United Nations

TD/B/C.II/ISAR/56

United Nations Conference on Trade and Development

Distr.: General
3 August 2010

Original: English

Trade and Development Board
Investment, Enterprise and Development Commission
Intergovernmental Working Group of Experts on
International Standards of Accounting and Reporting
Twenty-seventh session
Geneva, 13–15 October 2010
Item 3 of the provisional agenda

Capacity-building framework for high-quality corporate reporting

Note by the UNCTAD secretariat

Executive summary

High-quality corporate reporting is essential for a well-functioning market economy. In the wake of the financial crisis, policymakers at the highest level have been calling for improvements in this area. Member States need to develop a coherent approach to developing the capacity needed for achieving this objective.

This paper presents key issues that need to be considered in building national capacity in this area. It discusses key elements of a capacity building framework. These are: legal and regulatory framework; institutional framework; human capacity; and the capacity-building process. It provides a variety of international, regional and national references and good practice examples.

It is being presented for consideration by the twenty-seventh session of UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR). The deliberations of the twenty-seventh session of ISAR are envisaged to culminate with guidance on this issue.

Contents

Introduction

1. High-quality corporate reporting is fundamental to a well-functioning economic and financial system. Following the current financial and economic crisis, it has become more apparent than ever that sound financial reporting is essential for global financial stability and growth. It also highlighted the relevance of accounting, reporting and auditing standards and transparency for reducing the likelihood of fraud and mismanagement, promoting good governance, and maintaining investor and consumer confidence. The crisis has further raised awareness of the need to converge towards effective global reporting standards.

2. The crisis and following discussions of highest level policymakers on reforming the global financial system also highlighted a need for building institutional and technical capacity to facilitate improvement of corporate reporting along the entire reporting chain. The Financial Stability Forum has identified capacity-building as one of the measures that is needed to promote adherence to international standards and codes.

3. For over two decades, UNCTAD, through the work of its Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been contributing towards harmonization of corporate reporting to assist developing countries and economies in transition to meet international requirements in this area and facilitate investment.

4. At its twenty-sixth session in 2009, ISAR agreed on the need for further work in the area by addressing issues of capacity building needed for high-quality corporate reporting with a view to develop a capacity-building framework. It discussed that a guiding framework document based on good practices and lessons learned in capacity building can be a useful tool to assist developing countries and countries with economies in transition in formulating and carrying out such activities.

5. It requested the UNCTAD secretariat to reconstitute a consultative group to work on the issue and to propose an approach for consideration by the twenty-seventh session of ISAR. In accordance with this request, the Consultative Group was formed (see appendix V of TD/B/C.II/ISAR/56/Add.1) and held its first meeting in Geneva from 20 to 22 May 2010. It discussed a draft document prepared by the Secretariat with the assistance provided by the Association of Chartered and Certified Accountants (ACCA). Members of the group also provided electronic comments afterwards which are incorporated into this final version of the document to be presented to the twenty-seventh ISAR session.

6. The objective of the paper is to provide guidance on what are the key components of capacity needed to ensure high quality corporate reporting and what is required to build such capacity. It is not country-specific; rather, it summarizes good practices and has been informed by sources such as UNCTAD’s work on International Financial Reporting Standards (IFRS) practical implementation, the World Bank Report on the Observance of Standards and Codes (ROSC) programme and follow-up capacity development activities, the International Federation of Accountants (IFAC) Compliance Programme Action Plans, as well as on relevant research and the practical experience of different countries, agencies and Professional Accountancy Organizations on national capacity-building programmes, particularly in developing countries and countries with economies in transition. Some country practice references are cited in this paper to illustrate how particular systems work in practice. These are meant to serve as examples and no particular preference is intended for such arrangements over other systems.

7. In this paper, the term corporate reporting is used in a broader sense, including financial as well as non-financial reporting, such as corporate governance, corporate

responsibility and climate change disclosures. The paper does not cover public sector accounting issues. Although the latter constitutes an integral part of the capacity-building on accounting and reporting, it has distinct elements compared to corporate reporting. At this stage, it is an evolving area of reforms for many countries and time is needed to comprehend good practices and lessons learned on related matters in a concise way.

I. Capacity-building framework

8. In order to build capacity, some major decisions need to be taken to address the following issues:

(a) What standards and requirements should be used to achieve high-quality corporate reporting?

(b) What tasks need to be performed along the reporting chain to ensure consistency, coherence and efficiency of efforts towards high-quality corporate reporting?

(c) Who should be responsible and for which actions?

(d) How to ensure that tasks are implemented in a competent manner and the required technical expertise is in place?

(e) What should be the time-frame and what financial resources are needed?

9. Building capacity in accountancy is a complex process that requires a comprehensive approach because the accounting infrastructure itself is part of the entire legal and regulatory system designed to secure property rights, enforce contracts and provide financial information on an entities performance. It also requires consideration of interests of a number of stakeholders, as well as availability of financial, educational and human resources.

10. In order to grasp the complexity of capacity needed for high quality corporate reporting in a more structured way a matrix has been prepared which also provides an outline for this paper (see appendix I in TD/B/C.II/ISAR/56/Add.1). The objective of this matrix is to make the document more user-friendly. As with the paper, this matrix does not necessarily cover all aspects which may be required to be addressed in a specific country context.

11. In the context of this paper, capacity-building refers to assistance with putting in place the proper legal framework and institutional arrangements that need to be in place to support high-quality corporate reporting. Capacity-building also refers to assistance that is provided to entities which have a need to develop a certain skill or competence, or for general upgrading of performance ability. Capacity can refer to the capacity of individuals, groups or institutions and civic structures.

Core pillars

12. As it is suggested in the matrix, the capacity-building framework could be structured into four main pillars:

(a) Legal and regulatory framework;

(b) The institutional framework;

(c) Human capacity; and

(d) The capacity-building process itself.

13. These are each considered in relation to:

(a) Stages in the corporate reporting process;

(b) Elements making up each main part and the bodies/institutions involved in the process;

(c) International standards/principles available to build capacity;

(d) Good practice examples/guidance as benchmarks and references for building capacity (see Appendix II in TD/B/C.II/ISAR/56/Add.1); and

(e) Milestones and indicators to measure progress.

II. Legal and regulatory framework

14. One of the core pillars of the capacity-building framework is the legal and regulatory framework. This can take different forms depending on the background and culture of the country. However, some common aspects can be identified based on experience gained through years of accounting and audit reforms aimed at international harmonization and improving the quality of corporate reporting.

15. To ensure that all important elements are considered while building a regulatory framework it could be useful to look at stages which are followed in preparing and reporting companies' accounts:

(a) Preparing and keeping financial records (bookkeeping);

(b) Risk assessment, internal controls and internal audit;

(c) Preparing financial statements;

(d) Approving financial statements, including review by the Board of Directors and its relevant committee(s), in a manner consistent with sound corporate governance;

(e) Auditing financial statements, including interaction with the audit committee of the Board of Directors;

(f) Filing and publishing financial statements;

(g) Corporate governance;

(h) Analysis and use of financial statements;

(i) Reporting under multiple frameworks;[1]

(j) Oversight and quality assurance of auditors; and

(k) Monitoring and enforcement of standards.

16. However, it is important to recognize that not all of these stages apply to all entities. For example, micro enterprises may only keep basic records and may not file or publish accounts. Small and medium-sized enterprises (SME) may follow simplified accounting rules[2].

[1] Some entities apply more than one reporting framework to reports for different users – for example, investors and prudential regulators.

[2] Not all enterprises are required to have statutory audits.

A. Elements

17. The legal and regulatory pillar of the capacity framework should be set to ensure that participants along the reporting chain perform certain tasks at a required level of quality. For example, it should provide the framework to (a) develop, enact or amend appropriate laws and regulations; (b) endorse and enforce accounting and auditing standards and ethical norms; (c) license and monitor statutory auditors in line with quality control requirements; (d) review statutory financial statements and reports (for example, pertaining to prudential regulation) and/or listed company financial statements and reports in line with accounting standards and disclosure requirements; (e) qualify accountants at the professional level by both examinations and practical training as well as others, e.g. regulators; (f) discipline individuals and firms; (g) ensure continuing professional development (CPD); and (h) ensure good governance in both the private and the public sector.

18. In order to develop an adequate regulatory framework, the variety of regulatory and institutional models could be considered as a reference. Decisions and actions regarding the most efficient regulatory setting in a country should be based on a thorough consideration of a legal system of a particular jurisdiction, level of its economic development as well as availability of resources and required professional expertise.

19. The following elements are suggested to be included in legal and regulatory frameworks:

(a) Accounting and audit standards and requirements;

(b) Endorsement of standards;

(c) Enforcement of standards;

(d) Monitoring and compliance with standards and requirements;

(e) Licensing (normally of auditors);

(f) Training (of accountants, auditors, regulators and other stakeholders);

(g) Corporate governance;

(h) Ethical standards (for professional accountants and auditors);

(i) Investigation and discipline;

(j) Quality assurance mechanisms (normally of auditors); and

(k) Auditor liability and accountability.

20. Therefore, in shaping this pillar a number of issues need to be considered. Those include:

(a) A need to ensure a coherent accountancy/reporting legal and regulatory framework, as different aspects of company accounting and reporting are normally set out in such pieces of legislation as Accounting Act, Corporate Legislation, as well as in banking, securities and insurance legislation;

(b) Distinction between public-interest and non-public-interest entities, and the size limits of small and medium sized enterprises (SMEs), as well as the public sector role to clarify the scope of application of related standards and requirements;

(c) Mechanisms to ensure efficient coordination within the accounting legislative and regulation framework as well as with other related legislative sources such as on investment, finance, etc.; and

(d) Adequate enforcement and oversight mechanisms, compliance and discipline, including legal sanctions.

21. One problem is often that existing laws may have grown up piecemeal so that the regulatory system is fragmented and spread out among several different government departments or regulatory agencies. If the opportunity arises, it may be useful to consider drafting a new piece of legislation and/or regulation which centralizes the regulation of accounting and auditing within a unified framework.

B. Accounting and auditing standards

22. Another set of issues is related to making a decision on whether international standards will be used for statutory accounting requirements and national audit legislation.

23. To assist with building a regulatory framework which will allow systems to meet international requirements in the area of corporate reporting, a wide range of international standards issued by international bodies are available as well as other internationally accepted standards and guidance issued in countries that have well-developed accounting professional bodies, national standard setters and oversight bodies.

1. Accounting standards

24. Accounting frameworks may be built on the adoption of IFRS (including IFRS for SMEs and International Public Sector Accounting Standards (IPSAS)). In this regard, the scope of IFRS application should be considered.

25. The International Accounting Standards Board (IASB) develops global accounting standards and related interpretations collectively known as International Financial Reporting Standards (IFRS). IFRS are intended to be used for the preparation of general purpose financial statements. Regulators for specific sectors may have their own reporting requirements which differ from or supplement IFRS (or may use IFRS but require additional disclosures), particularly in regards to banks, insurance companies and taxation.[3]

26. Over 100 countries either require or permit the use of IFRS for the preparation of financial statements. For example, all member States of the European Union (EU) have adopted IFRS for the preparation of consolidated financial statements (but not necessarily for separate company accounts). Nevertheless, depending on the general economic situation, the existing regulatory framework and the financial reporting tradition, practical implementation of IFRS can pose considerable challenges.

27. When IFRS are adopted in a given jurisdiction the adoption can be handled in such a way that they become part of the existing laws and regulations of that jurisdiction. This requires assessment of the existing laws and regulations which might require amendments to recognize the introduction of IFRS. For example, the Peruvian Law establishes that consolidated and separate financial statements of Peruvian companies must be prepared according to IFRS as approved by the Peruvian accounting standards setter. In some cases,

[3] For the public sector entities, IPSAS could be used which have been published by the International Public Sector Accounting Standards Board under the auspices of IFAC. In developing countries and countries with economies in transition the public sector is often the dominant force in the economy and therefore controlling and accounting for government finances may be as important, or even more so than accounting for private sector enterprises. In the aftermath of the financial crisis the increased role of the public sector requires more efforts towards improvement of public sector reporting in all countries concerned.

situations arise where IFRS requirements contradict applicable provisions in national laws and regulations.

28. When the decision is made to adapt international standards rather than just accepting them as they are published certain issues need to be addressed. The IASB considers it should be the only body which issues official interpretations of its standards. It is important therefore to have a mechanism to interact with the IASB before a standard is issued or ask for clarification afterwards which can be published by the IASB.

29. Adapting standards for national use means the advantage of providing comparable financial information to users may be lost. On the other hand, certain regulators may need to set their own accounting rules to suit national circumstances. These would not normally apply to general purpose financial statements but may apply to particular sectors, e.g. banking or insurance. Some countries have created committees to deal with legal and economic local issues not addressed by IFRSs, in order to agree on the accounting treatment to be followed and avoid lack of comparability among companies' reports.

30. In some cases, countries use a differential approach to developing an accounting framework. A first tier uses IFRS (this might include listed companies and public interest entities) A second tier uses IFRS based standards adapted for that particular tier (this might be the IFRS for SMEs). A third tier consisting of micro enterprises uses a highly simplified system which is close to cash accounting. (UNCTAD has issued guidance on this referred to as Accounting and Financial Reporting Guidelines for Small and Medium–sized Enterprises or SMEGA Level 3.)

31. In this regard, a system of assisting SMEs in their compliance with the statutory accounting requirements should be considered.

32. In case of adopting international standards published by international bodies, an efficient mechanism for translation of these standards into a national language should be set up, including a coordinating mechanism with the related standard-setter and related quality controls in order to ensure that the standards will be available on time in the language required. The IASB has a policy that the permission of the International Accounting Standards Committee (IASC) Foundation is required before any translations of IFRS are allowed. The IASC Foundation will only allow one version of each translation.

2. Auditing and assurance standards

33. One of the common aspects of some countries which implemented IFRS is that they require the audit of IFRS financial statements to be conducted in accordance with International Standards of Auditing (ISA) issued by the International Auditing and Assurance Standards Board (IAASB). ISAs can be an important tool in enforcing the proper implementation of IFRS. Guidance for the application of ISA for small and medium-sized practices are available from IFAC's Small and Medium-sized Practices Committee (IFAC (2009). Guide to quality control for small and medium sized practices.)

34. Other sources of international principles, standards and guidance on accounting and auditing and regulation include:

(a) International Organization of Securities Commissions (IOSCO)[4] Objectives and Principles of Securities Regulation and related assessment methodology;

(b) Other IOSCO principles, statements and reports relating to financial reporting, auditing, internal control, auditor oversight and governance matters;

[4] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf.

(c) Basel Committee[5] principles, standards and guidance on corporate governance, accounting, auditing and disclosure (including valuation and provisioning) are particularly relevant for the supervision of banks;

(d) XBRL[6] (Extensible Business Reporting Language) which provides a global standard for the exchange of financial information;

(e) IAIS (International Association of Insurance Supervisors) principles, standards and guidance particularly relevant to insurers; and

(f) INTOSAI[7] (International Organization of Supreme Audit Institutions) guidance and standards particularly relevant to accounting and auditing in the public sector.

35. Regional and national sources include:

(a) EU 8th Company Law Directive[8] on Statutory Auditors;

(b) Sarbanes Oxley Act[9] in the United States;

(c) COSO[10] (Committee of Sponsoring Organizations of the Treadway Commission) model on internal controls;

(d) National banking codes; and

(e) Institute of Internal Auditors standards and guidance on internal audit.

3. Environmental, social and governance disclosure standards and guidelines

36. One of the evolving trends in the area of corporate reporting is a growing attention to non-financial matters, such as environmental, social and corporate governance issues.

37. At the current stage disclosure on a range of environmental, social and governance (ESG) issues is the subject of a number of voluntary international best practice guidelines. A national framework to address ESG issues can benefit from international best practice guidance, as well as international networks and management systems standards.

38. Reporting on environmental and social issues provides useful information to a range of key stakeholders, including government regulators, investors, business partners, employees and the local community. In both developed and developing countries, industrial activity poses a number of environmental risks; transparent reporting on these risks can improve risk management and mitigation efforts. A number of international guidelines can assist countries in developing a reporting framework in this area. UNCTAD has developed guidance to assist countries in this regard, including guidance on eco-efficiency indicators[11] and corporate responsibility indicators in annual reports.[12] The Global Reporting Initiative[13] has developed sustainability reporting guidelines that cover a broad range of

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5 http://www.bis.org/bcbs/.

6 http://www.xbrl.org/Home/.

7 http://www.intosai.org/en/portal/about_us/.

8 For the text of the EU 8th Directive see http://ec.europa.eu/internal_market/auditing/directives/index_en.htm.

9 http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf.

10 http://www.coso.org/guidance.htm.

11 UNCTAD (2004). *A Manual for the Preparers and Users of Eco-efficiency Indicators*. Available online at: www.unctad.org/en/docs/iteipc20037_en.pdf.

12 UNCTAD (2008). *Guidance on Corporate Responsibility Indicators in Annual Reports*. Available online at: www.unctad.org/en/docs/iteteb20076_en.pdf.

13 For more information on the Global Reporting Initiative and to obtain a copy of their *Sustainability Reporting Guidelines*, please visit: www.globalreporting.org/.

social and environmental subjects. The Organization for Economic Co-operation and Development (OECD) *Guidelines for Multinational Enterprises*[14] and the International Organization for Standardization (ISO) 26000 standard[15] on social responsibility both contain useful guidance on environmental and social reporting and management practices. An environmental management system standard, such ISO 14000, can also be helpful in providing guidance on internal reporting and data collection.[16] The United Nations Global Compact also has a reporting framework that allows companies to report on their activities relative to the ten principles of the Global Compact.[17]

39. Disclosure on governance structures are critically important for facilitating investor relations, promoting economic stability and building credibility in the governance and management systems that produce financial accounting reports. International guidance in this area is provided by a number of organizations, including the OECD (the *Principles of Corporate Governance*[18]), the World Bank (ROSC reviews and other guidance[19]), the International Finance Corporation (IFC) (especially the work of the Global Corporate Governance Forum[20]), IOSCO (various guidance and support for the development of securities regulators), the International Corporate Governance Network (*Global Corporate Governance Principles*) and UNCTAD (*Guidance on Good Practices in Corporate Governance Disclosure*[21] and reviews of corporate governance disclosure practices and regulation[22]). Newer institutions are also emerging (e.g. the International Interconnected Reporting Committee, and the Carbon Disclosure Standards Board), which aim to assist in promoting the harmonization of ESG standards and the integration of ESG issues into corporate reporting. National frameworks can use the guidance offered by these organizations as a basis for the development of their own national corporate governance codes and disclosure regulations.

40. Various institutions can also be developed to support reporting on ESG issues including for example (a) institutes of directors (especially for issues of corporate governance); (b) corporate social responsibility institutes (e.g. the Egyptian Corporate

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[14] OECD (2000) *Guidelines for Multinational Enterprises*. Available online at: www.oecd.org/dataoecd/56/36/1922428.pdf.

[15] The ISO guidance standard on social responsibility will be published in 2010 as *ISO 26000* and its use will be voluntary. It will not include requirements and will thus not be a certification standard. For more information, please visit: www.iso.org/sr.

[16] More information on the range of ISO environmental management system standards can be found here: www.iso.org/iso/iso_14000_essentials.

[17] The Global Compact publishes a number of guidance materials to assist companies in producing a *Communication on Progress* with the ten principles of the Compact. These guidance materials are available here: www.unglobalcompact.org/COP/Guidance_Material/index.html.

[18] OECD (2004) *Principles of Corporate Governance.* Available online at: www.oecd.org/dataoecd/32/18/31557724.pdf.

[19] As part of the Reports on the Observance of Standards and Codes (ROSC) initiative, the World Bank has established a program to assist its member countries in strengthening their corporate governance frameworks. The World Bank conducts corporate governance country assessments under the ROSC initiative at the invitation of country authorities. More information on this programme can be found here: www.worldbank.org/ifa/rosc_cg.html.

[20] The Global Corporate Governance Forum supports regional and local initiatives to improve corporate governance in middle- and low-income countries in the context of broader national or regional economic reform programs. More information on this programme can be found here: www.gcgf.org/.

[21] UNCTAD (2006) *Guidance on Good Practices in Corporate Governance Disclosure*. Available online at: www.unctad.org/en/docs/iteteb20063_en.pdf.

[22] UNCTAD’s annual corporate governance reviews examine regulatory requirements and actual company disclosure practices in a number of countries around the world. These studies are available online at: www.unctad.org/Templates/Page.asp?intItemID=2920&lang=1.

Responsibility Centre); or (c) Global Compact National Networks. Such institutions can provide technical support in human capacity-building in related areas.

4. Endorsement

41. Adoption of IFRS and ISA within national legislation and regulation may be supported by the establishment of an efficient endorsement mechanism. If such an endorsement function is established, this needs to be timely; otherwise national standards can fall behind international norms, For example, in the European Union, IFRS go through an endorsement process[23] before they become applicable.

5. Enforcement

42. One of the critical elements in the implementation of corporate reporting standards and codes is rigorous enforcement. The responsibility for enforcing (international) standards often rests with several different parties. Institutions such as securities exchange commissions, banking and insurance supervisory authorities, stock exchanges and capital market authorities all play important roles in enforcing financial reporting requirements.

43. In countries where these regulators have developed their own individual requirements, with separate legislative powers, the task of centralizing and unifying the regulatory environment requires a great deal of consultation and persuasion.

44. Assessing existing enforcement mechanisms requires a review of the regulatory structures in place, including the legislative environment and sample checks of regulatory procedures as they are implemented. This includes tests of quality controls within audit firms, tests of the effectiveness of monitoring visits and reports, and tests of compliance with standards and best practices, and action taken to rectify failings.

45. The International Organization of Securities Commissions (IOSCO) endorsed the IFRS standards in 2000. The IOSCO principles set global benchmarks for the regulation of securities markets and principles 8 to 10 deal with the enforcement of standards.[24]

6. Oversight, monitoring and compliance

46. Oversight, monitoring and compliance are important elements of the regulatory pillar of the capacity building framework.

47. In some cases, a government department may take statutory powers to set up a Public Oversight Board or it may take these powers itself. In some cases, countries set up independent boards or regulatory bodies with focused mandate and authority to fulfil the oversight function.

48. Oversight may also be extended to the national professional body or bodies of accountants, which generally will have responsibility for their members in respect of:

(a) Proper application of professional and ethical standards;

(b) Continuing Professional Development (CPD);

(c) Investigation, discipline and appeals;

(d) Qualification requirements for membership including professional exams and practical experience; and

[23] http://ec.europa.eu/internal_market/accounting/docs/ias/endorsement_process.pdf.
[24] See http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf.

(e) Licensing of members in public practice outside the scope of the Public Oversight Board e.g. for the audit of entities which are not deemed to be public interest entities or for services which are not audit services e.g. tax advice.

49. For setting mechanisms on compliance with statutory accounting and reporting requirements the following tasks should be considered:

(a) Design an appropriate review programme and checklists;

(b) Decide on the composition of the panel that will perform reviews;

(c) Set the criteria for the selection, training and evaluation of reviewers;

(d) Set the criteria for the selection of issuers and audit firms for monitoring;

(e) Formulate the classification of the findings;

(f) Establish review and sign-off procedures as part of internal quality control;

(g) Decide on the method of reporting findings to the issuer, audit firm and to the regulator, including the Registrar of Companies;

(h) Establish corrective action on serious non-compliance issues by issuers;

(i) Establish regulatory action on audit firms and consider the interaction with licensing and disciplinary systems.

50. In recent years, a trend has been evolving towards setting an independent external oversight of the audit function to strengthen the protection of the public interest and facilitate confidence in corporate reporting. One of the important decisions is this regard would be to consider its scope of work (for example, on cost-benefit grounds the oversight body may carry out quality assurance on audits of public interest entities only) and tasks to be performed. Based on existing practices, the following aspects are to be considered in this area:

(a) Define the standards against which monitoring should take place;

(b) Decide on the composition of the monitoring team;

(c) Set the criteria for the selection, training and evaluation of reviewers;

(d) Set the criteria for the selection of firms and audits for monitoring;

(e) Design an appropriate monitoring programme and checklists;

(f) Formulate the classification of monitoring findings;

(g) Establish review and sign-off procedures as part of internal quality control;

(h) Decide on the method of reporting findings on the firms monitored to the regulatory authorities including the Professional Accountancy Organizations;

(i) Establish regulatory action and follow-up procedures on unsatisfactory visit outcomes; and

(j) Consider the interaction with licensing and disciplinary systems;

7. Quality assurance

51. In building a regulatory pillar quality assurance mechanisms play a crucial role.

52. In this regard, IFAC's Statements of Membership Obligations (SMOs) could be a good source of information and guidance in building such mechanisms. As a global professional organization for accountancy bodies, IFAC's SMO 1 requires Professional Accountancy Organizations to establish and publish quality control standards and guidance

requiring firms to implement a system of quality control in accordance with the International Standard on Quality Control (ISQC 1). SMO 1 is to be applied by member bodies of IFAC to quality assurance review programmes for their members performing certain audit engagements of financial statements.

53. SMO 1 and ISQC 1 are standards which require considerable resources and expertise to implement properly. If the expertise is not readily available then a significant training programme is required to build up the required in-country expertise. In any event, the need for experts can represent a considerable financial demand on limited resources.

III. Institutional framework

54. One aspect of capacity-building as it relates to the legal and regulatory framework is to ensure that the main institutional bodies are in place.

55. Establishing the essential institutions requires the political will at the top level in government. It also requires buy-in by all the key stakeholders and it requires adequate resources. Sustaining these institutions also requires on-going funding and political support.

56. The institutional framework in which accountancy capacity-building takes place includes many civic institutions both private and public. The civic architecture may vary from country to country, but the strength of these institutions has a crucial bearing on the success or otherwise of capacity building projects. These institutions generally consist of:

(a) Legislative body (e.g. Parliament, Congress, etc.);

(b) Government ministries;

(c) Regulatory bodies;

(d) Judiciary;

(e) Government registry (of companies);

(f) Stock exchanges;

(g) Standard-setting bodies;

(h) Rating agencies;

(i) Accounting and audit firms; and

(j) Professional accountancy organizations.

57. Capacity-building projects have to take all these institutions into account and generally follow four main stages of development:

(a) Design and creation of sound governance structures;

(b) Ensuring the sustainability of these structures;

(c) Attracting and retaining talented people; and

(d) Continuous improvement and performance measurement.

58. They also require consideration of the following issues:

(a) The statutory responsibilities and legal status of each body within the regulatory framework; clarifying any regulatory roles delegated by the State to specific agencies and/or the accountancy profession;

(b) The governance arrangements within each regulatory body, including how members are appointed and their duties;

(c) The interaction and cooperation among the different institutions;

(d) The management structure and the role of senior staff within each body; and

(e) Funding arrangements for each body.

59. Regulatory bodies are charged with one or more of the following responsibilities: (a) adopting and approving accounting and/or auditing standards; (b) licensing and monitoring of auditors; (c) oversight; and (d) reviewing published financial statements and taking enforcement actions as appropriate. In most countries, these tasks are assigned to different bodies.

60. For example, the oversight the Financial Reporting Council (FRC) in the United Kingdom has been set up to oversee financial reporting and auditing (see appendix III of TD/B/C.II/ISAR/56/Add.1 for an illustration of how the FRC provides the public oversight function).[25] In the United States of America, the Public Company Accounting Oversight Board (PCAOB) oversees the work of audit firms that provide assurance on financial reports of listed companies. The United States Securities and Exchange Commission (SEC) conducts reviews of company reports. A regulatory framework is subject to changes that would arise over time. For example, at the end of July 2010, the United Kingdom Government made proposals,[26] including, merging the Financial Reporting Council (FRC) and the United Kingdom Listing Authority. The FRC has invited stakeholders' views on the proposal.

61. Difficulties often arise when the regulation of auditors as well as of accounting and auditing standards are spread out amongst a variety of regulators. This can lead to more than one list of approved accountants and auditors as well as a variety of standards and other requirements. In such cases, establishment of a coordination mechanism between different regulators is critical and a unified structure is preferable if this can be achieved. For example, in Mexico the Mexican Accounting Standards Board (CINIF) and the Securities and Exchange Commission (CNBV) have been working together in a convergence project to eliminate differences and inconsistencies between the accounting rules that CNBV issues for the financial system and the Mexican Financial Reporting Standards that CINIF issues for all companies.

62. Coordination among regulators will require the following:

(a) Coordinating among State agencies with regard to issuing legislation affecting corporate reporting;

(b) Coordination among agencies involved in implementation of legislation and regulations;

(c) Indicators for deciding which party should exercise its powers to ensure that the entities are not subject to more than one investigation or set of enforcement proceedings for the same infringement unless it is appropriate for both bodies to exercise different powers or impose different penalties in relation to the issuer;

(d) Conduct of concurrent investigations;

(e) Information sharing; and

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[25] As an independent regulator, the Financial Reporting Council (FRC) sets standards for corporate reporting and actuarial practice and monitors accounting and auditing standards. The FRC is also responsible for also oversee the regulatory activities of the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

[26] http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf.

(f) Confidentiality restrictions.

63. One of the dimensions of the regulatory and institutional framework is the relationship between government authorities and Professional Accountancy Organizations. Practices vary from complete self-regulation by Professional Accountancy Organizations to Professional Accountancy Organizations becoming in effect agencies of government.

64. The accountancy profession is one of the key institutional players of the capacity-building framework. In this regard, a well-organized and respected professional body is an essential part of a fully functioning accountancy profession. Setting up or developing a professional body requires a structure which involves consideration of a rather large number of matters. Detailed guidance on setting up a professional body could be found in the IFAC toolkit, *Establishing and Developing a Professional Accountancy Body.*[27] International standards related to Professional Accountancy Organizations include:

(a) IESBA Code of Ethics for Professional Accountants (including independence);[28]

(b) IAASB ISQC1 on quality control of audit and assurance engagements;[29] and

(c) IFAC Statements of Members Obligations.[30]

65. The main issues to be addressed in building a strong accounting/audit profession include areas such as availability of professional accountants required for efficient functioning of a reporting chain, technical knowledge, membership obligations, compliance, continuing professional development and training mechanisms, ethics, quality control and discipline.

66. The professional body could have its own regulatory structure which fits into the national legal framework. The elements of such structure could consist of:

(a) An Accounting Act (in some cases the regulatory scope may be limited to the work of auditors) which recognizes the professional body as the legal entity which represents the profession and may give it powers to regulate its members;

(b) A constitution and by-laws for the professional body;

(c) Admission requirements to the professional body and a register of members;

(d) Rules of professional conduct and ethics which go beyond the legal framework, e.g. rules on independence (see the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants*[31]); and

(e) Monitoring and disciplinary systems.

67. Professional Accountancy Organizations can play a role in enforcing adherence to regulatory requirements in connection with discharging their professional body

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[27] International Federation of Accountants (2007). *Establishing and Developing a Professional Accountancy Body.* Second Edition, New York, New York, November.

[28] International Federation of Accountants (2010). *Handbook of the Code of Ethics for Professional Accountants*, New York, New York.

[29] International Federation of Accountants (2010). *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, New York, New York, 2010 Edition, Part I.

[30] International Federation of Accountants (2006). *Statement of Membership Obligations 1-7,* New York, New York, November.

[31] International Federation of Accountants (2010). *Handbook of the Code of Ethics for Professional Accountants*, New York, New York.

responsibilities with respect to ensuring that their members adhere to their membership obligations. This may be true even in jurisdictions where a public oversight body performs inspections, investigations, and enforcement. This is more common in respect of members and their firms in public practice and in particular auditors. Such systems usually consist of five stages:

(a) Certification of members and firms to conduct audits or more generally work in public practice;

(b) Monitoring of licensed members and firms;

(c) An Investigations Committee to consider complaints and *prima facie* whether there is a case to answer;

(d) A Disciplinary Committee with powers to impose penalties on members, including removal of their license to practice; and

(e) An Appeals Committee to hear appeals against Disciplinary Committee decisions.

IV. Human capacity

68. Another pillar of a capacity-building framework is human capacity development. This includes the education and training, as well as retention of professional accountants and other participants in the regulatory and financial system.

69. Extensive training is absolutely essential to expand capacity and facilitate the smooth functioning of the corporate reporting system. This should include training of all participants of the regulatory authorities in the reporting chain, as well as just accountants and auditors. Such training should cover not only accounting, auditing and professional standards, but also training in how to institute and manage a regulatory body and conduct their activities. Professional Accountancy Organizations could consider collaboration with recognized regional accountancy organizations as well as with more developed member bodies of IFAC. International organizations, such as IOSCO, and the Basel Committee organize training programmes. These opportunities need to be considered as well.

70. The types of education required will cover:

(a) General education (school and often university);

(b) Professional education of auditors and accountants (preparers);

(c) CPD;

(d) Education for accounting technicians;

(e) Specific training in specialized areas, such as accounting, auditing, government accounting, internal controls and disclosures associated with financial instruments, financial firms, sound governance, and requirements for listed companies; and

(f) Education of other participants in the system, including regulators and analysts.

71. Education and training can be provided by schools, universities, private sector tutors, Professional Accountancy Organizations, and accounting and consulting firms. Programmes are also offered by international organizations, such as IOSCO, the World Bank, UNCTAD and others.

72. The recipients of this education may be:

(a) Students (at public or private institutions);

(b) Trainees (who may or may not be graduates) with accounting firms and other employers; and

(c) Other participants (who may or may not be accountants) of the reporting chain.

73. Issues to be considered include entry education requirements, professional education/training requirements and CPD, as well as how to retain qualified accountants in the country and the profession. Another important dimension is differentiated education and training for different levels of accountants, such as accounting technicians, as well as consideration of different needs in training for accountants and for auditors.

74. One of the important challenges is coordination of the education programmes on accountancy taught as part of general and specialized education in colleges and universities with professional requirements.

75. In setting up an Education pillar, international standards and benchmarks could provide useful sources of information. At a global level this includes the International Accounting Education Standards Board (IAESB) requirements in the area of education and professional training. It also includes the UNCTAD/ISAR model curriculum[32] which is based on IAESB standards and provides more detailed guidance on the content of accounting curriculum based on best practices. Other useful reference include the Common Content project[33] devised by a group of professional bodies and the EU 8th Directive on statutory auditors.

76. The International Accounting Education Standards Board of IFAC has issued a series of International Education Standards (IES)[34] which cover pre-qualification of members and continuing professional development, along with extensive background guidance. SMO 2 requires member bodies to use their best endeavours to achieve these standards

77. In addition Professional Accountancy Organizations normally require certain education and qualification levels. These would cover:

(a) Entry requirements;

(b) Counseling candidates;

(c) Professional level examinations;

(d) Ethical rules;

(e) Professional skills;

(f) Tuition and training facilities;

(g) Certification of members; and

(h) Ongoing professional development.

[32] http://www.unctad.org/en/docs/iteteb20039_en.pdf (see chapter VIII starting on page 200).

[33] http://www.commoncontent.com/.

[34] International Federation of Accountants, Handbook of International Education Pronouncements, New York, New York, 2009.

78. Professional level exams and training require:

(a) A professional level curriculum;

(b) Practical experience requirements for the professional level qualification;

(c) Systems for monitoring training within firms;

(d) Exam systems which ensure the exams are assessed at the professional level; and

(e) Tutorial support and study materials.

79. Within the EU, the Statutory Auditors Directive (the 8th Company Law Directive) lays down education and training requirements for statutory auditors in the EU. These are similar to and do not contradict the IFAC education standards, for example International Education Standard 8, which deals with requirements for audit professionals.

80. CPD systems also require rules for how much CPD members have to undertake, methods of ensuring these rules are complied with and provision for access to CPD courses and materials. IES 7 sets out the IFAC rules on CPD.

81. Other sources of reference/guidance include:

(a) IFAC guidance of technician level qualifications;

(b) The Bologna[35] agreement on the criteria for defining degrees at different levels;

(c) The Dublin[36] descriptors which elaborate on and extend the Bologna criteria;

(d) The NARIC[37] (National Recognition Information Centre) database which helps to recognize degrees at different levels worldwide;

(e) World of Learning,[38] which identifies recognized academic institutions; and

(f) Guidance issued by professional and oversight bodies in countries that have well-developed capabilities and organizations of such entities and other participants in the financial reporting chain.

V. Capacity-building process

82. An important part of a capacity-building framework is the capacity-building process itself. It includes the main elements such as a capacity-building strategy and a realistic action plan, which in turn includes identifying priorities, time-frames, human resources, financial resources, identification of the main stakeholders and allocation of responsibilities between them.

83. Specific steps therefore can include:

(a) Understanding the scope of the project, i.e. the framework of the capacity building challenge;

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[35] For an explanation and text of the Bologna agreement see: http://ec.europa.eu/education/policies/educ/bologna/bologna.pdf.

[36] For a complete set of the Dublin descriptors see: http://nbm20.kasetsart.org/document/piniti/Dublin.pdf.

[37] For information about charges and the services offered by UK NARIC see www.naric.org.uk.

[38] The Europa World of Learning is available on subscription see www.worldoflearning.com.

(b) Assessing the current situation, taking into account cultural, political and socio-economic conditions and key stakeholders;

(c) Identifying the gaps between the current situation and relevant international norms and best practice;

(d) Developing a strategy and action plan relevant to the country's needs, identifying priorities, defining resources needed, agreeing to a realistic time-frame, and identifying counterparties and strategic partners;

(e) Communicating the action plan to all the key stakeholders;

(f) Implementing the plan;

(g) Assessing the action plan and progress made; and

(h) Beginning next stage of the capacity building process.

84. In relation to establishing a professional body, the IFAC/DNC Guide to establishing and developing a professional body[39] provides a considerable amount of information which is useful in preparing action plans in relation to this pillar. Also, reference could be made to formulation and agreement on IFAC Compliance Programme Action Plans,[40] which IFAC member bodies have developed based on IFAC's SMO.

85. Some member bodies of IFAC are also prepared to twin with or mentor other professional bodies to assist them with developing systems to meet international norms. This can be by way of technical assistance, jointly organized examinations schemes and CPD events or train the trainer programmes. In some cases, this can lead to reciprocity of membership, for instance through common examinations. Working partnerships include the type of arrangements ACCA has with Cyprus, which cover regulation, examinations and training or NIVRA has with some accountancy organizations.

86. As discussed above, the capacity within a country to deliver high-quality corporate reporting depends on many interlocking key elements. It is unlikely that any one project can address all these areas, but it is important to understand the scope of the challenges at the start to identify priorities.

87. Developing a strategy and an action plan to facilitate capacity requires a realistic assessment of factors affecting the process. These include:

(a) Political goodwill at the highest level;

(b) Cultural and socio-economic climate;

(c) Relevant intellectual and technical expertise;

(d) Financial backing over a long period of time, including the ongoing sustainability phase;

(e) Buy-in by the key stakeholders, including government, regulators, Professional Accountancy Organizations and market participants; and

(f) Effective communication and publicity about potential benefits to the country of and economy of the changes, to support all of the above.

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39 International Federation of Accountants, Establishing and Developing a Professional Accountancy Body, Second Edition, New York, New York, November 2007.

40 http://www.ifac.org/ComplianceAssessment/published.php.

88. While developing a national plan on capacity-building based on international standards and benchmarks, it is important to consider specific country needs and good practices of technical assistance and capacity-building programmes.

89. To facilitate efficiency of capacity-building efforts, a number of activities could be considered, such as sharing good practices and lessons learnt by other countries, participation in international benchmarking exercises, exchange programmes, cooperation with major international bodies, regional coordination, and twinning arrangements.

90. In this regard, evaluation of the position of a country in comparison to international standards and codes in ROSC reports developed by the World Bank provides a good starting point for action plans in relevant cases.

91. In developing a capacity-building strategy, the following points should be borne in mind:

(a) Activities must be planned not only with a view to short-term objectives but also to the longer-term strategy of the host country or organization;

(b) In the case of implementation of international standards, full account of cultural differences in language and business should be taken into consideration;

(c) Political considerations should not lead to unrealistic timescales for outcomes of projects; and

(d) Allocation of resources should be made to ensure the sustainability of any project after the initial funding phase has been completed.

92. It is crucial to identify financial resources needed for capacity-building. Sources of funding could include government revenues, donor agencies, national and international non-governmental organizations, listed companies and large accounting firms.

93. In the case of Professional Accountancy Organizations, the sources of finance could be quite limited, mainly relying on members’ subscriptions and CPD income. This is particularly true in the case of small bodies, setting severe limits on the activities they can fund.

94. Lack of local expertise is a major restraint in most developing countries and countries with economies in transition, and training suitable experts is a long-term project. Some national regulatory and oversight organizations also offer training and expertise to counterparts in developing countries.

95. The time-frame should not be underestimated either. The set-up phase may take two or three years if all goes according to plan. There then needs to be provision made to sustain the new structures indefinitely.

VI. Measurement considerations

96. An important element of a capacity-building framework is to have or develop some relevant measurement methodology and indicators to assess the current status, the progress made and to identify priorities for further actions.

97. A number of qualitative assessment tools have been developed by different projects and agencies. At a global level, the World Bank ROSC programme provides comprehensive assessments for about 100 countries.

98. However, quantitative measures may be also useful in promoting comparability, measuring impact, identifying needs and priorities for further improvement compared to some common benchmarks.

99. Caution should be exercised in consideration of using quantitative measurement models before any proposed approaches are subjected to further study and public exposure. There are many ways that could be used to describe and quantify progress toward a set of designated milestones, and it is important that any models used do not become so prominent or so prescriptive or so complex that they could impede rather than facilitate progress in building capabilities in different countries having different circumstances.[41]

100. In order to provide a starting point to identify milestones for the pillars and elements discussed in this paper, some possible areas are suggested. Those are supported by specific questions to allow for assessment of the state of discussed components of capacity-building frameworks at a particular point of time and to identify priority areas for further actions (see appendix IV in TD/B/C.II/ISAR/56/Add. 1).

VII. Conclusion

101. Many member States continue to face capacity-building challenges in achieving high-quality corporate reporting. Those challenges include both institutional as well as technical aspects. This paper has suggested the major pillars and elements of a capacity-building framework that could guide policymakers in making sound decisions and developing a coordinated and coherent action plan to achieve high-quality corporate reporting.

102. Further discussions would be important to identify practices which could be helpful to facilitate the practical usefulness of the document for developing countries and countries with economies in transition in their capacity-building efforts. The debate is also needed on the approach on how to assess the progress and decide on priorities with regard to building a national capacity on corporate reporting.

[41] A methodology developed by the USAID/BISTA project on accountancy development index is one approach that could be considered as a basis for building up such a quantitative measurement tool. The project has been developed over a number of years, involving a steering committee comprised of leading authorities in the area of accountancy from different countries, and has been tested in about 40 countries. Since the end of 2009, UNCTAD has been conducting research jointly with Lieden University on the methodology and results of the pilot project.