial reporting. The creation of such an advisory group was one of the main recommendations of the trustees' strategy review. The ASAF planned to meet for the first time in April 2013.<sup>3</sup>

Historically, issues of compliance with standards were not given significant emphasis at the global level, reflecting a range of factors, including a limited level of available resources, traditions of self-regulation and professional peer review and the clear positioning of responsibilities for compliance, regulation and oversight activities at the national rather than international level. However, in recent years a number of developments have taken place reflecting a growing need for accountancy regulatory and institutional arrangements at a global level, including a need for further guidance to ensure a consistent application of international pronouncements.

A number of activities are taking place towards the improvement and strengthening of institutional arrangements at a global level. Most of them address a need for better institutional coordination and cooperation, the improvement of governance and monitoring arrangements for standard-setting processes for high-quality corporate reporting and monitoring and compliance with international standards. This includes the major developments detailed in the following paragraphs.

The Monitoring Board of the IFRS Foundation, created in 2009, is conducting a review of the Foundation's governance arrangements to assess whether they promote the primary mission of the International Accounting Standards Board of developing high-quality, understandable, enforceable and globally accepted accounting standards. In February 2012, the Monitoring Board announced the conclusion of its review of the governance of the IFRS Foundation and published its final report.<sup>4</sup> The Monitoring Board made a number of decisions regarding the Monitoring Board itself, the IFRS Foundation trustees and the IASB. With regard to membership on the Monitoring Board, it decided to confine membership to capital market authorities responsible for setting the form and content of financial reporting. It agreed to continue with consensus-based decision-making and also decided to coordinate its periodic governance review with the Foundation's five-yearly constitution reviews.

The issue of public oversight was also further addressed, in particular through the development of the International Forum of Independent Audit Regulators (IFIAR), which was established in September 2006. The IFIAR is committed to sharing knowledge and experience of the audit market and associated regulatory activities between independent national audit regulatory agencies. It seeks to promote collaboration and consistency in regulatory activity and to act as a platform for dialogue with other organizations with an interest in the quality of auditing. There are currently 28 independent national regulators that are members of this new international organization, including the PCAOB. Observers at IFIAR meetings include the Basel Committee, the European Commission, FSF, IAIS, IFAC, IOSCO, PIOB and the World Bank, again reflecting the increasingly interlocking nature of international regulatory relationships.

On 19 December 2012, the IFIAR released the first global survey of audit inspection findings, bringing together issues identified by IFIAR members located around the world. The survey was

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<sup>3</sup> Available at <http://www.ifrs.org/The-organisation/Governance-and-accountability/Annual-reports/Documents/2012-IFRS-Foundation-Annual-Report.pdf>.

<sup>4</sup> Available at <http://www.ifrs.org/NR/rdonlyres/2CABFD51-7F0E-47A5-BA99-F7A8B4E99C6F/0/GovernanceReviewFinalReportFeb2012.pdf>.

designed to identify the level of inspection activity among IFIAR members and common findings of members' inspections of the audits of public companies. The survey also responded to a request from the Financial Stability Board to provide details of findings from the inspections of audits of major financial institutions. The information in this report may be of use to audit firms, audit regulators, other regulators, policymakers and standard setters in their efforts to improve audit quality. It may also be of use to investors and audit committees as an indicator of the current status of inspections of auditors of public companies, including financial institutions in jurisdictions around the world.<sup>5</sup>

The Financial Stability Board (FSB), established in 2009, also contributed to the development of accounting and reporting standards in 2012. It aims to coordinate at the international level the work of national financial authorities and international standard-setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors and committees of central bank experts.

The FSB is responsible for coordinating and promoting the monitoring of the implementation of agreed financial reforms, of which convergence towards a single set of high-quality global accounting standards is an essential part and reporting on the progress to the G20. In order to strengthen the coordination and effectiveness of this monitoring, the FSB, in collaboration with the standard-setting bodies, established the Coordination Framework for Implementation Monitoring (CFIM) in October 2011, for monitoring and reporting on the implementation of the G20 financial reforms. This framework was subsequently endorsed by the G20 leaders at the Cannes summit in November 2011.

On 8 June 2012, the FSB published a report entitled A Global Legal Entity Identifier for Financial Markets (LEI report), which set out global LEI system high-level principles and 35 recommendations for the development of a unique global identification system for parties to financial transactions. The G20 endorsed the recommendations at the Los Cabos summit and asked the FSB to take forward the work to implement the system.<sup>6</sup>

The International Organization of Securities Commissions (IOSCO), established in 1983, is an acknowledged international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector. The IOSCO develops, implements and promotes adherence to internationally recognized standards for securities regulation, and is working intensively with the G20 and the Financial Stability Board (FSB) on the global regulatory reform agenda.<sup>7</sup> In May 2012 the IOSCO announced a restructuring of its governance structure, operations and funding, as follows:<sup>8</sup>

(a) Governance. In an effort to streamline the governance structure and decision-making process, a new transitional IOSCO Board was constituted. The new Board will subsume the functions of the IOSCO Technical Committee, Executive Committee and Emerging Markets Committee Advisory Board;

(b) Cooperation. The IOSCO approved a resolution that allows it to take tougher measures to encourage compliance by IOSCO members who have not yet signed the multilateral memorandum of understanding concerning consultation and cooperation and the exchange of information (MMoU). The MMoU allows member organizations to cooperate with each other in matters of enforcement. The new resolution is designed to assist non-signatories in overcoming obstacles in

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<sup>5</sup> Available at <http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2012/December/IFIAR-releases-first-global-survey-of-audit-inspec.aspx>.

<sup>6</sup> Available at [http://www.financialstabilityboard.org/publications/r\\_121220.htm](http://www.financialstabilityboard.org/publications/r_121220.htm).

<sup>7</sup> Available at <http://www.iosco.org/about/>.

<sup>8</sup> Available at <http://www.iasplus.com/en/news/2012/may/iosco-restructures>.

securing support from their Governments or legislatures for implementing the legal and regulatory changes required for compliance with the MMoU;

(c) Funding. The members discussed the need for alternative sources of funding to expand services to members, especially in emerging markets, including technical assistance, education and training and research on global securities market issues. The discussion included the possible creation of an IOSCO Foundation.

The IOSCO indicated that the restructuring measures were taken with a view to ensuring that IOSCO is structured and positioned to continue providing the lead in the development of regulatory standards for capital markets, has the resources needed to engage in the identification of emerging securities markets risks, possesses the capacity to meet the needs of its members and is prepared to respond to requests for project work by the G20 and the Financial Stability Board.

One of the major international bodies for the accountancy profession is the International Federation of Accountants (IFAC), which was founded in 1977. It increased its focus on global compliance issues with the launch in 2004 of its compliance programme, overseen by the Compliance Advisory Panel (CAP), which seeks to ensure that member bodies are meeting their membership obligations. In October 2011, the CAP published its member body compliance strategy for 2011–2014. According to the strategy, revision of the statements of membership obligations will be concluded by October 2012. The Compliance Advisory Panel notes that in coming years it will intensify its cooperation with independent standard-setting boards with a view to providing them with important feedback on successes and challenges in adoption and incorporation and the implementation of the respective boards' standards.

To ensure that the activities of IFAC and the independent standard-setting bodies supported by IFAC are responsive to public interests, an international Public Interest Oversight Board (PIOB) was established in February 2005. The members of the PIOB were selected by leading institutions in the international regulatory community, including the Basel Committee on Banking Supervision (BCBS), the European Commission, the FSF/FSB, the International Association of Insurance Supervisors (IAIS), the International Organization of Securities and Exchange Commissions (IOSCO) and the World Bank. The activities of the PIOB include monitoring all meetings of the IFAC standard-setting committees, making this a very active process of public oversight.

A number of developments have also taken place in the area of professional qualifications. Strengthening the competences of professional accountants is a central element in global efforts towards continuous improvement in corporate reporting and auditing practices. Professional accountants and other participants constitute part of the human capacity that serves as an integral part of the process of producing high-quality corporate reporting. The process of globalization implies that benchmarks should be set at the international and not national level. The bodies with statutory recognition for audit purposes in their home territory represent examples of qualifications that are examined other than in their home territory, and include the Association of Chartered Certified Accountants (ACCA), CPA Australia (CPAA), the Certified General Accountants Association of Canada (CGAA), the Institute of Chartered Accountants in England and Wales (ICAEW) of the United Kingdom, and the American Institute of Certified Public Accountants (AICPA) in the United States. The United Kingdom Chartered Institute of Management Accountants (CIMA) represents a management accounting qualification, which is available globally.

An international coalition of accounting bodies formed in 2006, the Global Accounting Alliance (GAA), also contributed to the development of accounting and reporting in 2012.<sup>9</sup> The GAA includes nine institutes from different countries around the world. The Alliance's aim is to promote the delivery of quality professional services, support its global membership base, share information

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<sup>9</sup> Available at <https://www.saica.co.za/Members/AboutMembers/AbsenteeMembership/GAAPassport/tabid/763/language/en-ZA/Default.aspx>.



and collaborate on international accounting issues. The alliance provides professional support to its 700,000 members. It also works with national regulators, Governments and stakeholders through member-body associations. In June 2011, the governing bodies of the AICPA and the CIMA (based in the United Kingdom) unanimously voted to create a new professional designation, the chartered global management accountant. The designation was officially launched globally on 31 January 2012. It was highlighted at the launch that the chartered global management accountant qualification is intended to provide companies with the competences needed for better integration between financial and non-financial information, with a view to driving business growth and to including that information in the financial reporting process.<sup>10</sup>

Another major player in this area at a global level is the International Accounting Education Standards Board (IAESB). It is an independent standard-setting body that serves the public interest by establishing standards in the area of professional accounting education that prescribe technical competence and professional skills, values, ethics and attitudes.<sup>11</sup>

The main activities of the IAESB in 2012 referred to the development of its project to revise and redraft its suite of International Education Standards (IESs). During the year, IESs 1, 5, 6 and 7 were modified to better approach the public interest.<sup>12</sup>

Another body responsible for the development of international accounting standards is the IFRS Foundation's Education Initiative. Its objective is to reinforce the IFRS Foundation's goal of promoting the adoption and consistent application of a single set of high-quality international accounting standards. In fulfilling its objective, the Initiative takes account of the special needs of small- and medium-sized entities and emerging economies.<sup>13</sup>

The IFRS Foundation Education Initiative published on the eIFRS website the 2012 edition of the international financial reporting standards, a briefing for chief executives, audit committees and boards of directors. This briefing provides summaries of all IFRS issued as at 1 January 2012, at a high level and in non-technical language. It is specially prepared for chief executives, members of audit committees, company directors and others who wish to gain a broad overview of IFRS and of the business implications of implementing them.<sup>14</sup>

Significant changes in non-financial reporting standards have also taken place. The Global Reporting Initiative (GRI), created in 1997 by the Coalition for Environmentally Responsible Economies (CERES), in partnership with the United Nations Environment Programme (UNEP), aims to raise the level of sustainable development methods to be on a par with that of financial reporting to ensure the comparability, credibility, frequency and verifiability of information communicated. The GRI has embarked upon this task with the active participation of companies, environmental and social NGOs, accounting firms, trade unions, investors and other stakeholders worldwide.<sup>15</sup>

Guideline G4, the fourth generation of sustainability reporting guidelines, will be published in 2013. The next generation of GRI guidelines addresses requirements for sustainability data, and enables reporters to provide relevant information to various stakeholder groups. It also improves on content in the current guidelines, G3 and G3.1, with strengthened technical definitions and improved clarity, helping reporters, information users and assurance providers.<sup>16</sup>

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<sup>10</sup> Chartered Global Management Accountant Magazine, 2012, CGMA launch focuses on non-financial value, long-term business strategies, 31 January.

<sup>11</sup> Available at <http://www.ifac.org/Education>.

<sup>12</sup> Available at [http://www.ifac.org/sites/default/files/publications/files/IAESB-2012-Annual-Report\\_0.pdf](http://www.ifac.org/sites/default/files/publications/files/IAESB-2012-Annual-Report_0.pdf).

<sup>13</sup> Available at <http://www.ifrs.org/Use-around-the-world/Education/Pages/Education.aspx>.

<sup>14</sup> Available at <http://www.iasplus.com/en/news/2012/june/ifrs-foundation-education-initiative-publishes-briefing-for-chief-executives>.

<sup>15</sup> Available at <http://www.reportingcsr.org/gri-p-161.html>.

<sup>16</sup> Available at <http://www.reportingcsr.org/gri-p-161.html>.

The International Integrated Reporting Council (IIRC) was established to support the evolution of integrated reporting. The IIRC brings together the world's leaders from the corporate, investment, accounting, securities, regulatory, academic and standard-setting sectors, as well as civil society. The IIRC aims to develop a new approach to reporting, one that is fit for purpose in the twenty-first century, building on the foundations of financial, narrative, governance and sustainability reporting, in a way that reflects the fact that these elements are closely related and interdependent and flow from an organization's overall strategy and business model. The GRI is one of the joint conveners of the IIRC and actively participates in its working groups and task forces.<sup>17</sup>

In 2012, the IIRC developed an integrated reporting framework, aiming to synergize with the principal financial reporting standards and major sustainability reporting frameworks. On 26 November 2012, the IIRC released a prototype of the international framework, a significant further step towards publication of the framework in 2013. This was an interim step intended to demonstrate progress towards defining key concepts and principles that underpin and support organizations' ability to produce an integrated report.<sup>18</sup>

One of the distinct trends in regulatory and institutional developments, therefore, is the facilitation of global institutional settings and the growing role of international bodies, not only in formulating standards but also in relation to their enforcement, consistent application and compliance. This means that in creating and strengthening national regulatory and institutional foundations, national regulators need to increase communication and cooperation with relevant international organizations. At the same time, international bodies need to further improve and expand means of ongoing interaction with national standard-setters. This poses challenges for both sides, as more resources are needed, including financial resources and technical expertise.

One of the ways to assist countries in their regulatory and institutional building is by providing forums and opportunities for national regulators to share good practices. One of the established forums in this regard is the ISAR standing group that, since 1982, has assisted developing countries and countries with economies in transition in the implementation of international standards on accounting and reporting. Many developing countries and countries with economies in transition need to newly build or upgrade their national regulatory and institutional settings towards standards and codes formulated by international standard setters, based on the most advanced international requirements and practices. Therefore, sharing good practices and lessons learned is of crucial importance for them. Comparative views of other regulatory systems enable regulators to develop a more tailored approach to their own systems.

Another significant global instrument, the reports on the observance of standards and codes (ROSCs), continued to develop in 2012.<sup>19</sup> The ROSCs are a joint International Monetary Fund (IMF) and World Bank initiative that helps member countries strengthen their financial systems by improving compliance with internationally recognized standards and codes. The objectives of the ROSCs project are to analyse the comparability of national accounting and auditing standards with international standards, determine the degree to which applicable accounting and auditing standards are complied with and assess the strengths and weaknesses of institutional frameworks in supporting high-quality financial reporting, as well as to assist countries in developing and implementing a country action plan for improving institutional capacity with a view to strengthening their corporate financial reporting regimes. To date, the World Bank's ROSCs programme has covered over 90 countries, publishing over 100 ROSCs.

A further important aspect of creating sound institutional and regulatory foundation is to further facilitate the participation of less developed countries in international processes to better understand and consider their needs. Reflecting this need, in 2009, the G20 advised the IASB to include emerging economies in the standard-setting process. As a result, the Emerging Economies

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<sup>17</sup> Available at <http://www.iasplus.com/en/resources/sustainability/iirc>.

<sup>18</sup> Available at <http://www.theiirc.org/2012/11/26/iirc-releases-prototype-of-the-international-ir-framework/>.

<sup>19</sup> Available at [http://www.worldbank.org/ifa/rosc\\_aa.html](http://www.worldbank.org/ifa/rosc_aa.html).

Group (EEG) was created in 2011.<sup>20</sup> Its activities focus on issues related to the application and implementation of IFRS in emerging economies, including suggestions of how the IASB can provide educational guidance on these matters. The current membership of the EEG includes Argentina, Brazil, China, India, Indonesia, Malaysia, Mexico, the Republic of Korea, the Russian Federation, Saudi Arabia, South Africa and Turkey. The group is chaired by the IASB Director of International Activities and the Vice-Chair is the Director-General of the Accounting Regulatory Department, Ministry of Finance, China.

Another recent trend in the area of regulatory settings is the growing interdependence of national regulatory requirements and the increasing impact of regulatory requirements of one country on another jurisdiction. This situation is particularly true in countries hosting the most important stock exchanges in the world, for instance the Public Company Accounting Oversight Board (PCAOB) in the United States, which performs inspection activities on accounting firms that audit companies listed in the United States market. In fact, companies listed in United States exchanges are required to be audited by an audit firm registered with the PCAOB. These inspection activities are also applicable to foreign issuers listed in the United States and, therefore, the PCAOB has been trying to achieve bilateral agreements with other countries in order to be able to review foreign accounting firms. Currently, more than 900 audit firms registered with the PCAOB are located outside of the United States, which corresponds to 87 countries and economies.<sup>21</sup> Of these, 110 firms are located in China and Hong Kong (China), 8 in Switzerland and 59 in the United Kingdom.

The PCAOB has recently entered into a cooperative agreement with the Swiss Federal Audit Oversight Authority and the Financial Market Supervisory Authority, which includes the sharing of confidential information. Indeed, the Dodd Frank Wall Street Reform and Consumer Protection Act<sup>22</sup> was signed into law in July 2010 and amended the Sarbanes-Oxley Act to allow the PCAOB to share confidential information with its non-United States counterparties.<sup>23</sup> With this cooperative agreement, United States regulators will be able to perform joint inspections with Swiss authorities of Swiss firms auditing companies listed in the United States. The PCAOB expects these agreements to encourage other countries to accept similar agreements. For example, negotiations have been renewed with China, and representatives from both regulators met in July to discuss a bilateral cooperation agreement.<sup>24</sup>

On the tenth anniversary of the passing of the Sarbanes-Oxley Act, a discussion was organized by the Centre for Audit Quality on 30 July 2012.<sup>25</sup> During the discussion, Senators Paul Sarbanes and Michael Oxley highlighted the global impact of the Act. One of the implications of the global reach of the Act has been the establishment of public audit oversight bodies worldwide that are similar to the Public Company Accounting Oversight Board. Furthermore, international cooperation among regulators of the accounting profession has been increasing over time.

### III. Developments at the regional level

An important development in the area of regulatory and institutional settings is the growing role of regional bodies aimed at carrying out and coordinating efforts related to IFRS implementation and the consistent application of standards.

In Europe, an example of enforcement and coordination at a regional level is the Committee of European Securities Regulators (CESR), now renamed the European Securities and Markets Authority (ESMA), which conducted a review of European enforcers' experience during the first

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<sup>20</sup> Available at <http://www.ifrs.org/The+organisation/Advisory+bodies/EEG/About-the-EEG.htm>.

<sup>21</sup> Available at <http://www.big4.com/deloitte/pcaob-strikes-swiss-deal-extending-oversight-into-switzerland-721/>.

<sup>22</sup> Available at <http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>.

<sup>23</sup> Available at <http://www.soxlaw.com/>.

<sup>24</sup> Available at [http://pcaobus.org/News/Releases/Pages/07062011\\_China.aspx](http://pcaobus.org/News/Releases/Pages/07062011_China.aspx).

<sup>25</sup> American Institute of Certified Public Accountants, Journal of Accountancy, July 2012.

year of IFRS adoption for European Union-listed issuers.<sup>26</sup> The report showed that 20 out of 27 member States had introduced an enforcement mechanism by 2006 that met, at least in part, the requirements laid down by ESMA standards on enforcement.

The ESMA established the European Enforcers Coordination Sessions (EECS) in 2004 as a forum in which its members and other European Union enforcers who are not members of ESMA may exchange views and discuss experiences on the enforcement of financial information. The EECS aims to promote a high level of consistency among enforcers' decisions. Cases discussed by the EECS are registered in a confidential database that can be accessed by all European enforcers.

Another example of regional institutional settings is the European Financial Reporting Advisory Group (EFRAG), created in 2001. It has the role of a technical committee and provides advice to the European Commission on the endorsement of new or amended IFRS and IFRS interpretations. It also provides input to the IASB/FASB convergence work and holds observer status in certain working groups of the IASB.

The Asian-Oceanian Standard Setters Group (AOSSG) was established in 2009 to promote the adoption of and convergence with IFRS by jurisdictions in the region, encourage consistent application, coordinate input from the region on the technical activities of the IASB and collaborate with Governments, regulators and other regional and international organizations to improve the quality of financial reporting.<sup>27</sup> Through its educational sessions, members try to build capacity, and more developed jurisdictions support others by sharing implementation experiences and examples.

The Group of Latin American Accounting Standard Setters (GLASS) was created on 28 June 2011 and its 12 members are Argentina, Brazil, the Plurinational State of Bolivia, Chile, Colombia, Ecuador, Mexico, Panama, Paraguay, Peru, Uruguay and the Bolivarian Republic of Venezuela.<sup>28</sup> Its objectives include the following:

- (a) Interacting with the IASB by providing technical input on all documents published for comments;
- (b) Promoting the adoption of and/or convergence with IFRS in the region, as well as their consistent application;
- (c) Cooperating with Governments, regulators and other regional, national and international organizations to contribute to the improvement of the quality of financial statements;
- (d) Collaborating in the dissemination of the standards issued by the IASB in the region, particularly in member countries;
- (e) Providing proposals for the IASB agenda and coordinating alignment with the agenda of the region;
- (f) Acting in the technical meetings of the National Standard Setters and World Standard Setters that are deemed appropriate and respecting the national sovereignty of each member country participating in both groups;
- (g) Interacting with other organizations in Latin America (UNASUR, MERCOSUR and CAN) on issues related to accounting standards.

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<sup>26</sup> CESR review of implementation and enforcement of IFRS in the European Union, November 2007, available at [http://www.esma.europa.eu/system/files/07\\_352.pdf](http://www.esma.europa.eu/system/files/07_352.pdf).

<sup>27</sup> Vision paper of the Asian–Oceanian Standard Setters Group 2011: A driving wind for IFRS from Asia–Oceania.

<sup>28</sup> Available at [http://www.glenif.org/es/index.php?option=com\\_content&view=article&id=52&Itemid=56](http://www.glenif.org/es/index.php?option=com_content&view=article&id=52&Itemid=56).

In Africa, the West African Economic and Monetary Union (WAEMU) aims to achieve the economic integration of its members, which include Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, the Niger, Senegal and Togo.<sup>29</sup>

In 1998, WAEMU created a common accounting system called the West African Accounting System (SYSCOA), intended to harmonize accounting practices in the region. The SYSCOA is a reference framework, covering bookkeeping and the legal aspects of accounting. It obliges all companies, except the financial and insurance sectors, to follow the same accounting method.

The Pan-African Federation of Accountants (PAFA) was launched in May 2011, forming the first continent-wide organization for the accountancy profession in Africa. The Federation is composed of 39 professional accountancy organizations representing 35 African countries. At its first general assembly held in Tunisia in May 2012, PAFA resolved to adopt IFRS, IFRS for Small and Medium-sized Enterprises (SMEs), ISAs, International Public Sector Accounting Standards (IPSASs), IESs and the code of ethics for professional accountants developed by the International Ethics Standards Board for Accountants.<sup>30</sup>

Members of the East African Economic Community, namely Burundi, Kenya, Rwanda, Uganda and the United Republic of Tanzania, have scheduled commitments from 2010 to 2015 on the progressive liberalization of services, including in the areas of accounting, auditing and bookkeeping.<sup>31</sup> Adoption of international standards by the respective members of the Community would facilitate the liberalization of services in terms of market access, as well as the mobility of accounting professionals within the Community.

Members of the Association of Southeast Asian Nations (ASEAN), namely Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam, are working towards regional economic integration by 2015. One of the implications of the economic integration of ASEAN with the accountancy profession is the increased facilitation of mobility of professional accountants within the region. As a result, professional accountancy organizations in ASEAN countries are working towards formulating arrangements for the mutual recognition of qualifications across the Association.<sup>32</sup>

The trend towards globalization has also prompted institutional developments at the national level. For example, in January 2012, the three national professional accountancy bodies in Canada, the Canadian Institute of Chartered Accountants (CICA), the Certified Management Accountants of Canada and the Certified General Accountants of Canada, published a framework for a merger.<sup>33</sup> By merging, the three professional bodies expect to best serve the profession and protect the public through the provision of a common certification programme and a single set of high ethical and practice standards, enhance and protect the value of the designation in an increasingly competitive and global environment, contribute to the sustainability and prosperity of the accounting profession of Canada and govern the accounting profession in an effective and efficient manner.

Cooperation and coordination within a region can provide a number of benefits for countries at the regional level, facilitating the implementation of standards and economies of scale. One of the important trends in this regard is the extension of activities towards areas of implementation and

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<sup>29</sup> Boka Moussa, On the Development of West African Accounting System, International Journal of Business and Management, Volume 5 Number 5, May 2010, Economics and Management School, Wuhan University, China.

<sup>30</sup> PAFA Press Release, 2012, PAFA General Assembly resolves to adopt international standards, 4 May, available at <http://www.pafa.org.za/siteitems/PAFA%20General%20Assembly%20Resolution%20to%20Adopt%20International%20Standards.pdf>.

<sup>31</sup> The East African Community Common Market, 2009, schedule of commitments on the progressive liberalization of services, November, available at [http://www.eac.int/index.php?option=com\\_docman&task=doc\\_view&gid=356&Itemid=163](http://www.eac.int/index.php?option=com_docman&task=doc_view&gid=356&Itemid=163).

<sup>32</sup> Available at <http://www.asean.org/communities/asean-economic-community/item/asean-mutual-recognition-arrangement-framework-on-accountancy-services-3>.

<sup>33</sup> Canadian Institute of Chartered Accountants (2012), Canada's three legacy accounting bodies issue unification framework, Toronto, 17 January.



the application of reporting standards and regulations. However, it is important to consider and address some potential risks of regional institutional settings, and arrangements should be in place in order to avoid delays in the adoption and implementation of international requirements unilaterally. For example, complications are evident when a common stock exchange exists and, if one country wished to move towards IFRS before other countries belonging to the common accounting system, listed companies would face a double set of requirements.

#### **IV. Developments at the national level**

The development of sound regulatory and institutional frameworks at the national level is a complex and challenging exercise. According to the ADT, the following aspects and related indicators should be taken into the consideration in assessing the regulatory and institutional settings for high-quality corporate reporting:

- (a) Indicators on legal and regulatory requirements:
  - (i) Financial reporting and disclosure;
  - (ii) Audits;
  - (iii) Environmental, social and governance reporting;
  - (iv) Enforcement, monitoring of implementation and compliance;
  - (v) Licensing of auditors;
  - (vi) Corporate governance;
  - (vii) Ethics;
  - (viii) Investigation, discipline and appeals.
  
- (b) Indicators on institutional arrangements:
  - (i) Clear institutional responsibilities;
  - (ii) Efficiency of coordination mechanisms;
  - (iii) Efficiency of funding arrangements; and
  - (iv) Professional accounting organizations.

The following paragraphs highlight the main aspects of developing regulatory and institutional foundations at the national level.

The continuous changes taking place at the international level demand countries to be able to quickly adapt to cope with the pace of all new regulations and benchmarks in the reporting arena. In this regard it is important, as mentioned above, that national regulatory and institutional settings include arrangements for regular and efficient communication with international standard setters and other international bodies in the area of corporate reporting.

Another important trend is the growing role of State regulators. In response to the problematic audits of Enron, Global Crossing and other large companies, the passing of the Sarbanes-Oxley Act in July 2002 replaced the self-regulation of the United States auditing profession with a system of independent inspection by the Public Company Accounting Oversight Board (PCAOB). Similar initiatives followed in other countries and there is an entirely new international emphasis on auditor oversight as an essential feature of audit regulation. This oversight is, for obvious reasons, done at the local level on a national basis. However, the Sarbanes-Oxley Act did not exclude foreign registrants on United States stock exchanges from the requirement for oversight by the PCAOB. This appears to have encouraged a number of large countries to establish their own auditor oversight systems in the hope that there will be mutual recognition of each other's systems. This, however, has only occurred to a limited extent, resulting in a considerable amount of extraterritorial activity by the PCAOB audit inspectors.

All European Union member States have established a public audit oversight body that takes responsibility for the education, qualification, quality assurance and disciplinary procedures concerning statutory auditors and audit firms, as well as for relevant standard setting.<sup>34</sup>

In the area of financial reporting and disclosure requirements, further efforts are being made towards the adoption and implementation of international standards.

With regard to accounting standards in recent years, progress towards global convergence has remained constant and, according to the International Accounting Standards Board (IASB), more than 100 countries already require, permit or are in the process of implementing IFRS. The proliferation of International Standards on Auditing (ISAs) developed by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) has also continued and was facilitated by its clarity project, which aimed at improving understanding of ISAs.

Countries continue to take different approaches towards the implementation of IFRS. For example, among the pilot test countries, two use IFRS as developed by the IASB, three implement IFRS after an endorsement process has been completed, one uses a convergence approach to align its standards with IFRS, one issues national accounting standards based on IFRS and one uses regional accounting standards.

Non-financial reporting remains a major challenge. Over the last decade, a number of jurisdictions have introduced or strengthened non-financial disclosure requirements related to environmental, social and corporate governance (ESG) issues. As research by UNCTAD on corporate governance disclosure has shown, many countries around the world, both developed and developing, have mandatory requirements in place for corporate governance disclosure.<sup>35</sup> Such requirements are often found in company law or stock exchange listing requirements. However, social and environmental issues are among the least required subjects. Nevertheless, member States have put an emphasis on promoting such sustainability reporting at a number of international forums.

In this regard, most recently in the outcome document of the 2012 United Nations Conference on Sustainable Development (Rio+20), member States declared the following: “We acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle” (paragraph 47, The Future We Want).

A number of member States and/or stock exchanges are pioneering sustainability reporting either through regulatory initiatives or listing requirements. The most popular tools for stock exchanges are sustainability indices that rank the performance of leading companies on ESG issues. While not a form of mandatory disclosure, these indices have been successful in promoting voluntary disclosure among companies.

Denmark, in 1995, became one of the first countries to introduce legislation mandating environmental reporting for very large companies through the Environmental Protection Act of Denmark. This law has been updated over the ensuing years to expand the scope and depth of reporting. In South Africa, to highlight another example, the Johannesburg Stock Exchange has required since 2010 that all companies listed on its exchange produce integrated reports including sustainability information. In June 2012, the United Kingdom introduced regulation to require listed companies to report on greenhouse gas emissions and this requirement is expected to enter into force for listed companies on the London Stock Exchange in 2013. In 2012, the OECD published a stocktaking of more examples from OECD countries.<sup>36</sup> In Brazil, Bovespa has

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<sup>34</sup> Available at [http://www.fee.be/publications/default.asp?library\\_ref=4&content\\_ref=1537](http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1537).

<sup>35</sup> UNCTAD, 2011, Corporate governance disclosure in emerging markets: Statistical analysis of legal requirements and company practices. Available at [http://unctad.org/en/docs/diaeed2011d3\\_en.pdf](http://unctad.org/en/docs/diaeed2011d3_en.pdf).

<sup>36</sup> OECD, 2012, Corporate greenhouse gas emission reporting: A stocktaking of Government schemes, available at <http://www.oecd.org/investment/investmentpolicy/50549983.pdf>.

introduced mandatory reporting around sustainability issues, on a comply-or-explain basis. Bovespa has also introduced a climate change-related index that led to a three-fold increase in climate change related reporting among the top 100 companies.<sup>37</sup> Almost half of the 30 largest exchanges in the world have ESG indices and many more exchanges are planning to introduce them.<sup>38</sup>

However, regulations on non-financial disclosure remain a challenge. Even in leading countries in this area there is a lack of regulatory requirements. As member States worldwide seek to address growing sustainability concerns, ESG reporting is expected to continue to be the subject of regulatory initiatives and listing requirements.

National efforts continue towards building regulatory and institutional foundations for enforcement, monitoring of the implementation of standards and compliance.

In this regard, an important trend is the increased role of stock exchanges, which have established themselves as promoters of the relevant governance recommendations for listed companies through their listing rules and maintenance requirements, as well as through the exercise of enforcement powers entrusted to them in some jurisdictions.

Listing requirements on stock exchanges can serve a function similar to regulatory initiatives in promoting high-quality corporate reporting and should be considered in any assessment of the overall corporate reporting infrastructure. This is especially the case in markets where a single stock exchange has a monopoly or near monopoly.

The facilitation of coordination among all institutions involved in the corporate reporting process has proven to be another major trend, as well as a remaining challenge in many countries.

Normally, there are several institutions involved in regulatory activities in the area of corporate reporting. For example, in Japan, the accounting regulatory system consists of the following three legislative components:

- (a) Securities and Exchange Law, enforced by the Financial Services Agency (FSA), a subagency under the Ministry of Finance (MoF);
- (b) Commercial Code, enforced by the Ministry of Justice (MoJ);
- (c) Corporation Tax Law, enforced by the National Tax Administration (NTA), a largely autonomous agency reporting to the MoF.

In Turkey the institutional setting related to financial reporting includes the following:

- (a) Istanbul University Institute of Accounting;
- (b) Expert Accountants Association of Turkey (TMUD);
- (c) Capital Market Board of Turkey (SPK);
- (d) Accounting and Auditing Standards Board of Turkey (TMUDESK);
- (e) Banking Regulation and Supervising Agency (BDDK);
- (f) Accounting Standards Board of Turkey (TMSK).

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<sup>37</sup> Available at <http://www.bmfbovespa.com.br/indices/ResumoIndice.aspx?Indice=IC02&Idioma=en-us>.

<sup>38</sup> Responsible Research, 2012, Sustainable stock exchanges: A report on progress, page.29.



In South Africa, some of the key institutions that are involved in corporate reporting matters are the following:

- (a) Ministry of Trade and Industry;
- (b) Financial Services Authority;
- (c) Financial Reporting Standards Council;
- (d) Financial Reporting Investigations Panel;
- (e) Independent Regulatory Board for Auditors;
- (f) Reserve Bank of South Africa;
- (g) Institute of Chartered Accountants of South Africa.

In Cote d'Ivoire, institutions that deal with matters of corporate reporting include several regional organizations and the following:

- (a) Ministry of Finance and Economy;
- (b) National Treasury;
- (c) National Accountancy Council;
- (d) Ordre des Experts Comptables et Comptables Agréés de Côte d'Ivoire.

Having a coordinating mechanism between different institutions that integrate the reporting chain is critical to avoid contradictions and the overlap of activities, as well as for improving the efficacy of efforts and resources used. Coordination needs to take place with regard to issuing legislation affecting corporate reporting, ensuring its implementation, carrying out investigations, imposing punitive actions, sharing information, etc. One of the key activities in which coordination plays a critical role is the development and implementation of a national strategy and an action plan. In some countries, action plans have been designed and implemented for a specific segment of activity such as the IFAC action plans developed by the Professional Accountancy Organizations (PAOs) to become IFAC members. However, these do not constitute a national strategy. Other countries have partial action plans involving only some institutions participating in the reporting chain or including only some areas of reporting.

An action plan refers to a comprehensive effort at the country level aimed at the improvement of the current status of accountancy infrastructure based on a national strategy and identified priority areas. Such a plan should also include the participation of all key institutions involved in corporate reporting. For example, some pilot countries that cooperate with UNCTAD on the implementation of its Accounting Development Tool (ADT), such as Cote d'Ivoire, Croatia and the Russian Federation, have used the results of the pilot tests of the ADT to identify priority areas for developing national action plans.

One example of an action plan agreed on a national level comes from Singapore. The Committee to Develop the Singapore Accountancy Sector (CDAS) was set up by the Government in 2008 to conduct a holistic review of the accountancy sector, aimed at positioning Singapore as a leading international centre for accountancy services and professionals.<sup>39</sup>

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<sup>39</sup> Transforming Singapore into a leading global accountancy hub for Asia-Pacific, final report of the committee to develop the accountancy sector, 12 April 2010.

The CDAS made 10 recommendations to transform Singapore into the leading global accountancy hub for the Asia–Pacific region by 2020. The recommendations seek to deepen expertise in the accountancy sector, upscale the value of services provided from the Singapore-based public accountancy entities and promote the regionalization of accountancy services. The committee determined that in order to enhance the public accountancy entities' capability and productivity, incentives should be given to encourage incremental investments in human capital development and the building of technical expertise.

The CDAS recommended the creation of a new institution to accomplish the transformation of the country, the Singapore Accountancy Council (SAC). This central body should be supported by a full-time secretariat comprising representatives from the public accountancy profession and sector, business and financial community, academia and public sector. It should be appointed by the Government and established via legislation to give it formal oversight responsibilities over administration of the following:

- (a) Accountancy sector development fund;
- (b) Accountancy services research centre;
- (c) Globally-recognized, Singapore-branded post-university professional accountancy qualification and the necessary accreditation processes;
- (d) Specialization pathways for the accountancy sector.

Another example of a coordinated approach towards regulatory requirements is Croatia's action plan for the implementation of audit act amendments. The activities included in the plan are as follows:

- (a) Enactment of the audit act amendments aligned with the eight directive;
- (b) Establishment of a service for audit and accountancy public policy issues within the Ministry of Finance;
- (c) 2009 budget proposal for the Public Oversight Committee;
- (d) Completion of preparatory work for administrative and technical support to the Public Oversight Committee;
- (e) Establishment of the Public Oversight Committee;
- (f) Employment of a quality assurance team leader within the Chamber of Auditors of Croatia;
- (g) General assembly of the Chamber of Auditors of Croatia;
- (h) Election of the new board of the Chamber of Auditors of Croatia in line with the audit act amendments;
- (i) Cooperation agreement between the Public Oversight Committee and the Chamber of Auditors of Croatia;
- (j) Public oversight implementation plan;
- (k) Quality assurance implementation plan;
- (l) Full staffing of the quality assurance team within the Chamber of Auditors of Croatia (up to five members).

One of the most important tasks for regulatory and institutional development at the national level relates to institutions in charge of education and training. Most of the pilot test countries reported an insufficient supply of qualified accountants, particularly for small and medium-sized enterprises and the public sector, which clearly reflects a further need for institutional building in this area. Keeping programmes up to date according to international benchmarks whether at the university or at the PAO level is very important. In this sense, coordination between key institutions involved in this process, such as the Ministry of Education and PAOs, is essential to guarantee that the educational curriculum is permanently aligned with the latest national and international regulations and requirements. This will ensure that professionals obtaining a certification are in a position to efficiently apply standards.

In this regard, one of the aspects highlighted in some pilot ADT tests has been the need to strengthen coordination between universities and PAOs at the national level. Complications appear when courses and training sessions are not able to cope with the pace of new requirements stemming from continuously changing regulatory environments. Additional complexity is added with the absence of a harmonized model curriculum for accountancy and audit studies. In fact, part of the difficulties in assessing the current situation in countries is related to the existence of different systems in place in the same country, especially in countries with a large number of universities and institutions involved in the educational area.

Another important aspect of regulatory and institutional foundations is sustainable and independent funding mechanisms for accountancy development. When establishing adequate regulatory and institutional arrangements, it is essential to ensure that these institutions will be able to effectively conduct their duties in an objective manner. In relation to standard setters, these bodies should have a secure and stable source of funding that is not dependant on voluntary contributions of those subject to the standards.

Independence means that the funding has to come with no conditions attached. For example, in 2006, the IASB Foundation established the following four principles related to funding:

(a) The system should be broad-based. A sustainable long-term financing system must expand the base of support to include the major participants in the world's capital markets;

(b) The system should be compelling. In this regard, support from relevant regulatory authorities would be required;

(c) The system should be open-ended and not contingent on any action that might infringe on the independence of the standard setting. The idea is that funding should be shared by the major economies of the world, using gross domestic product as a parameter to determine the level of contribution;

(d) Moving to a simple levy system, which would add an element of automaticity to the funding system and reduce any future claims of dependence on single-company contributions. Moreover, through this system, all companies who benefit from IFRS will contribute.

IASB principles could be used for other international, regional and national organizations conducting activities in different areas. However, at the national level and especially in developing countries, obtaining adequate funding can be a major challenge not only for ensuring independence but particularly for securing the sustainability of these institutions. For instance, many professional bodies in developing countries are often small, with few members, and are facing a lack of funding as one of their main challenges to survive and develop.

In other countries, the Government provides funding for several institutions or carries out the functions by itself. In these cases, it is important to pay attention to possible conflicts of interest that could arise in situations related to the process of appointment of the chair or director of these institutions. Independence could also be compromised when there is only one government

regulator carrying out activities such as the setting up of standards, enforcement, exercise of discipline functions, etc.

A critical element of a sound accounting infrastructure is the set of punitive actions that can take place in a country when a case of misconduct is identified. In addition, procedures related to obtaining and maintaining membership, licences and certifications play a key role in the quality and credibility of corporate reports. Findings from pilot tests show that building such a system is one of the important challenges for some countries as it relates to the withdrawal of licenses, certifications or membership of auditors and accountants. In certain countries, membership in a professional organization is indefinite and cannot be removed. Thus, CPD programmes are not a requisite for keeping membership and certification and as a result there is no mechanism to ensure that members have the ability to perform their duties according to the latest requirements.

In this regard, sharing good practices would be useful. For example, in Japan the legislative framework for the accounting profession and CPA qualification is set out in the certified public accountants law. The practice of the CPAs, among other functions, is overseen by the Financial Services Agency (FSA). The FSA has a subcommittee called the Certified Public Accountant System of the Financial System Council that establishes the policies for governing CPAs. The Institute for Certified Professional Accountants of Japan (JICPA) is the only professional accounting body in Japan and its key role is to keep a register of all CPAs in Japan. The JICPA has the authority to revoke the registration of any CPA who has been disciplinarily sanctioned.

In the United Kingdom, disciplinary activities are conducted by the Accountancy and Actuarial Discipline Board of the Financial Reporting Council. Proceedings related to investigations of misconduct may become public, as recently seen in the appeal from Deloitte over the MG Rover case. In the United States, the PCAOB even publishes all correspondence with companies under investigation.

## V. Conclusion

Building a sound regulatory and institutional foundation for high-quality corporate reporting is a complex and comprehensive exercise.

Recent developments in this area pose many challenges for regulatory and institutional building for stakeholders at global and national levels, including the following:

(a) The increasing role of international bodies, particularly in the area of compliance and consistent application of standards, which requires the further facilitation of communication between national regulators and international standard setters.

(b) New institutional arrangements, which might be needed to ensure the beneficial implementation of international pronouncements given the fact that, traditionally, these issues were dealt with in the past at a national rather than a global level and considering differences in national legal and institutional systems;

(c) The increasing focus on enforcement and compliance, which requires countries, particularly developing countries and countries with economies in transition, to further develop national expertise in the areas of enforcement, monitoring of compliance, investigation and discipline and to further improve coordination between all stakeholders in these areas of corporate reporting;

(d) More guidance, which is necessary to assist countries in developing regulatory and institutional foundations that would enable them to meet requirements for high-quality corporate reporting. This includes not only technical guidance on standards application, but also guidance on good practices in national institutional arrangements on standard implementation, including enforcement, monitoring of compliance, investigation and discipline;

(e) A more comprehensive and long-term approach towards strengthening regulatory and institutional foundations, which requires the further development of adequate tools to help countries measure and monitor progress in a consistent manner. This also includes the formulation of clear criteria and guidance based on which stakeholders of a country could develop consensus on the current status of accounting reforms and further priorities.<sup>40</sup>

(f) To ensure that international requirements respond to the needs of all countries. The participation of developing countries and countries with economies in transition in international discussions and processes on building regulatory and institutional foundations should therefore be further enhanced;

(g) To improve and enlarge education and training systems for professional accountants and auditors in order to address the issue of an insufficient supply of trained professionals compared to market demand, particularly for small and medium-sized enterprises and the public sector, as reported by most of the pilot test countries. This also includes better coordination between universities and providers of professional training;

(h) Non-financial and sustainability reporting, including issues such as the environment, corporate governance and corporate social responsibility, need to be better integrated into accounting development policies;

(i) The need to secure financial and human resources to ensure the adequate quality and sustainability of national regulatory and institutional foundations considering also the greater scope and complexity of required developments;

(j) The increased role of regional coordination, which poses a challenge to efficiently utilize the facilities of regional organizations in assisting countries in their efforts towards international harmonization of their accounting and reporting systems with international requirements based on some common needs and development objectives.

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<sup>40</sup> For example, some of the pilot tests reflected contradictory views from participating major national stakeholders. In many cases in answering the same question on the assessment questionnaire, some agreed that a particular element of national regulatory or institutional settings met a specified requirement for high-quality corporate reporting, while others disagreed.

## Part Two: Financial reporting

### I. Laws and regulations governing corporate reporting: Romania

#### A. Introduction

Romania is an ex-communist country geographically located in Central and Eastern Europe, and has been a member of the European Union since 2007. After the communist period (1947–1989), Romania underwent a continuous reformation process of its financial reporting model, a process still taking place, although at a slower pace. Immediately after the fall of communism in December 1989, the country's political objective was accession to the European Union and, therefore, Western accounting systems were considered models for reforming the one of Romania. Financial reporting was and still is regulated by the State, through the Ministry of Public Finances. Similar to other European Union countries, all entities are subject to financial reporting regulations, not only listed ones. The Ministry of Public Finances is also responsible for tax rules. Therefore, a strong relationship between accounting and taxation can be detected in regulations and especially in practice, although the national regulator declares its will to work towards disconnecting the two.

The subsequent waves of reform of the financial reporting model influenced the manner in which such rules are established and applied today. The first stage of reform was based on the French model, characterized by detailed rules, a juridical approach and the mandatory use of a single chart of accounts. In the late 1990s, the urgent need to secure funds from the International Monetary Fund and to attract foreign investment led to a second stage of reform, based on the international accounting standards (IAS). The IAS, with a few exceptions but including the framework, were translated and included in the national regulations, along with some remainders of the French-based system, such as the chart of accounts. All large entities were required to apply these regulations between 2000 and 2005. Ultimately, and in order to prepare the country's European Union membership, new regulations were issued in 2005 under the third stage of reform, ensuring the enactment of the European directives. This is the general context in which the current Romanian model governing corporate reporting emerged.

#### B. The current national model governing corporate reporting

The legal requirements regarding the application of the International Financial Reporting Standards (IFRS) were issued in 2006 when the IFRS conformity regulation was issued, thereby enacting Regulation 1606/2002 of the European Council.<sup>41</sup> It specifies that listed groups and banking institutions must use IFRS as adopted by the European Union in their consolidated financial statements, starting in 2007.<sup>42</sup> The consolidated statements of non-listed entities and insurance companies or other public interest companies could be prepared in accordance either with endorsed IFRS or with the seventh European directive.

Starting in 2012, credit institutions must prepare their financial statements in accordance with IFRS, being the first and so far only types of entities being required to apply IFRS as their only reporting system, including their separate financial statements. Other types of entities must prepare statutory financial statements (individual) in accordance with the national regulations and, if it the case, make the necessary adjustments in order to prepare consolidated financial statements in accordance with IFRS. Also, entities authorized and supervised by the capital market regulator (ro. Comisia Națională a Valorilor Mobiliare (CNVM)), i.e. investment funds, are required to prepare for 2011 and 2012 a second set of financial statements under IFRS.

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<sup>41</sup> This regulation requires listed entities, including banks and insurance companies, to publish consolidated financial statements in accordance with IAS/IFRS. European Union members have the option of extending IFRS application to individual accounts and unlisted entities.

<sup>42</sup> The European Union adopts IFRS only after consideration of their provisions.



With regard to national accounting regulations, Accounting Law No. 82/1991 prescribes the main accounting obligations of businesses, while the details concerning its application are published through ministerial orders. All companies doing business in Romania are required to organize their accounting systems, including managerial accounting mostly in terms of cost calculations, and to publish financial statements. The Accounting Law is applicable to private companies, State companies, public institutions, non-profit organizations, other legal entities and individuals authorized to carry out independent activities. The Ministerial Order currently applicable, Order of the Minister of Public Finances No. 3055/2009 for the approval of accounting regulations in accordance with the European directives, is a 300-page document, which includes the format of financial statements to be prepared, the principles, the recognition and measurement rules, the chart of accounts to be used and the functioning rules of accounts and various other accompanying reports that need to publish, for example, on internal controls.

This Order has been applicable to entities of all sizes since 1 January 2010, with differing levels of disclosure based on size and public interest considerations. Size criteria established under the Order are total assets of €3,650,000, turnover of €7,300,000 and an average number of employees of 50 during the financial year. Entities that exceed two of the three size criteria for two consecutive financial years, as well as listed companies regardless of their size are required to prepare regular financial statements, which include a balance sheet, an income statement, a statement of changes in equity, a statement of cash flows and notes. The other entities are required to submit abridged financial statements, which include an abridged balance sheet, an income statement and notes. For these entities, the preparation of a statement of changes in equity and of a statement of cash flows is optional. Financial statements are always accompanied by the administrators' report, which provides comments on the activities of the entity, its financial position and a description of the main risks and uncertainties faced by the entity. The Order details the expected information that should be presented in this report.

In conclusion, in Romania, IFRS must be applied by some entities, being either mandated (mainly listed groups, banks and credit institutions) or applied on a voluntary basis (other public interest companies), but the main reporting system remains, especially for separate financial statements, based on the national regulations. Therefore, the capacity of producing high-quality corporate reports heavily depends on the characteristics of the national regulations as compared to IFRS.

### **C. Romania's capacity for producing high-quality corporate reports**

The 2011 UNCTAD questionnaire is considered in elaborating on the capacity of Romania for producing high-quality reports. Pillar A of this questionnaire addresses the issue of legal and regulatory frameworks, and the main issues included in the first indicator (A1: Financial reporting and disclosure) are employed to provide an analysis of the existing regulatory system in Romania.

With regard to the first questions of the questionnaire, Section B of this case study covers the requirements regarding the use of IFRS in Romania, and highlights some of the particularities of Romania as follows:

- (a) IFRS are required for listed entities in consolidated financial statements;
- (b) IFRS are required for banks beginning in 2012 with regard to individual and consolidated financial statements;
- (c) Entities authorized and supervised by the capital market regulator, i.e. investment funds, are required to prepare, for 2011 and 2012, a second set of financial statements under IFRS.

Other entities must use national regulations to prepare their financial reports. Therefore, the IFRS adoption process and the similarities and differences between national regulations and IFRS are very important. In terms of the regulatory process, there is no formal due process to translate IFRS, update national regulations following developments of IFRS or clarify or resolve doubts or

disagreements related to the implementation of accounting standards. Since the State is the main actor in the regulation process, the entire due process is minimized in importance.

Regulations in Romania share both many similarities and many differences with IFRS. The 2011 UNCTAD questionnaire comprises a checklist of 60 items for assessing the similarities and differences between IFRS and national regulations. An overview of the regulations in Romania leads to a value less than 0.5 for this question (the methodology implies a binary variable, where 1 is given for each item where there is compliance and 0 otherwise). This value indicates the progress of national regulations towards IFRS, but also suggests reforms to be achieved. Computing this value is difficult, because in many fields there is work in progress towards IFRS and a clear-cut yes or no answer regarding compliance is difficult to provide. Issues such as parts of the conceptual framework, accounting policies and options, leases, property, plants and equipment are taken from IFRS and included in national regulations. In some cases, the provisions in the national regulations are taken from IFRS before they were revised, for example, for borrowing costs in Romania there is the option of capitalizing the cost, similar to IAS23 on borrowing costs, before the revision of the standard in 2008. In other cases, the provisions are incomplete, for example, for impairment reference is made to the requirement to have impairment tests, but without any other details. Similarly, in the case of deferred income taxes, the regulator has only included in the regulations the appropriate accounts in the chart of accounts, without any other principles or rules. Consequently, entities cannot make use of them.

The next topic in the UNCTAD questionnaire concerns accounting for SMEs, and more precisely the comparability between national regulations and IFRS for SMEs. As previously mentioned, the current national regulations contain similar accounting rules for all types of entities, except for some disclosure requirements, in the sense that SMEs publish abridged financial statements. There are also similarities and differences between this regulation and IFRS for SMEs. The applicability of IFRS for SMEs in Romania is a sensitive issue, because as a member of the European Union, Romania has to comply with European requirements and directives.

In conclusion, financial reporting regulations in Romania demonstrate a strong orientation towards IFRS, but significant differences remain, and efforts should therefore be devoted to improvement of the quality of financial reporting. However, the manner in which regulations are applied relies on the institutional foundation of corporate reporting.

#### **D. The institutional foundation of corporate reporting**

The manner in which standards and regulations are applied in practice and the quality of financial reporting depend on the institutional foundation of corporate reporting, including how business is conducted, corporate governance practices, users and their expectations regarding accounting information, development of the accounting profession and the level of enforcement.

Romania is a code-law country, with a juridical system based on the French model and with an emphasis on rules. Economic developments, especially after 2000, have been associated with developments in accounting and management practices. Similar to the case of other emerging economies, international organizations such as the International Monetary Fund, OECD and World Bank played a significant role in reforming the accounting and management system. For example, Romania became engaged in a programme of developing corporate governance practices beginning in 2001, when OECD elaborated a strategy that included recommendations and guidelines. The Bucharest Stock Exchange accordingly adopted a corporate governance code in 2001. A new and improved code was issued in 2008 and has been applied by listed companies beginning in 2010. These companies are bound to observe the code and to file a comply-or-explain report in a special statement attached to annual reports.

However, these advancements in the regulatory system were not fully accompanied by developments of practices, as the literature documents. An empirical study on listed entities by Gîrbină et al. assessing their level of disclosure against the ISAR 2008 benchmark finds a reduced level of disclosure, a finding in line with the case of other emerging economies. Besides the lack of



transparency in some cases, issues of non-compliance were found. For example, some listed entities do not publish consolidated financial statements in accordance with IFRS, even if this is required by law. These empirical results highlight the reduced level of enforcement in Romania, but also the variations in the quality of accounting information published by various entities.

Consequently, having high-quality standards is not sufficient to ensure high-quality information. In the case of Romania, besides the issues of low enforcement and the inevitable need for education both for accountants and other actors in the business environment, users and their expectations play a role in the quality of the accounting information (World Bank, 2008). The main user of accounting information in Romania is the State and, consequently, there is a strong relationship, especially for cost reasons, between accounting and taxation. The other users of accounting information (investors, bankers, analysts, etc.) rarely make pressures for more qualitative accounting information. When this is the case, a second set of financial statements is prepared, in accordance with IFRS.

In conclusion, progress has been made in Romania towards improving the quality of corporate reports. The most recent improvements are visible in relation to the decision of applying only IFRS for both separate and consolidated financial statements for banks beginning in 2012, in requiring a second set of financial statements in accordance with IFRS for some public interest companies for 2011 and 2012 and in modernizing the national regulations in 2009 by eliminating some of the divergences with IFRS. However, there still is room for progress, because there are still divergences or differences between the national regulations and IFRS. Besides this strict comparison between IFRS and national regulations, improvements must be made in areas such as corporate governance practices, education, enforcement and compliance in order to improve the quality of corporate reports.

## **II. Laws and regulations governing corporate reporting: Turkey**

### **A. Introduction**

The economic policies pursued in Turkey in the 1960s and 1970s were heavily based on the protection of import substitution industries. Rather than focusing on economic development and stability, Governments chose to follow populist policies that eventually resulted in crises and high inflation, especially during the late 1970s. These structural problems led Turkey to change its development policy from an inward-looking one to a world market-oriented one. Beginning in 1980, Turkey undertook broad stabilization and structural reforms to open up isolated and uncompetitive industries to international competition, which led to structural changes in different fields of economic life.

The 1990s was an economically unstable decade. The first crisis was in 1994, which was followed by further crises in 1997, 1998 and 1999. During this decade, the inflation rate surpassed 100 per cent. Turkey was further hit by a severe economic crisis in February 2011. There was a 7.5 per cent contraction in GDP and inflation jumped. Economic growth recovered in the following years and inflation fell below 10 per cent beginning in 2004 (UNCTAD, 2007). On December 2004, the European Council decided that Turkey sufficiently fulfilled the so-called Copenhagen political criteria to open accession negotiations.. It is worth remembering that Turkey has been officially represented in most of Europe's institutions, such as the Council of Europe, NATO and OECD since 1945 (Yılmaz, 2008).

Turkey has had a booming economy in the last decade, reaching a US\$772 billion GDP in 2011, up from US\$230 billion in 2002. Per capita income in Turkey tripled, rising from US\$3,311 in 2002 to US\$10,444 in 2010. Turkey is the seventeenth largest economy in the world and seventh largest in Europe. Currently, Turkey is the fastest growing economy in Europe and one of the fastest growing economies in the world, with real GDP growth rates of 9.2 per cent in 2010 and 8.5 per cent in 2011. As one of the top 10 emerging markets, it is also a member of G20.

## **B. Overview of laws and regulations**

### **1. Financial reporting standards**

The aim of financial reporting regulations in Turkey has been to protect the interests of the treasury. The accounting practices for most non-traded companies and SMEs have been strongly influenced by the need to produce information for tax authorities (Cooke and Çürük, 1996). With the exception of regulated entities, including publicly held companies, there were minimal general requirements for the publication of financial information and, consequently, there was little demand for an independent financial statement audit performed by qualified professionals (World Bank, 2007). Though the country faced high inflation rates from the 1970s to the beginning of the 2000s, companies did not use inflation accounting and financial statements lost their information value. Nevertheless, Turkey has been improving its financial reporting practices in recent years and further reforms are expected in upcoming years.

Being a candidate for the European Union and a member of the Basel Committee and IOSCO, Turkey began to comply with IFRS earlier. Financial institutions began as of 31 December 2002 and listed companies as of 31 December 2004. Without mentioning the level of compliance, one study reported that Turkey has been among the countries where IFRS have been entirely implemented since 2005 (Barth, 2007).

The most influential institutions affecting the development of International Financial Reporting Standards in Turkey are the Istanbul University Institute of Accounting, Expert Accountants Association of Turkey (EAAT-TMUD), Capital Market Board of Turkey (CMB-SPK), Accounting and Auditing Standards Board of Turkey (TMUDESK), Banking Regulation and Supervising Agency (BRSA-BDDK) and Accounting Standards Board of Turkey (TASB-TMSK).

The Institute of Accounting, Istanbul University, translated the published international accounting standards to Turkish and published them in its official journal from inception to 1992. The TMUD compiled all IAS translated and published by the Institute of Accounting in a book and published it in 1992. The TMUD was one of the founding members of the IFAC. However, the translated and published international accounting standards were not implemented or enforced by any authority since neither the TMUD nor the Institute were powerful organizations (Yılmaz and Selvi, 2004).

The forceful implementation of financial reporting standards came with the establishment of SPK, which was empowered by the capital markets law enacted in 1981. The SPK was based on the SEC in the United States and has extensive powers, including specifying accounting standards for companies. The listed companies in the Istanbul Stock Exchange (ISE) have begun to use accounting and reporting standards set by the Board. The Board issued in 2003 a broad set of financial reporting standards that are mostly compatible with IAS and IFRS. These standards became effective for listed companies from the beginning of 2005.

The BDDK, which was established in 2000 after the banking crisis in Turkey, is another regulatory body that set accounting standards for banks and financial institutions. The standards issued by BDDK in 2002 were compatible with IAS and IFRS.

The TMSK was established in 2002 by a legal regulation of Law No. 4487. The TMSK had legal power for setting Financial Reporting Standards of Turkey (TFRS) and sanctions for all corporations in Turkey. The TMSK translated the complete set of IAS and IFRS and published the translation by declaring them as the TFRS in April 2006. In addition, TMSK has been translating IFRS for SMEs as an ongoing process.

All of the accounting standards published by these different regulators were similar in nature. However, a harmonization of accounting standards within the country was needed. For this purpose, BDDK abolished its accounting standards by issuing a regulation in 2006. The SPK also abolished its accounting standards by issuing a communiqué in 2008. The TMSK became the only organization that published accounting standards, which are fully compatible with IFRS.

Until recently, there was no pressure on unlisted companies of Turkey to make publicly available comparable financial statements, because most businesses are family owned. According to the new Commercial Code of Turkey, which will come into force in July 2012, companies will be responsible for the preparation of financial statements in conformity with TFRS, which are identical to IFRS. Besides this, the new code requires all companies, including SMEs, to employ TFRS. This was a major move of the Government of Turkey towards a complete adoption of IFRS for both listed and unlisted companies.

## **2. Non-financial reporting codes and standards**

Since companies began to be aware that interest groups are interested not only in financial performance but in social, environmental and governance activities as well, they have begun to provide this type of information in their annual reports and on their websites, or they prefer to publish these reports separately.

In July 2003, SPK issued corporate governance principles of Turkey with the purpose of enhancing the corporate governance regulations for listed companies. The SPK principles were established mainly in accordance with OECD principles. Parallel to OECD, the SPK corporate governance principles were revised in 2005. Implementation of the principles is optional and companies should disclose the extent of compliance in a corporate governance compliance report and explain the reasons why some of the principles are not adopted (Needles et al., 2012). In addition, the ISE corporate governance index was founded in August 2007. As of November 2011, there were 34 companies listed on this index (Public Disclosure Platform of Turkey). The corporate governance rating of a company is granted by rating institutions upon the request of a company. Similar to corporate governance principles, corporate governance rating reports include four main sections, namely shareholders, public disclosure and transparency, stakeholders and board of directors.

The use of the Internet for non-financial reporting was mostly voluntary in Turkey. The SPK made it mandatory for public companies with a website to make annual reports, annual and interim financial statements and audit reports publicly available in an easily accessible manner for a period of at least five years (SPK Directive series XI, No. 29). Hence, there is still no guidance, recommendations or regulations regarding the scale and scope of non-financial disclosures for either listed or unlisted companies in Turkey. As a result, there is a disparity of Internet reporting among companies. Some companies prefer to disclose limited financial information, while others provide full sets of financial and non-financial information in a user-friendly manner (Türel, 2010). In order to improve transparency, the new commerce code of Turkey requires every capital stock company, including unlisted ones, to have a website, which should include all reports and relevant data concerning shareholders and stakeholders.

## **3. Auditing standards**

Independent auditing in Turkey began with the establishment of SPK in 1982, which developed its own standards of external auditing for companies listed on the ISE. The SPK issued some additional regulations in the area of independent auditing after the global scandals in the United States and European Union. The SPK regulations have some similarities to the Sarbanes-Oxley Act, such as restricting other services from auditing activities, a compulsory rotation period for audit partners and a requirement for an internal audit committee.

In 2006, a communiqué on independent auditing standards in the capital market was prepared by SPK in accordance with International Standards on Auditing (ISAs). According to the SPK regulations, in order to audit listed companies, auditors must be a certified public accountant or sworn-in certified public accountant and also have an independent auditing in capital markets licence.

The new commerce law introduces a fundamental change in the auditing of equity capital companies. According to the new code, all capital stock companies are required to be audited by

statutory auditors. New audits will be conducted by an auditor who is an expert, professionally competent and technically equipped. In addition, audits are required to be performed in accordance with the auditing standards of Turkey, which are identical to ISAs (PWC, 2011).

#### **4. Professional qualifications**

The provision of accountancy services in Turkey predates the formation of the Expert Accountants Association of Turkey in 1942. However, the forceful implementation of professional and ethical standards came with legal recognition of the independent accountancy profession through codification of Law No. 3568 in 1989. This Law gives legal recognition to the accountancy profession, establishes qualification requirements and regulates the organizational structure of the profession. The law also establishes accounting and auditing as a profession and defines those who render services in these fields as professionals. The Law creates and defines two categories of accounting and auditing professionals – certified public accountant and sworn-in certified public accountant – with different educational requirements for licensing and specific allowed activities.

### **C. Institutions supporting the implementation and enforcement of laws and regulations in Turkey**

#### **1. Capital Market Board of Turkey**

The capital markets law of 1981 established the Capital Market Board of Turkey (SPK), with powers to regulate companies listed on the Istanbul Stock Exchange, other companies that have more than 250 shareholders, mutual investment funds and financial intermediaries. The mission of SPK is to make regulations and perform supervision with the aim of ensuring fairness, efficiency and transparency in capital markets of Turkey and improve their international competitiveness. The SPK, which was empowered by the capital market law in 1981, is the regulatory and supervisory authority in charge of securities markets. For the last three decades, the SPK has made detailed regulations for organizing the markets and developing capital market instruments and institutions in Turkey.

#### **2. Stock exchanges**

The Istanbul Stock Exchange, which is the only securities exchange in Turkey, was established in 1986 for the purpose of ensuring that securities are traded in a secure and stable environment. The economy of Turkey has been an emerging one during the last decades, as has the capital market of Turkey. The total number of companies listed on the ISE was 374 as of March 2012 and the shares of foreign or international investors represented more than 60 per cent for the last five years. The total trading volume of the ISE stock market increased to US\$425.7 billion and total market values of the companies reached US\$350 million in 2010 (available at <http://www.ise.org>). At present, there are no foreign companies listed on the Istanbul Stock Exchange. A positive approach from regulators and the application of IFRS and ISAs contribute to making Turkey an attractive market for investors, as well as the fact that it is a dynamic country with a young population, talented work force, strategic location and excellent trade networks.

#### **3. Professional accountancy organizations**

The Union of Chambers of Certified Public Accountants and Sworn-in Certified Public Accountants of Turkey, TÜRMOB, which was founded in 1989, is the national professional body with the sole authority to award professional licences. The TÜRMOB is a member of IFAC and a well-resourced professional organization.

The TÜRMOB is the national umbrella organization for the local chambers and the organizational structure of TÜRMOB is supported by two distinct chambers, the Chamber of Certified Public Accountants (SMMM) and Chamber of Sworn-in Certified Public Accountants (YMM).

In order to fulfil its duties, such as development of the profession, protection of interests of its members and preservation of professional ethics and order, the Union carries out comprehensive

efforts in areas such as the awarding of licences, practical training, examinations, standard setting, quality control, application and enforcement of professional standards, professional rules and regulations, publications and continuous professional education.

#### **4. Audit public oversight boards**

Until recently, the Capital Market Board (SPK) had the authority to regulate the establishment requirements and operating principles for independent auditing firms and also regulate the standards for financial statements to be prepared by reporting entities and determine the principles for their auditing and announcement procedures. However, on 2 December 2011, Government Decree No. 660 was enacted, and the Public Interest, Accounting and Auditing Standards Board (PIAASB) was established in Turkey.

The decree law compiles the authority and responsibility of independent auditing and accounting, which used to be diversified between SPK and BDDK. According to the decree law, the Accounting Standard Board of Turkey was abolished as of November 2011 and authority to regulate financial reporting standards and auditing standards was delegated to PIAASB. Moreover, the decree law specifies that PIAASB will be the one to authorize the independent audit firms and publish the list of those that have licences. Furthermore, the decree law grants PIAASB authority to supervise and oversee the practices of audit firms and suspend or cancel the licences of auditing firms whose audit work is found inappropriate in inspections.

Furthermore, the responsibility and authority to set examinations and award licences for independent auditing, determine professional ethics codes and continuous education standards and establish quality control systems were given to PIAASB with the enactment of Decree Law No. 660.

#### **D. Conclusion**

The new commerce code will modernize the statutory regulation of company financial reporting and will set a major challenge for the accounting and auditing profession in Turkey through the requirement to apply financial reporting standards of Turkey based on IFRS and audits based on IAS.

The accounting managers of publicly owned companies are already familiar with IFRS based standards. However, most accounting managers of family-owned businesses and SMEs have not used such standards before. Once the new commercial code is in effect and companies begin to use IFRS, managers in family-owned companies and SMEs will be in extremely difficult positions with respect to preparing financial statements, not to mention that 90 per cent of enterprises and 94.1 per cent of SMEs in Turkey are family firms relying on private sources of finance rather than capital markets (Çalışkan, 2008). In addition, the transition programme from tax code-based accounting to IFRS for SMEs and family-owned firms has not yet been determined. It is not clear whether SMEs will use full IFRS or IFRS for SMEs.



# Part Three: Non-financial reporting

## I. Goals and perspectives in the society of Romania of the third millennium

### A. Introduction

Whether we like it or not, we are all born on this planet, being part of the great human family, and each one of us has the same right to live in a clean environment and to be healthy, while having the mission to leave behind a legacy untainted by own actions. In this context, the business community acknowledges and gradually accepts the need to implement a social and environmental policy. Environmental protection is no longer considered an area reserved exclusively for Government and community, but rather the common responsibility of several interest groups; companies, financial institutions, managers, creditors, contractors, customers and the public. Financial consequences, Environmental responsibilities and the risk of destroying a company's reputation are good reasons to adopt standards of ethical responsibility and environmental protection in each company. Civil society requires in turn to be consulted by industry actors, and organizations are more often asked to make public their standards of ethical conduct and the financial statements or market values. Certain industrial sectors are particularly sensitive to public opinion, in a world where communication is global and instantaneous.

This chapter will highlight the issues that contribute to form an image of the level of non-financial reporting in Romania, from the regulated issues (identified in the national legislation), to levels of responsibility and social and environmental involvement (specific to the initiatives adopted by non-governmental bodies) to private practices of reporting, highlighting the perception of economic entities to ensure the transparency and credibility of the information presented. The chapter will further present the research methodology, highlight the issues previously mentioned on non-financial reporting and conclude with discussions on the non-financial reporting environment in Romania, with an attempt to design a possible evolution of the area of non-financial reporting.

### B. The research methodology

Reporting of financial and accounting information is a current issue in the theory and practice of accounting. Considering the goals of financial reporting, a discussion about the accounting systems of reference, the Continental accounting system and the Anglo-Saxon accounting system, appears inevitable. Romania, a Latin country, based on the Roman law system, has an orientation in accounting theory and practice (at least in terms of normalization) of Continental origin. Thus appears the need for insights into the steps taken by governmental bodies regarding financial reporting regulations, a quantitative and qualitative analysis of the texts and papers that form the legal language of the accounting normalization in Romania, hoping to discover the issues related to non-financial reporting.

The perspective towards something new and the globalization of markets, especially the financial one, have brought a need for economic operators to belong to common reference systems, the need for comparability and the need of unification. This made possible the application at the level of economic entities, in addition to national and international regulations and the international reference system (IAS/IFRS).

Civil society is more than ever responsible and it is launching initiatives for the interest of both the State and economic agents in carrying out activities made less dominantly then the dictum "profit at any cost". Here is the key to sustainable repositioning, here is the foundation of building a responsible society and, practically, here is the essence of non-financial reporting. Economic operators begin to see social responsibility in a new way, begin to approach their local communities (basically behaving as a part of them), are effective in environmental protection and make these concerns known for better management of the potential sources of investment.

## **C. Institutional regulation of accounting in Romania and non-financial reporting**

### **1. Ministry of Finance**

Accounting activity in Romania is regulated by Order No. 3055/2009 issued by the Minister of Finance for the approval of accounting regulations in accordance with European directives and republished Accounting Law No. 82/1991. Law No. 82/1991 is a document regulating the organization of accounting activity, while Order No. 3055/2009 regulates financial reporting in Romania and will therefore be the main source of information in this case study. The first part of this order is dedicated to the application of accounting regulations in accordance with Directive IV of the European Economic Community. Paragraph 5, article 305, section 10 on the content of the managers' report, chapter II on the format and content of annual financial statements states: "The extent to which it is necessary to understand the development of the entity, its performance or financial position, the analysis includes financial indicators when appropriate, key non-financial indicators of performance, relevant to specific activities, including information about environmental issues and employees."

Point (1)(k) of article 307 in the same section provides information on corporate governance and point (2) strengthens the aspect of corporate governance, stating that "also, an entity whose securities are admitted to trading on a regulated market, as it is defined in the legislation regarding the capital market, it will include in the same section related to corporate governance a statement which shall include at least the following information: (a) a reference to: (i) the corporate governance code that applies to the entity and/or corporate governance code which the entity has decided to apply voluntarily. The entity shall indicate provisions which are publicly available; and/or (ii) all relevant information on corporate governance practices applied in addition to the requirements of national legislation. In this case, the entity shall make publicly available its corporate governance practices; (b) the extent to which, according to the national legislation, the entity is distant from the code of corporate governance that applies to it or that it chose to apply, an explanation of it regarding the parts of code that it does not apply and the reasons for not applying them."

Note 8 on information on employees and members of administrative, management and supervision bodies of section 5 on examples to illustrate the explanatory notes to the annual financial statements, chapter VI on the structure of annual financial statements shall be mentioned as follows:

- (a) indemnities given to the members of the administrative, management and supervision bodies;
- (b) contractual obligations relating to the payment of pensions to former members of the administrative, management and supervision bodies, indicating the total amount of commitments for each category;
- (c) the amount of advances and loans to members of administrative, management and supervision bodies during the year:
  - (i) the interest rate;
  - (ii) the main provisions of the loan;
  - (iii) the repayment by the date;
  - (iv) future obligations such as guarantees assumed by the entity on their behalf;
- (d) employees:
  - (i) average number, the breakdown for each category;
  - (ii) wages paid or payable for the year;
  - (iii) expenses for social security;
  - (iv) other expenses for pension contributions.

## **2. National Securities Commission**

With regard to institutional regulations, it should be noted that at the level of the capital market in Romania, activity is conducted by the Bucharest Stock Exchange (BSE) and carefully monitored by the National Securities Commission (Rom. CNVM). Law No. 297/2004 on capital markets regulates this domain of activity. Sections from chapter V on the transparency of issuers, of title VI on issuers, call into question many aspects of non-financial reporting (section 1 on obligations of companies whose shares are admitted to trading on a regulated market, section 2 on obligations of companies whose bonds are admitted to trading on a regulated market and section 3 on obligations of public authorities and international bodies that issue securities). In chapter VI on special provisions regarding companies admitted to trading, of the same title, there are many aspects related to corporate governance, in addition to those covered by republished Law No. 31/1990 on companies law. Corporate governance issues raised by the two legal texts show that things are progressing, that non-financial information has its role in assessing the performance and activities of economic entities and that Romania is on a good track in terms of alignment with the latest practices in the domain of non-financial reporting.

## **3. Bucharest Stock Exchange**

Regulation No. 6/2009 of BSE regarding the exercise of certain rights of shareholders in general meetings of companies, as evidenced by its title, strengthens the position and rights of shareholders. The regulation implements the provisions of Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies. When referring to BSE, in its strategy on corporate governance, the guidelines for implementing the corporate governance code (March 2010) in recommendation 25 state that “the company makes continuous and periodic reports on financial statements and other relevant information on the activity of the company”, basically leaving the gate open to non-financial information. Recommendation 36 states: “The company disseminates information on its corporate governance policy, implicitly to apply the recommendations/not to apply this code, according to the principle apply or explain.” The compliance statement on the corporate governance code that each listed entity must complete presents the following request: “Does the issuer perform activities on social and environmental responsibility of the company?”

In the Corporate Governance Code of BSE, article 1 on structures of corporate governance, under the auspices of principle 1 that “issuers will adopt clear and transparent structures of corporate governance that will be adequately disclosed to the general public”, recommendation 3 states: “In the annual report, issuers will provide a chapter on corporate governance in which it will be described all relevant events related to corporate governance registered during the previous financial year. If the company will not implement totally or partially one or more of the recommendations contained in this code, it will explain its decision in chapter GC of the report or annually, as well as in the statement or apply or explain.” This is an extremely important aspect because non-financial reporting gains the importance it deserves. In the same document, in article 7 on transparency, financial reporting, internal control and risk management, under the auspices of principles 12 (“the structures of corporate governance established by issuers must ensure an adequate and continuous periodic report on all important events concerning the issuer, including its financial statement, performance, ownership and management”) and 13 (“the Board of Directors will adopt strict rules, meant to protect the interests of the society, in areas of financial reporting, internal control and risk management”), recommendation 25 states: “Issuers will prepare and disseminate relevant periodic and continuous information, in accordance with the highest standards of financial reporting – International Financial Reporting Standards (IFRS) – and other reporting standards, i.e. environmental, social and management (environment, social and governance (ESG)). Information will be disseminated both in Romanian and in English, as international language in finance”.

In article 10 on the social responsibility of the issuer, under the auspices of principle 18 (“The structures of corporate governance must know and recognize the legal rights of any interested third party – the stakeholders – and to encourage the cooperation between the issuer and these ones in



order to create prosperity, jobs and to ensure sustainability of a solid company, from a financial point of view”), recommendation 37 states: “The issuers will make all efforts to integrate into their operational activities and in their interaction with the interested third party – the stakeholders – some economic, social and environmental concerns” and recommendation 38 states: “The issuers will supervise the increase of the employees’ level of involvement, their representatives and trade unions and interested people outside the company – creditors, consumers and investors – in the development and implementation of practices of social responsibility of the company.”

#### **4. BSE and corporate social responsibility: The code of conduct of BSE**

The Bucharest Stock Exchange has embraced the spirit of corporate responsibility in its strategy to meet the challenges of the educational, social and cultural sectors. Social responsibility is an important part of the philosophy of the Bucharest Stock Exchange and extending this belief to the level of each company and institution in Romania, it states that it shall, in addition to the continuous improvement of products and services, get involved with a sense of responsibility in solving the problems of the community and act responsibly towards the society in which it operates. The BSE has prioritized its corporate responsibility policy in three areas regarding education, talent support and volunteering.

In the spirit of promoting and enhancing a sense of social responsibility, the Bucharest Stock Exchange has set the following objectives:

- (a) development among employees and management of a culture of social responsibility to the company and brand on the one hand and to the problems around the company on the other hand, as well as the creation of a sense of social responsibility among participants on the market;
- (b) expansion and strengthening of the CSR BSE programme at the level of the BSE Group;
- (c) development of medium- and long-term partnerships for the purpose of leading corporate programmes in the direction provided in the social responsibility policy.

#### **D. Non-financial reporting a current concern for civil society: Social initiatives to ensure and strengthen a sustainable environment**

##### **1. Green Revolution Association**

Founded in March 2009, the Green Revolution Association is the first non-governmental organization on urban ecology in Romania. Green Revolution promotes and implements the following green measures underlying the construction of an “eco-city”: urban design; spatial planning; local policy reform; control of activities with an environmental impact. The goal of this association is to build a sustainable and healthy community from a social perspective that generates economically viable solutions. Green Revolution promotes and supports the following:

- (a) Legislative environmental projects;
- (b) Adoption of environmentally responsible behaviour by authorities and private and State companies;
- (c) Protection and expansion of green areas inside and outside cities;
- (d) Decrease in consumption of energy and raw materials;
- (e) Environmental education and respect for the environment;
- (f) The separate collection of packaging waste;
- (g) Ecologic and economic solutions and means of transport;

- (h) Use of bicycles as an alternative means of transportation and creating dedicated lanes for cyclists;
- (i) Organic products and healthy food;
- (j) “Eco” solutions and equipment intended for mass consumption;
- (k) Green buildings.

In two years of existence, the Green Revolution Association has shown that the imagination, energy and enthusiasm of a young team are able to develop local and national projects, including the campaigns Capital Grows Green, Green Parliament and Law 132 Public Institutions, proposal of the Barbecue Law, Green Business Index project, the conferences Romania on the Road to Copenhagen, Romania and Climate Change and Romania Between Copenhagen and Cancun, the multiannual projects of bicycle sharing La Pedale, I’Velo, StudentObike, Bikes With Tie and Law 132/2010.

## **2. Green Business Index**

The GBI, companies’ barometer of responsibility towards the environment in Romania, is a project that monitors the green initiatives of the business sector in Romania. In its third edition, the Green Business Index is the only free tool to evaluate companies’ responsibility towards the environment in Romania. It also provides assistance and training to improve their environmental performance. The project is based on environmental performance indicators that are internationally recognized, ISO 14031, ISO 26000 and ISO 16001, and it is developed with the support of a team of senior experts. The Green Business Index is supported by strategic partners with relevant expertise in environmental protection and in sustainable development, the Institute of National Economy and the Faculty of Transport, Bucharest Polytechnic University.

Based on the two largest sectors of the economy of Romania, industry/manufacturing and services/trade, GBI evaluates the environmental responsibility of companies in the following areas of analysis: sustainable development; environmental impact; sustainable transport; use of resources; state of buildings; green purchasing; management of waste. The GBI has a triple functionality. First, it is designed for companies as a support and training tool for improving environmental performance. Second, for authorities, its role is to encourage environmental protection by law, on macro- and microeconomic levels. Third, for the media and public, GBI is a means of sustainability reporting in Romania.

The 2011 edition of the GBI revealed that the incorporation of sustainable development in the policies and processes of a company involves the refinement of management systems, practices and procedures. To ensure that the sustainable development strategy is implemented, managers must conduct constant monitoring of environmental performances. According to article 94 (1)(d) of OUG No. 195/2005 on environmental protection, operating companies with a significant environmental impact are required to organize their own structures that are specialized for the protection of the environment. According to a Green Business Index survey, 67 per cent of surveyed companies stated that under the law they must have a sustainable development strategy and support staff for environmental management, safety and occupational health and that they comply with their duties in this respect. Only 8 per cent of the companies included in the GBI this year stated that they had already implemented a sustainable development strategy although they are not legally required to do so. On their own initiative, 15 per cent of surveyed companies plan to implement such a strategy. The remaining 10 per cent of surveyed companies are not required to have a sustainable development strategy and did not express their intention to implement such a plan.

### **3. Forum for International Communications Foundation: CSR Romania programme**

CSR Romania is a long-term programme that aims to promote the concept of corporate social responsibility and all that it entails, including good business practices, ethical standards that function as a landmark in relations between companies and society and ethical responsibilities of managers and shareholders towards communities, consumers and environment. The CSR Romania Programme began in March 2006. In October 2006, the programme expanded with the launch of a section on ethics and business communication. The programme involves the organization of debates that aim to bring together Romanian and foreign managers and specialists to identify ethical issues in the business environment of Romania.

This non-governmental organization has conducted research on the business environment in Romania with the aim of learning the opinions of businesspersons regarding two of the most controversial issues in the CSR domain, transparency in policies of corporate responsibility and the credibility of companies that carry out social programmes. The idea that the research was conceived and carried out will be presented, emphasizing the quantitative approach, in order to be able to reach a certain level of non-financial reporting among economic entities. The criteria that define transparency are found in 19 questions. The questions addressed issues of social and environmental audits (social auditing and areas covered by the audits), social reporting (publication of reports, their credibility and target groups in the report), the code of ethics (existence of the code of ethics and its publication) and social investments (evaluation and publication of evaluation results, evaluation methods used, areas of social investment and investment target groups). The survey was conducted from February 19 to March 2. The study was conducted online, on 250 business representatives involved in CSR. The research had two stages, the first one quantitative and the second qualitative; the latter analysed the answers to a set of questions from respondents to the survey.

Fifty-five businesspersons answered the questionnaire; the response rate was 22 per cent. Sixty-one per cent of respondents stated that their companies are not socially audited and do not publish social reports. According to the results, 24 per cent of companies are socially audited. Multinational companies prevail among socially audited companies. The companies that are not socially audited operate in the industries of alcoholic beverages, banking, pharmaceuticals, software, telecommunications and energy. Almost half of unaudited companies are multinational companies. It may be noted that, although they deal with CSR, 14.8 per cent of businesspersons stated that they do not know whether the companies where they work are socially audited. A significant percentage of respondents – 37 per cent – stated that their companies publish social reports. However, most of these companies do not have social reports published on websites. Among respondents, 16.7 per cent of businesspersons have not heard of companies in Romania that report socially, 11 per cent stated that the social reports of companies are not credible and 53.7 per cent stated that they find the social reports credible. Businesspersons consider that the main issues that must be taken into account by a social audit are related, in order of importance, to relations with local communities (77.8 per cent), rights and working conditions of employees (74 per cent), consumers (66.7 per cent) and the environment (66.7 per cent). Respondents argued that recycling, decrease in energy consumption and prevention of water and soil contamination are the main environmental issues that their companies should be concerned about.

A large proportion of businesspersons – 76 per cent – stated that their companies have ethical codes. Also, the main ways in which organizations promote their ethical codes are internal communication channels (74 per cent), training (46 per cent) and a corporate website (43 per cent). According to the research, ethical codes are addressed primarily to employees and unions (81 per cent), corporate customers (46 per cent) and shareholders (41 per cent). 87 per cent of respondents stated that their company invests socially. An even higher percentage of businesspersons – 93 per cent – believe that the organizations for which they work should invest in community issues. By contrast, 35 per cent of respondents admitted that their company does not evaluate social investment programmes. The main methods for evaluating social investments are, in order of importance, the invested budget (70 per cent), newspaper articles (55.6 per cent) and reports of NGO partners in social projects (48 per cent). The areas of social investment preferred by

companies are training and professional development opportunities for employees (94 per cent), education (70 per cent), working conditions for employees (69 per cent) and culture and art (63 per cent). Finally, the social investment areas preferred by employees are training and professional development opportunities for employees (69 per cent), education (69 per cent) and working conditions for employees (63 per cent).

This study shows that changes are taking place, that there is concern from the economic entities' side, that there are models and that there is concern from the civil society to monitor the activity of the economic entities.

## **E. Non-financial reporting: the link that makes possible a complete report at the level of economic entities**

This section aims to illustrate the non-financial reporting state reached by economic entities in Romania by following the reports published on their websites and highlighting issues of concern. The case study will try to outline whether the measures imposed by the law brought into question in the first section generate results and whether economic entities act to fulfil these new dimensions of reporting and how they do so. The websites of some of the most representative and popular economic entities that operate in Romania were accessed.

### **1. Coca-Cola**

Worldwide, the Coca-Cola Hellenic Group is recognized for the way it reports its economic, social and environmental performances. Its CSR reports include information about activities in Romania and are available on the Group's website. Since 2003, these reports have been in accordance with the Global Reporting Initiative (GRI) standard. In 2005, Coca-Cola Hellenic joined the United Nations Global Compact, pledging to respect the 10 principles of the organization. Since then, the quality of its reports has been recognized by the United Nations Global Compact every year by their inclusion in the list of notable Communications on Progress (COPs). Since 2000, the company has been listed on the FTSE4Good index, and since 2008 on the Dow Jones Sustainability Index. In Romania, as well as internationally, the company promotes social responsibility by investing in four directions: work (employees' improvement); market (consumers' health); community; environment (conservation and protection of water resources, energy and climate protection and recovery and recycling of packaging).

### **2. Commercial Bank of Romania**

For the Commercial Bank of Romania (BCR), long-term investments are important in areas that directly contribute to the healthy development of the community. Therefore, the bank develops community projects, especially in areas such as education (especially financial education), entrepreneurship and social. Also, secondarily, the bank is involved in areas such as culture, media and sport. The BCR CSR initiatives are coordinated by the Department of Community Relations. It also runs the analysis and selection process of sponsorship applications coming from outside. The BCR is attempting to put its employees' volunteering at the centre of all CSR initiatives. The ambition of the bank is to turn each colleague into a messenger of BCR's involvement in community life. Every year, hundreds of the bank's volunteers deliver financial education in schools, provide entrepreneurial advice for students (e.g. "START! Business"), are involved in planting activities (e.g. "The BCR Orchard") or contribute through various donations to programmes for the benefit of disadvantaged persons (e.g. "The Food Bank"). A major objective of the BCR is to help young people understand the principles of healthy management of money that they have at present and especially money that they will earn in the future as responsible adults. Among the most popular programmes of the bank in financial education are "My Finances" (addressed to high school students) and "The School of Money" (addressed to the public). The BCR is part of the international financial group Erste Group, whose majority shareholder is the ERSTE Foundation. Therefore, social solidarity is part of the core values of the bank's business model. Every year, BCR is involved in dozens of charitable projects to help certain disadvantaged groups. Among others, BCR is a strategic partner of the NGO Save the Children Romania, and

more than 2,500 disadvantaged children in educational centres of the organization benefit from financial support. Another well-known example is the educational project “BCR Hopes”. The report BCR: Good CSR 2009 was produced as part of the Good CSR 2009 regional programme, organized by the Braun and Partners agency. The BCR Report was awarded the prize for the best short report of Romania at the “Good CSR” gala held in November 2009 in Budapest.

### **3. Dacia Groupe Renault**

Dacia was founded in 1966 in Colibasi, Arges county, and was the brand around which the automotive industry in Romania was created and developed. From the start, there were close ties of cooperation between Dacia and Renault, as the French manufacturer was at the origin of the automotive industry in Romania. On 2 July 1999, Dacia became a brand of Renault Group by signing a privatization contract with the company. Following an investment of €489 million, the factory in Pitesti reached the highest European standards, with working methods applied at the Renault Group factories. Dacia is in pursuit of sustainable development, which refers to three dimensions, economic, environmental and social. “We started to rebuild and sustain the economic dimension: in 2005, with over 170,000 produced and ordered vehicles and with a turnover of €1.2 billion, Dacia was again a profitable company and an important vector of the economic development. Our environmental concerns have resulted in bringing the factory in Pitesti at the appropriate level of quality and in obtaining the ISO 14001 certification. With regard to the social domain, we did not want to focus our actions within the company, but we decided to make Dacia a society open to the outside, to interfere in matters of Romanian society and to help solve them.”

The analysis concludes here as, though the subject has not been treated substantially, an overview with significant examples has been provided. Further examples, results and a readjustment of individual consciences in the interest of the values and goals of contemporary society are required.

## **F. Conclusion**

This case study emphasizes that reporting, at the level of economic entities in Romania, is in a new era, of completing financial information with non-financial information, of completing the conceptual framework of financial reporting with the corporate governance framework and of translating the concern and responsibility of companies for profit to corporate social responsibility.

The three steps presented in this case study’s approach reveal the existence of regulations that enable non-financial reporting, the careful monitoring of non-governmental bodies, of the responsible practices and actions undertaken and reported by economic entities and, further, that each economic entity develops and reports according to rules and ideas that they individualize and rank in the landscape of the economic, social and business environment. Therefore, the case study attempted to illustrate in as varied a manner as possible, from institutional regulation to the actions taken by economic entities, under the close supervision of civil society through non-governmental organizations, in order to give a correct image of the area of non-financial reporting in Romania.

Beyond the ethical arguments, the reporting of non-financial aspects (the socially responsible behaviour of economic entities) has become a major competitive advantage. The adoption of CSR practices will increase as companies understand their importance in order to reach the objectives of business. This case study, without claiming to be complete, is a reference point, which will certainly improve over time, based on feedback provided by the local market and by international developments.

It is interesting to emphasize that the aspect of the regulation of non-financial reporting in Romania is not meant to limit the companies’ own possibilities, as evidenced by the three cases presented, on Coca-Cola, BCR and Dacia. The commercial entities are able to achieve this reporting according to their own visions, in agreement with the information needs expressed by various categories of users of the information reported.



## II. Corporate climate change-related reporting codes and standards

### A. Introduction

The multifaceted, multidisciplinary nature of climate change and its social, ecological, ethical and economic consequences demand complex policy decisions, private sector investment and active business strategies to adapt to changing environmental and market conditions. Worldwide, policymakers and others are responding to these challenges by introducing a range of measures and initiatives on greenhouse gas measurement and reduction, carbon trading, carbon taxation, risk management, governance, biodiversity protection, energy security and so on. To the extent that they apply to business organizations, the majority of these measures, whether designed to advance scientific, political, market-based, financial, social or environmental solutions to climate change, require some form of corporate reporting activity.

Climate change-related disclosure represents an evolution of reporting from the introduction of formal financial reporting in the 1960s. The gradual progress of corporate governance and environmental and social information over time has led to the development of connected or integrated reporting of financial and non-financial information in more recent times. The link between economic activity and the accumulation of greenhouse gas emissions in the atmosphere and the effect of pronouncements such as the Stern Review has brought climate change into economic activity and policymaking, as measures of stability and success beyond gross domestic product are formulated.

The increasing pressure business organizations face publically to disclose climate change-related information reflects the growing view that, together with the requirement to maximize shareholder value, they must also optimize human, natural and social capital, as well as supporting policy targets on energy and greenhouse gas emissions. Reporting is essential for the monitoring, by capital markets, policymakers and others, of corporate activity, and assessing their performance for the purpose of determining how to allocate resources.

### B. Institutions developing corporate climate change-related reporting requirements

The range of institutions involved in the development of corporate climate change-related reporting requirements reflects the multifaceted nature of the challenges presented by climate change and the variety of governmental, inter-governmental and non-governmental institutions with an interest in managing these challenges. Provisions that affect climate change-related disclosure can be introduced by securities, financial, environment, energy and corporate governance regulators, government agencies, policymakers, standard setters, stock exchanges, non-governmental organizations, investor and industry groups, indices and so on.

The type of organization involved varies from country to country as does the type of provision concerned. Institutions that introduce climate change-related disclosure provisions often focus on a particular aspect of information, such as the way in which climate change is governed within business organizations, the financial risks that climate change poses, quantitative details of greenhouse gases emitted to the atmosphere and so on. At the time of writing, there is no international coordination of activity to set requirements on different aspects of climate change-related reporting.

### C. Types of provisions requiring climate change-related reporting

In the absence of a single body of law or a single type of regulator responsible for climate change-related reporting, provisions take different forms, including the following:

- (a) Legal requirements, also referred to as mandatory or statutory requirements or provisions;
- (b) Standards, protocols, codes, principles, guidance, etc. such as the following:

- (i) developed through rigorous due process and stakeholder engagement;
  - (ii) referenced in legislation as representing the approach that should be taken to comply with legal requirements;
  - (iii) that have become so widely adopted as to constitute de facto standards;
- (c) Government-sponsored guidance prepared by government departments, which, while not representing legal requirements, provide authoritative guidance on how to comply with legal requirements or are designed to encourage practices and behaviours that support policy objectives.

Provisions may have a global application or apply at a State, federal, regional or national level. Some provisions are focused on particular industrial activities and facilities. Others are designed to apply to particular sectors.

Generally, provisions that require climate change-related reporting fall under the following three broad categories:

(a) Corporate (including financial, governance and securities) reporting provisions that require organizations to make disclosures in annual securities, company or financial filings about climate change risk management and strategies that are part of their corporate governance frameworks. Such requirements may be explicit or may apply because general risk reporting provisions have been interpreted to apply to climate change, for example the way in which the United States Securities Act 1933 has been interpreted, as detailed in the country-specific analysis under section E.

(b) Greenhouse gas/energy measurement and reporting provisions that prescribe rules and/or reference standards and/or methodologies that directly or indirectly affect the way in which greenhouse gases and energy consumption are monitored, measured, reported, taxed and/or traded. Subsets of this category of provisions might apply to the measurement and disclosure of greenhouse gas emissions embedded within products, goods and services, greenhouse gas mitigation activities and the validation, verification and assurance of greenhouse gas emissions results.

(c) Other types of provisions are relevant in some circumstances, such as those related to energy generation, waste management and so on, but such provisions are not considered in this report.

#### **D. Content of climate change-related reporting**

Whatever the source of the demand or the nature of the reporting provision, there is a degree of consensus about the type of information that companies should provide about climate change. Essentially, most requests are concerned with understanding how an organization's activities, business model and strategies affect (positively or negatively) or are (positively or negatively) impacted by climate change, such that the investors, society, consumers, the environment, the planet, the next generation, etc. are also positively or negatively affected. The type of information required in order to answer these questions generally falls into one or more of the following categories:

(a) Strategy and governance, including the way in which the reporting organization's business is affected by climate change and the strategies adopted to respond to the risks and opportunities it creates, including the resources and governance structures allocated to addressing climate change;

(b) Risks and opportunities, including how they are assessed and a description of the significant actions and plans that it is taking to manage them;

(c) Greenhouse Gas (GHG) emissions from an organization's direct and indirect activities, including from activities within the scope of carbon-trading schemes;



(d) Performance, including any plans or targets an organization has introduced to reduce or manage GHG emissions or energy consumption, together with disclosures about progress achieved.

## **E. National examples of approaches to climate change-related reporting**

The examples in section E have been selected for analysis because the approaches to climate change-related reporting introduced by the jurisdictions concerned are representative in one way or another of the types of rules, codes and provisions being introduced more widely around the world. The types of rules, codes and provisions in place in each jurisdiction are grouped according to the categories set out in paragraphs (a) and (b) above. The examples represent a summary of more detailed research available in the inventory of national and regional developments on climate change-related disclosure prepared for the twenty-eighth ISAR session in October 2011.

### **1. Australia**

(a) Corporate reporting provisions:

(i) The continuous disclosure obligations and directors' report requirements under the Australian Corporations Act 2001 and the Australian Stock Exchange (ASX) rules require a listed entity to disclose any information (including environmental information) that a reasonable person would expect to have a material impact on the price or value of the entity's securities (listing rule 3.1). In update number 5/11 dated 19 July 2011, the ASX confirmed that the carbon tax due to commence in Australia in July 2012 will not itself require any listed entity to make an announcement that would not otherwise be required by listing rule 3.1. However, such an obligation might arise if, "following a consideration and analysis of the effect of the proposed carbon tax and associated measures, a listed entity forms the view that the impact of the tax on the entity is materially price sensitive";

(ii) Principle 7 of the ASX Corporate Governance Principles and Recommendations with 2010 amendments provides that listed entities should "recognize and manage risk". The accompanying commentary states that these risks may include operational, environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks;

(b) Greenhouse gas/energy measurement and reporting provisions:

(i) The National Greenhouse Energy Reporting Act overseen by the Government of Australia Department of Climate Change and Energy Efficiency requires companies meeting certain thresholds to report on their greenhouse gas emissions, energy production and energy consumption;

(ii) The Energy Efficiency Opportunities Act overseen by the Government of Australia Department of Resources, Energy and Tourism requires businesses to identify, evaluate and report on cost-effective energy savings opportunities;

(iii) The Clean Energy Legislative Package passed by the Senate in November 2011 sets out the way in which Australia will introduce a carbon price to reduce Australia's carbon pollution and move to a clean energy future. The carbon pricing mechanism will start with a fixed price of \$A23 per ton of CO<sub>2</sub>e on 1 July 2012 before transitioning to an emissions trading scheme on 1 July 2015. Companies that generate over 25,000 tons of CO<sub>2</sub>e emissions each year will be liable under the carbon-pricing mechanism. Under the plan, liable entities must register under the national greenhouse and energy reporting system, report emissions and surrender permits for each ton of CO<sub>2</sub>e they emit. Carbon liabilities will be administered by the Clean Energy Regulator.

### **2. Brazil**

(a) Corporate reporting provisions:

(i) In the 2009 Code of Best Practices of Corporate Governance, the Institute of Corporate Governance of Brazil recommends that an organization disclose, at least on its website, "objective, timely and equitable reports from time to time on all aspects of its business activities, including its social and environmental agenda, related party transactions (see 6.2.1), costs of political and philanthropic activities (see 6.6), administrators' compensation and risk factors, among others, in addition to economic and financial and other information required by law". The Global Reporting

Initiative is recommended as the framework that companies should aspire to use for the purposes of reporting according to this recommendation;

(i) The BM and FBOVESPA questionnaire for the selection of companies for the Corporate Sustainability Index (ICE) requires companies that volunteer to participate in the index to make disclosures on climate change, as well as other aspects of environment, governance and social responsibility.

(b) Greenhouse gas/energy measurement and reporting provisions:

(i) The Ministry of the Environment (MMA), the Brazil Business Council for Sustainable Development (CEBDS) and the Centre for Sustainable Studies (FGV), jointly with the World Resources Institute, the World Business Council for Sustainable Development and other partners, promote voluntary reporting of GHG emissions under the GHG Protocol Programme of Brazil;

(ii) The Electricity Regulatory Authority of Brazil (ANEEL) requires all energy companies to report on their sustainability initiatives. In particular, all electric utilities of Brazil must publish annual social and environmental reports compatible with both Ethos and GRI guidelines.

### **3. Denmark**

(a) Corporate reporting provisions. Article 99a of the Financial Statements Act of Denmark requires companies to report on environmental and intellectual capital and on CSR policies in management's reviews with effect from 1 January 2009. The Act defines corporate social responsibility as the way that businesses "voluntarily include considerations for human rights, societal, environmental and climate conditions, as well as combating corruption in their business strategies and corporate activities". No particular standard is endorsed for compliance with requirements under the Financial Statements Act. However, businesses that have endorsed the United Nations Global Compact and publish a communication on progress are exempted from the requirement to report in their annual reports;

(b) Greenhouse gas/energy measurement and reporting provisions. There are no specific national mandatory or voluntary GHG emissions reporting provisions in Denmark, but companies in Denmark are within the scope of the European Union emissions trading scheme.

### **4. France**

(a) Corporate reporting provisions. Article 116 of the New Economic Regulations (NRE Regulations Law No. 2001-420) contains an obligation for listed companies to include in their annual reports a section on the social and environmental consequences of their activities. Article 83 of the Grenelle II law extends this by providing for the scope of the French Commercial Code (article L.225-102-1) to be extended so that non-listed companies must also include social and environmental data in their annual reports. Companies affected are those that employ more than 500 employees and whose balance sheet exceeds certain financial limits.

(b) Greenhouse gas/energy measurement and reporting provisions:

(i) Companies within the scope of the Grenelle II rules are required to establish a greenhouse gas balance sheet before 31 December 2012. Ademe, the French Environment Agency, publishes Bilan Carbone, which is a GHG emissions assessment tool widely used in France;

(ii) Article 85 of the Grenelle II law requires companies to provide customers with certain information on the carbon footprint of certain products, packaging and transportation services. The carbon cost and other environmental impacts of consumer goods must be displayed from 1 July 2011.

### **5. Japan**

(a) Corporate reporting provisions. There are no mandatory provisions requiring the disclosure of climate change-related information in the annual filings of companies of Japan;

(b) Greenhouse gas/energy measurement and reporting provisions. The Act on the Promotion of Global Warming Countermeasures and the Act on the Rational Use of Energy/Energy Saving Law

require certain companies to report their GHG emissions using guidance provided by the Ministry of Environment.

## **6. South Africa**

As of June 2010, all listed companies on the Johannesburg Stock Exchange are required to produce an annual report to integrate the management of financial and non-financial matters, including integrated sustainability reporting.

## **7. United Kingdom**

(a) Corporate reporting provisions. Section 417 of the Companies Act 2006 requires certain United Kingdom companies to report in their business reviews information on environmental risks, policies and KPIs to the extent necessary for an understanding of the business. The DEFRA issued reporting guidelines for United Kingdom businesses on environmental key performance indicators to assist United Kingdom companies with their compliance requirements in this respect;

(b) Greenhouse gas/energy measurement and reporting provisions:

(i) In September 2009, DEFRA in partnership with DECC published guidance on how to measure and report greenhouse gas emissions for United Kingdom companies;

(ii) Section 83 of the Climate Change Act 2008 requires the United Kingdom Secretary of State, not later than 6 April 2012, to make regulations under section 416(4) of the Companies Act 2006 requiring directors' reports to contain certain specific information about GHG emissions or to lay a report before Parliament explaining why no such regulations had been made;

(iii) The CRC Energy Efficiency scheme is designed to cut emissions in certain large public and private sector organizations. It includes certain reporting requirements on energy use.

## **8. United States**

(a) Corporate reporting provisions. The Securities and Exchange Commission (SEC) Regulation S-K items 101 and 103 require disclosure on the material effects of compliance with environmental laws and pending legal proceedings. In early 2010, the SEC issued interpretive guidance confirming that these provisions are capable of being applied to climate change matters;

(b) Greenhouse gas/energy measurement and reporting provisions. Following a public comment period from April to June 2009, the final Greenhouse Gas Mandatory Reporting Rule was signed by the United States Government on 22 September 2009 and published in the federal register. Under the rule, suppliers of fossil fuels or industrial greenhouse gases, manufacturers of vehicles and engines and facilities that emit 25,000 metric tons or more per year of GHG emissions are required to submit annual reports of their GHG emissions to the EPA. The Mandatory Reporting Rule was made under the Clean Air Act section 307(d) and amends the Code of Federal Regulations, especially 40 CFR, part 98.

## **F. Conclusion**

It is evident from the above summary analysis that there is no single regulatory path towards introducing climate change-related disclosure and no single body of provisions that may be uniquely described as representing climate change-related reporting requirements. Climate change-related reporting requirements are often incorporated in wider risk, environmental, social, governance and corporate social responsibility provisions. Specific provisions may be introduced through a range of regulatory approaches, including financial, corporate and environmental law.

In practice, corporate reporting practices have developed in response to both regulatory requirements and the activity of non-governmental organizations such as the Carbon Disclosure Project and Global Reporting Initiative and in response to stakeholder demands for transparency and accountability. Corporate reporting therefore reflects practices that have developed as a result of isomorphism and regulation. Even where specific laws exist on GHG emissions reporting, such

as in Australia, Carbon Disclosure Project statistics indicate that companies use many other methodologies in addition to those prescribed by law to prepare their corporate inventories. Conversely, even in the absence of specific legislation requiring the disclosure of climate change-related risk, the prevalence of reporting on such risks is significant, for example in Japan.

In the absence of a single body of law governing climate change-related disclosure, approaches to disclosure requirements and corporate responses vary considerably between and within jurisdictions in terms of quality, quantity and methodological approaches, although there is widespread coalescence around the WBCSD/WRI greenhouse gas protocol corporate standard for the purposes of preparing corporate carbon inventories. Complementary reporting developments, such as the integrated reporting movement, Government initiatives on narrative reporting, new thinking on impact investing, regenerative capitalism, long finance and shared value also affect the evolution of corporate climate change-related disclosure practices.

### **III. Providing truly desired information: Japan**

#### **A. Introduction**

The world economy has recently been paying a lot of attention to non-financial information. Why so? What exactly is required in the area of non-financial disclosure, where there has been no established global standard? Following a brief overview of the background that has led to non-financial disclosure, the disclosure guidelines issued by the Government of Japan in 2005 and cases of actual disclosure of companies in Japan are explained. Finally, necessary constituent features that should be incorporated in a possible globally accepted framework for the disclosure of non-financial information are outlined.

#### **B. Why non-financial information disclosure is crucial**

Three main background streams of encouraging the disclosure of non-financial information and one most recent movement that integrates these three are detailed in this section.

##### **1. Non-financial disclosure as a way of explaining risk**

Non-financial information has been increasingly expected to play a role in complementing the substance of financial reports. After long discussion, the International Accounting Standards Board (IASB) proposed in 2010 the type of function that may be fulfilled by management commentary, which is similar to management discussion and analysis in current annual reports. Since international financial reporting standards request companies to include anticipatory estimations, such information may get more uncertain. Thus, non-financial information is expected to play an important role in mitigating this uncertainty and in facilitating better communication between companies and investors. This effect is one of management commentary's primary goals. In this context, disclosure of non-financial information can be construed as a way of explaining future risks. A typical example of this effect is the requirement to disclose environmental information imposed on listed companies by the United States Securities Exchange Commission (SEC)<sup>43</sup>, which has pointed out a correlation between environmental risks and the uncertainty of companies since the 1970s and issued disclosure guidelines.<sup>44</sup>

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<sup>43</sup> Along with the introduction of the SOX Act, the SEC recognized that MD and A disclosures provided by corporations were insufficient and issued new interpretation guidelines for how to prepare MD and A in 2003. These guidelines instruct corporations to ensure the usability and transparency of disclosure to fulfil the following purposes along with traditional disclosure requirements. The guideline also states that business managers should create performance indicators including non-financial information important to the investors. Performance indicators include competition power index, customer satisfaction index, customer acquisition/loss rate, development index, including product supply, development lead-time achievement, worker productivity and moral, tenure index and market share. This is consistent with the third background stream in this chapter.

<sup>44</sup> In terms of social and environmental information, the SEC requires companies to disclose such information insofar as it may be considered to affect investor decision-making. Recently, the SEC required companies to disclose environmental risk information in Regulation S-K and launched climate change disclosure guidance in 2010.

## 2. Non-financial disclosure as a way of explaining CSR or ESG

Increasing requests for transparency in terms of social responsibility and environmental issues are a second background. These requests come from those who believe that firms are responsible not only for investors but also for other stakeholders, including employees, consumers and the local community. For these, corporate reporting should not focus exclusively on financial information, but rather needs to include non-financial, especially social and environmental, information. This idea led to sustainability reporting guidelines issued by the Global Reporting Initiative (GRI).<sup>45</sup> These guidelines, based on the definition of sustainability as the harmonized development of economy, environment and society, have encouraged companies to disclose non-financial material especially related to the environment, labour conditions, human rights, relations with local communities and political influences.<sup>46</sup>

## 3. Non-financial disclosure as a way of explaining the process of value creation

The third background reflects the change of substance of companies in the transfer to the knowledge economy, especially in developed countries, where sources of value creation by firms have shifted from tangible to intangible assets. In this case, traditional financial reporting proved incapable of describing the true origin of value creation. In the United States, the Brookings Institution issued a report in 2001 following four years of research.<sup>47</sup> Additionally, the American Institute of Certified Public Accountants (AICPA) released Enhanced Business Reporting (EBR) in 2004, a new reporting model that raised the quality and transparency of information in financial reports.<sup>48</sup> Similarly, the European Commission launched the MERITUM Project<sup>49</sup> in 1998 and the PRISM Project in 2001, followed by the attempts of several countries to publish guidelines for the measurement and disclosure of intangibles.<sup>50</sup> Following these two projects, the European Commission proposed a modernization of accounting directives in 2003 that required companies to disclose non-financial indicators related to the environment and employees as long as they are essential for stakeholders to understand the growth, performance or market position of the company. Referring to these initiatives, the OECD conducted a research project on intellectual assets and value creation during 2004–2008 and published the results with the help of the Government of Japan.

## 4. Most recent movement

The most noteworthy recent development is the integrated reporting approach proposed by the International Integrated Reporting Council (IIRC), established mainly by Accounting for Sustainability (A4S<sup>51</sup>) and GRI. This approach tries to combine non-financial and financial information under integrated thinking.

As shown in figure 1, the main objective of integrated reporting is to explain how companies utilize several kinds of inputs such as human, intellectual or natural capital, in order to create value in a sustainable way in the mid- or long-term through dynamic interaction with external factors and resources, based on the concept that the primary function of a company is to create value. In this way, integrated reporting aims to facilitate the disclosure of financial and non-financial information

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<sup>45</sup> Available at <https://www.globalreporting.org/reporting/reporting-framework-overview/Pages/default.aspx>.

<sup>46</sup> Available at <https://www.globalreporting.org/reporting/Pages/default.aspx>.

<sup>47</sup> Margaret M Blair and Steven MH Wallman, *Unseen wealth: Report of the Brookings Task Force on intangibles*, Brookings Institution Press, 2001.

<sup>48</sup> Available at <http://www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/EnhancedBusinessReporting/Pages/EnhancedBusinessReporting.aspx>.

<sup>49</sup> Available at [http://ec.europa.eu/research/social-sciences/projects/073\\_en.html](http://ec.europa.eu/research/social-sciences/projects/073_en.html).

<sup>50</sup> One example is Denmark, which published in 2003 Intellectual capital statements: The new guideline. In addition, activities related to intellectual assets-based management disclosure were found in Austria, Taiwan Province of China, France, Germany, the Republic of Korea, Scotland and Sweden, among others.

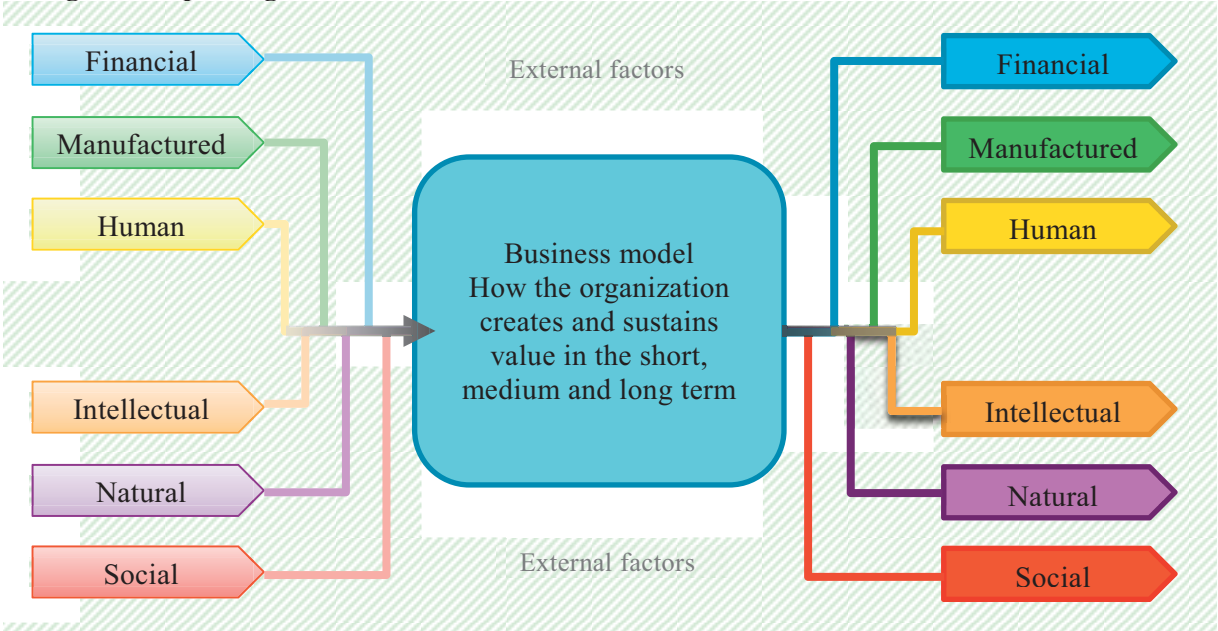
<sup>51</sup> Accounting for Sustainability was founded based on a proposal in 2006 by the Prince of Wales. The organization is composed of accountant associations, audit firms and private companies in Europe. Further information is available at <http://www.theiirc.org/about/pilot-programme/>.



for corporate strategies, including environmental, social, governance or intellectual asset information in an integrated manner.

Integrated reporting does not merely combine existing disclosures, but integrates management strategy, operations and sustainability elements, together with persuasive evidence by key performance indicators that can measure such intangible factors. This development would also combine the three above-mentioned streams.

Figure 1  
**Integrated reporting: Business model and value creation**



Source: IIRC, Towards Integrated Reporting.

**C. The Government of Japan’s Challenge**

Apart from the current practice of many companies in Japan to disclose non-financial information, especially CSR-related information, section C introduces the disclosure guidelines proposed by the Ministry of Economy, Trade and Industry (METI) in Japan, along with the third stream explained above. The guidelines aim to encourage companies to explain their own processes of value creation, together with material non-financial elements.

**1. Guidelines for the disclosure of intellectual asset-based management**

In 2004, METI studied various corporations in Japan and analysed sources of strength sustainable for the mid- or long-term. In doing so, it found that among many kinds of sources, intangible assets such as human resources, technology, know-how, teamwork, customer networks and business partner networks are the most important in sustaining the growth of companies. These can be generically called intellectual assets in the sense that they are brought about as a result of intellectual activity in one way or another.<sup>52</sup> If they are properly identified and used effectively for management, it is presumably possible to achieve sustainable profits and enhance corporate value. The METI refers to this method of corporate management as Intellectual Asset-based Management (IAbM) and has promoted IAbM since 2004.<sup>53</sup>

<sup>52</sup> Intellectual assets are intangible resources such as human capital, technology, organizational power, customer networks, brand, etc. This concept comprises not only intellectual property such as patents, copyrights or know-how, but also human capital, organizational capital and networks, etc.

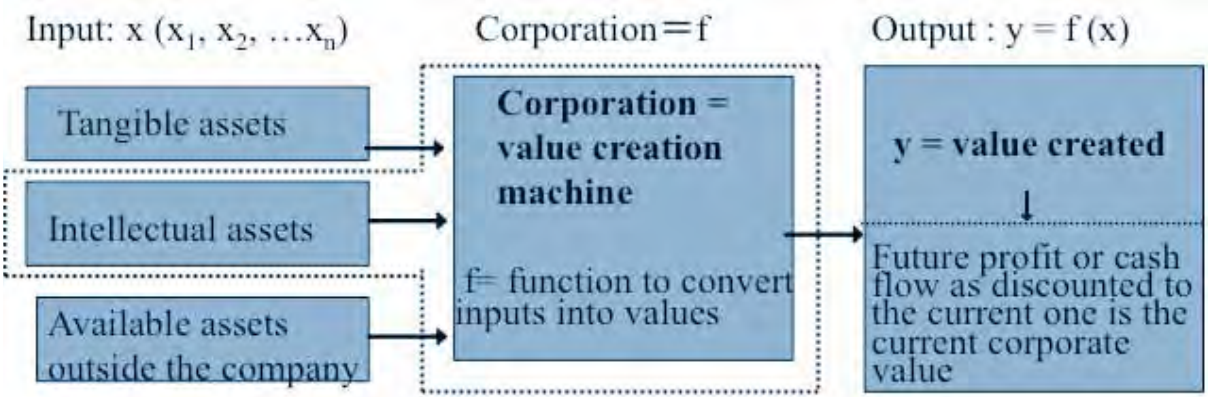
<sup>53</sup> Subcommittee on Management and Intellectual Assets, interim report, August 2005, available at [http://www.meti.go.jp/policy/intellectual\\_assets/pdf/InterimReport-jpn.pdf](http://www.meti.go.jp/policy/intellectual_assets/pdf/InterimReport-jpn.pdf). Activities or policies are introduced on the intellectual assets management website, available at [http://www.meti.go.jp/policy/intellectual\\_assets/index.html](http://www.meti.go.jp/policy/intellectual_assets/index.html).



Furthermore, considering the actual situation of corporate management, METI became concerned that firms in Japan were overly concentrated on short-term returns, neglecting investments in sources of sustainable growth, partly due to the current disclosure system. Therefore, METI began to discuss a solution that would lead companies to focus on intellectual assets.

METI noted the fact that the corporate disclosure system, primarily consisting of financial information, does not require companies to disclose such important elements as value creation mechanisms, important resources or intellectual assets, as shown inside the dotted area of figure 2.<sup>54</sup> It concluded that this is one of the main reasons for short-term views in many companies which do not involve an appropriate evaluation of intellectual assets, resulting in regarding those as the main target in changing the company into a “leaner and meaner” company with more short-term profits. In order to alter this trend, METI issued guidelines for the disclosure of intellectual assets-based management, which aimed to encourage companies to explain in detail their value-creation mechanisms for mid- or long-term growth, in order to enhance stakeholders’ understanding of the long-term point of view in corporate management.<sup>55</sup>

Figure 2  
**Value creation mechanism in a company: A model for growth**



Tangible and intangible assets (x) are considered input, while the function (f) that converts these into output (y) is considered to be a corporation. The input (x) and corporation (f) differ depending on the corporation. In order for a corporation to increase (y), it can invest in areas within (x) that are unique to the corporation and that have a relatively high priority, optimize the substance of (f) so that it matches the (x) that is thought to be a relatively high priority for the corporation or develop an (x) that is suitable for the substance of (f). Operations in the past consisted mainly of activities focused on areas that are visible, tangible assets (and y). However, the intangible areas that serve as the foundation for differentiation are also important.

Since the source of discrimination and the methods of utilizing assets (IAbM) depend on each individual corporation, the guidelines do not require companies to present a fixed set of items. Instead, each value-creation method should be actively shown in a timeline, first from past to present and second from present to future, as a narrative of value creation that recipients of the disclosed information can understand, as shown in figure 3.<sup>56</sup>

<sup>54</sup> In Japan, there is a tendency to evaluate corporations based on fluctuations of short-term profits, such as those for quarterly periods. Since corporate managers are most sensitive to these changes, there is a tendency for management decisions to be made in response to short-term concerns.

<sup>55</sup> Guidelines for the disclosure of intellectual assets based management, available at [http://www.meti.go.jp/policy/intellectual\\_assets/pdf/2-guideline-jpn.pdf](http://www.meti.go.jp/policy/intellectual_assets/pdf/2-guideline-jpn.pdf).

<sup>56</sup> When METI launched its guidelines for the disclosure of intellectual assets-based management, activity in the stock market in Japan was very active, for example hostile takeover bid happened. Thus, the problem of miscommunication between the decision-making timeline in the stock market and the decision-making timeline among corporate managers. was demonstrated Therefore, a new communication tool that could convey corporate long-term strategy to investors was required.

Thus, the aim of these guidelines are to promote stakeholder understanding of the underlying elements of a company, which brings about financial results, including the method of value creation and future profits or the possibility of their continuation. In this sense, the guidelines do not recommend only non-financial information disclosure, but promote companies to combine financial information with non-financial information as an essential factor to generate certain financial results.

Figure 3  
**Value-creation method timeline**

<p>General:          Basic management philosophy          Outline of business characteristics</p> <p>From past to present:          (a) Management policy in the past;          (b) Investment (based on (a)) (performance figures included);          (c) Unique intellectual assets accumulated in the company, strengths based on these and the value creation method (based on (a) and (b)) (supporting intellectual asset indicators included);          (d) Actual performance in the past, such as profits (as a result of value creation (c)).</p> <p>From present to future:          (e) (Based on (c) and the assessment of the past to the present) Intellectual assets that are rooted in the company and will be effective in the future, and the future value creation method based on them (supporting intellectual asset indicators included);          (f) Identification of future uncertainty/risks, how to deal with them and the future management policy including these elements;          (g) New/additional investment for the maintenance and development of the intellectual assets needed (in line with management policy (f)) (figures included);          (h) Expected future profits, etc. (based on (e) to (g)) (numerical targets included).</p>
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**2. Founding of World Intellectual Capital/Assets Initiative**

The Ministry of Economy, Trade and Industry founded the World Intellectual Capital/Assets Initiative (WICI) in 2007, in cooperation with other organizations, including the Enhanced Business Reporting Consortium (EBRC) and the European Federation of Financial Analysts Societies (EFFAS).<sup>57</sup> The WICI proposed a new business reporting framework based on the IAbM disclosure framework and EBR2.0. This framework places a focus on the value-creation story, material intellectual assets and the two cycles of past to present and present to future. Since the idea of IAbM and WICI is quite similar to the idea of integrated reporting, the experience of Japan since 2004, explained in section D, can contribute to the new attempt for a global standard in this area by IIRC.

Common features of WICI and IIRC include the following:

- (a) Aiming at integrating non-financials and financials;
- (b) Focusing on sustainable value creation and a strategy based on recognition of a value-creating mechanism;
- (c) Not only looking at the past but also bringing the future into view;
- (d) Presenting not only a short-term view but also mid- and long-term views;

<sup>57</sup> Available at <http://www.wici-global.com>.

(e) Stressing various intangible assets, such as human and intellectual assets;

(f) Relying more on characteristics and substances of firms, and therefore proposing flexible disclosure frameworks, which enable companies to choose their own material factors to be disclosed.

#### **D. Practice in Japan**

In this section, the current situation in Japan related to IAbM will be explained. Small and medium-sized enterprises (SMEs) actively disclose their own IAbM, partly because many SMEs in Japan creating value by utilizing their unique know-how or technologies need a tool to correctly present their intangible strengths and partly because CEOs of SMEs, recognizing every detail of their own companies, including their strengths and weaknesses, can easily describe their value-creation story as recommended by the IAbM disclosure guidelines<sup>58</sup>.

There are also many kinds of support available. The Financial Service Agency in Japan, a regulatory body for financial institutions, encourages them to use the information from intellectual assets-based management reports in the context of relationship banking. Moreover, METI issued keys to intellectual asset-based management evaluation finance in 2009, as a guidebook for bankers to evaluate intangible assets, and has promoted these guidelines to every bank in Japan.<sup>59</sup>

Many supporting organizations, such as the organization for Small and Medium Enterprises and Regional Innovation, Japan Patent Attorneys Association, Gyoseishoshi Lawyers Association and Japan Small and Medium Enterprise Management Consultants Association, provide assistance for SMEs to summarize IAbM reports.<sup>60</sup> Thanks to their active support, more than 800 IAbM reports have been published to date, with more than twice as many reports as those produced for internal use only.<sup>61</sup>

However, IAbM reports are not popular among large companies. Rather, they disclose only a part, such as intellectual property rights, corporate social responsibility or environmental issues, in independent reports. For example, 694 out of 1659 listed companies in the first section of the Tokyo Stock Exchange voluntarily issue CSR reports, environmental reports or social and environmental reports. The substance of these reports includes some elements of an IAbM report, such as human resources, relationships with consumers, business partners and employees. In this case, the main elements are already reviewed in the process, though the outcomes cannot be regarded as IAbM reports without a comprehensive story of their own value creation mechanisms.

To date, non-financial disclosures by large companies have not been successful because the substance is not necessarily material to the company, in order to meet as many interests of stakeholders as possible. However, recently, similar reports to IAbM reports, as a result of attempts by some companies to combine annual reports with CSR reports, may be found. For example, 11 of the Fortune Top 20 companies in the first section of the Tokyo Stock Exchange have already begun to integrate CSR or environmental information in their annual reports, which might offer an overview of financial and non-financial elements. This may be regarded as the beginning of a period of transition from fragmentary non-financial disclosure to non-financial disclosure in accordance with IAbM reporting.

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<sup>58</sup> For example, Showa Denki Corporation, which is an SME in Osaka, Japan, joined the IIRC integrated reporting project.

<sup>59</sup> Available at [http://www.meti.go.jp/policy/intellectual\\_assets/english.html](http://www.meti.go.jp/policy/intellectual_assets/english.html).

<sup>60</sup> The organization for Small and Medium Enterprises and Regional Innovation in Japan publicized an intellectual assets based management manual in 2007, available at [http://www.meti.go.jp/policy/intellectual\\_assets/pdf/01\\_1-3.pdf](http://www.meti.go.jp/policy/intellectual_assets/pdf/01_1-3.pdf).

<sup>61</sup> Available at <http://www.jiam.or.jp/CCP013.html>.

## **E. Conclusion**

The global standard for the disclosure of non-financial information should be the precursor that encourages a company to correctly reflect its specific way of creating value, strategies for doing so and even its cultural background. Certainly, comparability is important, yet it is also true that the more companies make an effort for differentiation, the less it is likely to easily compare companies in a uniform manner. It may even be true that the companies that have unique elements difficult to compare to other companies' elements may have a competitive superiority. In this situation, the global standard for the disclosure of non-financial information should incorporate the following:

(a) Allowing companies to choose the most relevant information concerning their business strategies, avoiding attempts to identify common or universal disclosure items. For example, parts of CSR and ESG information may be essential for some companies, but are not necessarily so for all companies. Without being limited to a concrete category of information, asking companies to disclose their own truly material factors to describe their own story for value creation, including intellectual assets such as organizational strength, human resources, business networks, technologies and specialized knowledge, which might not be categorized as ESG or CSR information;

(b) Putting an emphasis on providing clues for investors to estimate the future performance of companies, by using the two-cycle method of past to present and present to future, while explaining, first, current performance as a result of past strategy, activities and unique resources utilized and second, future prospects as a result of future value-creation strategies based on estimations of risks or opportunities and unique assets utilized;

(c) Providing indicators as supportive evidence, without forgetting the limitation that no indicators can be universally applicable to all companies, while recognizing that indicators or combinations of indicators may and should be unique for each company, and are hopefully also used in their internal controls;

(d) Investing in augmenting the capability of users to search various information by introducing systems such as XBRL, which result in the increased possibility of comparing many kinds of information.

If a standard with the above-mentioned nature is established, the source of differentiation and management methods to utilize them or value creation in a sustainable manner may be properly estimated. Then, companies with such sources and management capability for creating value will be highly appreciated. This situation would create a positive effect on the world economy.

## **IV. Role of stock exchanges in promoting transparency and disclosure**

### **A. Stock exchanges and corporate governance standards**

Historically, stock exchanges have played an important role in the oversight of listed companies and the promotion of good corporate governance practices among them. Exchanges have suggested several rationales for establishing themselves as a source of corporate governance-related regulations. In essence, by raising the bar for transparency and disclosure practices and discouraging illegal or irregular practices, exchanges have positioned themselves to accumulate reputational capital.

Over the years, stock exchanges have established themselves as promoters of the relevant governance recommendations for listed companies through their listing rules and maintenance requirements, as well as through the exercise of enforcement powers entrusted to them in some jurisdictions. In addition, stock exchanges have contributed to the creation of effective corporate governance frameworks by collaborating with other supervisory, regulatory and enforcement

agencies to prevent and detect insider trading, to promote better corporate disclosure and to raise awareness among issuers.

Exchanges have also been active in providing incentives to already listed companies to commit to higher governance standards. Perhaps the most widely cited example of this has been the establishment of Novo Mercado by the Stock Exchange of Brazil. This approach effectively provides an incentive for already listed companies to improve their governance. In addition to creating higher governance segments, some exchanges have also incorporated corporate governance criteria in listing standards for different listing tiers.

The forms in which corporate governance standards have been mandated for listed companies necessarily differs by jurisdiction. Some corporate governance-related provisions have been integrated in listing standards or listing agreements between an exchange and individual companies. For instance, the Stockholm Stock Exchange (now part of NASDAQ OMX) and the Toronto Stock Exchange (TSE) both impose standards in relation to the composition, competence and independence of the board as part of their listing requirements. In some jurisdictions, such as Australia (ASX) and Egypt (EGX), listing standards incorporate elements of the local corporate governance code.

This is not surprising insofar as stock exchanges have emerged as key players in developing corporate governance codes and recommendations. In most jurisdictions, exchanges were involved in the commissions that drafted the national corporate governance code or guidelines. In some markets (e.g. Denmark), exchanges have even led the development of the national corporate governance code or guidelines. That said, when it comes to monitoring company disclosure against these provisions or enforcing these provisions, exchanges tend to play a less prominent role.

The role of exchanges in monitoring company disclosure against the national corporate governance code or guidelines is typically limited to the elements of the code that are incorporated in the listing requirements. For instance, in Australia, only those recommendations of the code that are also part of the listing rules are subject to regular surveillance and enforcement by the ASX. Generally speaking, in other jurisdictions where corporate governance requirements are incorporated directly in the listing standards, exchanges' surveillance and enforcement powers are typically stronger. For example, the New York Stock Exchange (NYSE) can enforce compliance with its corporate governance listing standards through a letter of reprimand or delisting.<sup>62</sup>

Particularly when the listing function is retained by an exchange, it can usually exercise some enforcement powers. Across markets and regions, enforcement powers vis-à-vis listed companies are most often vested with the securities regulators. However, exchanges often have some limited enforcement roles, either directly or through delegated authority from the securities regulator. Aside from relatively extreme measures such as delisting, exchanges have other means of enforcement through the publication of opinions on compliance or levying of financial penalties.

More often than not, the substance of exchanges' enforcement responsibilities is related to their capacity to monitor market developments and bring cases to the attention of securities regulators. In this regard, exchanges have made an important contribution to the prevention of market manipulation and other abusive practices. Exchanges can also publicize cases of breaches of regulations or force companies to disclose non-compliance with their provisions.

Two trends raise questions about whether exchanges are in a position to carry out enforcement activities. First, insofar as exchanges have been privatized and self-listed, they might not have the incentives to be rigorous in enforcing against large issuers. Second, considering the rise of foreign listings in some markets, the regulatory basis for enforcement by exchanges may be questioned. In addition, foreign companies are increasingly accepted to list on foreign markets based on their

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<sup>62</sup> The standards are mandatory for listed companies, having been approved by the United States Securities and Exchange Commission (SEC).



compliance with the corporate governance rules in the country of origin, if they are considered to be equivalent.

## **B. Stock exchanges and the promotion of transparency and disclosure**

The promotion of transparency and disclosure has been an overriding prerequisite for exchanges, considering their need to attract investors and assure them of the integrity of the market in which they have invested or are considering investing. Given their role as information gateway for the investor community, exchanges often play a greater role in facilitating better company disclosure than do other governance practices. That said, the role of exchanges in monitoring corporate disclosure is more often than not shared with the securities regulator.

While transparency and disclosure requirements are typically encompassed in the companies and securities legislation and regulations, exchanges are often in a position to ensure that the requisite information is disseminated to the investor community. In some markets, key company reporting can be accessed through websites administered by the securities regulators (e.g. EDGAR in the United States). In others, such as in Israel, Saudi Arabia, Turkey and many other jurisdictions, company filings are made available through websites operated by stock exchanges.

In Israel, the Tel Aviv Stock Exchange (TASE) operates a platform that provides market information to the public. In Saudi Arabia, the Tadawulaty website is operated by Tadawul in cooperation with broker firms. In Turkey, the Public Disclosure Platform, developed jointly by the Capital Market Authority (CMA) and the Istanbul Stock Exchange (ISE), provides investors with electronic notifications on matters that companies are required to report on publicly. Information about listed companies, exchange-traded funds and brokerage houses, as well as announcements by regulatory bodies, are published directly on this platform and disseminated to over 2,500 users across the country.

In addition to facilitating periodic disclosure, exchanges often play a key role in monitoring overall market transparency by facilitating continuous disclosure to the market about material events and conducting monitoring of trading activity to ensure market integrity. For instance, in Israel, the responsibility for monitoring possible insider trading activity is divided between the securities regulator, the Israel Securities Authority, and the Tel Aviv Stock Exchange. In case of any anomalies in trading activity, TASE notifies the Israel Securities Authority.

Beyond facilitating corporate disclosure, exchanges have on some occasions supported the broader integrity and anti-corruption agenda. In Egypt, for instance, the stock exchange was closed for over a month after the resignation of the Mubarak Government in 2011. When the markets reopened, all listed companies were asked to report to the exchange on any affiliations with the former regime as well as on any investigations or charges pending against key corporate officers or owners. As highlighted by this example, the practice of separation of ownership from management has facilitated the ongoing listing of companies whose owners were indicted or investigated.

In recent years, exchanges have been part of the movement to promote better environmental, social and governance (ESG) and sustainability practices. Some exchanges have established indices to attract investment to select companies based on their ESG performance against a given methodology. Standard and Poors, in cooperation with local exchanges, has launched such indices in Egypt and India and has partnered with the Hawkamah Institute to establish a similar pan-Arab index. Some exchanges, such as Bursa Malaysia, the Shanghai Stock Exchange and the Tel Aviv Stock Exchange, have moved to establish their own indices.

It is important to highlight that these ESG indices have taken a wide variety of forms. Some indices are oriented towards a single issue (e.g. NYSE Euronext has an index on climate change), while others seek to measure company performance on a range of ESG issues (e.g. Egypt and India). Regardless of their form, the emergence of ESG indices appears to be a growing trend in both developed and emerging markets. Further empirical work on whether these indices are actually



successful in isolating and promoting companies with good ESG practices and attracting investment to them is still required.

Arguably the most important function that exchanges have played in promoting good corporate governance is facilitating a transparent price formation process. This function of exchanges has to some extent been endangered by the emergence of off-exchange trading platforms (predominantly in Europe and North America). The result of this phenomenon is that over the past few years, most trading activity in these jurisdictions has shifted to off-exchange venues and there is a risk that trading fragmentation endangers the ability of exchanges to ensure a transparent price-discovery process.

Another trend that has affected the ability of exchanges to ensure the transparency of the price-formation process is the emergence of dark pools. While broker dealers have for a long time internalized orders in order to avoid having to pass through exchanges, the development of dark pools represents an additional step in moving trading away from regulated exchanges, and hence reducing the ability of exchanges to ensure transparency in the price formation process.

An additional issue is that many dark pools welcome high-frequency traders (HFTs) who can use their speed to exploit price differences between exchanges and dark pools. High-frequency trading has gained ground globally and in some markets (e.g. the United States) it is estimated to account for more than half of the stock trading volume. The consequence of this situation is that exchanges' ability to ensure orderly trading is constrained, as the "flash crash" that occurred on 6 May 2010 demonstrated. That said, some dark pools where HFT occurs are now owned and operated by exchanges themselves and securities regulators are increasingly contemplating regulating HFT.

### **C. Incentives faced by stock exchanges**

The above discussion raises questions on the incentives faced by exchanges to maintain high standards for listing. The demutualization and subsequent self-listing of stock exchanges have engendered active debate about the regulatory powers of exchanges. Securities regulators have been concerned about the conflicts of interest that could arise between an exchange's for-profit activities and its regulatory responsibilities. On the one hand, exchanges are expected to maximize profit and may have a fiduciary duty to do so. On the other hand, exchanges are expected to exercise their regulatory functions by refusing issuers or sanctioning non-compliant companies.

Additional conflicts of interest that could arise from the self-listing of exchanges have also concerned regulators. Notably, the conversion of exchanges to listed companies is thought to have intensified competition among them, and this continues to be a significant force behind national and cross-border consolidation. This has in turn raised important additional questions concerning the exercise of regulatory functions by exchanges. As mentioned above, one area of concern has been the application of regulations, including governance codes, by multinational exchanges to listed companies.

To address these and other potential conflicts of interest, regulators have intensified their oversight over exchanges and a number of measures have been adopted. For instance, in the United States, SEC reviews any proposals for demutualization to ensure they satisfy certain governance requirements and to ascertain the independence of an exchange's regulatory function. In Australia, the securities regulator holds the listing authority related to the ASX listing. In Canada, the Ontario Securities Commission (OSC) requires that the TSX provide certain additional disclosures now that it is self-listed.

These examples are instructive for other exchanges considering a similar transition. A number of recently adopted capital market laws leave open the possibility of the eventual privatization and listing of exchanges, as is the case, for example, for a number of exchanges in the Middle East (e.g. Kuwait, Saudi Arabia, etc.). In future, in markets where the ownership of exchanges is expected to pass to private hands, it will be important to consider potential conflicts of interest between an exchange's regulatory and profit-making functions. Arrangements introduced by exchanges in

Europe and North America that have already gone through this process highlight a variety of options, from outright legal separation between the different functions of the exchange to softening measures to isolate these activities.

#### **D. Conclusion**

Considering that market integrity and transparency are fundamental for attracting listings and investors, stock exchanges have a reason to continue to play a major role in fostering good governance in listed companies. As highlighted in this chapter, the instruments and powers of exchanges to introduce and enforce corporate governance requirements vary considerably, from provisions incorporated in listing requirements, to corporate governance codes, to specialized segments and indices.

For State-owned exchanges, the exercise of regulatory functions and the appropriate division of authority among different regulators is less controversial in the sense that they are not subject to the commercial obligations and conflicts of interest that private competitors are faced with. That said, experience demonstrates that in some cases even Government-operated exchanges may face conflicts of interest. This may occur, for example, if a Government wishes to list a stake in a State-owned company on a State-owned exchange, and can pressure the latter to lower its criteria for this particular listing.

For exchanges that have transitioned to the private ownership model, and especially for listed exchanges, managing conflicts of interest has been and remains a priority to ensure that commercial interests do not triumph over the need to maintain appropriate corporate governance standards for issuers. In particular, as markets become more globally integrated, it might be tempting for some exchanges to exempt foreign issuers from their rules on account of companies' compliance with provisions in the jurisdiction of origin, which may be less rigorous or not fully enforced.

Exchanges are fair to point to the rise of off-exchange and high-frequency trading as reasons for which they are no longer able to guarantee the same level of transparency in price discovery. That said, the public will continue to hold exchanges and regulators accountable for any failures in the governance of publicly traded companies. Exchanges therefore have an interest to ensure that a clear position emerges on their role in promoting good corporate governance practices in an environment where they retain their listing powers but not their historic trading monopoly.

## Part Four: Human capacity reporting

### I. A global approach to the training of professional accountants

#### A. Introduction

Globalization is a trend that is affecting capital markets, financial reporting standards, auditing standards and the free exchange of goods and services across national frontiers. The trend towards globalization has been further encouraged by the growth of emerging market economies, the use of English as a common business language, the efforts of the World Trade Organization (WTO) and others to promote the free movement of qualified accountants worldwide and by the growth of the Internet as a means of global communication. Since accountancy can be said to be the language of business, it has a key role to play in binding the global marketplace together.

The combination of these factors points to the need for a global approach to the training of accountants, which provides qualifications that are transportable over national frontiers while still being relevant to national law and tax regimes. Of the bodies with statutory recognition for audit purposes in their home territories, the Association of Chartered Certified Accountants (ACCA), CPA Australia (CPAA), the Certified General Accountants Association of Canada (CGAA), the Institute of Chartered Accountants in England and Wales (ICAEW) and the American Institute of Certified Public Accountants (AICPA) represent examples of qualifications that are examined other than in their home territory. The United Kingdom Chartered Institute of Management Accountants (CIMA) represents a management accounting qualification that is available globally.

Nevertheless, most countries still have their own national professional qualifications and these are examined in their national languages. Since these languages include Russian, Chinese and Spanish, this results in a large number of accountants who qualify in languages other than English. Their tax and law regimes are also necessarily always stated in the national language.

National professional bodies have a continuing role to play in regulating their members and, usually, in testing competency in local law and tax. The process of globalization means, however, that benchmarks of performance are increasingly set at the international and not the national level, meaning that accountants in the twenty-first century need to have a skill set that reflects this development. A global approach to accountancy qualifications can help to provide employers with accountants who are not only trained in these international benchmarks but who are skilled in all areas that are substantially the same regardless of national frontiers. These include the core subjects of management accounting, financial management, business management, information technology, economics and quantitative techniques.

This chapter sets out the rationale for a global approach to professional training and discusses the criteria that define this approach. It also offers some comparisons of the missions of six leading global bodies and the goals they intend to achieve, as well as the progress made by these bodies towards meeting the criteria for a global body.

#### B. Demand

Employment market for professional accountants. The demand for professional accountancy qualifications is often led by the employment market. In the case of a global qualification, employers such as large accountancy firms and other multinationals find it convenient to have staff with comparable skill levels who can be moved quite easily between their various national offices. Where, for example, companies and firms are accustomed to preparing accounts based on IFRS, it is more efficient from their point of view to adopt training systems that are based on IFRS, as opposed to a series of systems based on national standards.

Mobility of professional accountants across national frontiers. It is not only large firms calling for mobility. Individual accountants who relocate for career or personal reasons do not wish to have to

completely requalify when they emigrate. Qualifications set by reference to a uniform global standard make this easier to achieve.

Global capital markets require comparable financial information. Regardless of national legal requirements, the globalization of international financial markets means that investors appreciate having access to financial information that is comparable across national frontiers. This generates a demand for professional accountants who can produce accounts based on IFRS and audited according to International Standards on Auditing (ISAs).

Globally orientated qualifications can add value for members and employers in that they espouse and promote global rather than national values. Professional values are or should be comparable globally. Core values such as professional independence differentiate professional accountants from holders of other higher level qualifications such as MBAs. The International Federation of Accountants (IFAC) expects all its member bodies to adopt a code of ethics that is equivalent to the IFAC code. In an increasingly global market, this helps members and employers to meet global rather than national standards of professional conduct and helps to reassure international investors that, when dealing with the work of qualified accountants, high standards may be assumed.

### **C. Requirements of a global qualification**

As opposed to a national qualification, a global qualification imposes certain requirements that may not be necessary for a national qualification. Some of these are resource intensive, but economies of scale may compensate for this. These are considered in this section.

Based on IFRS and ISAs. From the above it follows logically that the curriculum of a global qualification should be based on international benchmarks, especially IFRS and ISAs. This means that where separate national accounting standards are maintained, a global qualification cannot entirely displace qualifications that are based on the domestic environment, although any lack of training in national requirements can be made up for by the undertaking of appropriate CPD. In the European Union for instance, although IFRS have been adopted for listed companies' consolidated accounts, national standards are often maintained and in many cases are still used as the basis for tax computations.

Based on global standards for ethics, professional conduct and corporate governance. It also follows that a global qualification should be based on global standards of ethics and professional conduct, for example the IFAC code of ethics, as well as internationally respected principles of corporate governance. A series of market and audit failures have demonstrated that high-quality accounting and auditing standards must be accompanied by a commitment on the part of individual professionals to ethical and responsible conduct. It is vital that this aspect be fully integrated into the training process and, post-qualification, regulated effectively by an accountant's qualifying body.

Conform with international education standards. A global qualification should conform with the IFAC international education standards. These set out common standards for all components of a professional accountancy qualification, including for the following:

- (a) Entry requirements to a professional accounting education programme;
- (b) The content of a professional accounting education programme;
- (c) Professional skills and general education;
- (d) Professional values, ethics and attitudes;
- (e) Practical experience requirements;
- (f) The assessment of professional capabilities and competence;

(g) Continuing professional development.

This provides a common template for all professional accountancy qualifications and, in particular, encourages convergence on a common, uniform and global qualification. Not all national qualifications can meet these standards, partly due to resource constraints, but with more resources at its disposal, a global qualification should be in a better position to meet these standards. This is one way in which a global qualification can supplement national qualifications.

The IFAC itself does not issue a professional qualification, but has produced extensive guidance to support each of its education standards.

A global qualification should be based on a single, uniform syllabus. UNCTAD has published a model syllabus in the form of its global curriculum for the education of professional accountants (1998). However, tax and law are invariably national in scope and require either variant papers on these subjects or CPD to bridge the gap. Other national differences in accounting and auditing practices may require similar treatment. UNCTAD does not issue a professional qualification, but is currently engaged in an extensive project to promote capacity-building in the area of sound corporate reporting, including education and training.

Single set of competences. To a substantial extent the competences of professional accountants are the same or very similar worldwide, in particular, the competences related to professionalism, ethics and governance, personal effectiveness, business management plus and information technology are mostly equivalent. The technical competences are similar as well, but professional accountants may not possess all of them. Options might include financial accounting and reporting, performance measurement and management accounting, finance and financial management, audit and assurance and taxation. There are also many other specialities such as insolvency, forensic accounting and public sector accounting. The advantage of a global qualification is that it can adopt a single set of competences at the same level, albeit with options on the technical side.

Similar practical experience requirements globally. A common set of competences can give rise to a common set of practical experience requirements. This might be attractive to large accountancy firms and other multinationals since it means they can standardize their training materials and systems worldwide, with consequent savings in costs. It also means they can be sure their staff members have been trained to the same level of competence, which makes them easier to relocate around the world.

Resources to conduct examinations in different countries. The implication of a global qualification is that its examinations are available anywhere in the world. This is not always the case, but some bodies can effectively offer examinations virtually anywhere, sometimes through the British Council or computer-based examinations.

Procedures to enable marking to be carried out to a global standard while ensuring the integrity and security of examinations. The key challenge for a global qualification is to mark examinations to the same standard anywhere in the world while safeguarding the integrity and security of the examinations and the multitudinous examination centres. United Kingdom bodies, for example, have developed extensive, elaborate and exhaustive procedures to protect their examinations from any threat to their quality or performance. Strict security also surrounds the invigilation of examinations and the movement of question papers and scripts. Once again, only economies of scale make this possible on a global basis.

Brand, market and, if possible, formal recognition of a global qualification. In order to survive and prosper, a global qualification needs recognition at many levels:

(a) Brand recognition is the most general requirement. This may be enhanced through relationship management, public relations, active involvement in professional affairs and a concerted commitment to enhancing the body's reputation and influence in all its markets;



(b) Brand recognition can contribute to market recognition, i.e. acceptance by employers. This is sufficient in unregulated areas where no licence to work is required, e.g. in business;

(c) Formal recognition is normally at the national level and applies to regulated activities, e.g. a licence to audit or conduct a public practice. Formal recognition also applies to accreditation of national educational frameworks.

In order to secure formal recognition, a global qualification needs a mechanism whereby it can gain recognition at the national level. This can take many forms, including the following:

(a) Some form of partnership with the national body or regulator which itself has licensing rights, e.g. through exemptions from the national qualification;

(b) Mutual recognition agreements that provide joint membership with the national and global body. This might be connected to joint examination schemes such as that of the ACCA or alliances between a group of bodies. The Global Accountancy Alliance and the Common Content Project are examples. The GAA was formed in November 2005 and is an alliance of 11 leading professional accountancy bodies in significant capital markets. The CCP comprises nine of Europe's leading accountancy institutes, which are working together to bring their professional qualifications closer;

(c) Regional forms of mutual recognition, for example through the eighth European Union company law directive on statutory auditors or the International Qualifications Appraisals Board that originated in North America and has been extended to Australia, Hong Kong (China), Ireland, Mexico and New Zealand.

Formal recognition usually requires additional tests in national law and tax to be imposed on individual accountants before they may be issued a licence to operate in the regulated area or market.

Online examinations. Information technology and the Internet have greatly increased the ability of globally organized bodies to make their examinations available worldwide. Examinations are increasingly being made available online and on demand. This means that a single qualification can be provided to a uniform standard at almost any place and any time. The up-front costs of building a question bank and providing testing facilities are higher, but the marking costs should be lower. In the meantime, students may be serviced locally but from a central point and more economically.

Global tuition providers plus distance learning. Distance learning providers can provide learning materials over the Internet on a global scale in support of a global qualification.

National offices around the world. Global bodies generally set up national offices or representatives worldwide to represent their bodies locally and to provide some services to members and students.

#### **D. Limitations**

Any global qualification has certain limitations and restrictions when compared to qualifications that are primarily national in scope, some of which are as follows:

Usually examined in English. A global qualification is normally examined in English. It is not easy to examine in a variety of languages, mainly due to quality control issues across language platforms.

Tax and law systems are national in scope and not uniform across national frontiers. Regulators sometimes insist on additional tests being imposed to assess a candidate's competence in national tax and law. For example, the European Union directive on statutory auditors requires an aptitude test in national tax and law before an auditor qualified in one European Union country may be



allowed to practice in another. The IQAB system operates on a similar basis. On a voluntary basis, global qualifying bodies may choose to set variant papers in national tax and law in order to enhance the local relevance and appeal of their qualifications, but this approach can prove costly.

Formal recognition status may be restricted. A global qualification is restricted in the formal recognition it enjoys from statutory regulators across national borders. For example, European Union recognition is regional and IQAB recognition is currently limited to seven countries.

Audit licences and public practice rights usually require additional tests in national tax and law, at a minimum. As a result, audit licences and rights to public practice are usually granted nationally with, in most cases, tests in at least tax and law, plus local experience for those with non-national qualifications.

Discipline and regulation of members is often a matter for the national body. As the discipline and regulation of members, particularly members in public practice, is usually a matter for the national body, a global qualification may be supplementary to national qualifications.

## **E. International comparisons**

The extent to which bodies have embraced these criteria varies, and depends partly on the goals each body intends to achieve. Some have actively sought growth through international membership, such as ACCA, while others essentially cater to a large domestic membership, such as AICPA. The following comparative analysis of existing systems seeks to identify the missions of various bodies and the goals they intend to achieve, as well as the progress made by these bodies towards meeting the above criteria.

### **1. Mission statements and goals**

This section sets out the mission statements and goals adopted by six bodies that give an indication of how far they view themselves as global as opposed to national players. Most of them mention the global or international aspect of their qualifications. The exception is AICPA, which focuses on its national role and the state boards of accounting and state societies. However, the joint venture with CIMA on the Chartered Global Management Accounting (CGMA) qualification is a recent innovation with a global remit.

(a) ACCA. Will be universally recognized by employers in the corporate, practice and public sectors as the leading global professional accountancy body in reputation, influence and size;

(b) CPAA:

(i) Vision: CPA Australia is the global professional accountancy designation for strategic business leaders;

(ii) Market: CPAA's brand and members are global – CPAA has operations in chosen markets throughout the world;

(iii) Goal: Maximize share of persons who want a career built on professional accounting skills. CPA Australia's way to achieve its goal: Build the CPA Australia brand and market for growth; provide CPA programme and entry pathways that are globally competitive;

(c) CGAA. CGA-Canada advances the interests of its members and the public through national and international representation and the establishment of professional standards, practices and services. The Association sets national educational standards and develops and maintains an internationally competitive programme of professional studies and examinations to certify CGAs in Canada and overseas;

(d) CIMA (United Kingdom). CIMA is the world's largest professional body of management accountants. CIMA offers the most relevant finance qualification for business. CIMA has recently adopted the title of CGMA in conjunction with AICPA. This is described as the global designation for management accountants;

(e) ICAEW. ICAEW's vision is for ICAEW to be acknowledged as leading the global accountancy and finance profession, so people can do business with confidence;

(f) AICPA. The American Institute of Certified Public Accountants is the national professional organization for all certified public accountants. Its mission is to provide members with the resources, information and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients. In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where public reliance on CPA skills is most significant.

## 2. Criteria

The extent to which bodies have moved towards the criteria set out in section C depends partly on their missions and goals, and varies accordingly. Table 2 gives an indication of how they compare to the criteria for a global body.

Table 2

### Criteria for a global accounting qualification body: Comparison of six national bodies' levels of achievement

	ACCA	CPA A	CGAA	CIM A	ICAE W	AICPA
Curriculum based on IFRS	√	√	√	√	√	
Curriculum based on ISAs	√	√	√		√	
Global approach to ethics, professional conduct and corporate governance	√	√	√	√	√	
Conformity with international education standards	√	√	√	√	√	√
A single set of competences	√	√	√	√	√	
Similar practical experience requirements globally	√	√	√	√	√	vary state by state
Resources to conduct examinations in several different countries	√	√	√	√	√	√
Procedures to enable marking to be carried out to a global standard while ensuring the integrity and security of examinations	√	√	√	√	√	√
Brand, market and, if possible, formal recognition of the qualification (varies by country)	√	√	√	√	√	√

Online examinations (some in process)	√	√	√		√	√
Global tuition providers plus distance learning	√	√	√	√	√	√
National offices around the world	√	√	√	√	√	

Most of these bodies meet most of the criteria and some meet all of them. However, how this commitment is demonstrated varies. For example, some have more national offices than others, while only two, ACCA and CPA Australia, provide variants in national tax and law.

### 3. Global dispersion

Within these criteria, different bodies have spread out globally at varying rates. The statistics provided in table 3 help to illustrate this.

Table 3  
Statistics of six national accounting qualification bodies

	ACCA	CPA A	CGAA	CIMA	ICAEW	AICPA	Notes
	March 2012	mid-2011	2010–2011	December 2011	December 2011	2010–2011	
Number of members in hundreds of thousands	155	*87	50	87	138	**352	*Figures supplied by CPAA for the ASEAN Federation of Accountants (AFA) training and development analysis, 2011. **Voting members only. NASBA licences over 650,000 CPAs altogether.
Number of students/trainees in hundreds of thousands	434	*47	26	107	19	**n/a	*Figures supplied by CPAA for the ASEAN Federation of Accountants (AFA) training and development analysis, 2011. **Some 225,000 students enrolled in accounting programmes and 120,000 candidates for the uniform CPA examination per year.
Number of examination centres provided in countries outside home territory***	168	109	*8	163	16	**6	*Includes more than one Caribbean country. **2011: Bahrain, Japan, Kuwait, Lebanon and United Arab Emirates. 2012: Brazil. ***CPAA, CIMA and ICAEW also use a service provider to deliver computer-based examinations at lower levels in these and other countries.

Offices and representative offices outside home territory	82	12	4	18	6	*0	*Becker has established partnerships with tuition providers in some 46 countries to promote the CPA qualification.
Percentage of members based outside home territory	51	26	*8	25	15	2	*Estimate supplied by CGA-Canada.
Percentage of members in public practice	26	18	*13	1	32	45	Percentage based on all members, including retired and unemployed members. *Estimate supplied by CGA-Canada.

Note: Some data is based on 2010 figures (e.g. members based outside home territory and members in public practice for CIMA and ICAEW). Home territory includes the United Kingdom and Ireland for ACCA and CIMA.

As shown in table 3, some bodies have pursued the global route more intensively than others. For example, ACCA has the greatest proportion of members and national offices outside its home territory, while AICPA has the least, although AICPA has arrangements with Becker to promote the CPA qualification in several countries.

#### 4. Regional coverage

None of the bodies reaches every region. A comparison is shown in table 4.

Table 4

#### Regional coverage of six national accounting qualification bodies

	Asia–Pacific/Oceania	Caribbean	Africa	North America	Europe	Middle East	South America
ACCA	√	√	√		√	√	
CPAA	√						
CGAA	√	√		√			
CIMA	√	√	√				
ICAEW	√		√		√	√	
AICPA	√			√		√	√

Within regions, there are also heavy concentrations of members in certain countries especially in Asia–Pacific, where members are concentrated in Hong Kong (China), Malaysia, Singapore and, more recently, in China.

## F. Summary

Globalization and the convergence of standards are driving the spread and growth of global professional accountancy qualifications. The basic proposition for these qualifications is that they train aspiring accountants to a level of competence that equips them to work in the world of global standards while providing them with the skills they need to understand and work with divergent national practices as well. The demand for a global qualification derives from international firms that wish to relocate staff across national frontiers, as well as individuals who wish to emigrate.

A global qualification needs to take on certain characteristics, not all of which may be essential in the case of national-based qualifications. They include the following:

- (a) Curriculum based on IFRS and ISAs;
- (b) Based on global standards for ethics, professional conduct and corporate governance;
- (c) Conformity with international education standards;
- (d) A single set of competences;
- (e) Similar practical experience requirements globally;
- (f) Resources to conduct examinations in different countries;
- (g) Procedures to enable marking to be carried out to a global standard while ensuring the integrity and security of examinations;
- (h) Brand, market and, if possible, formal recognition of the qualification;
- (i) Online examinations;
- (j) Global tuition providers plus distance learning;
- (k) National offices around the world.

A global qualification also comes with certain limitations and restrictions. These include the following:

- (a) Usually examined in English;
- (b) Tax and law systems are national in scope and not uniform across national frontiers;
- (c) Formal recognition status may be restricted;
- (d) Audit licences and public practice rights usually require additional tests in national tax and law, at a minimum;
- (e) Discipline and regulation of members is often a matter for the national body.

The extent and depth to which certain bodies have pursued the global route in the development of their qualifications varies, and this is illustrated by some of the tables above. All of them have adopted a global approach to some degree.

## II. Overview of professional accounting qualification systems in five selected countries

### A. Introduction

This chapter reports on the institutional certification and licensing (qualification) requirements that exist as of December 2011 in five countries, namely Canada, Denmark, Japan, Mexico and South Africa.

Professional accountants and other participants constitute part of the human capacity that serves as an integral part of the process of producing high-quality corporate reporting. Strengthening the competences of professional accountants has therefore become a central element in global efforts towards continuous improvements in corporate reporting and auditing practices. The education, training and qualification of professional accountants are therefore embedded components in the capacity-building framework for high-quality reporting (UNCTAD, 2010).

A high-level description of the certification requirements in the respective countries is provided, followed by a short comparative assessment and a conclusion.

### B. Canada

The Accounting Standards Board (AcSB) in Canada adopted IFRS as the GAAP of Canada for publicly accountable enterprises for fiscal years beginning on or after 1 January 2011.

The Canadian Institute of Chartered Accountants (CICA) was incorporated by the Parliament of Canada as a not-for-profit entity in 1902, under the Canadian Institute of Chartered Accountants Act (2006). The act sets forth that the CICA is mandated to support and maintain consistent standards for the profession's qualification process. In Canada, CAs are admitted to the profession through one of their provincial or territorial institutes, which are responsible for establishing and administering the qualification process.<sup>63</sup>

The qualification process in Canada consists of three components, education, experience and evaluation. To begin the process, a candidate is required to hold a university degree and complete a provincial institute, "ordre" or regional student professional programme or its equivalent.<sup>64</sup>

In 2001, the CICA initiated changes to the CA qualification process that came into effect in 2003. The changes introduced a shift from a syllabus approach by which CA candidates "would just memorize the knowledge necessary to practice as a CA, to a competency-based approach" (CICA, 2002, available at <http://www.cica.ca>). A competency approach is described as an approach in which candidates are required to integrate knowledge, skills and attitudes to solve real-world business problems (CICA, 2002).

### C. Denmark

Denmark is a member State of the European Union. This means that financial reporting and accounting practices, as well as the accounting profession are, to the extent European Union directives are in place, harmonized within the Union.

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<sup>63</sup> Canada's International Qualification Appraisal Board (IQAB) determines whether to allow members of foreign accounting bodies to practice as CAs of Canada.

<sup>64</sup> In Canada, Chartered Accountants (CAs) enter the profession through their provincial institute or "ordre". These are responsible for establishing and administering the qualification process, admission criteria and performance standards within their jurisdictions. Pre-qualification education is delivered regionally, through one of four systems across Canada.



Beginning with financial statements for financial year 2005 onward, the European Union requires European companies listed in a European Union securities market, including banks and insurance companies, to prepare their consolidated financial statements in accordance with IFRS (European Union Regulation 1606/2002/EC on the application of international accounting standards). The accounting profession within the European Union is regulated through the directive on statutory audits (2006/43/EC).

Within the regulatory framework of the European Union, Denmark has its own judicial system. For the regulation of the accounting profession in Denmark, the Commerce and Companies Agency of Denmark sets out the particular rules on continuing education and on the oversight thereof. The Danish Act on Approved Auditors and Audit Firms sets the conditions for the approval and registration of auditors and audit firms. In Denmark, the term auditor is used rather than professional accountant.

Foreningen af Statsautoriserede Revisorer (FSR) is the professional body that oversees the accounting profession in Denmark. Candidates to enter the profession are required to hold a master's degree, complete three years of practical training and pass a final examination of professional competence.

To become a State-authorized auditor in Denmark, it is a requirement to have finalized a master's programme in business economics and auditing. In order to gain authorization, students are required to have at least three years of experience working for a State-authorized accountancy firm. Two of the three years must follow completion of the master's degree programme.

In 2010–2011, the Accounting Committee of Denmark considered the educational framework of the profession. A proposal was drawn up in spring 2011. It suggested that the two accounting professions of Denmark be merged. To support such a change, new forms of examination were also suggested.

Currently, only candidates holding a specific master's degree in accounting and auditing may enter the profession. It is suggested that candidates with other and related master's degrees be permitted to enter the profession. It is expected that a bill will be presented to the Parliament of Denmark during its 2012–2013 session.

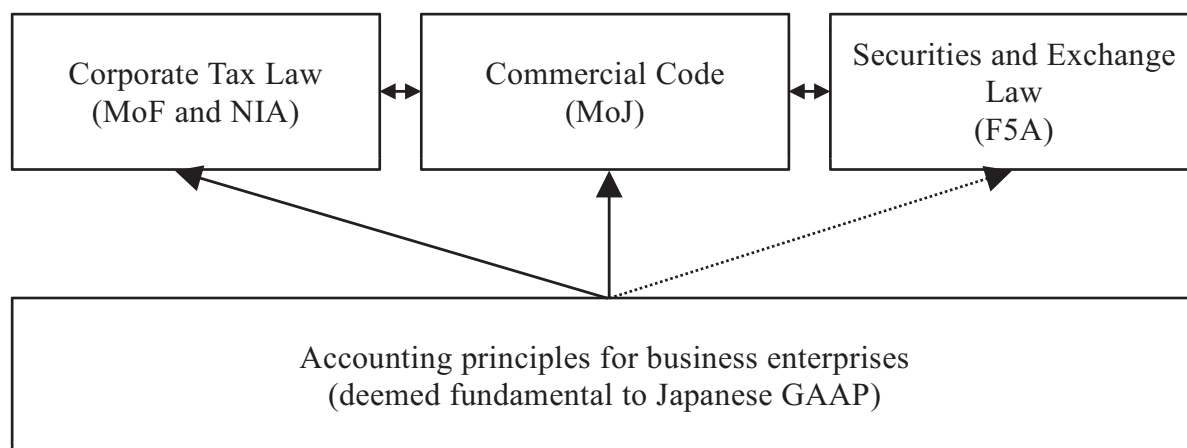
## **D. Japan**

Japan is often described as having a unique accounting regulatory system due to its triangular structure. This structure consists of the following three legislative components, as shown in figure 4:

- (a) Securities and Exchange Law, enforced by the Financial Services Agency (FSA), a subagency under the Ministry of Finance (MoF);
- (b) Commercial Code, enforced by the Ministry of Justice (MoJ); and
- (c) Corporation Tax Law, enforced by the National Tax Administration (NTA), a largely autonomous agency reporting to the MoF.

Figure 4

**Japan: Accounting regulatory system structure**



The underlying objectives of each of these laws differ, while at the same time they are interrelated, as shown in figure 4. Auditing standards, the practice of CPAs and audit corporations (*kansa houjin*)<sup>65</sup> in Japan are today overseen by the FSA. With regard to financial reporting, Japan is reporting under the GAAP of Japan but is on a convergence route towards potential use of IFRS.

The legislative framework that prescribes the rules for the accounting profession is set out in the certified public accountants law that was passed in 1948. The CPA law institutes the CPA qualification. It was through the establishment of the CPA law that the Institute for Certified Professional Accountants of Japan (JICPA) was established.<sup>66</sup>

The FSA has a subcommittee called the Certified Public Accountant System of the Financial System Council (available at <http://www.fsa.go.jp>, 2006), which establishes the policies for governing CPAs. The JICPA is the only professional accounting body in Japan and its key role is to keep a register of all CPAs in Japan. The JICPA has the authority to revoke the registration of any CPA who has been disciplinarily sanctioned and in this regard the JICPA may perform a role equivalent to that of the State Accountancy Board in the United States (JICPA, 2004).

To keep pace with the requirements of the contemporary economic environment in Japan, the CPA law was amended in June 2003 (the amendments were implemented on 1 April 2004) to strengthen control over CPAs and to make changes to the CPA examination system. The amendments of the reforms of the CPA examination system became effective as of January 2006.

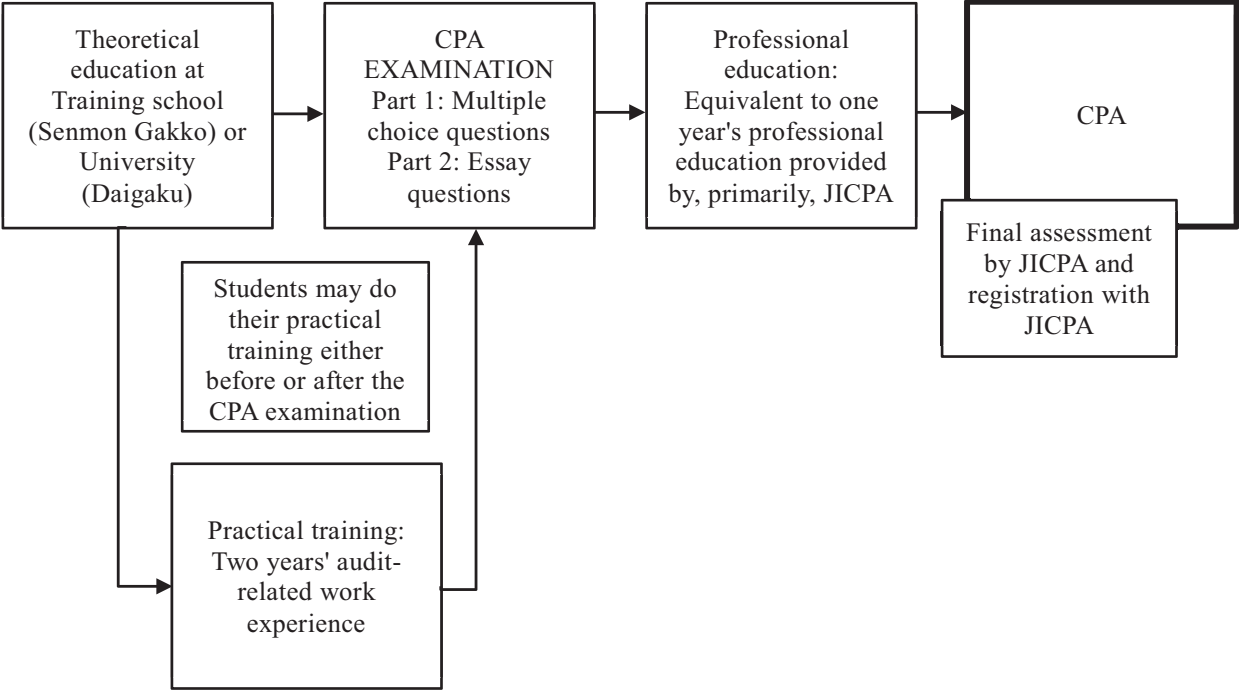
The reformed CPA law requires that “not only the applicants’ professional knowledge but also their ability to think and judge practically be considered in order to appropriately judge whether the applicants have enough professional knowledge applicable to practice as certified public accountants” (article 8, paragraph 4).

The qualification requirements for CPAs include a professional education, professional examinations, practical experience and language skills, as shown in figure 5. It may be noted, however, that the CPA of Japan examination may be taken by any candidate, irrespective of their educational background. The requirement for two years of practical experience may be satisfied before or after the examination.

<sup>65</sup> Audit corporations are defined as corporations that consist solely of CPAs with unlimited liability.

<sup>66</sup> The JICPA was incorporated as a private establishment on 1 April 1953. The constitution of the JICPA includes provisions on members’ obligations to observe the code of ethics and other resolutions of its committees, such as the Audit Standards, Quality Control Review and Audit Practice and Review Committee. Changes in the constitution of the JICPA must be approved by the FSA (JICPA, 2004).

Figure 5  
**Japan: Process to qualify as a certified professional accountant**



According to the CPA law, the CPA examinations shall be conducted at least once each year. In practice, the examinations are conducted only once per year. They are conducted on a nationwide basis, and there is therefore no different treatment among individual provinces in Japan. The examination is held only in Japanese. It consists of a multiple-choice test and an essay. Candidates successful in the multiple-choice test are entitled to sit the essay part of the test.

An individual seeking to qualify as a CPA in Japan must pass three levels of CPA examinations, as shown in table 5, conducted by the Certified Public Accountants and Auditing Oversight Board, an advisory body to the Financial Services Agency (FSA), as noted in figure 5. University graduates are exempt from the first level.

Table 5  
**Japan: Certified professional accountant examination levels**

Examination Level	Educational requirements
First	None
Second	May be taken by students who have either graduated from college/university or completed two years of study at college/university or candidates who have passed the first examination
Third	May be taken by candidates who have passed the second examination

Source: JICPA, 2006, available at <http://www.jicpa.co.jp>.

## E. Mexico

In Mexico, a multiplicity of legal arrangements prescribe the requirements for accounting and financial reporting.<sup>67</sup> Mexico opted to adopt the International Financial Reporting Standards (IFRS) in full from 2012 for listed companies (Hoogervorst, 2012).<sup>68</sup>

The accounting profession is regulated under Article 5 of the Constitution by the Ministry of Education (Dirección General de Profesiones de la Secretaría de Educación Pública), while the Mexican Institute of Public Accountants (Instituto Mexicano de Contadores Públicos (IMCP)), which operates as a self-regulated institution, oversees the accounting profession.<sup>69</sup>

The IMCP prescribes that, in order to qualify to begin the process of becoming a professional accountant, a contador público certificado (CPC), an individual must have completed high school studies and obtained a university degree. In addition to the requirement of having completed an academic degree, a CPC must complete prescribed experience requirements of three years in public accounting activities and pass the “examen uniforme de certificación”.

Having obtained the professional title, a CPC is required to register it with the Government, in order to practice the profession in the country. The professional registration (cédula profesional) allows CPCs to provide services throughout the country.

Canada, Mexico and the United States agreed in September 2002 to mutually recognize the substantial equivalency of each nation’s professional accounting designations, the CA (chartered accountant), CPC and CPA, respectively.

Under the new accord, which took effect when ratified by the NAFTA Free Trade Commission (January 1994), individuals holding any of these designations are allowed to practice in either of the other countries after demonstrating, through an examination, an understanding of the differences between their own national accounting systems and principles and those of the other country (Peek et al., 2007).

## F. South Africa

South Africa’s Financial Reporting Standards Council (FRSC), formed in late 2011, is the legally constituted standard setter for South Africa for financial reporting and accounting practices.<sup>70</sup> A law promulgated in 2011 specified in its regulations that entities in South Africa are permitted to use either International Financial Reporting Standards (IFRS), IFRS for small and medium-sized enterprises or statements of Generally Accepted Accounting Practice (GAAP) of South Africa, depending on their public interest score.

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<sup>67</sup> The central elements of the statutory framework for accounting and financial reporting include the general law for commercial enterprises (ley general de sociedades mercantiles (LGSM)), which prescribes general rules on the form of financial information provided to shareholders and the securities market law (ley de mercado de valores (LMV)), which specifies that all listed companies must prepare consolidated financial statements in accordance with accounting standards approved by the national Banking and Securities Commission (Comisión Nacional Bancaria y de Valores (CNBV)).

<sup>68</sup> Address by Hans Hoogervorst, Chairman of the IASB, to the Consejo Mexicano de Normas de Información Financiera (CINIF) in Mexico City, Mexico, 7 March 2012.

<sup>69</sup> Prior to 2004, the Institute of Public Accountants of Mexico (Instituto Mexicano de Contadores Públicos (IMCP)) was responsible for the issuance of accounting standards. However, from 1 June 2004, the Board for the Research and Development of Financial Reporting Standards of Mexico (Consejo Mexicano de Normas de Información Financiera (CINIF)) assumed the duties and responsibilities for issuance of IFRS of Mexico. One of the key assignments of the CINIF was to conduct a study of IFRS and the United States GAAP to identify the most significant differences with a view to promoting their convergence. The first step was to revise the framework, as well as revising some older standards of Mexico to bring them closer to IFRS.

<sup>70</sup> The predecessor to the FRSC was the Accounting Practices Board (APB). The APB was a private-sector body consisting of a number of accounting and industry bodies and was empowered to issue accounting standards for companies of South Africa to follow.

In South Africa, the Chartered Accountants Designation (Private) Act regulates the accounting profession and restricts the use of certain designations related to chartered accountants.

The requirements for qualification as a chartered accountant in South Africa consist of three components, education, practical experience and a final examination. The key educational requirement is a bachelor's degree in accounting.

In addition, three years of practical experience need to be gained through either training inside public practice with a registered training organization, a firm of chartered accountants in public practice or training outside public practice with an approved training organization in commerce and industry, typically at a large bank or corporate (excluding practice as an auditor). The qualification process is considered complete when the candidate passes the qualifying examination.

## **G. Comparison**

In reviewing the regulatory and institutional arrangements for the process of qualifying as a professional accountant in the five selected countries, it is clear that the main substance of the overall design of the qualification process is similar. However, certain distinct differences exist. Each country has requirements for practical experience as well as a final qualifying examination. There are differences with regard to educational requirements. Japan, for example, has a qualification system whereby candidates may enter the qualification process through an entrance examination if they do not have a university degree. In Denmark, candidates are required to complete a master's degree in business economics and auditing, though this requirement is currently under discussion. The other three countries require candidates to hold a bachelor's degree. Each country, except Japan, has a requirement for three years of practical training as an integral part of the qualification process.

The review of the five countries has also illustrated that the basis of the regulation of the accounting profession in each of the countries is enshrined in legislation. In each country, except Canada and South Africa, there is a governmental regulatory body involved in the qualification process.





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