TD/B/COM.2/34
TD/B/COM.2/ISAR/13

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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

Held at the Palais des Nations, Geneva,
from 10 to 12 September 2001

Distr.
GENERAL

TD/B/COM.2/34
TD/B/COM.2/ISAR/13
15 November 2001

Original: ENGLISH

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

Held at the Palais des Nations, Geneva,
from 10 to 12 September 2001

## CONTENTS

## INTRODUCTION

The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) held its eighteenth session at the Palais des Nations, Geneva from 10 to 12 September 2001. In the course of its session, it held two plenary meetings and six informal meetings.

# Chapter I

# AGREED CONCLUSIONS ON ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES

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

1. The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) recalls that during its seventeenth session it agreed that improved accounting information would permit small and medium-sized enterprises to be better managed and to access finance more easily, and would permit a more accurate calculation of their taxes. With that in mind ISAR also agreed that SMEs needed a financial accounting and reporting framework which would:

(a) Be simple, understandable and user-friendly;

(b) Produce useful management information;

(c) Be as standardized as possible;

(d) Be flexible enough to accommodate the growth of business and increase the potential of some SMEs as they expand to use international accounting standards (IAS);

(e) Be easily reconcilable for taxation purposes;

(f) Recognize the environment in which SMEs operate.

2. It also agreed that it was up to each country to define the term “small and medium-sized enterprise” in accordance with its national economic environment, as well as to define the different categories of SMEs in a manner appropriate to its needs, and that any proposed accounting framework put forth would be voluntary and would constitute optional guidance for member States.

3. At its eighteenth session, ISAR expressed appreciation for the excellent work of the ad hoc consultative group of experts, and at the conclusion of its deliberations based on the report of the ad hoc consultative group, it reconfirmed the urgent need for guidance on an accounting framework for SMEs which took into consideration the fact that one uniform set of accounting rules would not suit the needs of large, medium-sized and small enterprises. Any framework should cover all entities likely to prepare annual financial reports, in order to cover different definitions of SMEs. Furthermore, the objective of such a framework would be to allow enterprises to proceed logically from one level to another as they developed. Such a framework could have at least three levels or categories. The most sophisticated level would comprise a tier of entities that need to comply with all International Accounting Standards (Level I), which include listed enterprises and enterprises in which there is significant public interest. Below this level the second tier (Level II) would be larger SMEs, for which the full IAS might be beyond their needs since they are less likely to have

transactions foreseen in the more complex standards and the costs could outweigh the benefits. It is preferable that these enterprises use a condensed set of standards, based on IASs, including recognition and measurement criteria, but with reduced disclosure requirements. The final Level III would be for smaller entities which have limited availability of and access to accounting expertise and so would be required to provide simplified accounts that comply broadly with the essential principles of accruals accounting. The accounting approach for Level III would aim at producing useful information for management, fiscal and other national authorities and other interested parties.

4. ISAR reaffirms that the actual definitions of each of the three tiers and even the eventual number of tiers must rest with the national regulators who might choose to adopt the proposed system.

5. It notes that the accounting framework for Level I enterprises is increasingly being set by the International Accounting Standards Board (IASB). The ad hoc consultative group elaborated its proposal for Levels II following an approach in which a separate standard for smaller entities would be produced as a subset of condensed standards. ISAR notes that the IASB has on its work programme a potential project on accounting by SMEs and in emerging markets. ISAR concurred with the consultative group's thinking that an abridged set of rules for smaller businesses could be particularly useful in developing countries. First, it could serve as a stepping stone on the way to full IAS compliance. Second, it could form the starting point for the development of a "technician" level of accounting expertise, specifically for SMEs. The services of such an expert would be cheaper and better adapted to the needs of small enterprises.

6. At its eighteenth session, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) reviewed the report of the ad hoc consultative group of experts on accounting by SMEs (TD/B/COM.2/ISAR/12, and it agrees with the general approach to accounting by SMEs suggested by the consultative group. Based on its deliberations, ISAR also agrees that the report needs further refinement, and it requests the ad hoc consultative group to continue its work. In particular the ad hoc group should take into account the recommendations for revisions for which there is consensus. It is considered desirable: to further elaborate the guidance for Level III entities so that interim voluntary technical aid is developed and disseminated as soon as possible; to further explain for Level II the rationale for the selection of the standards in the "minimum set of standards" and the rationale for excluding standards not in the "minimum set"; to further indicate the extent of disclosures and to finalize the draft pro-forma example of condensed standards for Level II; and to demonstrate the consistency between the international conceptual framework and the proposed approach for accounting by SMEs.

7. ISAR also recommends that the ad hoc consultative group should disseminate its revised report for comments to all members and observers of ISAR and submit the final draft to the ISAR's nineteenth session.

8. ISAR also agrees to initiate discussions on partnerships with professional bodies to consider how accounting technicians could be trained in the new approach.

9. In the meantime, ISAR would like to bring to the attention of International Accounting Standards Board and other relevant international bodies such as the International Monetary Fund, the Bank for International Settlements, and the World Bank the fact that accounting by SMEs is an urgent issue for economic and social development for developed and developing countries alike.

10. ISAR requests the IASB to take up this issue as a priority and on a timely basis. ISAR further indicates to the IASB that it has requested the ad hoc consultative group to continue its work and that ISAR is ready to cooperate with the IASB.

11. It further agrees that the results of the consultations be presented to the nineteenth session and that the main agenda items for consideration would be accounting by SMEs and corporate governance.

## B. Further work to follow up on the fifteenth session

*Environmental accounting and reporting*

12. The work on environmental performance indicators is important in order to link environmental performance and financial performance. ISAR agrees to cooperate more closely with other initiatives, including with the Global Reporting Initiative (GRI).

13. The environmental accounting and reporting project should be a two-stage process. The outputs that have been disseminated to over 25 countries and training activities should be followed up. More training is needed to enhance the capacity of accountants to deal with environmental issues in developing countries and countries with economies in transition.

14. There is a need to train experts to evaluate and measure environmental performance and to recognize positive and negative externalities, including training on the application of ISAR guidelines and other sustainability standards.

## C. Further work to follow up on the sixteenth session

*Assessment of professional qualification requirements*

15. Taking into account the positive and recognized contribution that the guideline on national requirements for the qualification of professional accountants that ISAR adopted at its sixteenth session is making towards the goal of raising the level of professional qualifications, ISAR recommends that the UNCTAD secretariat continue to cooperate with international, regional and national organizations and professional bodies to strengthen accounting education and professional qualification.

## D. Future work

16. ISAR encourages the secretariat to work with the members of the Group during the intersessional periods to identify future topics for discussion.

## Chapter II

## OPENING STATEMENTS

17. The **Director of the Division on Investment, Technology and Enterprise Development** commended the positive contribution that ISAR made towards trade and development, highlighting the technical intricacies that the Group dealt with.

18. The **Secretary-General of UNCTAD** said that ISAR presented a "permanent room" for the discussion of accounting issues from the perspective of developing countries and countries with economies in transition. ISAR's efforts to promote reliability and comparability in financial reporting complemented the efforts of other international standard-setting bodies. However, ISAR's important contribution was that it was able to take into consideration structural differences in economies that influenced how enterprises operated. ISAR was also able to offer technical assistance to those that were having difficulties in making progress in the areas of financial transparency and accountability.

19. The integration of financial markets meant that a crisis in one market could no longer be confined to that market. Discussions therefore had to include all players and stakeholders from developed and developing countries. The Bank for International Settlements in Basle had attempted to set new rules for capital adequacy, but the committee concerned did not have a sufficient number of developing countries and it had failed to consider the negative impact on developing countries that were trying to attract foreign direct investment. Thus, it was important that other international groups took ISAR's concerns into consideration.

20. The question of financial stability was not just a question of global governance but also a question of corporate governance. He gave an example from Brazil, where capital market growth had been stunted because of old-fashioned practices that had failed to protect minority shareholders. Improved corporate governance could bring many benefits, including increased financial stability and foreign direct investment. Good corporate governance required that the interests of all stakeholders be balanced.

21. Lastly, small and medium-sized enterprises were important elements in the economies of both developed and developing countries. However, SMEs often faced severe difficulties in accessing finance because of the lack of reliable financial information that could be presented to creditors and investors. Hopefully, the Working Group's eighteenth session would result in guidance on a user-friendly accounting system that could satisfy the needs of both the users and preparers of financial statements of SMEs.

22. The outgoing **Chairman of the seventeenth session of ISAR** said that the work of ISAR showed the importance of understanding different perspectives and reconciling different needs, since there were no easy answers when the global economy was involved. A very crucial point on the frontier of accounting and economic development was that efforts to improve accounting standards at a global level really came down to job creation, social welfare and the elimination of inequalities through business opportunities. There were many challenges confronting the accounting profession, including variable remuneration related to performance, the link between past performance and future cash flows, and fair value

accounting vs. historical accounting. Accountants had two choices: either to deal adequately with these issues and remain at the main table or be thrown back to the role of “bookkeepers”.

23. Small and medium-sized enterprises contributed to job creation and social development in all economies of the world. They were a powerful tool for wealth and job creation, and consequently their problems represented a valid topic for discussion by accounting experts. While listed companies dominated the international accounting agenda, ISAR could not fail to pay attention to the level and quality of accounting and financial reporting by SMEs. Their high mortality rate was a cause for concern first and foremost for employees, but also for policy-makers, economists and accountants. ISAR was particularly well qualified to study SME accounting and reporting problems and offer solutions.

## Chapter III

## CHAIRPERSON'S SUMMARY OF INFORMAL DISCUSSIONS

### A. Report by the ad hoc consultative group of experts on accounting by small and medium-sized enterprises

(agenda item 3)

24. An UNCTAD resource person, introducing the item, recalled that the mandate given to the consultative group, whose report was contained in document TD/B/COM.2/ISAR/12, had been to decide on a categorization of SMEs and a user-friendly accounting and reporting framework for SMEs and identify implementation difficulties.

25. Concerning any accounting system for SMEs, it should be simple, understandable, and user friendly. It should contain management information, and this was a major departure from the usual financial accounting framework, which contained information for external users rather than for internal users. However, ISAR had decided that the needs of SME managers should be taken on board. The system should be reconcilable for tax purposes and should take into consideration the SME environment, particularly resource constraints. The framework proposed by the consultative group was based on several assumptions, including that different-sized enterprises required different accounting rules, that rules should be aligned with resources, and that rules should be consistent with the International Accounting Standards (IAS) and its conceptual framework.

26. If the assumption was accepted that in any economy there were many different-sized businesses and that a single accounting framework would therefore ignore economic reality, a system should be created which was internally consistent and allowed enterprises to go from level to level. The consultative group proposed that enterprises be divided into three categories

- **Level I**: entities which issued public securities and entities in which there was significant public interest, as well as banks and financial institutions
- **Level II:** larger SMEs that did not issue public securities and did not prepare financial reports for the general public.
- **Level III: ent**ities that were small businesses and new entrants.

27. Level I entities would apply full IAS. Level II would apply a core set of IAS. Level III small businesses would do simple accruals, while new entrants would be allowed to do cash accounting for a brief period. Each country would have to define "significant public interest". However, it was generally thought to be enterprises with a "significant" number of employees, in-house accounting skills and the potential to expand to level I. The dividing line between level II and III would have to be determined by each country according to its economic structure.

28. For level II enterprises, the application of full IAS might be beyond their needs, and costs would outweigh benefits. These enterprises would apply a set of accounting standards which was an “abridged IAS” consisting of a specified set of IAS which covered most of their transactions. He referred to the 80/20 rule, whereby 20 per cent of the standards covered 80 per cent of SME transactions. However, if an SME were to encounter a transaction that the “core standards” did not address, it would be required to comply with full IAS. Level II enterprises would always have the choice of complying with full IAS if they so wished.

29. The consultative group felt that a condensed set of rules for smaller businesses could be particularly useful in a developing country environment and could serve as a stepping-stone on the way to full IAS compliance. Second, it could form the starting point for the development of a “technician” level of accounting expertise, specifically for SMEs.

30. Most importantly, the consultative group took the view that the “abridged IAS” should preserve the recognition and measurement base of the full IAS, but with limited disclosure requirements. As a result the selection process would involve first identifying those standards thought unlikely to concern larger SMEs and second identifying disclosure requirements that would not be applicable to level II SMEs or could be simplified. The “abridged IAS” could eventually be a single document that would bring together the relevant elements of the “core SME standards”. He then proceeded to explain which IAS had been included and which excluded. The criteria for inclusion included frequency of use and degree of complexity.

31. With respect to the smallest SMEs, he pointed out that the consultative group was of the view that these SMEs should follow a simple accruals system that would be consistent but not fully compliant with IAS. The accounting framework would principally aim at producing useful information for management, tax officials and creditors. He also introduced a set of sample financial statements (set out in annex I of the ad hoc consultative group’s report) that would fulfill the external and internal reporting needs of SMEs. These included a model chart of accounts that contained a list of headings that could be used to maintain a general ledger directly linked to the main financial statements. Such a chart would allow the creation of a database that tracked transactions and complied with accounting rules and could be handled by an accounting technician. The uniform approach imposed by the use of a chart of accounts would cut the cost of training and retraining at both the enterprise and the economy levels as people transferred from enterprise to enterprise or even from country to country.

32. In the discussion that followed, the Group of Experts reviewed and deliberated on the report prepared by the ad hoc consultative group. Although most experts agreed with the general approach to accounting by SMEs proposed by the consultative group, different views were expressed about specific aspects of the suggested accounting and reporting framework. Thus, for example, some experts questioned the usefulness of a uniform chart of accounts for level III SMEs. In their opinion, model ledger accounts might lead to meaningless figures and could not translate the individual nature of an enterprise. Others stressed that model ledger accounts were desirable in order to make financial statements more comprehensible for lenders. A harmonized system would also lower costs of training and provision of software. Some experts were of the opinion that a detailed chart of accounts tended to be too

prescriptive. As a result it did not allow for a thorough analysis of the essence of a transaction by the person entering it in the accounting system. Others were of the opinion that a model chart of accounts would be a useful guide, particularly for very small SMEs that did not have adequate expertise in-house. One expert cited economic integration efforts under way in his region and underlined the positive contribution that a uniform chart of accounts could have in harmonization efforts.

33. With respect to the suggested three-tier accounting framework it was generally felt that a uniform set of accounting rules would not suit the needs of all enterprises. Different-size enterprises did require different accounting rules. A large number of experts supported the view of the consultative group that companies that issued public securities or enterprises in which there was significant public interest should comply fully with International Accounting Standards. A number of experts suggested that the proposed framework should comprise more than three levels, breaking levels II and III down further. However, numerous experts strongly favoured the three-tier approach suggested by the consultative group.

34. One expert pointed out that ISAR should not come up with a final solution for accounting by SMEs, since it was up to the International Accounting Standards Board (IASB) to develop financial accounting and reporting standards. He suggested that ISAR should rather develop and publish a concise issues paper that would promote consensus on the issue of accounting by SMEs. Furthermore, it would help to focus the attention of the IASB on the importance and urgency of the issue of accounting by SMEs, especially but not exclusively in developing countries. Another expert noted that although IASB had a lot of experience on financial reporting by multinational companies, he questioned its competence in the area of accounting by SMEs. He added that there were complementarities between ISAR and IASB. He considered accounting by SMEs an important topic that needed to be addressed urgently, and therefore initial guidance by ISAR would be welcomed, particularly in developing countries. One expert stressed in this respect that developing countries could not wait any more. A number of experts concurred with this view, while stating that cooperation by IASB would be appreciated. Others felt that IASB should take up the issue as a priority.

35. Concerning the suggested level II enterprises, comprising significant commercial entities that issued neither public securities nor financial reports to the general public, it was by and large agreed that the exact definition should be left to each country to decide. Although it was to a large degree felt that the suggested condensed set of IAS might be appropriate for larger SMEs, a number of experts commented on technical details of the proposed approach. Many in particular stated that it was difficult to establish a cut-off point between level II and level III enterprises. A number of experts also questioned the rationale for the identification of some of the proposed "core" standards while suggesting that other standards should be included in the minimum list of "abridged IAS". In replying to questions raised, the resource person clarified that if an SME found that it had a transaction that was not covered by the "abridged IAS", it would be required to refer to full IAS for appropriate guidance. Furthermore, a company that complied with "abridged IAS" would have to disclose in its accounting policy note that its financial statements were prepared in accordance with "abridged IAS" and not full IAS. If it did not comply with all elements of full IAS, an enterprise would be obliged to report compliance with "abridged IAS" only. The basic

criterion used to determine whether a particular standard should be included in the minimum list of standards was whether a majority of larger SMEs was likely to have a particular transaction addressed by an individual standard. Finally, he stressed that level II enterprises would always have the option to comply with the full IAS if they so wished.

36. Most experts supported the view expressed by the consultative group that a condensed set of standards should be based on IAS recognition and measurement criteria, but with limited disclosure requirements. Nevertheless, a number of experts drew attention to the potential complexity of some IAS and the fact that some standards were difficult to implement in an SME environment, especially in a number of developing countries. Another important aspect was that the cost of meeting the requirements of some standards might outweigh the potential benefits.

37. One expert said that ISAR should develop a conceptual framework paper for accounting by SMEs. Numerous experts noted that the approach suggested by the consultative group was similar to the approach adopted by the United Kingdom. Nevertheless, one expert stated that other “differential reporting” approaches should also be considered when developing guidance on accounting by SMEs.

38. A number of experts noted that the approach suggested by the consultative group for larger SMEs needed further refinement and considered that the consultative group should continue its work. Although the ad hoc consultative group that prepared the report consisted of 23 experts from a wide cross-section of countries, international organizations, accountancy bodies, standard-setters and academics, some experts favoured the enlargement of the consultative group into a more widely based working party.

39. Numerous experts, especially from developing countries, underlined that interim guidance for smaller SMEs (level III) was highly desirable. By and large, they concurred with the opinion of the consultative group that voluntary technical aid for small commercial entities that were owner-managed should follow a simple accrual-accounting system, broadly consistent with IAS. They therefore urged further work to elaborate guidance for these SMEs so that an initial interim guideline could be developed and disseminated as soon as possible. It should provide information for such users as management, fiscal authorities and creditors.

40. There was general consensus that new entrants might be allowed to provide accounts on a cash basis for a limited transitional period of time. Nevertheless, some developing country experts were of the view that micro-enterprises were an economic reality and therefore constituted a distinct category of SMEs. Most of their transactions were cash-based and small in amount. Additionally, the amount of fixed assets was insignificant. In this connection they stressed that it was important to encourage the smallest SMEs to move into the formal sector by allowing them to use cash accounting on a temporary basis.

41. In response to comments regarding the mandate of the International Accounting Standards Board, the observer from the IASB stated that, though there was a general perception that the IASB was predominantly concerned with accounting and reporting issues for sophisticated capital markets, it was also mandated to take into consideration the needs of other users, such as private capital market participants.

42. A number of experts also commented in more detail on the "core-set of standards" that the ad hoc consultative group proposed for level II SMEs. An expert from a country with an economy in transition felt that *IAS 36, Impairment of Assets* was particularly relevant in her region. The expert wondered why IAS 36 was not included in the core-set of standards for Level II. One expert was of the opinion that *IAS 8, Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* was a basic standard and did not understand why the ad hoc consultative group suggested that the standard could be simplified further. He also felt that the 15 standards that made up the core-standards were not sufficient to cover the needs of SMEs.

43. Several experts further commented on the model financial statements and chart of accounts for level III SMEs. Some experts were of the opinion that the model income statement and management report were trying to cater for too many needs of too many users. It had financial, managerial and tax components – all on A4 size paper. As a result it was too complicated. A number of experts described practices in their countries and indicated that tax reporting was clearly differentiated from financial reporting. One expert commented that management accounting should be left to management. Other experts were of the opinion that the reporting system needed to provide information for managerial decision-making. With regard to SME management "buy-ins", these would be easier if the system, in addition to basic financial reports, generated information that was useful for managers.

44. Many experts were of the view that global comparability on accounting and reporting by SMEs was not one of the intended outputs of the exercise that the Group of Experts was undertaking. Most were of the opinion that such comparability did not serve any particular purpose.

45. One expert commented that the approaches proposed by the ad hoc consultative group did not take into consideration the interpretations of International Accounting Standards provided by the Standing Interpretations Committee (SIC). Some of the approaches of the ad hoc consultative group proposed reporting on a tax basis rather than providing a "true and fair view". Such a deviation might lead to what were sometimes known as "IAS light", and this might undermine the work of the IASB. The expert also stated that the proposed guideline would need updating. He was concerned that ISAR might not have the necessary resources to update it regularly.

46. Several experts noted that in many economies SMEs faced great difficulty in accessing finance, particularly when they were unable to provide collateral. Many experts agreed that there was an urgent need to provide SMEs with a guideline on how to prepare meaningful financial information so that they could gain better access to financing.

47. Following the extensive debate, the resource person reiterated that the proposal presented by the ad hoc consultative group was not a standard. The output of the work on accounting by SMEs would be used as a voluntary technical aid for member States that wished to use it. As a result, enforcement of the approaches suggested or the global comparability of accounting reports by SMEs was not an issue that the Group of experts needed to be concerned with. He also reminded participants about the development aspects of the work at hand.

48. The resource person said that accounting regulation was an evolving matter and that there would not be perfect accounting at any given time. The "true and fair view" was not something that could be objectively determined. It depended on the expectations of the user group for which the financial statements were prepared. In respect of the number of standards making up the "core set" for level II SMEs, the reporting requirements placed on SMEs needed to be cost-effective. The selection of an accounting system represented a strategic decision for an enterprise. The availability of in-house resources was a consideration in determining the components of the "core set". It was therefore not advisable to increase the number of standards in the "core set" beyond the 15 that were proposed by the ad hoc consultative group.

49. The resource person provided further clarifications on several issues:

- A model chart of accounts would be useful for software development as well as training purposes.
- The ad hoc consultative group had not taken as a criterion whether an enterprise was incorporated or not in determining the kind of financial reporting that SMEs needed to prepare.
- The rationale for further simplification of some IAS suggested by the ad hoc consultative group was that originally certain clauses had been added to standards though it was clear that these clauses would not be generally applicable.
- Management information and tax reporting were desirable outputs of an accounting and reporting system to encourage SME owners and managers to implement accounting and reporting systems.
- A top-down approach was used in arriving at the reporting system for level II and a bottom-up approach for level III SMEs.
- The accounting and reporting approach suggested for level III SMEs was on an accrual basis. The temporary exemptions were suggested only in the case of new entrants to the formal economy. Like many other issues, the duration of the exemption period would be dependent upon the economic reality of a given member State.

50. Several experts suggested that the updated draft document should be forwarded to member States in the form of an exposure draft for comment.

51. All experts agreed with the general approach to accounting by SMEs suggested by the consultative group. They requested the ad hoc consultative group to continue its work and to further elaborate the interim guidance for small owner-managed businesses and to disseminate it as soon as possible. The results of its work should be submitted to the nineteenth session of ISAR, to be held in 2002.

52. The Group also requested the International Accounting Standards Board (IASB) to take up the issue of accounting by SMEs (level II) as a priority and expressed its readiness to cooperate with the IASB.

## B. Other business

(agenda item 4)

### 1. Follow-up to previous sessions

#### *(a) Fifteenth session - Update on the work on environmental accounting*

53. The secretariat informed the group on follow-up work on environmental accounting and reporting. In 1998 and 2001, ten national and regional workshops had been held in Africa, Asia, Central Europe and South America to disseminate ISAR's recommendations on environmental accounting and reporting. This had been made possible by financial assistance from the World Bank, the Government of the Netherlands, the Brazilian National Bank for Economic and Social Development, and several professional accounting institutions. In the fall of 2000, a "train the trainers" course had been held in Geneva for members of professional institutions and business associations. The course had enabled institutions around the world to acquire the capacity to continue training.

54. UNCTAD's training workshops had allowed professional accountants and financial analysts in over 29 developing countries and countries with economies in transition, including over 16 professional accounting institutions, to contribute to the formulation of guidance and to acquire immediate assistance in its implementation. This work had influenced thinking and regulation in developed countries, including the European Union. UNCTAD had completed stage one of a second project to produce standardized environmental performance indicators (EPIs) in order to link environmental performance and financial performance.

#### *(b) Sixteenth session - Update on assessment of professional qualification requirements*

55. The secretariat informed experts on further work on the professional qualification of accountants. Since the adoption of the guideline on professional qualifications at the Group's sixteenth session, UNCTAD had participated in the work of the Group on the Assessment of Professional Accountancy Qualifications (comprising the International Federation of Accountants (IFAC), the World Bank and numerous regional and national accountancy bodies and associations). The Group agreed that the main objective was to improve the level of qualifications, thus facilitating freedom of movement of professional accountants across national boundaries and aiding reciprocal recognition of qualifications.

56. It was established that leadership of the project would be the joint responsibility of UNCTAD and the Education Committee of IFAC. The Group had developed a questionnaire for assessing professional qualification systems, based on the ISAR guideline as a benchmark, to conduct self-assessment of professional qualifications by volunteer pilot professional accountancy bodies. The questionnaire had been submitted to the steering committee of the Group for final comments.

57. The initial implementation phase would take the form of self-assessment in pilot countries. Participants were invited to participate as pilot countries. The objective of the

initial implementation phase would be to identify gaps and move closer to international professional qualification requirements.

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

58. The representative from the European Commission briefed participants on recent developments in the EU. The European Commission had issued a new Financial Reporting Strategy in June 2000 with the aim of adapting EU legislation on financial reporting to present needs. It required the application of International Accounting Standards (IAS) for financial reporting by all listed EU companies. In line with this strategy, the Commission had presented a proposal that would require all EU companies listed on a regulated market, including banks and insurance companies, to prepare consolidated accounts in accordance with IAS. This requirement would enter into force at the latest by 2005.

59. The EU Accounting Directives had not been significantly amended since their adoption in 1978 and 1983 and therefore needed to be adapted in line with accounting developments. A first step in this direction had been the adoption of a Directive that modernized the EU accounting rules by introducing a “fair value” accounting method for certain categories of financial instruments. The Directive enabled EU companies that used such financial instruments to apply IAS 39 while meeting the requirements of the EU accounting law. There were plans for further modernization of the Accounting Directives in order to update them, incorporate new accounting developments and bring them closer to IAS.

60. The representative from the Organization for Economic Cooperation and Development expressed appreciation for the work of ISAR. He emphasized that fair, reliable and accurate financial disclosure and transparency could not exist without a sound system of checks and balances between business, government, independent professional accountants or auditors, and self-regulatory associations based on international standards.

61. He indicated that the OECD Council of Ministers had endorsed OECD Principles of Corporate Governance in May 1999. He also briefed the session on the OECD financial disclosure and transparency projects. He then focused on two regional accounting reform initiatives covering the activities of the International Regional Federation of Accountants and Auditors – Eurasia (IRFAA) and the South Eastern European Partnership on Accountancy Development (SEEPAD). IRFAA had been constituted in June 1999. The overall goal was to improve financial disclosure, accounting and audit practices in the Eurasian region and promote sound corporate governance, transparency and accountability. The SEEPAD initiative had been launched in December 1999 by OECD and USAID with the support of UNCTAD. Its members included accounting and auditing associations in South Eastern Europe. The goal was to create sound corporate governance, financial disclosure and accountancy regimes. Finally the Group was informed of future meetings and reviews, including a major review of experience with the OECD Principles of Corporate Governance to determine if any revisions needed to be made.

62. The Executive Director of the International Federation of Accountants (IFAC) briefed the Group on the work carried out on corporate governance by a number of institutions. He mentioned three basic points that had to be grasped in order to understand corporate governance, namely the need for adequate, accurate and timely information, the importance of supervision by the board, and the need for protection of minority shareholders. Without government endorsement and support to oversee those three aspects, it would be very difficult to implement sound corporate governance practices.

63. He also informed the Group about the recently established cooperative initiative to raise the level of accounting and auditing practices, entitled the International Forum on Accountancy Development (IFAD). It had been launched in 1999 by IFAC and the World Bank in close cooperation with UNCTAD and other international public and private sector organizations that had committed themselves to joining efforts and working in partnership to improve the quality of financial reporting and auditing on a worldwide basis. Under this partnership, countries such as Slovakia and Brazil had committed themselves to improving their financial reporting and auditing structures and practices.

64. Recognizing the importance of public sector and public governance, he said that the public sector committee of IFAC had embarked on a project to develop accounting standards for public sector entities. A number of public sector accounting standards had been issued recently.

65. He further reported on developments in the establishment of IFAC's new self-regulatory regime consisting of the Forum of Firms, the Transnational Audit Committee and the Public Oversight Board. IFAC had also created a compliance regime, which was more a partnership with IFAC member bodies than a police regime. The regime was intended to promote better compliance of national institutes with the commitments they had made when joining IFAC and to support the mission of IFAC, which was the development of an international profession with harmonized standards that was able to offer services of consistently high quality in the public interest.

66. Finally, he urged members to implement corporate governance principles because the paybacks, which included financial stability and investor confidence, were crucial elements that were equally important for both developing and developed countries.

67. The representative from the International Accounting Standards Board (IASB) informed the Group on the new operating structure and work programme of his organization. IASB was an independent, privately funded accounting standard setter. Its Board had 14 members. Other important bodies included the Trustees, a Standards Advisory Council, a Standing Interpretations Committee, and Steering and Advisory Committees. IASB had assumed accounting standard-setting responsibilities from its predecessor, the International Accounting Standards Committee. The Standards Advisory Council represented organizations and individuals with an interest in international financial reporting, gave advice to the Board on agenda decisions and priorities, and provided inputs. The work and roles of the Standing Interpretations Committee, the Steering and Advisory Committees and Board members having formal liaison responsibilities with significant national standard setters were explained. The Standing Interpretations Committee, which provided guidance on the

application and interpretation of IAS, would be restructured and renamed the "International Financial Reporting Interpretations Committee". It would interpret the IASB conceptual framework, as well as the International Financial Reporting Standards (IFRS). Finally, he presented an outline of current and future IASB projects.

68. The Chief Executive of the Eastern, Central and Southern African Federation of Accountants (ECSAFA) updated participants on developments in his organization, which had adopted international accounting standards three years previously. ECSAFA was an enthusiastic supporter of environmental accounting and accounting for SMEs. He also indicated that accounting for SMEs would be discussed at the upcoming ECSAFA congress in Mauritius in 2002.

69. Accounting standards and management skills in developing countries could be raised through the implementation of the ISAR Guideline on professional qualification requirements. ISAR should disseminate SME guidelines in developing countries. The lack of knowledge and skills was due to the high cost of accessing international standards and the differing accounting regimes in Africa. Finally, he expressed appreciation to UNCTAD for organizing a workshop in Nairobi on environmental accounting and reporting.

70. A representative from the South Asian Federation of Accountants (SAFA) described recent developments in his organization. SAFA had been established to achieve coordination and harmonization of the accounting profession in the region and to build up regional accounting cooperation. SAFA aimed to serve the community and accelerate economic development and equitable prosperity.

71. It was a federation of seven countries, namely Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, with its permanent headquarters in India. SAFA co-ordinated and guided efforts in such areas as developing technical, ethical and educational guidelines within the region, achieving international recognition of qualifications of accountancy bodies of the region, providing opportunities for consultation through conferences of accountants within the region, encouraging and assisting the development of national accountancy organizations within the region, and arranging exchange programmes for students and teachers to expand training opportunities. Finally, he elaborated on a number of projects undertaken by SAFA.

### 3. Review of existing corporate governance practices and country, company and regional codes and principles

72. At its seventeenth session, ISAR had requested the UNCTAD secretariat to review existing corporate governance practices and country, company and regional codes and principles and report on the findings to the eighteenth session. The resource person started by providing the definition of corporate governance and discussing its role and importance in fostering financial and economic stability, investment, accountability and transparency. He then presented a brief review of various existing sets of corporate governance principles and codes, emphasizing the OECD principles as a base for corporate governance developments. He described the principal elements of corporate governance, such as rights of shareholders and other stakeholders, disclosure and transparency requirements and responsibilities of

directors, and outlined different corporate governance models and approaches. Finally, he suggested possible steps countries might consider to strengthen sound corporate governance practices.

73. In the discussion that followed, a number of experts, especially from developing countries, underlined the fact that that there was no single right corporate governance model. One expert pointed out that every country could learn from the experience of others. Another expert suggested that it was also necessary to take into account economic, social and cultural differences among countries.

74. The discussion then focused on how ISAR could contribute to the improvement of corporate governance practices in member States and on how it could assist particularly developing countries and economies in transition to improve financial disclosure, accountability and transparency and implement best corporate governance practices.

75. A number of experts argued that ISAR's contribution needed to add value to existing initiatives. Other experts stressed that duplication of work with other organizations should be avoided. Some experts added that while considering the issue of corporate governance ISAR should act within its mandate to promote increased transparency and financial disclosure. One expert said that corporate governance was very relevant to UNCTAD's work on improving financial stability and promoting investment in developing countries. Another expert pointed out that it was very evident that better corporate governance promoted both stability and investor confidence. Several experts underlined the importance of education and suggested that corporate governance training might be useful for implementation of sound corporate governance practices. Another expert suggested that the UNCTAD secretariat should prepare an analysis of potential topics on corporate governance to be undertaken by ISAR and recommend a specific topic in line with the ISAR mandate. A number of suggestions were made regarding the future work of ISAR in the area of corporate governance. These included the following topics:

- Analysis on how developing countries and economies in transition could benefit from implementing corporate governance principles and rules;
- Corporate social responsibility as part of corporate governance;
- Guidance on the implementation of best corporate governance practices based on an ISAR comparative analysis of the experience of different countries;
- Sound public governance as a precondition for good corporate governance;
- Corporate governance for state enterprises;
- Functions and role of an audit committee in the context of management of companies;
- Role of multinational corporations in promoting best corporate governance practices in developing countries;
- Promotion of transparency and financial disclosure in the context of corporate governance.

76. Finally, it was agreed that corporate governance would be a second main agenda item at the nineteenth session of ISAR. The specific topic on corporate governance would be

selected by the Commission on Investment, Technology and Related Financial Issues at its session to be held early next year. The UNCTAD secretariat was to suggest a selection of possible topics for consideration by the Commission.

# Chapter IV

# ORGANIZATIONAL MATTERS

## A. Opening of the session

77. The session was opened on Monday, 10 September 2001, by Mr. Karl Sauvant, Director of the Division on Investment, Technology and Enterprise Development, and Mr. Rubens Ricupero, Secretary-General of UNCTAD.

## B. Election of officers

78. At its opening plenary meeting, on Monday, 10 September, the Intergovernmental Working Group elected its officers as follows:

| | |
|---|---|
| Chairperson: | Mr. Richard Martin (United Kingdom) |
| Vice-Chairperson-cum-Rapporteur: | Mr. Tihomir Domazet (Croatia) |

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

79. At its opening plenary, the Intergovernmental Working Group adopted the provisional agenda for the session (contained in TD/B/COM.2/ISAR/11). The agenda was thus as follows:

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

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

80. At its closing plenary meeting, on 12 September 2001, the Intergovernmental Working Group adopted its agreed conclusions on this topic (see chapter I). It also agreed that the Chairperson should summarize the informal discussions on this agenda item (see chapter III).

## E. Other matters

81. The representative of **Spain** said that he was surprised by the composition of the ad hoc consultative group of experts on accounting by SMEs, since there were no Spanish-

speaking or Arabic-speaking members. The principle of equitable geographical distribution was important.

82. The representative of **Brazil** said that, at ISAR's seventeenth session, under his chairmanship, all members of ISAR had been invited to participate in the work of the ad hoc consultative group. Those who had volunteered to participate had become members of the group.

## F. Adoption of the report of the Intergovernmental Working Group on its eighteenth session

83. Also at its closing plenary meeting, the Intergovernmental Working Group authorized the Vice-Chairperson-cum-Rapporteur, under the authority of the Chairperson, to finalize the report after the conclusion of the meeting.

## Annex I

## PROVISIONAL AGENDA FOR THE NINETEENTH SESSION[1]

1. Election of officers
2. Adoption of the agenda and organization of work
3. Accounting by small and medium-sized enterprises
4. [Corporate governance][2]
5. Other business
6. Provisional agenda for the twentieth session
7. Adoption of the report

[1] Based on the agreed conclusions of the Intergovernmental Working Group (see chapter I, para. 11).
[2] Specific topic in the area of corporate governance to be selected by the Commission on Investment, Technology and Related Financial Issues (see para. 76 above).

## Annex II

## ATTENDANCE [*]

1. Representatives from the following member States of UNCTAD attended the session:

Angola
Argentina
Bahrain
Bangladesh
Belgium
Benin
Brazil
Bulgaria
China
Congo
Croatia
Cyprus
Czech Republic
Democratic People's Republic of Korea
Egypt
Ethiopia
France
Ghana
Hungary
India
Italy
Jordan
Madagascar
Mali
Malta
Mexico
Morocco
Nigeria
Panama
Philippines
Poland
Portugal
Romania
Russian Federation
Saudi Arabia
Slovakia
Spain
Sri Lanka
Sudan
Swaziland
Switzerland
Syrian Arab Republic
Thailand
The Former Yugoslav Republic of Macedonia
Tonga
Turkey
Uganda
United Kingdom of Great Britain and Northern Ireland

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

European Commission
Organisation for Economic Cooperation and Development

3. The following non-governmental organizations were represented at the session:

Center for Exchange and Cooperation Centre for Latin America
International Organization for Standardization

[*] For the list of participants, see TD/B/COM.2/ISAR/INF.4.