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Preface

Over the last two years, the world economy has gone through a major crisis. The twenty-sixth session of UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) provided an important opportunity for examining various issues pertaining to corporate accounting and reporting in the context of the financial crisis.

The economic downturn has prompted extensive focus on accounting and reporting standards. Legislators and regulators in a number of member States have been conducting hearings on accounting and reporting issues. Some member States are considering major reforms with a view to enhancing regulation of the financial sector. Recent Group of Eight (G-8) and Group of Twenty (G-20) Summits have considered accounting and reporting issues. At their Pittsburgh Summit, the G-20 leaders have called on international accounting bodies to redouble their efforts to achieve a single set of high quality global accounting standards within the context of their independent standard-setting process, and complete their convergence project by June 2011. Furthermore, at their Pittsburgh Summit, the G-20 leaders called for stricter rules on risk-taking, improved corporate governance mechanisms that align compensation with long-term performance and greater transparency in corporate governance.

While achieving a single set of high quality global accounting standards is a very important step, the benefits of such standards would be fully realized only when they are consistently implemented and enforced around the world. The increasing volume and growing complexity of global standards – such as International Financial Reporting Standards (IFRSs) – has put many developing countries and countries with economies in transition in the persistently difficult position of struggling to keep pace with frequent changes in global standards. The financial crisis has demonstrated once again the growing interdependence and interconnectedness of economies around the world. Restoring financial stability and economic growth will require concerted efforts by all member States.

Given the magnitude and the rapid geographical spread of the financial crisis, the recent focus of world leaders has been on this issue. However, climate change is another major crisis that has been on the horizon for a while. In the coming months, the world community will continue the dialogue that started in Copenhagen in December 2009 to address this issue. Measuring and reporting emissions in a more reliable and comparable manner would certainly contribute towards addressing the impacts of climate change.

This volume contains ISAR's deliberations on the issues noted above and a number of other related topics. It is my pleasure to present this very timely publication to readers who seek to understand the latest thinking on a number of corporate accounting and reporting issues.

Supachai Panitchpakdi

Secretary-General of UNCTAD

Introduction

UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) held its twenty-sixth session at the Palais des Nations in Geneva from 7 to 9 October 2009. The session brought together regulators, standard setters, professional accounting organizations and firms, and academia from all regions of the world. The proceedings of the twenty-sixth session of ISAR are contained in the eight chapters of this volume.

The first chapter of this volume contains a report entitled "Review of Practical Implementation Issues of International Financial Reporting Standards: Impact of the Financial Crisis". This paper was considered by the twenty-sixth session of ISAR under the main agenda item of the session. Two panel discussions were conducted on this topic. A summary of the deliberations on this report is presented at the beginning of the chapter.

The second, third and fourth chapters of this volume contain reports on corporate governance disclosure. The twenty-sixth session of ISAR considered a number of topics under other business, and one of the major topics discussed was corporate governance disclosure. The second chapter of this volume contains a report on the "2009 Review of the Implementation Status of Corporate Governance Disclosures; an Examination of Reporting Practices among Large Enterprises in 12 Emerging Markets". The third chapter contains a report with the title "2009 Review of the Implementation Status of Corporate Governance Disclosures: an Inventory of Disclosure Requirements in 24 Emerging Markets". The third chapter contains a report on the "2009 Review of the Implementation Status of Corporate Governance Disclosures: Case Study of Pakistan". A summary of the discussions on these reports is presented at the beginning of chapter two.

Another major topic that ISAR considered under other business dealt with environmental and corporate responsibility reporting. To facilitate ISAR's deliberations on this topic, two reports were presented. The first report was the "2009 Review of Corporate Responsibility Reporting: the Largest Transnational Corporations and Climate Change-related Disclosure". The second report was the "2009 Review of the Reporting Status of Corporate Responsibility Indicators: Case Study of Brazil". These two reports are contained in this volume in chapters 5 and 6, respectively. Furthermore, two ISAR experts submitted papers on the practical implementation issues of fair value measurement requirements in IFRSs. These papers are contained in chapters VII and VIII.

UNCTAD expresses its appreciation to the Chairman of the twenty-sixth session of ISAR, Syed Asad Ali Shah (Pakistan) and the Vice-Chair-cum-Rapporteur Nancy Kamp-Roelands (Netherlands) for their leadership in conducting the session in an efficient manner, building consensus and culminating the deliberations with meaningful outcome. UNCTAD expresses special thanks to Julie A. Erhardt, Deputy Chief Accountant, Securities and Exchange Commission, United States, for delivering a keynote address at the opening of the twenty-sixth session of ISAR and sharing important insights. UNCTAD is grateful to the Permanent Mission of the United States to the United Nations Office in Geneva for its continued support to ISAR in general, and for facilitating Ms. Erhardt's participation at the twenty-sixth session of ISAR in particular. UNCTAD acknowledges with appreciation the contributions of Remo Croci, European Commission; John Hegarty, World Bank; Michael Stewart, International Accounting Standards Board (IASB); Paul Thompson, International Federation of

Accountants (IFAC); and Nicolas Véron, Bruegel to the panel discussion on implementation of IFRSs and the impact of the financial crisis. UNCTAD is grateful to panel members who contributed to the discussion on fair value measurement requirements, namely: Fabio Da Costa, FUCAPE Business School, Brazil; Christian Dreyer, Chartered Financial Analyst Institute; Jim Osayande Obazee, Nigerian Accounting Standards Board (NASB); Veronica Poole, Deloitte, United Kingdom; and Michael Stewart, IASB.

UNCTAD expresses its appreciation to panellists who contributed to the discussion on corporate governance disclosure, namely: Alexander Berg, Corporate Governance Department, World Bank; Kevin Campbell, University of Stirling, United Kingdom; Jackie Cook, Fund Votes, Canada; and Saira Nasir, Institute of Chartered Accountants of Pakistan. UNCTAD is also grateful to Marcelle Colares Oliveira, Universidade de Fortaleza and Universidade Federal do Ceara, Brazil and Nancy Kamp-Roelands, Ernst & Young, Netherlands for their contributions to the panel discussion on environmental and corporate responsibility reporting.

UNCTAD is grateful to Richard Martin, Association of Chartered Certified Accountants (ACCA); Vickson Ncube, Eastern, Central and Southern African Federation of Account (ECSAFA); Paul Pacter, IASB; Saskia Slomp, Fédération des Experts Comptables Européens (FEE); and Paul Thompson, IFAC for their contributions to the panel discussion on accounting and financial reporting needs of small and medium-sized enterprises (SMEs). UNCTAD is also grateful to Elizabeth Adegite, Accountancy Bodies in West Africa; Gregory Elders, Global Reporting Initiative (GRI), Netherlands; Ashraf Gamal El-Din, Institute of Directors, Egypt; and Bill Phelps, CARANA Corporation for their contributions to the panel discussion on capacity-building in accounting and reporting. UNCTAD acknowledges with appreciation the contributions of the representatives of regional and international organizations who presented at the twenty-sixth session of ISAR updates on activities of their respective organizations. These are: Lois Guthrie, Carbon Disclosure Standards Board; Vickson Ncube, ECSAFA; Saskia Slomp, FEE; and Paul Thompson, IFAC.

Members of the UNCTAD secretariat who contributed to the successful organization of the twenty-sixth session of ISAR are: Tatiana Krylova, Head, Enterprise Development Branch; Yoseph Asmelash, Head, Accounting Unit; and Anthony Miller, Economic Affairs Officer. UNCTAD acknowledges with appreciation excellent research support provided by Arthur Louche and Yusuke Nakazawa in preparing the 2009 Review of the Implementation Status of Corporate Governance Disclosure. Jelina Mitrovic, Peter Navarrette and Jacqueline Du Pasquier provided essential support in organizing the twenty-sixth session of ISAR.

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Chapter I

Review of Practical Implementation Issues of International Financial Reporting Standards: Impact of the Financial Crisis

Summary of discussions

The Chair invited the UNCTAD secretariat to introduce the agenda items that the session would be dealing with. In his introductory remarks, the Director of the Division on Investment and Enterprise provided a broader context within which the work of ISAR was being undertaken in UNCTAD. He indicated that UNCTAD's work consisted of three pillars, i.e. research, consensus-building and technical cooperation. He highlighted a number of flagship products that the Division on Investment and Enterprise had been producing over the years, including the *World Investment Report*. He identified ISAR as one of the flagship activities, and highlighted the importance of ISAR's work in the context both of the Division on Investment and Enterprise and of UNCTAD.

The Head of the Enterprise Development Branch provided an introduction and background to the agenda items that the twenty-sixth session was about to deal with. With respect to agenda item 3, "Review of practical implementation issues of International Financial Reporting Standards", she indicated that the UNCTAD secretariat had organized a conference on the implications of the financial crisis for the international financial reporting infrastructure and financial stability. The conference had taken place in Geneva on 1 July 2009. She drew participants' attention to the issues note with the symbol TD/B/C.II/ISAR/53, which had been prepared on the basis of inputs provided by panellists and participants at the conference. She highlighted the extensive attention that fair value recognition and measurement issues had been attracting during the financial crisis, and indicated that the panel discussion about to take place would focus on that topic.

Following the introduction of the agenda items by the UNCTAD secretariat, a panel of experts made presentations on recent developments in the area of the practical implementation of IFRSs in the aftermath of the financial crisis. The first speaker, a representative of the World Bank, highlighted the global impact of the financial crisis including on global gross domestic product (GDP), trade investment, net private capital flows, poverty and infant mortality. In discussing causes of the financial crisis, the speaker indentified optimism supported by a long period of high growth, low real interest rates, volatility and policy failures. With regard to policy failures, he spoke about financial regulation, macroeconomic policies and the fragmentation of surveillance systems in the global financial architecture. The speaker discussed the responses of the International Monetary Fund and the G-20, and initiatives under way in the European Union (EU). He underscored the fundamental importance of enforcement of high quality accounting and auditing standards in strengthening the financial regulatory system. Furthermore, he highlighted the importance of strengthening all the supporting pillars of the financial reporting architecture, including accounting standards, statutory and governance frameworks, monitoring and

enforcement, education and training, the accounting profession and ethics, and auditing standards.

The next speaker, a representative of the European Commission, began his presentation by providing background information on the implementation of IFRSs in the EU. He elaborated on the EU's International Accounting Standards regulation (EC/1606/2002) and noted that this regulation was applicable in all 27 EU member States. He also elaborated on the endorsement mechanism and related endorsement criteria applicable in the EU, and on the reclassification amendment that the IASB had made in October 2008 on International Accounting Standard (IAS) 39 and IFRS 7. He discussed the IASB's guidance on fair value of financial instruments, as well as impairment rules, fair value options and embedded derivatives. He noted the growing concern at the EU level regarding the need for closer cooperation between the IASB and the Financial Accounting Standards Board (FASB) in the United States, to address key issues and to avoid risks of competitive distortions. He discussed the IASB's exposure draft on the classification and measurement of financial instruments. He also discussed loan loss provisioning.

The next speaker, a representative of the IASB, noted that in 117 jurisdictions around the world, domestic companies were either required or permitted to use IFRSs. He elaborated on the structure of the International Accounting Standards Committee Foundation, the constitutional review and the IASB's consultation process in setting standards. He also elaborated on a number of IASB projects that were aimed at addressing technical issues that had emerged in the course of the financial crisis. He noted that the IASB had published proposals in relation to derecognition, fair value measurement and credit risk in liability measurement. The IASB was in the process of developing documents addressing issues such as consolidation and financial instruments.

The next speaker, from Bruegel, highlighted the success of the IASB in formulating a global set of standards that were being widely adopted. He expressed satisfaction with the broadening geographical base from which board members were being recruited. He noted that the IASB's efforts were geared towards achieving a single set of high quality accounting standards. However, whether the IASB's standards were of high quality or not could not be determined without clearly defining who the IASB's constituents were. The speaker was of the view that in the international accounting standard-setting arena, emerging economies should be treated on equal basis with developed markets. He also noted the importance of playing a proactive role in the standard-setting process for emerging markets. He expressed concern that the IASB's funding and accountability were shifting more towards governments than the private sector. He also cautioned about the possible negative impacts of convergence efforts between the IASB and the FASB.

The last speaker, from IFAC, focused his presentation on practical implementation of International Standards on Auditing (ISAs) and the Code of Ethics for Professional Accountants. He noted that IFAC's strategic objectives included setting high quality standards and assisting its member bodies with the adoption and implementation of standards. The speaker noted that in March 2009, the International Auditing and Assurance Standards Board had completed a suite of 36 ISAs as well as an International Standard on Quality Control (ISQC 1). These standards were scheduled to come into effect for audits in 2010. The speaker said that the clarified ISAs were scalable and made special consideration for smaller entities and practices. He informed participants about the implementation assistance resources that were available on the IFAC's Clarity Centre website. He continued his presentation by discussing the revised

and redrafted Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants. He also discussed IFAC's small and medium practices committee, statements of membership obligations and compliance advisory panel.

The Chair opened the floor for questions. Several delegates raised specific questions regarding the adoption and implementation of IFRSs. Some participants were of the view that adapting IFRSs to national needs was a preferable initial implementation step, rather than full adoption. On this issue, one of the panellists noted that adapting IFRSs does not provide the full benefit of implementing IFRSs as issued by the IASB. One expert noted that his country was in the process of implementing IFRSs by 2011 and highlighted the fact that adopting IFRSs was not a mere technical exercise but rather a major undertaking that required the involvement of various stakeholders at the national level.

On the question of the EU's endorsement criteria in relation to competitiveness, one of the panellists cited the example of endorsement of the IFRS 8 on segment reporting. He indicated that the European Commission had had to examine the potential risk that European companies would face if they were going to be required to reveal competitive business information in order to comply with IFRS 8. The panellist further noted that at the end of the process, it was determined that the standard did not pose such risks, and so it was endorsed for implementation.

One delegate raised the implications of IFRSs for Islamic financial institutions. Delegates exchanged views on the issue. The Chair explained that in his view accounting standards needed to be religion-neutral, as the purpose of standards is to ensure accurate reporting of business performance and financial position. One participant cited the experience of Malaysia, where IFRS-based financial reporting standards coexisted with financial reports prepared in compliance with religious requirements.

One participant expressed concern that the IASB and the FASB were moving in different directions in developing a revised standard in the area of financial instruments. He noted that this divergence was contrary to the call by the G-20 for a single set of global standards. One of the panellists responded that the two boards were working in close consultation, with a view to avoiding divergence.

The Chair invited another panel of experts to share their views on fair value measurement requirements and on the most significant challenges in applying fair value requirements that had emerged during the financial crisis. The first panellist, a technical partner in a "Big Four" accounting firm, elaborated on some misconceptions about the role of fair value accounting in the financial crisis. She cited a number of studies showing that fair value had not caused the financial crisis. With regard to the relationship between fair value and pro-cyclicality, the panellist cited findings that indicated that financial statements were being used too crudely in the calculation of regulatory capital requirements. The speaker highlighted the following weaknesses/difficulties in fair value accounting: the difficulty of applying fair value accounting in illiquid markets; delayed recognition of loan losses, structured credit products and other financial instruments; the extraordinary complexity of standards for financial instruments; the inability to determine whether declines in value are related to changes in liquidity or to probable credit losses; and insufficient best practice guidance and disclosure. She discussed various actions that the IASB and the FASB had taken in the area of fair value accounting in response to the financial crisis. She also elaborated

on a number of considerations that auditors need to make in relation to fair value-based measurements in the aftermath of the financial crisis.

The next speaker, from the IASB, elaborated on IFRSs that required fair value measurement either at initial recognition or subsequent measurement, and on IFRSs that permitted fair value measurement as an option. He noted that the financial crisis had revealed various challenges in applying fair value measurement requirements. In his discussion of the IASB's project on fair value measurement guidance, he emphasized that the proposed guidance did not introduce new fair value requirements, nor did it change the measurement objectives in existing IFRSs. It was intended to provide guidance on how to meet fair value measurement requirements. He elaborated on the proposed definition of fair value, highlighting the exit price element. He also discussed valuation techniques and fair value hierarchy contained in the proposed guidance.

The next speaker, from the Chartered Financial Analyst Institute, discussed the importance of fair value-based information for investment decision-making. He noted that fair value provided relevant information for all rational economic decision-making. In his view, other value measurement methods were less useful for investors, because they did not provide the information needed for forward-looking resource allocation decisions. He also discussed some common objections to fair value accounting, which included the introduction of unacceptable measurement errors, the paradox of recognizing a gain when a firm's debt was downgraded, the high cost of obtaining fair value prices and pro-cyclicality. The speaker then presented the following arguments against the objections: measurement errors would occur if fair value measurements were to be compared to historical cost, and historical cost was not relevant in his view; the gain recognized on downgrading of own debt would be offset by the higher cost of refinancing as a result of the downgrade; when businesses are managed on a fair value basis, the cost of obtaining fair value would not be an issue; and fair value does not contribute to pro-cyclicality – this occurs in the context of highly leveraged financial institutions and strictly held capital requirement rules. With respect to the financial crisis and accounting standard-setting, the speaker elaborated on three interrelated aspects, namely transparency, stability and complexity. He noted that transparency was important for investors, but that it had the potential to reduce inherent systemic stability. If accounting standards were to be developed to ensure economic stability, then the standards would become more complex and less useful, i.e. less transparent for investors. He highlighted the need to recognize the limitations of accounting standards and identifying priorities and catering for secondary objectives by other means, such as modified capital requirement rules or separate accounting for regulatory purposes.

The next panellist, who represented a business school in Brazil, described the challenges in applying fair value measurement requirements in developing countries. His discussion focused on the Latin American and Caribbean region. He pointed out that the debate about fair value was often conducted with developed capital markets in mind. As a result, the special circumstances of developing markets had not adequately been taken into consideration. In describing the main characteristics of enterprises based in the Latin American and Caribbean region, the speaker noted that the countries in the region were at different stages of economic development, capital markets were often small and businesses were often funded by loans from financial institutions, one or a few investors controlled voting rights, the legal environment was based on civil law, and accounting standards were often rules-based. The adoption of IFRSs was still being discussed in many of the region's countries. Brazil had decided to implement IFRSs by 2010, Argentina by 2011 and Mexico by 2012. Thus, fair value was one among several other accounting topics – such as leases, intangible assets and business

combinations – that were being debated in the region. He noted that in Brazil the debate on fair value was focused on financial assets, financial instruments and financial institutions. He indicated that illiquid markets were more common in developing countries and that most fair value measurements were likely to be based on Level 2 and 3 inputs. He emphasized that developing countries could contribute to better implementation of fair value measurement by sharing their experiences in developing valuation models. For example, Brazil could share its experiences in developing valuation models for biological assets.

The last speaker, who represented the Nigerian Accounting Standards Board, described the challenges to applying fair value measurement requirements in Nigeria. In describing the Nigerian capital market, he noted that there were few listed securities compared to developed markets, fewer market makers and low trading volumes relative to market capitalization; that prices were sensitive to even very small trades; that large blocks of shares were held by a small number of shareholders; and that there was significant information asymmetry and a weak regulatory and institutional environment. It was, therefore, difficult to estimate fair value in a reliable manner, as required by a number of IFRSs such as IFRS 2, IAS 19 and IFRS 3. There were few qualified professionals who could apply measurements on fair value basis. The number of qualified actuaries was limited, too. There was no active secondary market for government bonds.

The Chair opened the floor for questions. One delegate noted that in his region, some countries that did not have stock exchanges were requiring all enterprises to implement full IFRSs, regardless of their size. One of the panel members responded that the IASB's standard for small and medium-sized entities (IFRS for SMEs) would be a feasible solution for such countries. Another delegate noted that out of 24 banks in his country, 15 were facing serious financial problems. He further indicated that the audit reports on those banks had failed to provide users with warning signals. A delegate whose country was scheduled to implement IFRSs in a few years' time expressed concern with respect to the impact of fair value measurement at the time of conversion and the potential for fraudulent financial reporting. One participant cited as an example the transition of the central bank in his country to IFRSs, which had resulted in a considerable gain due to fair value measurement. One of the panellists indicated that in the area of accounting, standard-setting was a long-term process, and he expressed hope that ultimately the mixed attribute model would be eliminated.

Another panellist emphasized that the role of the accountancy profession was to portray the financial position of business entities as of a specific date, and their financial performance over a specific time period. The role of the profession was not to predict potential increases or decreases in valuations. It was not the task of the profession to second-guess the market. The panellist was also of the view that the accounting profession had an important role to play in improving the quality of the financial information that was being fed to financial markets.

The Chair invited a panel of experts to share their views on recent developments in the area of accounting by SMEs, focusing on the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) that the IASB had published a few months earlier. The IASB director of the IFRS for SMEs highlighted the various stages of the project that had led to the publication of the IFRS for SMEs. He noted that the 230-page-long standard was a completely standalone standard, with the exception of a fallback option to full IFRS in the case of IAS 39. That would be the case only if an entity were to choose to apply IAS 39 instead of the financial instruments section of the IFRS for SMEs. He noted that the simplified IFRS

for SMEs had been developed by omitting topics that were not relevant for SMEs, including only the simpler options where the full IFRS had options, simplifying recognition and measurement requirements, reducing disclosures and simplifying drafting. In response to a question about implementation plans for the IFRS for SMEs, the speaker indicated that out of 51 jurisdictions, 19 indicated that they planned to require the IFRS for SMEs, 11 planned to permit it, 10 indicated that they may require it, while 11 had no plans to either require or permit the standard. The speaker highlighted plans for train-the-trainer sessions on the IFRS for SMEs that were scheduled to take place over the coming months in different regions of the world.

The Chair opened the floor for questions and comments. Several delegates highlighted the positive impact that ISAR's work on accounting by SMEs had had on the IASB's IFRS for SMEs project. Some delegates were of the view that the IFRS for SMEs would be difficult for smaller entities to implement. One delegate asked whether there were plans to organize train-the-trainer events in Africa. The panellist who discussed the IFRS for SMEs responded that some jurisdictions could allow very simplified accounting for smaller entities. He assured African delegates that plans were under way to organize train-the-trainer events in Africa. In response to a question about how the recent developments that had impacted a number of IFRSs would affect the IFRS for SMEs, another panellist responded that preparers could count on a 4–5 year period of a stable platform before any changes were introduced to the IFRS for SMEs. He also indicated that the European Commission was planning to hold consultations, including on prospects for implementing the IFRS for SMEs.

The next speaker, from the AACA, discussed proposals for implementing the IFRS for SMEs in Ireland and in the United Kingdom. He noted that the Accounting Standards Board in the United Kingdom had made a proposal to adopt a three-tier system starting from 2012. The IFRS for SMEs would replace full United Kingdom standards and would be adopted in full without amendments. The Financial Reporting Standard for Smaller Entities (FRSSE) would be retained for the foreseeable future. Smaller entities would have a choice between the IFRS for SMEs and the FRSSE. He discussed a number of the differences between the IFRS for SMEs and the FRSSE.

In discussing the prospects for implementing the IFRS for SMEs, a representative of the ECSAFA noted that a majority of the countries in his region intended to adopt or consider adopting the IFRS for SMEs. Some of the practical implementation considerations were in relation to legislative changes, sensitizing regulators about the IFRS for SMEs, defining SMEs and determining which ones would qualify to apply the IFRS for SMEs, training users and preparers, and developing implementation guidelines. In cooperation with the IASB, his regional professional accountancy organization was planning to carry out training for trainers.

The speaker from the European Federation of Accountants discussed a number of activities that an accountancy organization for her region had been undertaking to meet the accounting and financial reporting needs of SMEs. She highlighted various initiatives that had been undertaken to simplify the accounting carried out by SMEs. She noted that her organization had not taken a final position on the IFRS for SMEs. However, she indicated that her organization was of the view that SMEs with cross-border activities, branches and subsidiaries would benefit from implementing the IFRS for SMEs, and that regional directives should not form an impediment for countries in her region that wished to implement the IFRS for SMEs.

The speaker representing IFAC emphasized the importance of the SME sector for economic development, highlighting its contribution to GDP, employment and

innovation. He noted that his organization had been closely monitoring the IASB's project on IFRS for SMEs and welcomed the issuance of the standard. He further noted that the international response to the publication of the IFRS for SMEs had been highly positive. He noted that a smooth transition to the IFRS for SMEs required education and training, information, guidance and tools, as well as the sharing of experiences.

The Chair opened the floor to additional questions and comments. Several delegates indicated that smaller entities would need a different reporting system, such as ISAR's Accounting and Financial Reporting Guidance for Level 3 SMEs (SMEGA Level 3). There was a general understanding that the IFRS for SMEs would not be suitable for not-for-profit organizations. Some delegates suggested that ISAR could contribute on this topic. Some delegates suggested that the UNCTAD secretariat could explore extending the ISAR mandate, with a view to incorporating issues of public sector reporting into its agenda. With respect to the cooperatives sector – such as credit unions – one panellist indicated that in his country, such entities were required to apply full IFRSs, since they were considered to be financial institutions.

In concluding its deliberations on this agenda item, the group of experts welcomed with appreciation the publication of the *International Financial Reporting Standard for Small and Medium-sized Entities* by the IASB. Delegates stressed the role that ISAR had played in persuading the IASB to develop an IFRS for SMEs. ISAR agreed on the need to consider withdrawing SMEGA Level 2 as a result of the publication of the IFRS for SMEs by the IASB. They also requested the UNCTAD secretariat to continue compiling feedback on practical implementation of the revised SMEGA Level 3. ISAR further requested the UNCTAD secretariat to conduct studies on practical implementation of the IASB's IFRS for SMEs with a view to facilitating a sharing of the experiences gained in different regions of the world.

I. Introduction

UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been reviewing practical implementation issues relating to IFRSs. This work has been conducted within the context of the widespread adoption of IFRSs in recent years, and within ISAR's mandate to promote the harmonization of international accounting and reporting. ISAR's work in this area includes issues pertaining to institutional and regulatory arrangements, enforcement mechanisms, technical issues and capacity-building. The objective of this work is to assist developing countries and countries with economies in transition in their efforts towards the practical implementation of IFRSs. The work has been grounded in the sharing of best practices and lessons learned from actual country experiences with IFRSs.

The financial crisis that besieged the world economy beginning in the summer of 2007 has had broad negative impact around the world. For example, in the area of foreign direct investment (FDI), recent UNCTAD figures suggest that, after a peak of $1.9 trillion in 2007, global FDI plunged by 15 per cent in 2008.[1] The prospects for 2009 are not good either. In fact, UNCTAD's latest survey on FDI prospects indicates

[1] http://www.unctad.org/en/docs/webdiaeia20091_en.pdf.

that sustained FDI flows will not resume before 2011.[2] With respect to world merchandise trade, UNCTAD's studies project a 6–8 per cent decline. Exports from developing countries and transition economies are also expected to fall, in the range of 7–9 per cent. According to the World Bank, global output is expected to decrease this year by 2.9 per cent – the first ever decline since the Second World War. The International Labour Organization expects the number of unemployed persons to rise to 50 million in 2009.[3] Hunger has also increased dramatically, with the number of hungry people up by 100 million since last year alone, bringing the total number to 1 billion – one of every six people on this planet.

Since the onset of the global economic and financial crisis, accounting and reporting issues have gained an unprecedented level of attention at the highest levels of government. A wide range of key actors have been devoting significant attention to the role of accounting and reporting in the context of the financial crisis, including the 2008 and 2009 Summits of the G-20, the June 2009 meeting of the G-8 Finance Ministers, the European Council of Ministers, the United States Congress and the Financial Crisis Advisory Group (established by the IASB and the FASB of the United States). The attention paid to this subject reflects a growing recognition of the importance of a sound accounting and reporting system for global financial and economic stability.

All of the major international meetings since the twenty-fifth session of ISAR in 2008 have reconfirmed the need for a single set of high quality global accounting standards. The international community has underscored the importance of strengthening cooperation and coordination among global standard setters, regulators, supervisors and national standard setters, with the goal of ensuring high quality, comparable financial reporting and consistent application and enforcement of accounting standards. Also outlined at these various international meetings were a number of priority issues in this area that need to be addressed urgently to improve the global financial architecture and restore investor confidence.

At the June 2009 United Nations Conference on the World Financial and Economic Crisis and its Impact on Development, member States stressed the importance of strengthening the international financial system to overcome severe impacts of the current crisis and to help prevent the occurrence of similar crises in the future. In this regard they called for, inter alia, concerted efforts by all jurisdictions towards consistent and non-discriminatory implementation of corporate transparency requirements and related international standards.[4]

These developments have added additional issues to already wide-ranging national and international debates on the implementation of IFRSs. Established issues within this area already included: (a) the complexity of accounting standards; (b) the need for additional guidance on their practical implementation (especially in such areas as valuation of financial instruments); (c) the suitability of international accounting standards for SMEs; and (d) a number of other important technical matters (e.g. fair value measurement). Adding to this field, a new group of issues has now emerged related to financial reporting in a distressed economic situation. These include such challenges as: (a) measurement in illiquid markets; (b) the pro-cyclicality of IFRSs; (c) provisioning aspects; and (d) risk management and related disclosures and audit considerations. One of most important new issues to have emerged in these debates is

[2] http://www.unctad.org/en/docs/diaeia20098_en.pdf.

[3] http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_101461.pdf.

[4] See United Nations (2009). Conference on the World Financial and Economic Crisis and Its Impact on Development. A/Conf.214/3.New York. 24–25 June.

how to ensure that the financial reporting system not only provides a fair and objective reflection of company's financial status and performance, but also provides early warning signals that can help to avert major financial disasters. These new issues add to previously existing challenges for all countries, but particularly for those countries with less developed financial markets and accountancy infrastructure.

Another major aspect of the accounting-related global agenda in the wake of the financial crisis is the need to strengthen the institutional framework for the creation of one set of global accounting standards. This includes the need to re-evaluate the governance of global standard-setting institutions to ensure the integrity and independence of the process. The financial crisis has highlighted tensions between the need for expediency in stabilizing economies and the need for due process in creating a single high quality international standard.

Therefore, gaining a deeper understanding of the impact of the financial crisis on accounting and reporting has become essential for assisting member States with their efforts towards the harmonization of their financial reporting requirements and the implementation of IFRSs. The UNCTAD secretariat has prepared this review to facilitate ISAR's deliberations on this matter.

This publication presents an overview of the practical implementation issues of IFRSs that emerged during the financial crisis. It has been prepared on the basis of inputs provided by the panellists and participants of the July 2009 Conference on the Financial Crisis and its Implications for the International Financial Reporting Architecture and Financial Stability, which was organized by UNCTAD at the request of the twenty-fifth session of ISAR.

II. Financial reporting and auditing issues that emerged during the financial crisis

A. Impact of the financial crisis on the global accounting agenda

The financial crisis originated in the subprime mortgage market of the United States and rapidly spread throughout the global financial sector, with knock-on effects for the real economies of countries around the world. Subprime mortgage loans are distinct due to the fact that such loans are made to high risk borrowers, usually with poor credit history. In the ordinary course of business, mortgage banks packaged and transformed these subprime mortgage loans into securities that were sold to investors around the world.

The global financial crisis that was triggered by the collapse of the subprime mortgage market in the United States has been the subject of extensive debate and examination by different stakeholders at the national, regional and international levels. In recent decades, the world economy has been integrating at a rapid pace. One of the manifestations of the growing integration of financial markets has been the highly correlated movements of equity markets around the world. A direct implication of this rapidly globalizing world economy has been the emergence of global standards, including in the area of financial reporting. The number of countries and jurisdictions that require or permit the use of IFRSs has reached 113.[5] Global standards such as

[5] http://www.ifrs.com/ifrs_faqs.html#q3.

IFRSs facilitate the flow of information to market participants by enabling the measurement and reporting of economic activities in a comparable manner, regardless of the jurisdiction in which the economic activity takes place.

The financial crisis has given accounting and financial reporting debates a new prominence and moved these issues into the highest levels of governmental and intergovernmental discussion. Working Group 1 of the G-20 on Enhancing Sound Regulation and Strengthening Transparency[6] identified the following as drivers of the current turmoil:

(a) Weaknesses in underwriting standards;
(b) Lack of oversight of systemic risks;
(c) Lack of oversight of unregulated pools of capital;
(d) Weak performance by credit rating agencies;
(e) Pro-cyclical tendencies fed by regulatory and accounting frameworks;
(f) Shortcomings in risk management practices;
(g) Financial innovation outpacing risk management;
(h) Weaknesses in disclosure;
(i) Weaknesses in resolution procedures;
(j) Lack of transparency in various over-the-counter markets.[7]

In its declaration of 2 April 2009, the G-20 agreed that accounting standard setters should take action by the end of 2009 to:

(a) Reduce the complexity of accounting standards for financial instruments;
(b) Strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information;
(c) Improve accounting standards for provisioning, off-balance sheet exposures and valuation uncertainty;
(d) Achieve clarity and consistency in the application of valuation standards, internationally, working with supervisors;
(e) Make significant progress towards a single set of high quality global accounting standards;
(f) Within the framework of the independent accounting standard-setting process, improve the involvement of stakeholders, including prudential regulators and emerging markets, through the IASB's constitutional review.

As a result of the G-20 summit in April 2009, the Financial Stability Board was established as a stronger successor to the Financial Stability Forum. The board was tasked with, inter alia, calling on accounting standard setters to work urgently with regulators to improve standards on valuation and provisioning, with a view to achieving a single set of high quality global accounting standards.

B. Responses of major accounting standard setters

In response to the financial crisis, the IASB has launched a number of projects, such as fair value measurement and financial instruments. In October 2008, the IASB amended requirements on the reclassification of some financial assets from fair value

[6] Created by the 2008 G-20 Summit.

[7] G-20 Working Group 1 (2009). Enhancing sound regulation and strengthening transparency, final report. 25 March. http://www.g20.org/Documents/g20_wg1_010409.pdf.

categories to amortized cost categories.[8] The IASB has also issued additional technical guidance on the determination of fair values of financial assets in illiquid or inactive markets.[9] The guidance explains the need to consider all relevant market information and acknowledges that, in some circumstances, an entity may have to use its own assumptions about future cash flows and risk-adjusted discount rates. This guidance has been reinforced by the May 2009 *Exposure Draft on Fair Value Measurement*.[10]

The IASB project on financial instruments will have three phases: (a) classification and measurement; (b) impairment; and (c) hedge accounting and others. The classification and measurement phase is aimed at producing decision-useful information about amounts, timing and uncertainty of cash flows. The IASB is proposing two measurement methods (amortized cost and fair value) to be used depending on the circumstances. Amortized cost would be used only when assets have basic features of a loan and are managed on a contractual yield basis. All other financial instruments are to be measured on a fair value basis with the fair value option available in case of mismatches between assets and liabilities.

At the end of 2008, the IASB and the FASB established the Financial Crisis Advisory Group, which was tasked to advise both the IASB and the FASB on the implications of the financial crisis to the standard-setting process and potential changes in the regulatory environment. At the end of July 2009, the advisory group concluded that the financial crisis had underscored the importance of four principles:[11]

(a) Effective financial reporting;

(b) Limitations of financial reporting;

(c) Convergence of accounting standards;

(d) Standard setter independence and accountability.

During the advisory group's debates a number of specific accounting issues were raised:

(a) Valuation and measurement in illiquid markets (particularly of financial instruments);

(b) Pro-cyclicality of accounting standards;

(c) Provisioning, risk management and disclosures;

(d) Reconciliation between financial reporting and prudential regulations.

The advisory group made a number of recommendations in each of the above-listed areas. A more general question raised by the group was what role accounting and

[8] http://www.iasb.org/NR/rdonlyres/BE8B72FB-B7B8-49D9-95A3-CE2BDCFB915F/0/AmdmentsIAS39andIFRS7.pdf

[9] IASB (2008). *Measuring and Disclosing the Fair Value of Financial Instruments in Markets that are no longer Active*. London, IASCF. http://www.iasb.org/NR/rdonlyres/0E37D59C-1C74-4D61-A984-8FAC61915010/0/IASB_Expert_Advisory_Panel_October_2008.pdf.

[10] http://www.iasb.org/NR/rdonlyres/C4096A25-F830-401D-8E2E-9286B194798E/0/EDFairValueMeasurement_website.pdf.

[11] Financial Advisory Crisis Group (2009). *Report of the Financial Crisis Advisory Group*. http://www.iasb.org/News/Press+Releases/Financial+Crisis+Advisory+Group+publishes+wide-ranging+review+of+standard-setting+activities+followi.htm.

audit could play in providing early warning signals regarding potentially dangerous financial practices.

The Committee of European Securities Regulators conducted a study of the application of and disclosures related to the amendment on IAS 39 and IFRS 7 that were made in October 2008.[12] The committee selected a sample of 100 European financial companies, of which 61 per cent opted for the reclassification option.

III. Selected issues

A. Measurement issues

In the aftermath of the financial crisis, most of the debate has been focused on measurement issues, particularly in relation to financial instruments. Measurement is a key element in accounting and financial reporting. The measurement process determines the monetary value that will be assigned to items that will be reported in the financial statements of an entity. Over the years, as the enterprises' activities have grown and financial markets have developed, different measurement approaches have evolved. Users of financial statements have different measurement preferences. For example, financial analysts support measurement approaches based on fair value. On the other hand, prudential regulators support measurement approaches that can be easily verified, for example, historical costs.

For many years, measurement has been the subject of extensive debate among various stakeholders, a debate that has intensified significantly in the aftermath of the financial crisis. One of key issues raised has been the role of fair value accounting in the financial crisis, including its relevance, reliability and applicability in the case of market uncertainty and illiquidity. Some experts argue that measuring assets at fair value has led to unwarranted write-downs in the present value of still-performing long-term assets whose long-term value remains unchanged; thus, it is argued, fair value accounting has been misleading to investors and other users of such information about the real value of such assets. This argument contends that unwarranted write-downs in the value of long-term assets led to panic selling of certain mortgage-backed financial instruments and the subsequent collapse in these markets that triggered the financial crisis.[13]

Others argue that fair value accounting is useful under normal market conditions, but becomes practically unworkable during periods of illiquid markets and rapid price fluctuations that mark a financial crisis. For example, a survey conducted in 2009 by the Valuation Research Corporation indicated that a majority of surveyed financial professionals believed that, while in less volatile times fair value accounting has improved transparency, during times of financial distress it becomes more difficult to implement and understand.[14]

Another view is that, despite its imperfections, fair value measurement provides a far better platform for the price adjustment process needed during financial distress. This argument contends that other measurement models (e.g. amortized cost accounting) have also been subject to asset impairment write-downs. Thus, the role of asset measurement in the financial crisis would have been similar even under

[12] CESR (2009). Application of and disclosures related to the classification of the financial instruments. CESR/09-575. 15 July.

[13] For more details, see Ryan SG (2008). Accounting in and for the subprime crisis. *The Accountancy Review.* 83: 6.

[14] VRC (2009). *Survey: Perceptions of Fair Value Accounting Hit Hard by Financial Crisis.*

alternatives to fair value accounting standards. Nevertheless, proponents of fair value measurement agree that guidance on its application during periods of market distress needs to be improved.[15]

Responding to recent debates, the IASB has continued its efforts towards improving requirements on fair value measurement. In the *Exposure Draft* the IASB issued in May 2009,[16] fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction[17] between market participants at the measurement date. This definition is consistent with the one in Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements,[18] issued by the FASB in the United States.

The IASB's new *Exposure Draft on Fair Value Measurement* proposes the use of valuation techniques for estimating the prices at which an orderly transaction would take place between participants at the measurement date. Examples of such valuation techniques include matrix pricing, present value and option pricing models (such as the Black-Scholes-Merton formula).

All valuation techniques require the use of inputs, for example, prices, cash flows, income, expenses and interest rates. The IASB *Exposure Draft* proposes that an entity must maximize the use of relevant observable inputs and minimize the use of unobservable inputs. Its proposed hierarchy of inputs, derived from SFAS 157, gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. Therefore, the fair value of an asset that is determined solely by reference to quoted prices (unadjusted) in active markets for identical assets is described as a Level 1 Fair Value, or the most reliable in the hierarchy. Level 2 inputs are inputs other than the quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (as derived from prices). This includes quoted prices for similar assets or liabilities in active markets.

The fair value of an asset that relies significantly on unobservable inputs (for example, entity-specific cash flows) is described as a Level 3 Fair Value. The *Exposure Draft* proposes extensive disclosures about the valuation techniques used and the inputs used in the chosen techniques. In addition, Level 3 Fair Value requires the disclosure of the effect of the measurements on profit or loss or other comprehensive income.

In practice (and as noted in the table below), preparers tend to use Level 2 inputs for fair value measurement purposes. The table below presents the aggregate results of a study of financial institutions' use of the fair value hierarchy of assets and liabilities in Europe and the United States.[19]

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[15] See e.g. Ryan SG (2008). Accounting in and for the subprime crisis. *The Accountancy Review.* 83 (6).

[16] http://www.iasb.org/NR/rdonlyres/C4096A25-F830-401D-8E2E-9286B194798E/0/EDFairValueMeasurement_website.pdf

[17] An orderly transaction is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale).

[18] http://www.fasb.org/pdf/aop_FAS157.pdf

[19] The total for Levels 1, 2 and 3 may not add up to 100 per cent due to rounding of numbers.

Table I.1. Use of inputs for fair value measurement by financial institutions in the United States and Europe (per cent)

	United States financial institutions	European financial institutions	Total (United States and European)
Level 1	22	28	25
Level 2	72	67	69
Level 3	6.4	4.4	6.4

Source: Fitch Ratings, based on 2007 company annual reports.

When observable market data are not available, preparers use mathematical models for valuation purposes. This is commonly known as "mark-to-model". This valuation process depends on significant inputs that are based on managers' judgments. The objective of the model is to arrive at prices that would be equivalent to quoted prices had a market existed for the particular financial instrument for which the preparer needed to obtain fair value. Therefore, the model needs to simulate, as close as possible, prevailing market conditions. Formulating such a model in an objective manner, particularly in a market downturn, is challenging. Use of Level 3 inputs proves to be a significant challenge for market participants. The above-mentioned Valuation Research Corporation survey has indicated that financial professionals feel least confident about these valuations, particularly for assets held by banks, hedge funds and private equity firms.[20]

The financial crisis has also brought into focus fair value measurement requirements in relation to an entity's own debt. IFRSs require that, if an entity's credit standing suffers and its obligations with respect to its own debt instruments decrease, that entity should recognize a gain equal to the amount of the decline in its obligations. The general view is that it would be counterintuitive to recognize a gain in such circumstances. However, there are differing opinions on this issue. Some feel that there should be symmetry in accounting for assets and liabilities and any accounting mismatch should be avoided.

B. Audit issues

The financial crisis has also highlighted a number of issues in the area of auditing. In October 2008, the International Auditing and Assurance Standards Board issued a practice alert with respect to challenges in auditing of fair value accounting estimates.[21] The staff alert noted that, in the market environment that prevailed at that time, obtaining reliable information relevant for fair value accounting had become one of the greatest challenges faced by preparers, and consequently by auditors. It also noted that, as markets became inactive, the tendency had been for preparers to move away from valuation by market price to valuation by model. It drew auditors' attention to the degree of consistency of valuation approaches and the appropriateness of changes in approaches or assumptions that preparers made in arriving at fair value estimates. Additional considerations the staff alert addressed include the increased risk of

[20] Valuation Research Corporation (2009). Survey: Perceptions of fair value accounting hit hard by financial crisis.

[21] International Auditing and Assurance Standards Board (2008). *Challenges in Auditing Fair Value Accounting Estimates in the Current Market Environment*.

fraudulent financial reporting, "going concern"[22] assumptions and the independent auditor's report (particularly in relation to the emphasis of matter with regard to fair value estimates).

C. IFRSs and national regulatory requirements

Another challenging area of the practical implementation of IFRSs that has been amplified by the financial crisis is the interplay between financial reporting information and regulatory requirements (particularly capital requirements). It is broadly recognized that financial statements prepared under IFRSs are for general purpose use rather than for regulatory purposes. However, regulators in some jurisdictions utilize general purpose financial statements as an initial input and then adjust the figures to meet regulatory reporting requirements.

During periods of declining markets, entities are required to continue measuring their financial instruments by applying fair value measurement requirements. As a result, entities are forced to recognize significant losses, thereby decreasing their total assets and capital and then facing the possibility of failing to meet regulatory capital requirements. Other entities in the real sector may also fail to meet their debt covenants.

Some regulators are proposing the use of dynamic provisioning throughout the economic cycle as a way of mitigating the current incurred loss model[23] in IFRSs. The joint IASB/FASB Financial Crisis Advisory Group noted that prudential regulators may require institutions to adopt a wide range of measures, such as establishing regulatory provisions or reserves beyond the provisioning required by accounting standards. Some academic studies[24] indicate that one way to tackle the pro-cyclicality of the accounting system is to deviate from market prices in situations where contagion is likely to occur. IFRSs allow such deviations in certain circumstances. IFRSs state that market prices from forced sales should not be used. This protects against negative spillovers from distressed banks. As part of its reconsideration of its requirements for financial assets and financial liabilities, the IASB is seeking inputs from parties concerned regarding the feasibility of the dynamic provisioning model favoured by some banks and bank regulators.[25] The joint IASB/FASB Financial Crisis Advisory Group noted that, if an alternative to the incurred loss model is developed that uses more forward-looking information, it may well narrow the difference between the requirements of the accounting standards and regulatory standards. To the extent that differences remain, the advisory group urged the IASB and the FASB to develop a method of transparently depicting any additional provisions or reserves that may be required by regulators, without undermining the integrity of financial reporting by affecting income statement-based metrics.

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[22] In preparing financial statements, "going concern" is one of the underlying assumptions that an entity will continue its operations for the foreseeable future and does not plan to liquidate or curtail materially the scale of its operations.

[23] The incurred loss model in IFRSs requires an entity to recognize an impairment loss if a credit loss has been incurred and not to recognize an impairment loss for losses expected as a result of future events or future credit losses that have not been incurred.

[24] Laux C and Leuz C (2009). The crisis of fair value accounting: making sense of the recent debate. Working Paper No. 33, Initiative on Global Markets. University of Chicago, Booth School of Business. Chicago. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1392645.

[25] http://www.iasb.org/NR/rdonlyres/CA916D12-9B8E-4889-B75D-D305DD413974/0/RequestforInformation.pdf.

IV. Concluding remarks

The financial crisis has made clear the need to further strengthen the institutional framework and governance of global accounting standard-setting and improving the quality of international financial reporting. A number of financial reporting and auditing issues have emerged. Most of the debate has been focused on fair value measurement and related valuation techniques. Similar issues have also emerged from the audit perspective. The interplay between general purpose financial reporting, on the one hand, and reporting for regulatory requirement purposes, on the other, has been a topic of significant debate.

This review has presented an overview of the impact of the financial crisis on the IFRS debate and on practical implementation challenges of IFRSs. Delegates at the twenty-sixth session of ISAR may wish to deliberate on the following issues:

(a) What are major institutional challenges in the area of accounting and reporting brought to light by the recent financial crisis?

(b) Are there some additional practical implementation issues that countries have been experiencing with regard to the impact of the financial crisis on financial reporting requirements and IFRSs?

(c) What kind of assistance do countries need to keep pace with international developments in relation to accounting, especially in the aftermath of the financial crisis, and what particular role could ISAR play in addressing these challenges?

Chapter II

2009 Review of the Implementation Status of Corporate Governance Disclosures: an Examination of Reporting Practices among Large Enterprises in 12 Emerging Markets

Summary of discussions

The Chair introduced the agenda item and gave the floor to a member of the secretariat, who presented the findings of the "2009 Review of the implementation status of corporate governance disclosures: an examination of reporting practices among large enterprises in 12 emerging markets" (TD/B/C.II/ISAR/CRP.6). The paper provided useful data on the current state of corporate reporting on non-financial subjects in emerging markets.

Following this presentation, the Chair introduced an invited expert from the University of Stirling, who presented the findings of a joint UNCTAD/University of Stirling paper entitled "2009 Review of the implementation status of corporate governance disclosures: an inventory of disclosure requirements in 24 emerging markets" (TD/B/C.II/ISAR/CRP.8). This paper was an update to the inventory conducted by UNCTAD in 2007.

The Chair then called on an invited expert from the Institute of Chartered Accountants of Pakistan, who presented the findings of a country case study produced jointly by UNCTAD and the Institute of Chartered Accountants of Pakistan entitled "2009 Review of the implementation status of corporate governance disclosures: case study Pakistan" (TD/B/C.II/ISAR/CRP.5). The study highlighted the corporate governance disclosure practices in Pakistan among leading large enterprises.

The Chair introduced two additional panellists, one from Fund Votes (a corporate governance research organization) and one from the World Bank's corporate governance department. The founder of Fund Votes presented an overview of regulatory developments in the wake of the financial crisis that will impact on corporate governance and disclosure. The World Bank representative commented on UNCTAD's studies of corporate governance disclosure and the impact of the financial crisis on developments in the area of corporate governance and disclosure. With regard to UNCTAD's research, he praised the work for its unique and valuable contribution to the field. He indicated that he was in agreement with the comments from the floor about the need to measure the quality of disclosure, in addition to its existence, noting that this is a very difficult issue to address from a research perspective and one that the World Bank itself struggles with. On the financial crisis, the World Bank representative noted that many aspects of the crisis were unique to the larger financial markets where it had originated, but that there was still a need for further examination of what lessons from this crisis, and resulting reforms, could be applied in

emerging markets. For example, he noted that in some cases, emerging market regulators were already drawing conclusions about state intervention in the economy based on what was taking place in the more developed countries at the centre of the crisis; he suggested that further debate should take place about the utility of such policy decisions in emerging markets before firm conclusions could be drawn.

After the panellists had made their presentations, the Chair opened the floor and a broad discussion on the subject of corporate governance disclosure ensued. Several delegates commented on the three studies presented, recognizing their usefulness and making suggestions for improvements and future research in that area.

Broad discussion was also sparked by questions about the impact of the financial crisis on corporate governance and disclosure. The specific issues addressed included the role of corporate boards of directors in risk management, and the design of executive compensation packages. There were also questions on the unique conditions of developing countries, such as family ownership and government shareholding, and the relevance of the lessons learned from this financial crisis for corporate governance practices in emerging markets. Several participants stated that while the situation in developing countries was different with respect to some corporate governance issues (e.g. executive compensation), there were nevertheless important lessons to be learned from this crisis, such as ensuring that executive compensation, whatever its form or absolute value, does not create counterproductive incentives that could endanger enterprises' long-term viability. The Group of Experts concluded its discussion with calls for the secretariat to continue its work in this area.

I. Introduction

Corporate governance has been a major area of work for ISAR since 1989 (E/C.10/AC.3/1989/6). Since the twenty-first session of ISAR, the group of experts has requested an annual review of the implementation status of corporate governance disclosure. Annual reviews were presented at the twenty-first, twenty-second, twenty-third, twenty-fourth and twenty-fifth sessions of ISAR. At the twenty-fifth session, ISAR considered the document "2008 Review of the implementation status of corporate governance disclosures: an examination of reporting practices among large enterprises in 10 emerging markets" (TD/B/C.II/ ISAR/CRP.1, hereafter the "2008 CG Review").

UNCTAD's studies on this subject use as a benchmark ISAR's conclusions on corporate governance disclosure found in the 2006 UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure* (UNCTAD/ITE/TEB/2006/3). This study follows up the data presented in the 2008 CG Review. While the 2008 CG Review looked at the reporting practices of enterprises from the top 10 most heavily weighted United Nations member States found in the Emerging Markets Index produced by Morgan Stanley Capital International[26] (hereinafter the "MSCI EM Index"), this study examines the

[26] MSCI is a commercial provider of financial information, including equity indices tracking publicly listed enterprises around the world. The MSCI EM Index is considered by institutional investors to be the industry standard to gauge emerging markets performance, and is an important tool for facilitating foreign portfolio investment to developing countries and countries with economies in transition.

actual disclosure practices and requirements of enterprises from the smallest 12 markets, by index weighting, within the MSCI EM Index. This line of enquiry is expected to provide policymakers and other interested parties with an indication both of what enterprises are reporting and the compliance of enterprises with corporate disclosure rules and regulations. The findings, along with a detailed analysis, are presented in section I.

The findings show that on average, and as a group, enterprises from the smallest 12 markets of the MSCI EM Index are reporting on the same number of subjects regarding their corporate governance practices as the 10 largest emerging markets studied in 2008. Further analysis indicates that, while required disclosure items are reported more frequently than non-required disclosure items, there are still significant gaps in compliance among enterprises vis-à-vis the reporting requirements of their home markets.

II. Status of implementation of good practices in corporate governance disclosure

A. Background and methodology

1. ISAR benchmark

The purpose of this study is to evaluate the level of implementation of good practices in corporate governance disclosure highlighted in the 2006 UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure* (based on the ISAR document TD/B/COM.2/ISAR/30). This publication forms a benchmark (hereafter the "ISAR benchmark") of 52 disclosure items on corporate governance. This benchmark was used in earlier ISAR studies on this subject from 2005 to 2008, as well as in country case studies of China and Egypt (both in 2007). Readers should note that, as was the case with ISAR's previous annual reviews on this subject, this report is not intended as a measure of the quality of disclosure within individual markets; it is a measure of the existence of the selected disclosure items within the public reports of the companies studied.

Compared to previous reviews, one minor change was made to the benchmark list of indicators: the item on "Disclosure practices on related party transactions where control exists" was removed. This disclosure item was subtracted due to its substantial similarity with the other disclosure item on "Nature, type and elements of related-party transactions".

The complete set of 52 disclosure items are grouped into five broad categories, or subject areas, of corporate governance disclosure, and are presented and analysed by category in section B. These categories are:

(a) Financial transparency;

(b) Board and management structure and process;

(c) Ownership structure and exercise of control rights;

(d) Corporate responsibility and compliance;

(e) Auditing.

2. Sample studied

The present study uses the ISAR benchmark to measure the disclosure practices of 88 leading enterprises from 12 emerging markets. The sample used in this study is comprised of selected enterprises[27] from each of the smallest 12 markets found in the MSCI EM Index. The MSCI EM Index tracks more than 700 publicly listed enterprises, which account for roughly 85 per cent of the market capitalization of 23 emerging markets.[28] Table II.1 provides a list of the economies included in the MSCI EM Index.

Table II.1. The 23 economies included in the MSCI EM Index (as of March 2009)

1. Argentina	14. Malaysia
2. Brazil	15. Mexico
3. Chile	16. Morocco
4. China	17. Peru
5. China, Taiwan Province of	18. Philippines
6. Columbia	19. Poland
7. Czech Republic	20. Russian Federation
8. Egypt	21. South Africa
9. Hungary	22. Thailand
10. India	23. Turkey
11. Indonesia	
12. Israel	
13. Republic of Korea	

The smallest 12 markets, by index weighting, within the MSCI EM Index are listed in table II.2, along with their total index weighting. In addition, table II.2 shows the weighting of the enterprises surveyed for this study. The enterprises selected for this study are the top 10 largest enterprises from each country (by index weighting). Where countries have less than 10 enterprises included in the MSCI EM Index, all of the enterprises for that country are included in the study. The selected enterprises from each country account for between 77 per cent and 100 per cent of their respective country's index weighting. These enterprises were selected due to their economic significance within their home countries, and as samples of leading companies in each country. As a group, the 88 enterprises from emerging markets represent 8.3 per cent of the market capitalization of the entire MSCI EM Index. Additionally, as indicated in figure II.1 below, the selected enterprises represent a diversified range of industrial sectors.

[27] Note that in some countries, some of selected enterprises by index weighting, were related enterprises. This study sought to avoid reviewing the reporting practices of different entities within the same industrial conglomerate, and for this reason the "selected top enterprises" described in this paper may not correspond exactly with the top enterprises by index weighting for each country; in some cases the selected top enterprises consists of enterprises selected from among the top 15 largest enterprises by index weighting.

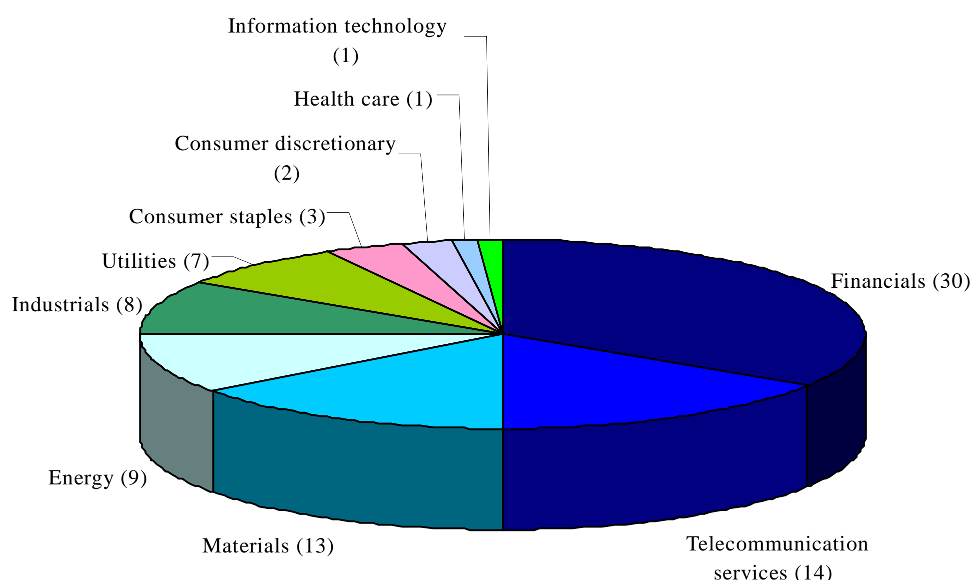
[28] All MSCI EM Index data used in this study is based on the index as of 11 March 2009. Note that Argentina is no longer part of the MSCI EM Index as of May 2009. For up to date information on the MSCI EM Index please see www.mscibarra.com.

Table II.2. Smallest 12 United Nations member States included in the MSCI EM Index, by index weighting

Country	Index weighting of country (per cent)	Number of companies from this country in the index	Selected companies as per cent of country weighting	Selected companies as per cent of index total market capitalization
Chile	1.6	15	85	1.3
Thailand	1.4	24	80	1.1
Turkey	1.2	24	77	1.0
Poland	1.2	21	85	1.0
Czech Republic	0.7	5	100	0.7
Peru	0.6	4	100	0.6
Colombia	0.6	7	89	0.5
Egypt	0.6	12	94	0.5
Philippines	0.5	13	91	0.5
Morocco	0.5	6	100	0.5
Hungary	0.4	4	100	0.4
Argentina	0.1	4	100	0.1
Total	**9.5**	**139**		**8.3**

Figure II.1. Sample of 88 emerging market enterprises by sector[29]

(number of companies)



The 88 emerging market enterprises described above form the core sample and primary focus of this study. To provide some context and comparison to developed market practices, a secondary sample was created of 10 leading Japanese enterprises. (UNCTAD's 2008 CG Review included comparative data on the disclosure practices of enterprises from the United Kingdom and the United States; with Japan, these three developed countries are the three largest equity markets in the world.) This secondary sample was created by taking ten of the largest enterprises by market capitalization from the Nikkei 225.[30] A complete list of enterprises included in the study is found in annex II.I.

[29] Based on the Global Industry Classification Standard (GICS) as of 29 August 2008. Source: www.mscibarra.com.

[30] The 10 selected enterprises from the Nikkei 225 are selected from among the top 11 enterprises in that index to avoid reviewing an enterprise that is a subsidiary of another member of the list.

In total, the review considered 5,096 individual data points. This is comprised of the 52 disclosures in the ISAR benchmark multiplied by the 98 enterprises that make up both the primary and secondary samples.

3. Research questions

The primary research question applied to the sample enterprises was: How many of the items comprising the ISAR benchmark of corporate governance disclosures are reported by each of the enterprises? To answer this question, the study examined a range of publicly available corporate reports including annual reports, corporate governance reports, corporate responsibility reports, exchange filings and other information available from financial databases (e.g. Thompson, Reuters, Bloomberg) and company websites.[31] These reports were then compared with the 52 items in the ISAR benchmark to gauge what, within the benchmark, these enterprises were disclosing. The main findings of this research question are presented in section B. An analysis of these reporting practices by market is also presented in section C.

An additional research question applied to the sample enterprises was: How do the actual reporting practices of the selected enterprises compare with the reporting requirements of their home countries? To answer this question, the main findings of the review of disclosures were compared with the disclosure requirements that were the subject of a separate UNCTAD 2009 inventory of corporate governance disclosure requirements (TD/B/C.II/ISAR/CRP.8). The main findings of this research question are presented in section D, with further details presented in annex II.I.

B. Disclosure practices of 88 emerging market enterprises

Table II.3 presents the results of the study, giving the number of enterprises disclosing each item from the sample of 88 emerging market enterprises. The information is presented within each of the five broad categories discussed in section A. This grouping of the disclosure items allows readers to draw their own conclusions based on the importance they assign to a particular category or subject area and, within that category, a particular disclosure item. It also facilitates the analysis that follows on the relative level of disclosure within each category. The categories are presented in order of highest to lowest average rate of disclosure, and within each category, the disclosure items are presented in order from most often disclosed to least often disclosed. It is again noted that the findings below make no indication of the quality of disclosure found among the enterprises, only whether or not some disclosure exists for each of the disclosure items listed below.

[31] Wherever possible, the enterprises in the study were contacted to allow them to review the preliminary findings of their reporting; a number of replies were received and their comments and suggestions were incorporated into this study. In total, 86 of the 88 enterprises were contacted, and 31 of these replied. The replies ranged from brief to detailed, involving both written and telephone communication. This engagement with the enterprises provided additional information and in some cases highlighted one or more disclosure items that had not previously been identified. Two of the 88 enterprises were not contacted due to a lack of contact information or unanswered telephone calls. As the study consists of a review of publicly available information, it was not required to speak with each company to carry out the study; however, the effort was made in order to engage enterprises in a dialogue on this subject, and to obtain additional insights where available.

Table II.3. Information disclosed by 88 emerging market enterprises
(per cent of enterprises disclosing this item)

Disclosure items by category	Rate of disclosure (per cent)
Financial Transparency and Information Disclosure	
Financial and operating results	100
Company objectives	98
Critical accounting estimates	94
Nature, type and elements of related-party transactions	93
Impact of alternative accounting decisions	80
Board's responsibilities regarding financial communications	72
Rules and procedure governing extraordinary transactions	59
The decision-making process for approving transactions with related parties	50
Board and Management Structure and Process	
Composition of board of directors (executives and non-executives)	99
Risk management objectives, system and activities	95
"Checks and balances" mechanisms	92
Governance structures, such as committees and other mechanisms to prevent conflict of interest	90
Composition and function of governance committee structures	90
Role and functions of the board of directors	90
Determination and composition of directors' remuneration	88
Qualifications and biographical information on board members	84
Duration of directors' contracts	84
Types and duties of outside board and management positions	81
Number of outside board and management position directorships held by the directors	81
Independence of the board of directors	75
Existence of procedure(s) for addressing conflicts of interest among board members	70
Material interests of members of the board and management	68
Existence of plan of succession	65
Performance evaluation process	61
Availability and use of advisorship facility during reporting period	57
Professional development and training activities	36
Compensation policy for senior executives departing the firm as a result of a merger or acquisition	11
Ownership Structure and Exercise of Control Rights	
Ownership structure	95
Control structure	94
Availability and accessibility of meeting agenda	89
Control rights	86
Process for holding annual general meetings	83
Control and corresponding equity stake	82
Changes in shareholdings	59
Rules and procedures governing the acquisition of corporate control in capital markets	38
Anti-takeover measures	27
Auditing	
Process for appointment of external auditors	88
Internal control systems	86
Process for interaction with internal auditors	83
Process for interaction with external auditors	75
Process for appointment of internal auditors / Scope of work and responsibilities	75
Duration of current auditors	73
Auditors' involvement in non-audit work and the fees paid to the auditors	55
Board confidence in independence and integrity of external auditors	30
Rotation of audit partners	30
Corporate Responsibility and Compliance	
Policy and performance in connection with environmental and social responsibility	97
Mechanisms protecting the rights of other stakeholders in business	76
A code of ethics for all company employees	64
Impact of environmental and social responsibility policies on the firm's sustainability	59
A code of ethics for the board and waivers to the ethics code	50
Policy on "whistle-blower" protection for all employees	36
The role of employees in corporate governance	14

General Overview

In total, table II.3 summarizes 4,576 individual data points (52 disclosure items multiplied by 88 emerging market enterprises). As illustrated in figure II.2, 71 per cent of individual disclosure items in the ISAR benchmark were reported by the sample group of 88 emerging market enterprises (i.e. 3,260 out of 4,576 possible disclosures). This suggests that, generally, the enterprises studied are providing a substantial amount of information regarding their corporate governance practices.

Figure II.2. Disclosure of ISAR benchmark items for 88 emerging market enterprises
(total number of disclosure items = 4,576)

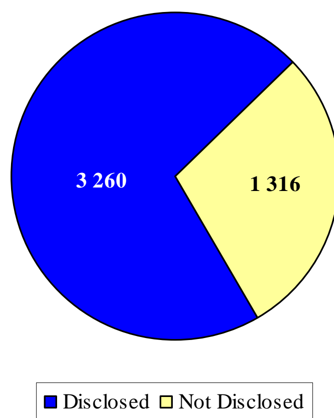
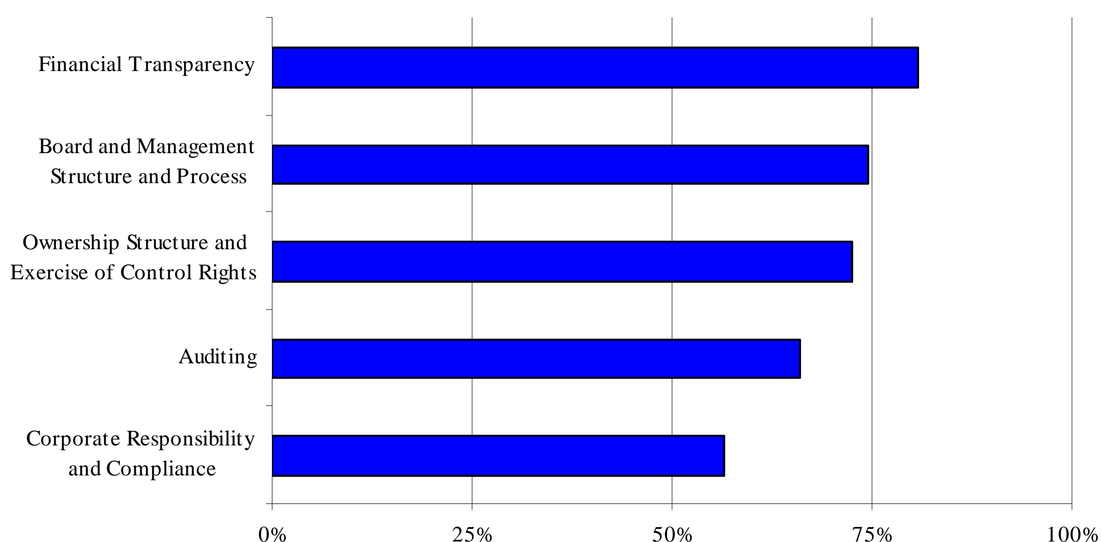


Figure II.3 examines disclosure practices by subject category. Consistent with earlier reviews, the financial transparency category is still subject to the highest average level of disclosure, followed by the board and management category and the ownership structure category. One finding that stands out from earlier UNCTAD studies on this subject is the average disclosure rate for items in the auditing category is not the lowest. As figure II.3 indicates, the average disclosure rate for the group of items in the auditing category is slightly higher than for the items in the category corporate responsibility, and also higher than the average for auditing items found in the UNCTAD's 2008 CG Review. Nevertheless, auditing disclosure items still, on average, are less prevalent than the items in most other categories of disclosure.

Figure II.3. Overview of disclosure practices by category
(Average rate of disclosure by category)



The average disclosure rate for the 88 emerging market enterprises fell below 50 per cent for 8 of the 52 disclosure items, which can be seen in table II.4. While these eight items were not concentrated in any one category (two items were in the category corporate responsibility and compliance, two in auditing, two in ownership structure and exercise of control rights, and two in board and management structure and process) five of these eight were also among the 10 least prevalent disclosure items reported by enterprises from the top 10 most heavily weighted United Nations member States found in the MSCI EM Index in the 2008 CG Review (see table II.4, note (b)). The disclosure item with the lowest rate of disclosure in the entire study was "compensation policy for senior executives departing the firm as a result of a merger and acquisition". This item was disclosed by only 10 of the 88 emerging market enterprises studied.

Table II.4. Most prevalent and least prevalent disclosure items
(percentage of enterprises disclosing this item)

Top 10 most prevalent disclosure items reported by 88 emerging market enterprises	**Rate of disclosure (per cent)**	**Bottom 10 least prevalent disclosure items reported by 88 emerging market enterprises**	**Rate of disclosure (per cent)**
Financial and operating results [(a)] [(c)]	100	The decision-making process for approving transactions with related parties [(b)]	50
Composition of board of directors (executives and non-executives) [(a)] [(c)]	99	A code of ethics for the board and waivers to the ethics code [(b)]	50
Company objectives [(a)]	98	Rules and procedures governing the acquisition of corporate control in capital markets	38
Policy and performance in connection with environmental and social responsibility	97	Policy on "whistle-blower" protection for all employees [(b)]	36
Ownership structure [(a)] [(c)]	95	Professional development and training activities [(b)]	36
Risk management objectives, system and activities [(a)]	95	Board confidence in independence and integrity of external auditors	30
Control structure [(c)]	94	Rotation of audit partners [(b)]	30
Critical accounting estimates [(a)]	94	Anti-takeover measures [(b)]	27
Nature, type and elements of related-party transactions [(a)]	93	The role of employees in corporate governance	14
"Checks and balances" mechanisms	92	Compensation policy for senior executives departing the firm as a result of a merger or acquisition [(b)]	11

[(a)] Disclosure item also appears among the top 10 most prevalent disclosure items reported by the enterprises studied UNCTAD's 2008 CG Review.

[(b)] Disclosure item also appears among the bottom 10 least prevalent disclosure items reported by the enterprises studied UNCTAD's 2008 CG Review.

[(c)] Disclosure item also appears among the top 10 most prevalent disclosure items required among the 25 markets comprising the MSCI EM Index, as indicated in UNCTAD's 2009 inventory of disclosure requirements.

Of the 10 most prevalent disclosure items, four are in the category of financial transparency, three are in board and management structure and process, three are in ownership structure and exercise of control rights, and one is in corporate responsibility and compliance. Seven of these top 10 most prevalent disclosure items were also among the top

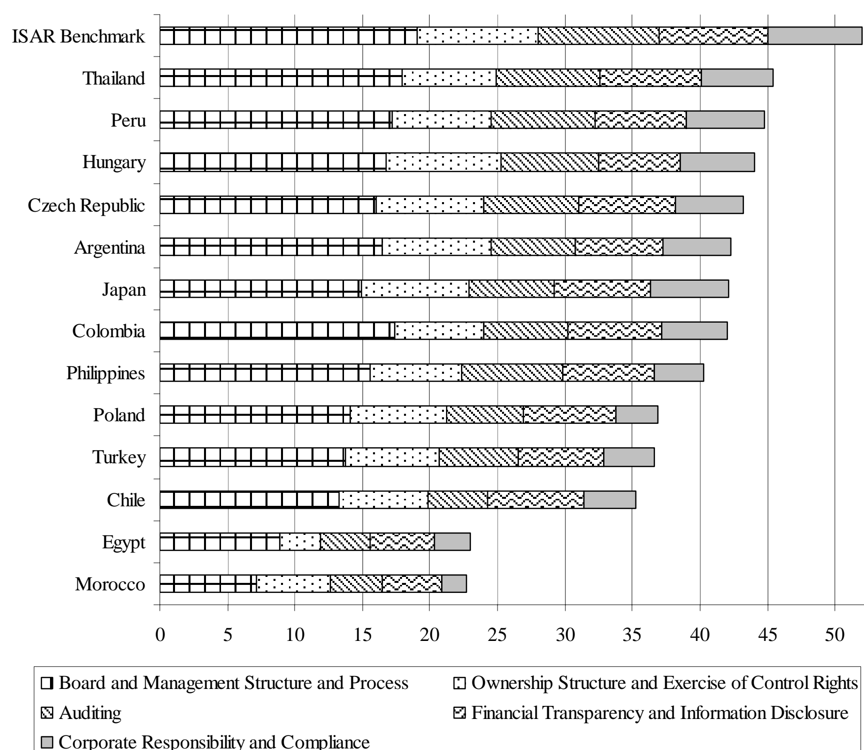
10 most prevalent items found among the enterprises included in UNCTAD's 2008 CG Review (see table II.4, note (a)). It is also noted that four of the top 10 most commonly disclosed items were also among the most frequently required disclosure items for MSCI EM Index markets (see table II.4, note (c)). Indeed, there is a clear correlation between market requirements and disclosure rates: none of the most required items appear on the list of least disclosed, and none of the least disclosed items are required. One exception to this general pattern is the disclosure item "policy and performance in connection with environmental and social responsibility". This item is found among the top 10 most commonly disclosed items above, but it is also found among the bottom 10 least frequently required items among MSCI EM Index markets. This is significant in showing the widespread nature of voluntary disclosures on corporate social responsibility and the role of other factors in driving disclosure, such as the demands for information from shareholders and other stakeholders. The relationship between disclosure requirements and actual disclosure practices is explored in more detail in section D. Section C provides an overview of disclosure practices for enterprises by market.

C. Company disclosure practices by market

Figure II.4 displays the average number of disclosure items reported by each of the selected enterprises with a breakdown by home market and category of disclosure. Despite the low per country sample size of enterprises, the position of these enterprises among the largest and most economically significant for each economy makes the analysis nevertheless useful for comparing relative practices between markets. Figure II.4 can be seen as an indication of what leading large enterprises in different markets are disclosing about their corporate governance practices. For comparison purposes, figure II.4 also includes data on the disclosure practices for 10 of the largest enterprises in Japan.[32]

[32] This study provides data on enterprises from Japan to supplement comparison data collected on enterprises from the United Kingdom and the United States that is presented in the 2008 CG Review. These three markets are the largest equity markets in the world and are thus useful sources of examples of practices in developed countries.

Figure II.4. Average number of disclosure items by market and category

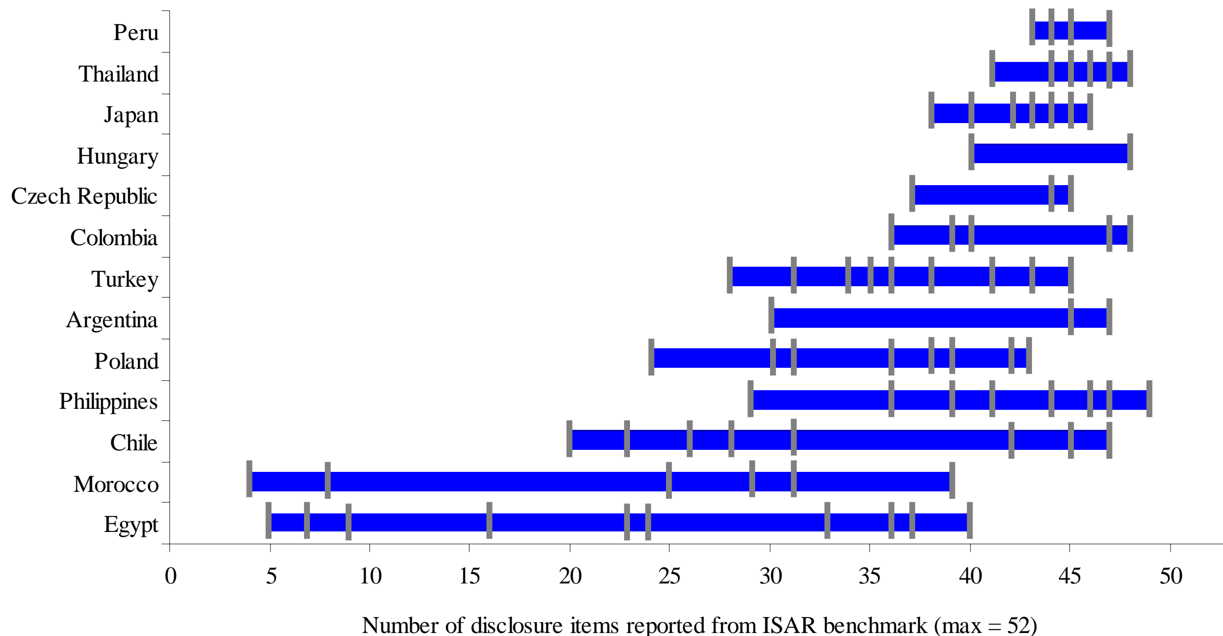


This overview of disclosure items suggests that there are relatively good disclosure practices among leading firms in the emerging markets studied. Indeed, in 10 of the 12 emerging markets examined, selected enterprises disclosed, on average, more than half the items in the ISAR benchmark. This analysis also provides a view of differences between reporting for particular subject categories. For example, the Polish and Turkish enterprises in this study display almost the same total level of reporting (an average of 36 items per company in both countries), yet show differences in per category reporting: the Turkish enterprises tend to report more in the area of corporate responsibility and compliance, while the Polish enterprises tend to report more in the area of financial transparency.

The averages displayed in figure II.4, however, mask inconsistencies in reporting practices between the different selected enterprises. Figure II.5 provides an overview of the range of total disclosure items in the ISAR benchmark that were reported by the selected enterprises within each market. This analysis suggests a significant degree of difference between the consistency of reports among selected enterprises in different markets. For instance, the selected enterprises from Peru display a high degree of consistency in reporting practices: 43 items were reported by the company with the least number of disclosed items from the ISAR benchmark, and 47 items were reported by the company with the most. Likewise, the reports of Czech Republic, Hungarian and Thai enterprises are relatively consistent in the amount of information presented. In contrast, enterprises from Chile, Egypt and Morocco demonstrate a relatively high degree of inconsistency between companies in their reporting practices. It is noteworthy, however, that none of the markets in the study show consistently low levels of disclosure; for all markets in the study, at least some enterprises have relatively high rates of disclosure. Higher consistency in reporting practices tends to coincide with higher levels of compliance with national codes and regulations. This issue of compliance is examined in more detail in section D.

Figure II.5. Consistency in reporting practices: spreading range analysis of disclosure practices by market

(The length of bar indicates the difference between the enterprise with the lowest number of disclosure items and the enterprise with highest number of disclosure items. The vertical line corresponds to the absolute number of disclosure items per enterprise; the number of vertical lines is lower than the number of enterprises studied as some enterprises have the same absolute number of disclosure items.)



D. Compliance with disclosure requirements

This section deals with the issue of compliance with national codes and regulations on corporate governance disclosure by comparing actual reporting practices with the disclosure requirements found in national regulations and listing requirements. The data on national regulations and requirements is taken from the 2009 inventory of disclosure requirements (TD/B/C.II/ISAR/CRP.8).[33] The main findings of the examination of compliance are presented below, with additional details presented in annex II.I.

The analysis begins by comparing the disclosure of the required items versus the non-required disclosure items in the ISAR benchmark. Figure II.6 provides an overview of how disclosure practices differ between the required items and the non-required items. Of the 4,576 disclosure items examined (52 items in the ISAR benchmark multiplied by 88 emerging market enterprises) 3,114 are required by local regulators or stock exchange officials. Figure II.6 indicates that required items are subject to a significantly higher rate of disclosure compared to non-required items. This finding is consistent with earlier UNCTAD studies on this subject and supports the generally accepted view that regulations and listing requirements play an important role in ensuring corporate transparency. The relatively high rate of disclosure among non-required items, at nearly 60 per cent, suggests that other influencing factors, including investors and voluntary codes, also play an important role in promoting corporate governance disclosure.

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[33] Note that the 2009 data on disclosure requirements are updates of UNCTAD's 2007 inventory of requirements.

Figure II.6. Disclosure compliance for 88 emerging market enterprises: per cent

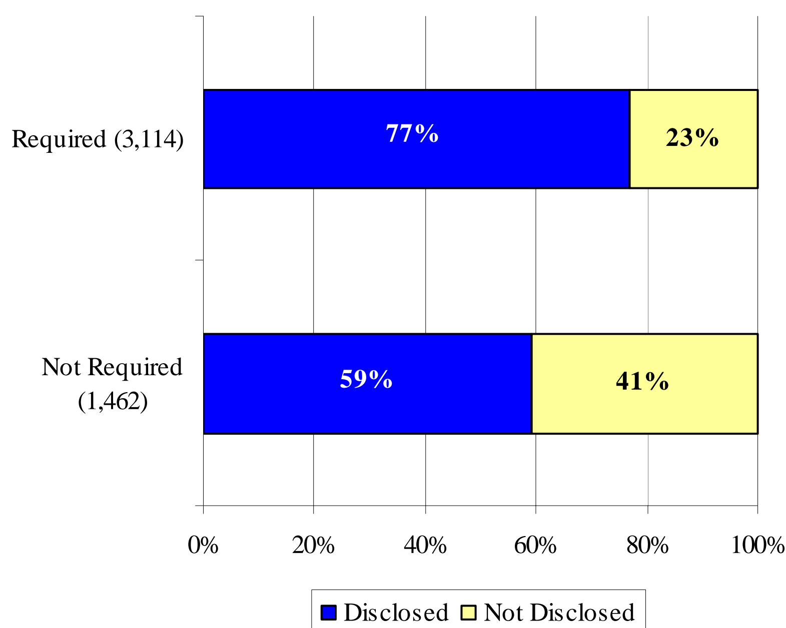
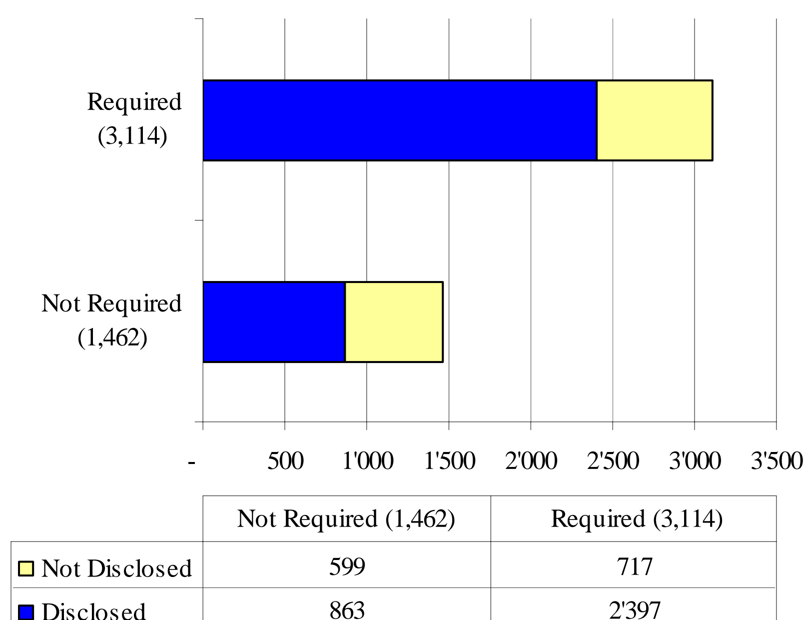


Figure II.7 shows the actual numbers, rather than per cent figures, for the data presented in figure II.6. The actual figures provide an important sense of the relative number of disclosure items that are required by emerging markets: 68 per cent (or 3,114 of the 4,576 total disclosure items reviewed for the emerging market companies in this study) were the subject of local requirements. Together, the data presented in these two figures supports the conclusion that most corporate governance disclosure in emerging markets is the subject of local regulation, and that required disclosure items tend to be disclosed at a higher rate than non-required items. This conclusion implies that robust national policies on corporate disclosure can lead to improved corporate transparency.

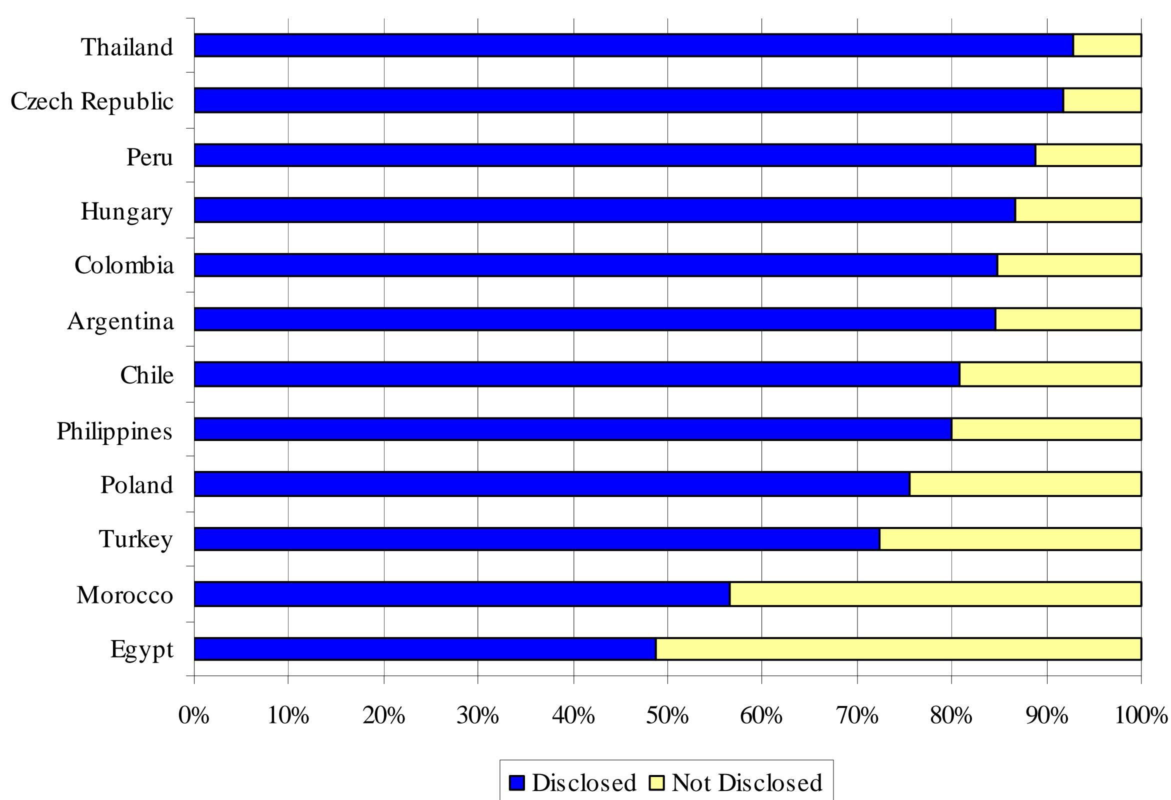
Figure II.7. Disclosure compliance for 88 emerging market enterprises: actual



	Not Required (1,462)	Required (3,114)
Not Disclosed	599	717
Disclosed	863	2'397

While the data has so far supported the conclusion that regulations are widely used and tend to promote more comprehensive reporting, there are nevertheless lingering questions about compliance. Figure II.8 presents an examination of disclosure compliance for selected enterprises in each of the emerging markets studied. The markets are ordered by the size of the compliance gap, i.e. the percentage of required disclosure items that were not found among the public reports of the sample companies. A noticeable correlation exists between the compliance gaps in figure II.8 and the consistency analysis presented in figure II.5. The markets with the largest compliance gaps tend to have the highest levels of inconsistency between the reporting practices of selected enterprises. Overall improvements in company compliance with disclosure requirements can help produce more consistent and higher quality corporate governance disclosure.

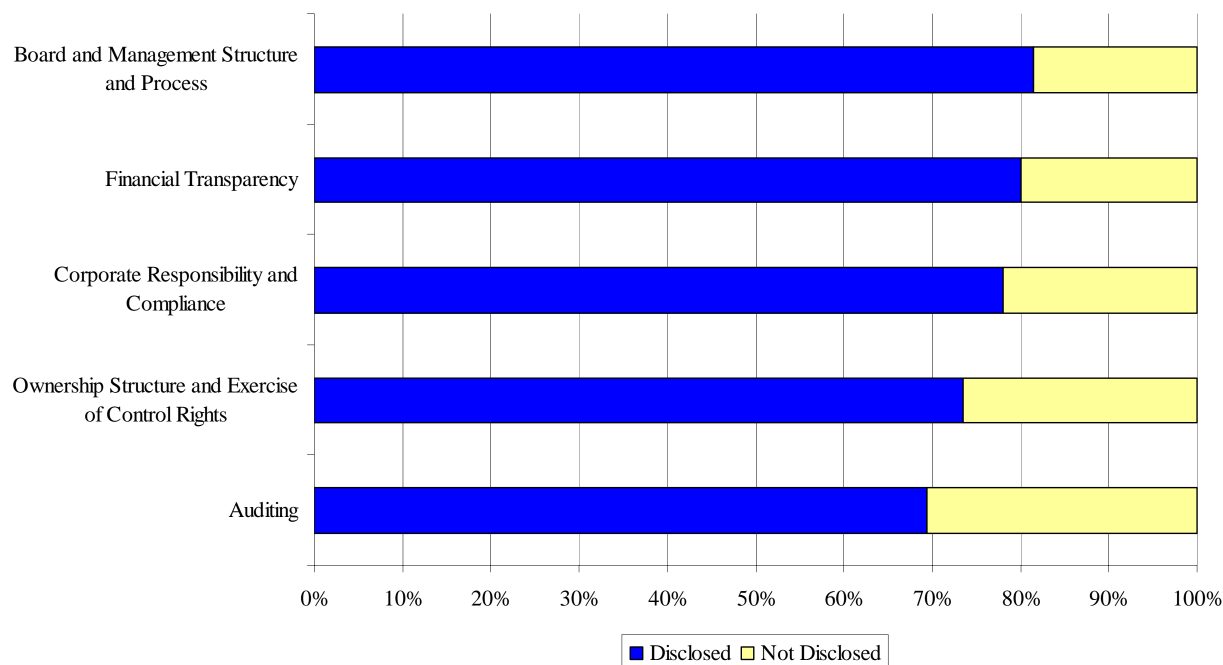
Figure II.8. Disclosure compliance for selected enterprises by market: per cent
(Required disclosure items)



An analysis of disclosure compliance by subject is provided in figure II.9. This figure shows the number of required items that are disclosed or not disclosed for each subject area. The correlation between figure II.9 and figure II.3 in section B is weaker in this year's study than in UNCTAD's 2008 CG Review, but it is not absent. Issues of compliance continue to play an influential role in the types of information being reported. For example, the category of auditing is subject to the second lowest level of reporting among the 88 emerging markets enterprises in this study (figure II.3), while at the same time the auditing category suffers from the largest disclosure gap in this study: more than 30

per cent of the required disclosure items related to auditing issues were not found among the public reports of the enterprises studied (figure II.9). For investors, policymakers and other stakeholders that consider auditing disclosures critical to the overall credibility of corporate reports, this lack of compliance with auditing requirements may be a call to relevant bodies to consider stronger measures to promote the observance of corporate disclosure regulations.

Figure II.9. Disclosure compliance for 88 emerging market enterprises, by subject
(required disclosure items)



III. Conclusions

This report focuses on the disclosure practices of 88 leading emerging market enterprises. The study makes no judgment on the quality of the disclosure of these enterprises, rather it simply tests whether or not selected disclosure items have been reported by the companies in the study. The sample of 88 enterprises is comprised of the largest enterprises from the smallest 12 markets, by index weighting, found within the MSCI Emerging Markets Index. These enterprises were chosen as the sample for the study due to the economic significance of these enterprises within their home economy and the influential role the MSCI EM Index plays in facilitating foreign portfolio investment towards developing economies and economies in transition.

The main findings of this study show that, on average, enterprises from the smallest 12 markets of the MSCI EM Index report the same amount of information regarding their corporate governance practices as the top 10 emerging markets studied in UNCTAD’s 2008 CG Review. Indeed, enterprises of both samples disclosed around 70 per cent of the ISAR benchmark items. It is also noted that many emerging market enterprises disclose more information than some enterprises in developed markets. In this study one developed market was included as a comparator and six of the emerging markets had enterprises disclosing an equal or greater number of items from the ISAR benchmark.

One finding that stands out from earlier UNCTAD studies on this subject is the average disclosure rate for items in the categories of auditing and corporate responsibility. In this study, it was found that the average disclosure rate for the group of items in the auditing category were slightly higher than for the items in the corporate responsibility category. This result differs from the findings of UNCTAD's earlier studies on corporate governance disclosure: those studies consistently found that items in the category of auditing were the least reported, on average, among enterprises from emerging markets. That said, auditing disclosure items are still on average less prevalent than the items in most other categories of disclosure. Given the critically important role of auditing in an enterprise, this remains an area where further efforts to improve transparency are required.

This study also examined the compliance of enterprises with disclosure rules in their home markets. The findings indicate that while enterprises are, on average, more likely to disclose information if it is required by regulators, significant gaps in compliance exist. For some countries these gaps are relatively small, but in other countries they are large. This situation highlights the continuing need to align the actual corporate reporting practices of enterprises with regulatory requirements.

A number of measures can be found among existing country practices to address these compliance gaps. Such measures include penalties for non-compliance as well as recognition (e.g. awards) for companies that display best practices. Practical actions also include capacity-building programmes to raise awareness and provide training on how to produce good quality corporate governance disclosures: in many cases, the root cause of poor disclosure may be a lack of awareness about what is required and a lack of technical knowledge of exactly how to prepare corporate governance disclosures. An additional measure concerns the confusion a few companies exhibit with regard to reporting to regulatory officials and reporting to shareholders. In the course of this study, it was found that some companies considered that they had publicly disclosed corporate governance information because they had submitted disclosures to regulators; upon examination, however, none of these disclosures were found among readily accessible records. Further steps, therefore, might usefully be taken by both companies and regulators to ease investor access to the corporate governance information found in the publicly available regulatory filings of companies (e.g. making it accessible via the Internet). For their part, companies may wish to improve disclosure by including in their direct communication to shareholders the corporate governance information that has already been prepared for regulatory filings.

Annex II.I. List of enterprises included in the study, by market

Argentina
- BANCO MACRO B
- PETROBRAS ENERGIA PART B
- SIDERAR A
- TELECOM ARGENTINA B

Chile
- BCO SANTANDER CHILE
- CENCOSUD
- CMPC (EMPRESAS)
- COLBUN
- EMPRESAS COPEC
- ENDESA (CHILE)
- ENERSIS
- ENTEL
- LAN AIRLINES
- SOQUIMICH B

Colombia
- BANCOLOMBIA
- CEMENTOS ARGOS
- ECOPETROL
- INTERCONEXION ELEC
- SURAMERICANA INVERSIONES

Czech Republic
- CENTRAL EUROPEAN MEDIA A
- CEZ CESKE ENERG. ZAVODY
- KOMERCNI BANKA
- TELEFONICA O2 CZECH REP.
- UNIPETROL

Egypt
- COMMERCIAL INT'L BANK
- EFG-HERMES HOLDING
- EGYPT KUWAIT HOLDING
- EGYPTIAN MOBILE SERVICES
- EL EZZ STEEL REBARS
- EL SEWEDY CABLES HLDG CO
- ORASCOM CONSTRUCTION IND
- ORASCOM TELECOM HOLDING
- SIDI KERIR PETROCHEMCIAL
- 0TELECOM EGYPT

Hungary
- MAGYAR TELEKOM
- MOL MAGYAR OLAJ GAZIPARI
- OTP BANK
- RICHTER GEDEON

Japan
- CANON INC.
- HONDA MOTOR CO., LTD.
- MITSUBISHI CORPORATION
- MITSUBISHI UFJ FINANCIAL GROUP
- NIPPON TELEGRAPH & TELEPHONE
- PANASONIC CORPORATION
- SUMITOMO MITSUI FINANCIAL GROUP INC.
- TAKEDA PHARMACEUTICAL COMPANY LIMITED
- THE TOKYO ELECTRIC POWER CO INC
- TOYOTA MOTOR CORPORATION

Morocco
- ATTIJARIWAFA BANK
- BMCE
- CGI
- DOUJA PROM GROUPE ADDOHA
- MAROC TELECOM
- ONA OMNIUM NORD AFRICAIN

Peru
- BUENAVENTURA (MINAS)
- CIA MINERA MILPO
- CREDICORP (USD)
- SOUTHERN COPPER C

Philippines
- AYALA COR
- AYALA LAND
- BANK OF PHIL ISLANDS
- ENERGY DEVELOPMENT CORP
- GLOBE TELECOM
- JOLLIBEE FOODS CORP
- MANILA ELECTRIC CO
- PHIL LONG DISTANCE TEL
- SM INVESTMENTS
- SM PRIME HOLDINGS

Poland
- ASSECO POLAND
- BANK PEKAO
- BANK ZACHODNI WBK
- GLOBE TRADE CENTRE
- KGHM POLSKA MIEDZ
- PBG
- PKO BANK POLSKI
- POLISH OIL & GAS
- POLSKI KONCERN NAF ORLEN
- TPSA TELEKOM POLSKA

Thailand

- ADVANCED INFO SERVICE
- BANGKOK BANK FGN
- BANK OF AYUDHYA
- BANPU
- CP ALL PCL
- KASIKORNBANK FGN
- PTT
- PTT EXPLORATION & PROD
- SIAM CEMENT FGN
- SIAM COMMERCIAL BANK

Turkey

- AKBANK
- ANADOLU EFES BIRACILIK
- ENKA INSAAT VE SANAYI
- EREGLI DEMIR CELIK FAB.
- TUPRAS TURKIYE PETROL
- TURK TELEKOMUNIKASYON
- TURKCELL ILETISIM HIZMET
- TURKIYE GARANTI BANKASI
- TURKIYE IS BANKASI C
- YAPI VE KREDI BANKAS

Disclosure item	Argentina	Chile	Colombia	Czech Republic	Egypt	Hungary	Morocco	Peru	Philippines	Poland	Thailand	Turkey
Number of enterprises disclosing this item / number of enterprises studied in the related country Shaded square indicates that the item is required in the company's home market*												
Ownership structure	4/4	10/10	5/5	5/5	6/10	4/4	6/6	4/4	10/10	10/10	10/10	10/10
Process for holding annual general meetings	4/4	5/10	5/5	5/5	5/10	4/4	4/6	4/4	7/10	10/10	10/10	10/10
Changes in shareholdings	3/4	9/10	3/5	3/5	1/10	3/4	2/6	2/4	7/10	8/10	3/10	8/10
Control structure	4/4	10/10	5/5	5/5	5/10	4/4	6/6	4/4	10/10	10/10	10/10	10/10
Control and corresponding equity stake	4/4	7/10	3/5	5/5	3/10	4/4	4/6	4/4	9/10	9/10	10/10	10/10
Availability and accessibility of meeting agenda	4/4	8/10	4/5	5/5	5/10	4/4	5/6	4/4	10/10	10/10	10/10	9/10
Control rights	4/4	8/10	5/5	5/5	3/10	4/4	4/6	4/4	10/10	9/10	10/10	10/10
Rules and procedures governing the acquisition of corporate control in capital markets.	2/4	6/10	2/5	3/5	1/10	4/4	1/6	2/4	2/10	4/10	4/10	2/10
Anti-takeover measures	3/4	3/10	1/5	4/5	1/10	3/4	1/6	1/4	2/10	1/10	3/10	1/10
Financial transparency and information disclosure												
Financial and operating results	4/4	10/10	5/5	5/5	10/10	4/4	6/6	4/4	10/10	10/10	10/10	10/10
Critical accounting estimates	4/4	10/10	5/5	5/5	7/10	4/4	4/6	4/4	10/10	10/10	10/10	10/10
Nature, type and elements of related-party transactions	3/4	10/10	5/5	5/5	8/10	3/4	4/6	4/4	10/10	10/10	10/10	10/10
Company objectives	4/4	10/10	5/5	5/5	10/10	4/4	5/6	4/4	10/10	9/10	10/10	10/10
Impact of alternative accounting decisions	3/4	8/10	3/5	5/5	4/10	4/4	4/6	3/4	10/10	9/10	10/10	7/10
The decision-making process for approving transactions with related parties	2/4	9/10	2/5	2/5	1/10	1/4	0/6	4/4	7/10	6/ 10	9/10	1/10

Disclosure item	Argentina	Chile	Colombia	Czech Republic	Egypt	Hungary	Morocco	Peru	Philippines	Poland	Thailand	Turkey
Number of enterprises disclosing this item / number of enterprises studied in the related country Shaded square indicates that the item is required in the company's home market*												
Rules and procedure governing extraordinary transactions	2/4	5/10	5/5	5/5	4/10	2/4	2/6	1/4	1/10	9/10	6/10	10/10
Board's responsibilities regarding financial communications	4/4	9/10	5/5	4/5	3/10	2/4	1/6	3/4	10/10	6/10	10/10	6/10
Auditing												
Process for interaction with internal auditors	3/4	6/10	5/5	5/5	7/10	4/4	4/6	4/4	9/10	6/10	10/10	10/10
Process for interaction with external auditors	3/4	6/10	3/5	5/5	6/10	4/4	3/6	4/4	9/10	5/10	10/10	8/10
Process for appointment of external auditors	3/4	9/10	4/5	5/5	5/10	4/4	4/6	4/4	10/ 10	10/10	10/10	9/10
Process for appointment of internal auditors / Scope of work and responsibilities	4/4	5/10	5/5	5/5	6/10	3/4	2/6	4/4	8/10	6/10	10/10	8/10
Board confidence in independence and integrity of external auditors	1/4	0/10	0/5	0/5	1/10	1/4	0/6	0/4	4/10	8/10	7/10	4/10
Internal control systems	4/4	7/10	5/5	5/5	6/10	4/4	4/6	4/4	10/10	7/10	10/10	10/10
Duration of current auditors	3/4	4/10	4/5	3/5	4/10	4/4	4/6	4/4	10/10	7/10	10/10	7/10
Rotation of audit partners	1/4	2/10	3/5	2/5	2/10	1/4	0/6	3/4	7/10	2/10	3/10	0/10
Auditors' involvement in non-audit work and the fees paid to the auditors	3/4	5/10	2/5	5/5	0/10	4/4	2/6	4/4	8/10	6/10	7/10	2/10
Corporate responsibility and compliance												
Policy and performance in connection with environmental and social responsibility	4/4	10/10	5/5	5/5	9/10	4/4	5/6	4/4	10/10	9/10	10/10	10/10
Impact of environmental and social responsibility policies on the firm's sustainability	2/4	5/10	4/5	4/5	3/10	4/4	2/6	3/4	5/10	7/10	7/10	6/10
A code of ethics for the board and waivers to the ethics code	4/4	5/10	3/5	2/5	2/10	2/4	1/6	4/4	6/10	2/10	10/10	3/10

Disclosure item	Argentina	Chile	Colombia	Czech Republic	Egypt	Hungary	Morocco	Peru	Philippines	Poland	Thailand	Turkey
Number of enterprises disclosing this item / number of enterprises studied in the related country Shaded square indicates that the item is required in the company's home market*												
A code of ethics for all company employees	3/4	6/10	5/5	4/5	3/10	3/4	1/6	4/4	6/10	4/10	10 /10	7/10
Policy on "whistle-blower" protection for all employees	3/4	4/10	2/5	2/5	3/10	2/4	0/6	4/4	2/10	2/10	6/10	2/10
Mechanisms protecting the rights of other stakeholders in business	4/4	8/10	5/5	4/5	6/10	3/4	2/6	4/4	8/10	4/10	10/10	9/10
The role of employees in corporate governance	0/4	0/10	0/5	4/5	1/10	4/4	0/6	0/4	0/10	3/10	0/10	0/10
Board and management structure and process												
Governance structures, such as committees and other mechanisms to prevent conflict of interest	4/4	9/10	5/5	5/5	6/10	4/4	4/6	4/4	9/10	9/10	10/10	10/10
"Checks and balances" mechanisms	4/4	10/10	5/5	5/5	6/10	4/4	4/6	4/4	9/10	10/10	10/10	10/10
Composition of board of directors (executives and non-executives)	4/4	10/10	5/5	5/5	9/10	4/4	6/6	4/4	10/10	10/10	10/10	10/10
Composition and function of governance committee structures	4/4	9/10	5/5	5/5	6/10	4/4	4/6	4/4	9/10	9/10	10/10	10/10
Role and functions of the board of directors	4/4	10/10	5/5	5/5	5/10	4/4	3/6	4/4	9/10	10/10	10/10	10/10
Risk management objectives, system and activities	4/4	10/10	5/5	5/5	8/10	4/4	4/6	4/4	10/10	10/10	10/10	10/10
Qualifications and biographical information on board members	3/4	5/10	5/5	5/5	8/10	4/4	2/6	4/4	10/10	10/10	10/10	8/10
Types and duties of outside board and management positions	3/4	5/10	5/5	4/5	8/10	4/4	1/6	4/4	10/10	9/10	10/10	8/10
Material interests of members of the board and management	4/4	8/10	5/5	4/5	0/10	4/4	3/6	4/4	6/10	7/10	10/10	5/10
Existence of plan of succession	4/4	5/10	5/5	4/5	4/10	2/4	2/6	4/4	6/10	2/10	10/10	9/10
Duration of directors' contracts	4/4	8/10	5/5	5/5	3/10	4/4	2/6	4/4	9/10	10/10	10/10	10/10

Disclosure item	Argentina	Chile	Colombia	Czech Republic	Egypt	Hungary	Morocco	Peru	Philippines	Poland	Thailand	Turkey
Number of enterprises disclosing this item / number of enterprises studied in the related country Shaded square indicates that the item is required in the company's home market*												
Compensation policy for senior executives departing the firm as a result of a merger or acquisition	1/4	0/10	0/5	5/5	0/10	0/4	0/6	1/4	3/10	0/10	0/10	0/10
Determination and composition of directors' remuneration	4/4	10/10	5/5	5/5	4/10	4/4	4/6	4/4	10/10	10/10	10/10	7/10
Independence of the board of directors	4/4	8/10	5/5	2/5	5/10	4/4	1/6	4/4	10/10	7/10	10/10	6/10
Number of outside board and management position directorships held by the directors	3/4	5/10	5/5	4/5	8/10	4/4	1/6	4/4	10/10	9/10	10/10	8/10
Existence of procedure(s) for addressing conflicts of interest among board members	3/4	8/10	5/5	4/5	2/10	4/4	2/6	4/4	6/10	8/10	10/10	6/10
Professional development and training activities	2/4	1/10	2/5	1/5	1/10	2/4	0/6	1/4	8/10	2/10	9/10	3/10
Availability and use of advisorship facility during reporting period	4/4	5/10	5/5	3/5	3/10	3/4	0/6	4/4	5/10	3/10	10/10	5/10
Performance evaluation process	3/4	7/10	5/5	4/5	3/10	4/4	0/6	3/4	7/10	6/10	10/10	2/10

* Disclosure requirement information based on UNCTAD 2009 Review of the implementation status of corporate governance disclosure: an inventory of corporate governance disclosure requirements.

Chapter III

2009 Review of the Implementation Status of Corporate Governance Disclosures: an Inventory of Disclosure Requirements in 24 Emerging Markets

Introduction

Corporate governance has been a major area of work for the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) since 1989 (E/C.10/AC.3/1989/6). Since the twenty-first session of ISAR, the group of experts has requested an annual review of the implementation status of corporate governance disclosure. Annual reviews were presented at the twenty-first, twenty-second, twenty-third, twenty-fourth and twenty-fifth sessions of ISAR. At the twenty-fourth session, ISAR considered the document "2007 Review of the implementation status of corporate governance disclosures: an inventory of disclosure requirements in 25 emerging markets" (TD/B/COM.2/ISAR/CRP.6, hereafter the "2007 CG Inventory"). For ISAR's twenty-fifth and twenty-sixth sessions, respectively, UNCTAD prepared the documents "2008 Review of the implementation status of corporate governance disclosures: an examination of reporting practices among large enterprises in 10 emerging markets" (TD/B/C.II/ ISAR/CRP.1, hereafter the "2008 CG Review") and "2009 Review of the implementation status of corporate governance disclosures: an examination of reporting practices among large enterprises in 12 emerging markets" (TD/B/C.II/ISAR/CRP.6), hereafter the "2009 CG Review"). UNCTAD's studies on this subject use as a benchmark ISAR's conclusions on corporate governance disclosure found in the 2006 UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure* (UNCTAD/ITE/ TEB/2006/3).

The purpose of this study is to update the data presented in the 2007 CG Inventory. The data and analysis presented in this study were prepared by the UNCTAD secretariat in cooperation with the Stirling Management School's Division of Accounting and Finance at the University of Stirling.[34]

The main findings of this study show that most of the 24 emerging markets examined require some form of mandatory disclosure of most of the items in the ISAR benchmark. Comparison with the 2007 CG Inventory reveals that, while some changes have taken place, the main findings are still the same. Namely, the three main categories where mandatory disclosure is required are "ownership structure and exercise of control rights", "financial transparency" and "auditing". The category with the least mandatory disclosure of items is "corporate responsibility and compliance". Detailed analysis of the findings is presented in section I of this chapter.

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[34] This paper was prepared by the UNCTAD secretariat on the basis of data and draft text provided by Kevin Campbell, Director of the Chartered Financial Analyst Programme Partner MSc in Investment Analysis at the University of Stirling, United Kingdom, and a visiting professor in the Faculty of Management at the University of Gdansk, Poland. Research assistance was provided by Yung-Hsiang Teng and Barbara Tschirnich of the University of Stirling.

I. Status of implementation of good practices in corporate governance disclosure at the regulatory level

A. Background and methodology

1. ISAR benchmark

The purpose of this study is to conduct an inventory of regulatory requirements related to the disclosure items identified in the 2006 UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure* (based on the ISAR document TD/B/COM.2/ISAR/30). This publication provides a benchmark (hereafter the "ISAR benchmark") of 52 disclosure items on corporate governance. This benchmark was used in earlier ISAR studies on this subject from 2005 to 2008, as well as in country case studies of China and Egypt (both in 2007). Readers should also note that, as was the case with ISAR's previous annual reviews on this subject, this report is not intended as a measure of the quality of disclosure within individual markets; rather, it is a measure of the existence of regulations requiring the selected disclosure items.

In an effort to continually improve and update the data available to ISAR, the purpose of this study is to re-examine and update the inventory of disclosure requirements first presented in UNCTAD's 2007 CG Inventory. This study, like the 2007 study, seeks to complement UNCTAD's other research on corporate governance disclosure by providing an overview of what disclosure items are required in a range of emerging markets around the world. This study looks at the corporate governance disclosure requirements of regulators and stock exchanges in 24 emerging markets. While UNCTAD's corporate governance reviews provide a useful picture of what enterprises are actually disclosing, it is also important to improve the understanding of the requirements placed on companies by regulators and stock exchanges, and how these requirements might vary from country to country and therefore influence the firm-level disclosure of corporate information. In order to gain a better understanding of the regulatory environment in which publicly listed enterprises operate, the 2007 CG Inventory compared the corporate governance disclosure requirements of regulators and stock exchanges with the ISAR benchmark on good practices. The 2009 review continues this approach and seeks to account for changes in regulations and listing requirements.

Compared to previous reviews (and in particular the 2007 CG Inventory), one minor change was made to the benchmark list of indicators: the item on "Disclosure practices on related party transactions where control exists" was removed. This disclosure item was subtracted due to its substantial similarity with the other disclosure item on "Nature, type and elements of related party transactions".

The complete set of 52 disclosure items are grouped into five broad categories, or subject areas, of corporate governance disclosure, and are presented and analysed by category in section B. These categories are:

(a) Financial transparency;

(b) Board and management structure and process;

(c) Ownership structure and exercise of control rights;

(d) Corporate responsibility and compliance;

(e) Auditing.

2. Sample studied

The present study uses the ISAR benchmark to inventory the corporate governance disclosure requirements of 24 emerging markets. The sample of markets examined in this study is drawn from the MSCI EM Index.[35] The current MSCI EM Index tracks more than 700 publicly listed enterprises, which account for roughly 85 per cent of the market capitalization of 23 emerging markets.[36] Table III.1 provides a list of the 24 markets included in the MSCI EM Index. The study also includes information on Jordan, a former constituent of the MSCI EM Index.

Table III.1. The 24 markets included in the study

1. Argentina	14. Republic of Korea
2. Brazil	15. Malaysia
3. Chile	16. Mexico
4. China	17. Morocco
5. Taiwan Province of China	18. Peru
6. Columbia	19. Philippines
7. Czech Republic	20. Poland
8. Egypt	21. Russian Federation
9. Hungary	22. South Africa
10. India	23. Thailand
11. Indonesia	24. Turkey
12. Israel	
13. Jordan	

3. Research question and sources of information

The research question applied to this sample was: which of the corporate governance disclosure items recommended by ISAR are required to be reported by enterprises listed on the major stock exchanges of each of the 24 markets studied? The study examined government laws and regulatory instruments as well as the listing requirements of major stock exchanges. The origin of disclosure requirements varied from market to market, with some markets primarily relying on regulatory instruments and others relying on stock exchange listing rules. The research was performed primarily using publicly available documents from the Internet, but in some cases relied partly on direct communication with regulators and or stock exchange officials if the documents available online needed to be supplemented or clarified.

A preliminary copy of updated findings for each market was submitted to the regulators or stock exchange authorities in that market for comment. Where replies to e-mail and telephone enquiries had not been received as of the date of writing this review, the 2007 data were used if no obvious changes to the regulations and listing requirements had occurred since 2007. In the case of Colombia, Mexico and Peru, there were no changes to the 2007 data. While every effort was made to be thorough in this research, this report cannot claim to have covered all applicable laws and regulations.

Note that this survey does not take into account voluntary codes; it is an inventory of mandatory requirements in both mandatory codes and "comply or explain"

[35] MSCI is a commercial provider of financial information, including equity indices tracking publicly listed enterprises around the world. The MSCI EM Index is considered by institutional investors to be the industry standard to gauge emerging markets' performance, and is an important tool for facilitating foreign portfolio investment to developing countries and countries with economies in transition.

[36] All MSCI EM Index data used in this study is based on the index as of 11 March 2009. Note that Argentina is no longer part of the MSCI EM Index as of May 2009. For up-to-date information on the MSCI EM Index please see www.mscibarra.com.

codes. The exclusion of voluntary codes should not be interpreted as discounting the value of voluntary codes; it is merely an attempt to highlight the role of regulators and stock exchanges in setting disclosure requirements. Given the high compliance rate of companies in some markets with voluntary codes, additional mandatory requirements may not be necessary. Other markets have mandatory requirements but compliance with these by enterprises is weak. This report should therefore not be used as a measure of the quality of disclosure within individual markets, rather it is a measure of the existence of regulations requiring the selected disclosure items.

B. Disclosure requirements of 24 emerging markets

Table III.2 presents the results of the study, giving the number of markets requiring each corporate governance disclosure item. The information is presented within each of the five broad categories discussed in section A. This grouping of the disclosure items allows readers to draw their own conclusions based on the importance they assign to a particular category or subject area and, within that category, a particular disclosure item. It also facilitates the analysis that follows on the relative number of disclosure requirements within each category. The categories are presented in order of highest to lowest average number of markets requiring each item, and within each category, the disclosure items are presented in order from most often required to least often required.

Table III.2. Main findings of inventory of disclosure requirements in 24 emerging markets
(Number of markets requiring this item)

Disclosure items by category	**No. of markets (max. = 24)**
Ownership structure and exercise of control rights	
Ownership structure	24
Process for holding annual general meetings	24
Changes in shareholdings	24
Control and corresponding equity stake	24
Control rights	24
Control structure	23
Availability and accessibility of meeting agenda	23
Rules and procedures governing the acquisition of corporate control in capital markets	22
Anti-takeover measures	21
Financial transparency	
Financial and operating results	24
Nature, type and elements of related-party transactions	22
Company objectives	22
The decision-making process for approving transactions with related parties	22
Board's responsibilities regarding financial communications	22
Rules and procedure governing extraordinary transactions	19
Critical accounting estimates	17
Impact of alternative accounting decisions	14
Auditing	
Process for appointment of external auditors	22
Process for interaction with external auditors	20
Internal control systems	20
Process for interaction with internal auditors	18
Process for appointment of internal auditors / Scope of work and responsibilities	18
Board confidence in independence and integrity of external auditors	17
Auditors' involvement in non-audit work and the fees paid to the auditors	15
Duration of current auditors	14
Rotation of audit partners	14
Board and management structure and process	
Governance structures, such as committees and other mechanisms to prevent conflict of interest	24
Composition of board of directors (executives and non-executives)	23
Role and functions of the board of directors	23
Determination and composition of directors' remuneration	22
Composition and function of governance committee structures	21

Disclosure items by category	No. of markets (max. = 24)
Material interests of members of the board and management	21
"Checks and balances" mechanisms	19
Qualifications and biographical information on board members	19
Duration of directors' contracts	17
Independence of the board of directors	17
Risk management objectives, system and activities	16
Existence of procedure(s) for addressing conflicts of interest among board members	16
Existence of plan of succession	15
Number of outside board and management position directorships held by the directors	15
Types and duties of outside board and management positions	14
Professional development and training activities	13
Availability and use of advisorship facility during reporting period	12
Performance evaluation process	11
Compensation policy for senior executives departing the firm as a result of a merger or acquisition	6
Corporate responsibility and compliance	
Mechanisms protecting the rights of other stakeholders in business	15
Policy and performance in connection with environmental and social responsibility	13
A code of ethics for the board and waivers to the ethics code	9
A code of ethics for all company employees	8
The role of employees in corporate governance	7
Impact of environmental and social responsibility policies on the firm's sustainability	6
Policy on "whistle-blower" protection for all employees	2

General overview

As shown in table III.2, many of the disclosure items recommended in the ISAR benchmark are already part of the mandatory requirements for listed companies in most of the countries studied. Almost half of the 52 disclosure items are required by 20 or more of the 24 countries. All items in the category "Ownership structure and exercise of control rights" are required to be disclosed in more than 20 markets. Improvements have taken place in the category "Financial transparency" as some countries have implemented IFRSs, which automatically require disclosure of all items of the ISAR benchmark in this category. On the other hand, some disclosure items, especially in the "Corporate responsibility and compliance" category, are required by less than 10 markets. The small number of markets requiring disclosure of these items demonstrates that the "novelty" (as stated in the 2007 report) of these items still persists and it may take some more time before they are considered for integration into mandatory disclosure requirements.

Considering further the disclosure items by category, no major changes have taken place compared to UNCTAD's 2007 CG Inventory. The first three categories are still supported in most countries included in this study. Some minor changes regarding the number of countries requiring a particular item resulted from the reclassification of some regulations reviewed in the 2007 CG Inventory. The corporate governance code of the Czech Republic, for example, was classified as following a (mandatory) "comply or explain" approach in the 2007 CG Inventory, but following confirmation of its status by the supervisory authority in that country, it was reclassified for this study as a voluntary code. This change leads the Czech Republic to having fewer disclosure requirements in 2009 than in the earlier review.

In some cases, regulators and stock exchanges issued new disclosure requirements, therefore increasing the mandatory disclosure items in the list in table III.2. Five of the nine items in the category "Ownership structure and exercise of control rights" have to be disclosed by enterprises in all markets in this study. The other four items are still required by more than 20 markets. Also, in the category "Financial transparency", over half the items are mandatory in more than 20 of the markets studied. Only three of the nine items in the category "Auditing" are required by more

than 20 markets. A similar situation appears in the category “Board and management structure and process” where six of the 19 items are subject to mandatory disclosure in more than 20 markets. The remaining items in “Auditing” and all but one of the remaining items in “Board structure” are still required by at least 14 and 11 markets, respectively. The category with the least mandatory disclosure is “Corporate responsibility and compliance”, where five of the seven items are required by less than 10 markets. Figure III.1 provides an overview of the maximum and minimum number of markets supporting individual disclosure items in each category.

Figure III.1. Overview of disclosure requirements by category

(Maximum and minimum number of markets requiring disclosure items in this category; the length of bar indicates the difference between the disclosure item required by the lowest number of markets, and the disclosure item required by the highest number of markets, within the same category)

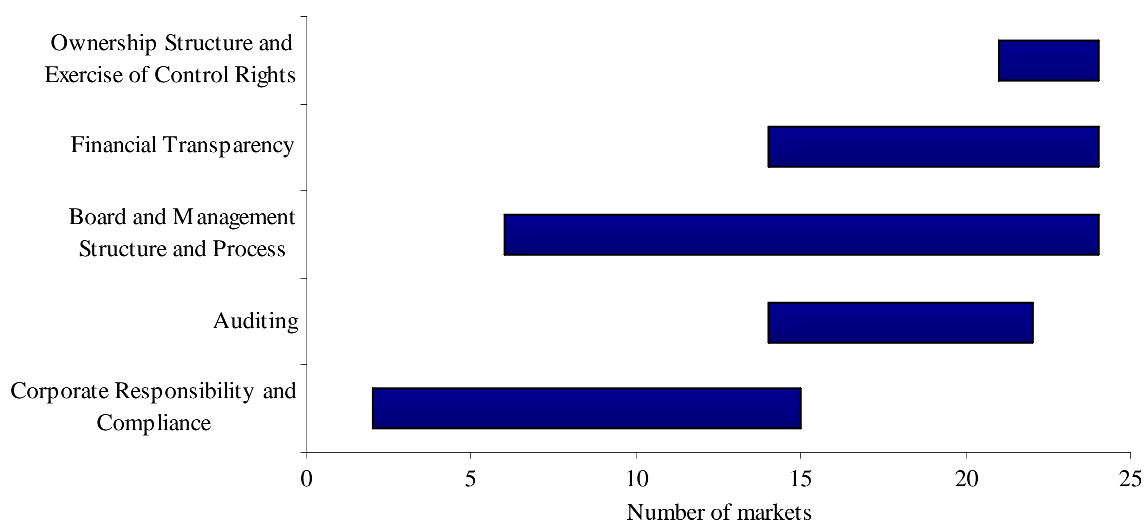


Figure III.1 illustrates the extent of mandatory disclosure requirements in each of the five categories. This analysis remains consistent with the findings of the 2007 CG Inventory. It also shows a different perspective on reporting of auditing issues. In the 2005, 2006 and 2008 CG Reviews, which examined the actual disclosure practices of enterprises, it was the auditing category that was consistently the subject of the lowest level of disclosure among emerging markets. In the 2007 and 2009 CG Inventories, it is found that auditing disclosures are relatively common among the mandatory disclosure rules of emerging markets. The difference between what is required and what is actually disclosed is explored in more depth in both the 2008 and 2009 CG Reviews.

Table III.3. Most prevalent and least prevalent disclosure items
(Number of markets requiring this item)

Top 10 most prevalent disclosure items required among 24 emerging markets	No. of markets (max.=24)	Bottom 10 least prevalent disclosure items required among 24 emerging markets	No. of markets (max.=24)
Ownership structure	24	Policy and performance in connection with environmental and social responsibility	13
Process for holding annual general meetings	24	Professional development and training activities	13
Changes in shareholdings	24	Availability and use of advisorship facility during reporting period	12
Control and corresponding equity stake	24	Performance evaluation process	11
Control rights	24	A code of ethics for the board and waivers to the ethics code	9
Financial and operating results	24	A code of ethics for all company employees	8
Governance structures, such as committees and other mechanisms to prevent conflict of interest	24	The role of employees in corporate governance	7
Control structure	23	Impact of environmental and social responsibility policies on the firm's sustainability	6
Availability and accessibility of meeting agenda	23	Compensation policy for senior executives departing the firm as a result of a merger or acquisition	6
Composition of board of directors (executives and non-executives)	23	Policy on "whistle-blower" protection for all employees	2

Table III.3 shows the 10 most prevalent and the 10 least prevalent disclosure items required in the 24 markets studied. Compared to the 2007 CG Inventory, there are not many changes in the items required for disclosure by regulators. Seven of the 10 most prevalent disclosure items are from the category "Ownership structure and exercise of control rights". This is one item more than in the 2007 study; the item concerned is "Control and corresponding equity stake". It is also noteworthy that seven of the 10 most prevalent disclosure items are required by all markets included in this study. This demonstrates that there is a consensus internationally about the information that it is regarded as important to disclose.

There is also not much change between the 2007 and 2009 CG Inventories regarding the 10 least prevalent disclosure items. The item "Policy on 'whistle-blower' protection for all employees" is still the least required disclosure item. Six of the 10 items in table III.3 are from the category "Corporate responsibility and compliance", demonstrating that a number of corporate responsibility issues have not yet been integrated into mandatory disclosure rules for listed companies.

C. Gap analysis of disclosure requirements

Table III.4 illustrates where gaps exist in corporate governance disclosure requirements. The top line of the table lists the numbers of the 52 disclosure items found in the ISAR benchmark. This excludes item 15 which, as noted earlier, was dropped from the initial list of 53 disclosure items. To facilitate comparisons with the 2007 study, the subsequent items were not renumbered but retain their initial number (16 to 53). The items are grouped according to the five categories. The blank or white

spaces in the table indicate the absence of a mandatory requirement for disclosure of that item. The markets in the table are listed from top to bottom in order of the total number of disclosure items required. The three large developed markets are included at the top of the table for comparison purposes.

The table demonstrates that all of the items in the category "Ownership structure and exercise of control rights" are mandatory disclosure items in almost all the emerging markets included in this study. The category "Financial transparency and information disclosure" has a few more gaps but all of the items are still required by 13 of the 24 emerging markets.

Requirement of the disclosure items under the categories of "Auditing" and "Board and management structure and process" is certainly less prevalent. As far as auditing is concerned, there is no particular emphasis on either disclosure of external or internal auditing information. Countries that require disclosure of external auditing items usually also require information on internal auditing structures. Items 25 (duration of current auditors), 26 (rotation of audit partners) and 27 (auditors' involvement in non-audit work and the fees paid to the auditors) are the least required items of disclosure in this category, as they also were in the 2007 study.

The largest variation in requirements between items can be found in the category "Board and management structure and process". Only item 35 (governance structures, such as committees and other mechanisms to prevent conflict of interest) is mandatory for all 24 markets. This demonstrates the widespread importance accorded to this issue. While disclosure of information regarding board and management structures is generally required, the format of the board of directors differs from country to country. Some countries operate a two-tier board system (supervisory board and management board) while others follow the Anglo-Saxon model of a one-tier board system. The latter model usually requires more mandatory information on executive and non-executive directors. For these reasons, the ISAR benchmark items in this category show the greatest variation. Compared with the 2007 study, the position of item 46 (compensation policy for senior executives departing the firm as a result of a merger or acquisition) has not changed and it is still not a requirement in most emerging markets.

Table III.4 also highlights the major gaps in disclosure requirements for the "Corporate responsibility and compliance" category. There are six countries that do not require disclosure of any of the items in this category. These markets are also among the markets with the fewest number of disclosure requirements, with the exception of Poland. Poland's lack of disclosure requirements in this category thus stands in contrast to the number of disclosure requirements Poland has in the other categories.

Table III.4. Gap analysis of disclosure requirements in 24 emerging markets and three large developed markets*

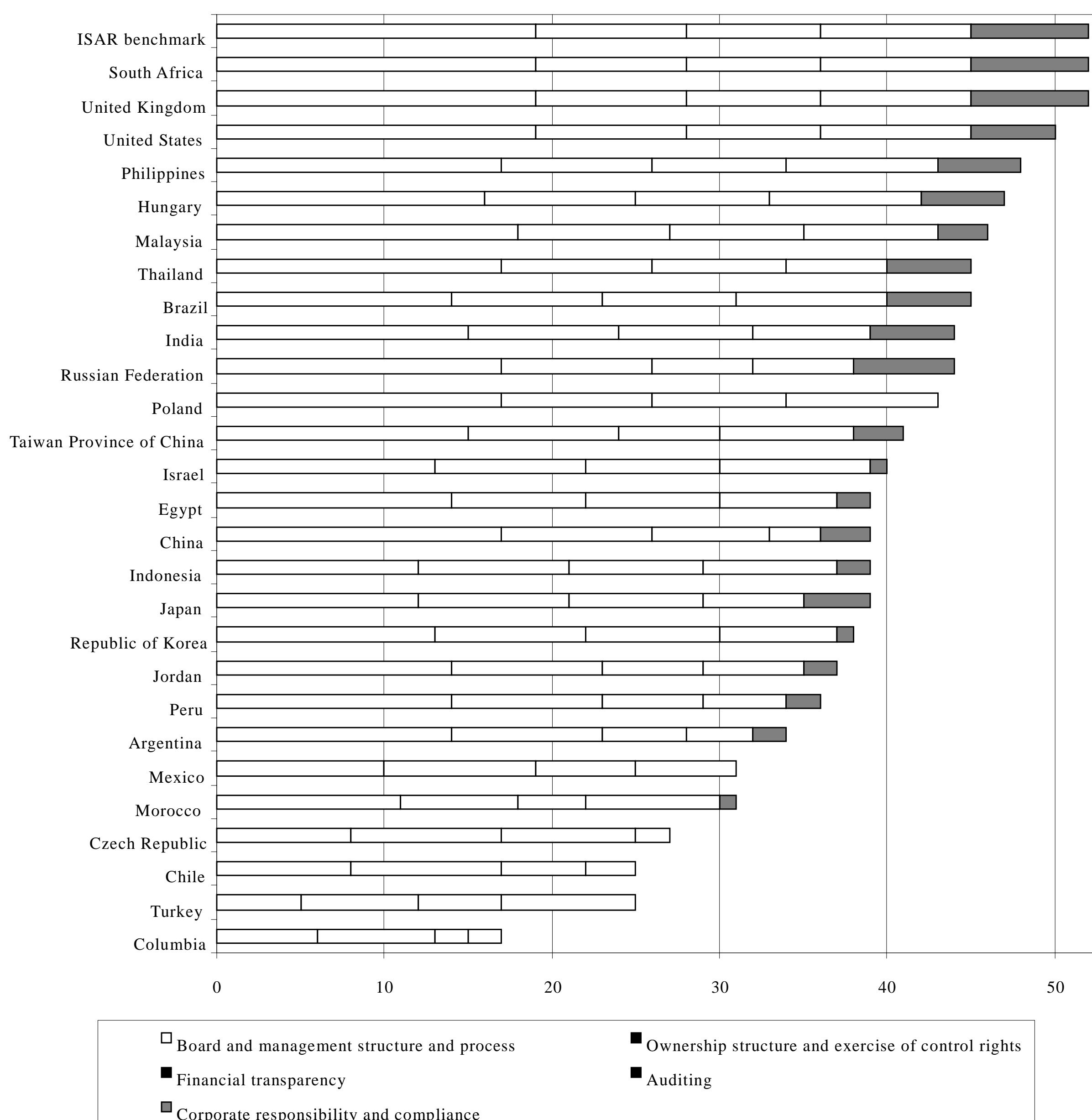
Disclosure / Market	Ownership structure									Financial transparency								Auditing									Corporate responsibility and compliance							Board and management structure and process																		
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49	50	51	52	53
United Kingdom																																																				
United States																																																				
Japan																																																				
South Africa																																																				
Philippines																																																				
Hungary																																																				
Malaysia																																																				
Brazil																																																				
Thailand																																																				
Russian Federation																																																				
India																																																				
Poland																																																				
Taiwan Province of China																																																				
Israel																																																				
Indonesia																																																				
China																																																				
Egypt																																																				
Republic of Korea																																																				
Jordan																																																				
Peru																																																				
Argentina																																																				
Mexico																																																				
Morocco																																																				
Czech Republic																																																				
Turkey																																																				
Chile																																																				
Colombia																																																				

* Empty white squares indicate that the disclosure item is not required. Disclosure item 15 intentionally omitted. The name of individual disclosure items can be found in the list in annex III.II.

D. Comparison of disclosure requirements between markets

Figure III.2 presents an overview of the number of disclosure items required for each category of disclosure in each of the 24 emerging markets reviewed. For comparison purposes, the figure also includes the number of disclosure items for each category found in the ISAR benchmark of good practices in corporate governance disclosure, as well as the disclosure requirements for Japan, the United Kingdom and the United States.

Figure III.2. Disclosure requirements by market and category



The figure demonstrates that the majority of emerging markets support mandatory disclosure of most of the items in the ISAR benchmark. Only four of the emerging market countries actually require disclosure of less than 30 of the ISAR benchmark items in their laws and regulations.

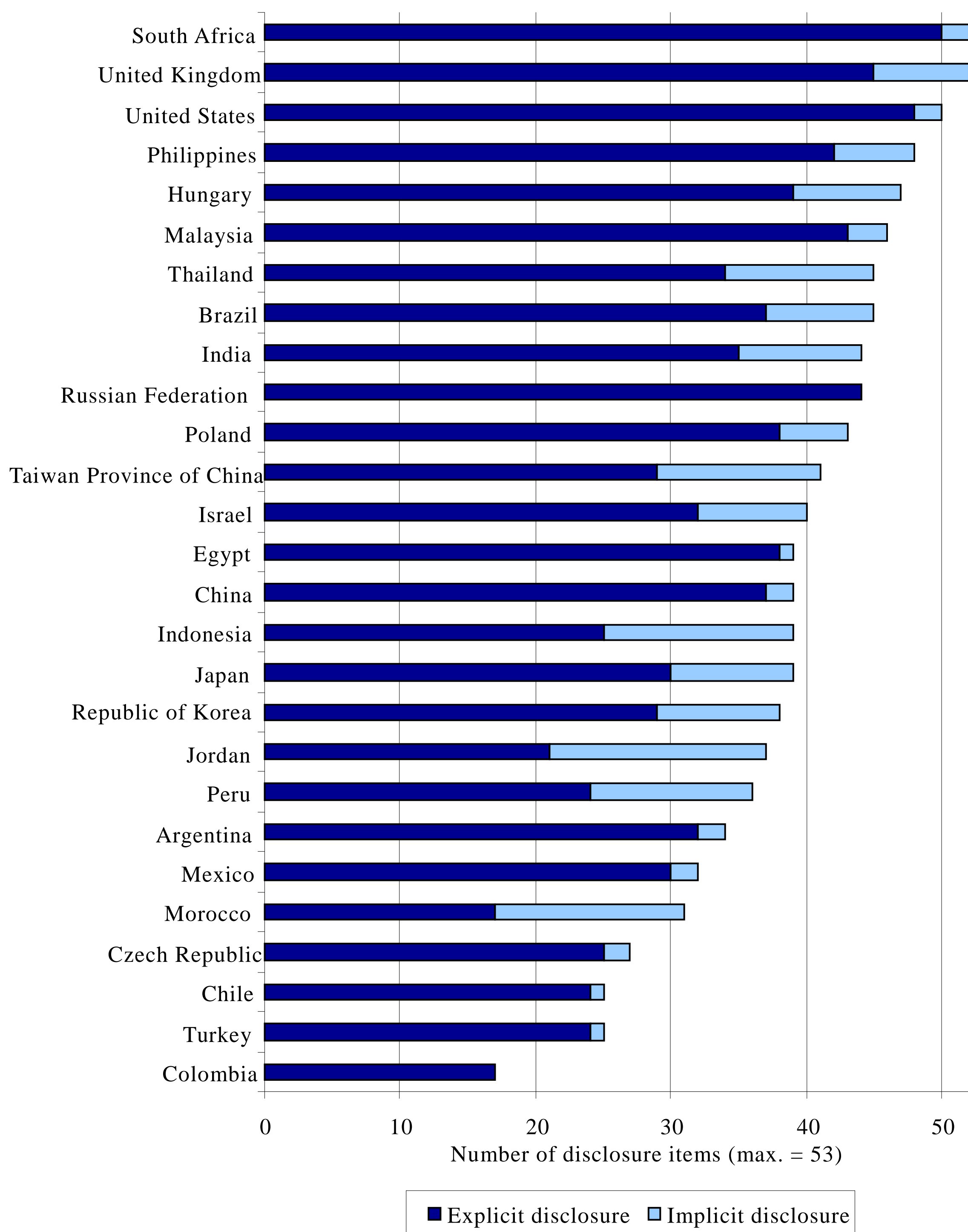
The comparison provided in figure III.2 also suggests that many emerging markets have levels of mandatory disclosure that are similar to the largest developed country equity markets, both in terms of the number of disclosure items covered and the range of topics addressed. While this observation does not address issues of compliance with disclosure requirements or the quality of disclosure, it does make clear that emerging market policymakers share with their developed country counterparts a similar understanding of not only what should be disclosed, but also how disclosure can be encouraged, i.e. through the use of requirements.

E. Clarity of requirements: explicit and implicit disclosure requirements

During review regulations and exchange listing requirements, it was observed that for some disclosure items there was an obvious and explicit requirement to disclose or report the item. For example, the text may state: “enterprises must disclose in their annual reports the ownership structure of the enterprise”. In other instances, the requirement to disclose a particular item was less obvious and more implicit. For example, a regulation might require a particular item to be recorded in the minutes of the meeting of the board of directors, without explicitly stating that it should be publicly disclosed. The same regulation may go on to state that the board’s minutes are to be filed with a regulator and made available to the public. In such cases, the regulation implies that certain issues are the subject of mandatory public disclosure. Therefore, all information that is made publicly available, even if it is not in the enterprise’s annual report, was considered “disclosure” for the purposes of this study.

Figure III.3 presents an overview of the number of explicit and implicit disclosure requirements for each market. As can be seen, these vary considerably from market to market, and may be related to the legal traditions of a given jurisdiction. Nevertheless, explicit references to disclose information might be useful as an aid both to enterprises wishing to list on exchanges in these markets, as well as to investors wishing to better understand the disclosure requirements of such markets.

Figure III.3. Explicit and implicit disclosure requirements



Compared to the 2007 CG Inventory, the number of implicit disclosure requirements has decreased in favour of more explicit requirements. One of the reasons for this switch is that some countries issued new corporate governance codes, mostly on a "comply or explain" basis, that included more explicit requirements for disclosure. Another explanation is that a few of the emerging markets included in this study have implemented IFRSs for listed companies and therefore disclosure on "Financial transparency" automatically became more explicit. For investors wishing to better understand the disclosure requirements of these markets, the increase of explicit disclosure requirements is certainly advantageous.

II. Conclusions

This report is an update of UNCTAD's 2007 CG Inventory. This study focuses on the disclosure requirements applied to publicly listed firms by regulators and stock exchanges in 24 emerging markets. The study makes no judgments on the quality of disclosure or regulations in any market, rather it simply tests for the existence of selected requirements.

The main findings of this study show that most of the 24 emerging markets examined require some form of mandatory disclosure of most of the items in the ISAR benchmark. Comparison with the 2007 CG Inventory reveals that, while some changes have taken place, the main findings are still the same. Namely, the three main categories where mandatory disclosure is required are "Ownership structure and exercise of control rights", "Financial transparency and information disclosure" and "Auditing". The category with the least mandatory disclosure of items is "Corporate responsibility and compliance". The data analysis also provided some insights into differences between the markets in the sample group, both in regards to the particular disclosure items required, as well as the degree of specificity of the rules regarding disclosure. The use of "explicit" disclosure rules has increased, but many markets still have "implicit" disclosure rules that could be made clearer. A comprehensive list of explicit disclosure requirements in every market would assist enterprises in preparing their reports and investors in understanding what information is required from companies.

Whereas UNCTAD's annual CG Reviews examine the actual disclosure practices of listed companies in their annual reports, the 2007 and 2009 CG Inventories concentrate on mandatory disclosure required by regulators and stock exchanges. These two approaches allow ISAR to address some of the questions surrounding the relationship between disclosure rates and disclosure requirements. The complementary role of the two approaches is designed to address the question of whether or not the low rates of disclosure of some enterprises, particularly in developing countries and economies in transition, was influenced by local regulations within these markets. The 2008 and 2009 CG Reviews examine this question.

Annex III.I. List of sources by market

Argentina
- Stock Exchange Rules (“Reglamento de Cotización”);
- National Securities Rules (“Normas de la Comisión Nacional de Valores”);
- Decree no. 677/01;
- Corporate Law no. 19.500 (“Ley de Sociedades Comerciales”).

Brazil
- Law no. 10.303 of 31 October 2001 (Corporate Law);
- Law no. 6.404 of 15 December 1976;
- CVM Instruction no. 308 of 14 May 1999;
- CVM Instruction no. 358 of 3 January 2002;
- CVM Instruction no. 457 of 13 July 2007;
- Corporate Governance Code.

Chile
- Characteristics of the Chilean Stock Market, Bolsa de Comercio de Santiago, 2003;
- Questionnaire of the Santiago Stock Exchange, Serie Institucional no. 3, Bolsa de Comercio de
- Santiago, 1999;
- Law no. 18,045 (Securities Market Law);
- Law no. 18,046 (Corporations Law).

China
- Rules Governing the Listing of Stocks on Shanghai Stock Exchange (revised in 2008);
- Provisional Code of Corporate Governance for Securities Companies;
- Securities Law of the People’s Republic of China (revised in 2005);
- Company Law of the People’s Republic of China (revised in 2005).

Taiwan Province of China
- Corporate Governance Best Practice Principles for TSEC/GTSM Listed Companies;
- Corporate Governance Best Practice Principles for TSEC/GTSM Listed Companies;
- Taiwan Stock Exchange Corporation Rules Governing Information Reporting by Listed Companies (amendment in Dec 2008);
- Business Mergers and Acquisitions Law;
- Co., Ltd. Self-Regulatory Rules on Disclosure of Merger and Acquisition Information;
- Company Act.

Colombia
- Código de Comercio;
- Código de Mejores Prácticas Corporativas: Código País.

Czech Republic
- Section III of the Exchange Rules of the Prague Stock Exchange;
- Act on Undertaking on the Capital Market;
- Act on Auditors;
- Commercial Code No. 513/1991 (“Obchodní zákoník”).

Egypt
- Egyptian Code of Corporate Governance (2005);
- Listing Rules of the Cairo Alexandria Stock Exchange;
- Capital Market Law (second edition of 1998);
- Auditing Standards;
- Accounting Standards.

Hungary
- Directive 2004/109/EC of 15 December 2004;
- Regulations of the Budapest Stock Exchange for listing, continued trading and disclosure;
- Corporate Governance Code;

- Act IV of 2006 on Business Associations.

India
- Listing Agreement for Equity, Bombay Stock Exchange;
- Report of the Kumar Mangalam Birla Committee on Corporate Governance;
- Securities and Exchange Board of India Notification.

Indonesia
- Regulation Number I-A Listing Requirements, Jakarta Stock Exchange;
- Regulation Number I-E Concerning the Obligation of Information Submission, Jakarta Stock Exchange;
- Bapepam Rules Number VIII.G.11;
- Bapepam Rules Number VIII.G.2;
- Bapepam Rules Number IX.E.1;
- Bapepam Rules Number IX.E.2;
- Report on the Observance of Standards and Codes.

Israel
- Company Law 5759-1999;
- Securities Law;
- Identifying a principal shareholder in a reporting corporation;
- IFRS.

Japan
- Security Listing Regulations, Tokyo Stock Exchange (TSE);
- Principles of Corporate Governance for Listed Companies, TSE;
- Criteria of Listing, TSE;
- Listing Guides for Foreign Companies, TSE;
- Companies Act;
- Rules on Timely Disclosure of Corporate Information by Issuer of Listed Security and the Like, TSE;
- New Legislative Framework for Investor Protection, Financial Services Agency;
- Law Concerning the Promotion of Business Activities with Environmental Consideration by Specified Corporations, Ministry of the Environment;
- The Whistle-Blower Protection Act.

Jordan
- Directives for Listing Securities on the Amman Stock Exchange, 2004;
- Securities Law, 2002;
- Companies Law no. 22 of 1997;
- JSC Directives of Disclosure and Auditing and Accounting Standards of 2004.

Malaysia
- Listing Requirements for Main Board and Second Board, KLSE;
- Malaysian Code on Corporate Governance, Securities Commission Malaysia.

Mexico
- Ley General de Sociedades Mercantiles;
- Ley del Mercado de Valores;
- Code of Best Corporate Practices, 2006, Bolsa Mexicana de Valores (BMV);
- Corporate Governance Code for Mexico, 2002, BMV;
- Code of Professional Ethics of the Mexican Stock Exchange Community, BMV.

Morocco
- General Rules of the Stock Exchange (Casablanca-Bourse);
- Loi no. 17-95 Relative aux Sociétés Anonymes.

Peru
- Reglamento de Inscripción y Exclusión de Valores Mobiliarios en la Bolsa de Valores de Lima (Regulation of Inscription and Exclusion of Values in the Stock Exchange of Lima);
- Ley General de las Sociedades (General Societies Law);

Reglamento de Hechos de Importancia, Información Reservada y Otras Comunicaciones (Regulation of Important Facts, Reserved Information and Other Communications) o Reglamento de Propiedad Indirecta, Vinculación y Grupos Económicos (Regulation of Indirect Property, Linkages and Economic Groups);

- Reglamento de Oferta Pública de Adquisión y de Compra de Valores por Exclusión (Regulation of Public Supply of Acquisition and Purchase of Values by Exclusion);
- Reglamento de Información Financiera y Manual para la Preparación de Información Financiera (Regulation of Financial Information and Manual for the Preparation of Financial Information);
- Manual para la Preparación de Memorias Anuales y Normas Comunes para la Determinación del Contenido de Documentos Informativos (Manual for the Preparation of Annual Reports and Common Norms for the Determination of the Intelligence Document Content).

Philippines
- Corporation Code of the Philippines;
- Financial Disclosure Checklist (Philippines Securities and Exchange Commission);
- Securities Regulation Code;
- Philippines Code of Corporate Governance.

Poland
- Commission Recommendation of 15 February 2005;
- Best Practices for Warsaw Stock Exchange Listed Companies, 2007;
- WSE Listing Regulations;
- Act of 29 July 2005 on Public Offerings.

Republic of Korea
- Stock Market Disclosure Regulation, 2007, KRX;
- Stock Market Operational Guidelines on Fair Disclosure, 2007, KRX;
- Stock Market Listing Regulation, 2008, KRX;
- Enforcement Rule of Stock Market Listing Regulation, 2008, KRX;
- Commercial Act, Republic of Korea.

Russian Federation
- Corporate Governance Code;
- Law on Securities Markets;
- Russian Civil Code.

South Africa
- Stock Exchange Listing Rules for the Johannesburg Stock Exchange;
- The King Report III.

Thailand
- Disclosure Manual, 2007, Stock Exchange of Thailand (SET);
- Principles of Good Corporate Governance for Listed Companies, 2006, SET;
- Listed Companies Handbook, 2009;
- Listing of Ordinary Shares or Preferred Shares as Listed Securities, 2001 (amended in 2009).

Turkey
- Commercial Code;
- Communiqué on Principles Regarding Public Disclosure of Material Events (Capital Markets Board of Turkey);
- Communiqué Amending the Communiqué Regarding Independent Auditing in Capital Markets;
- Capital Markets Law, 2007.

United Kingdom
- Disclosure Rules and Transparency Rules, Finance Service Association (FSA);
- FSA Handbook;
- City Code on Takeovers and Mergers, Panel on Takeovers and Mergers;
- Alternative Investment Management;
- Combined Code on Corporate Governance, 2008.

United States

- Security Act, 1933;
- Listed Companies Manual, NYSE;
- Sarbanes-Oxley Act;
- Standards relating to listed company audit committees;
- Regulation S-K, SEC.

Annex III.II. List of disclosure items in the ISAR benchmark

No.	Disclosure item
Ownership structure and exercise of control rights	
1	Ownership structure
2	Process for holding annual general meetings
3	Changes in shareholdings
4	Control structure
5	Control and corresponding equity stake
6	Availability and accessibility of meeting agenda
7	Control rights
8	Rules and procedures governing the acquisition of corporate control in capital markets
9	Anti-takeover measures
Financial transparency and information disclosure	
10	Financial and operating results
11	Critical accounting estimates
12	Nature, type and elements of related party transactions
13	Company objectives
14	Impact of alternative accounting decisions
~~15~~	~~Disclosure practices on related party transactions where control exists~~
16	The decision-making process for approving transactions with related parties
17	Rules and procedures governing extraordinary transactions
18	Board's responsibilities regarding financial communications
Auditing	
19	Process for interaction with internal auditors
20	Process for interaction with external auditors
21	Process for appointment of external auditors
22	Process for appointment of internal auditors/scope of work and responsibilities
23	Board confidence in independence and integrity of external auditors
24	Internal control systems
25	Duration of current auditors
26	Rotation of audit partners
27	Auditors' involvement in non-audit work and the fees paid to the auditors

Corporate responsibility and compliance	
28	Policy and performance in connection with environmental and social responsibility
29	Impact of environmental and social responsibility policies on the firm's sustainability
30	A code of ethics for the board and waivers to the ethics code
31	A code of ethics for all company employees
32	Policy on "whistle-blower" protection for all employees
33	Mechanisms protecting the rights of other stakeholders in business
34	The role of employees in corporate governance
Board and management structure and process	
35	Governance structures, such as committees and other mechanisms to prevent conflict of interest
36	"Checks and balances" mechanisms
37	Composition of board of directors (executives and non-executives)
38	Composition and function of governance committee structures
39	Role and functions of the board of directors
40	Risk management objectives, system and activities
41	Qualifications and biographical information on board members
42	Types and duties of outside board and management positions
43	Material interests of members of the board and management
44	Existence of plan of succession
45	Duration of directors' contracts
46	Compensation policy for senior executives departing the firm as a result of a merger or acquisition
47	Determination and composition of directors' remuneration
48	Independence of the board of directors
49	Number of outside board and management position directorships held by the directors
50	Existence of procedure(s) for addressing conflicts of interest among board members
51	Professional development and training activities
52	Availability and use of advisorship facility during reporting period
53	Performance evaluation process

Chapter IV

2009 Review of the Implementation Status of Corporate Governance Disclosures: Case Study of Pakistan

Introduction

ISAR has been working in the area of corporate governance since 1989 (E/C.10/AC.3/1989/6). During the twenty-first session of ISAR in 2004, the group of experts requested the development of an annual study to assess the state of reporting on corporate governance. This resulted in a series of annual reviews and individual country case studies presented at subsequent ISAR sessions. These annual reviews examined corporate governance disclosure practices around the world, with a special focus on emerging markets. The studies were facilitated by the development of ISAR's benchmark of good practices in corporate governance disclosure. This benchmark consists of over 50 individual disclosure items and is explained in detail in the UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure* (UNCTAD/ITE/TEB/2006/3). This publication was the outcome of ISAR deliberations, particularly those of the twenty-second session. At the twenty-fifth session, the group of experts requested that UNCTAD continue to carry out such studies, in partnership with local institutions wherever possible, and with a focus on providing practical information to policymakers, investors and other stakeholders.

This report is a case study of corporate governance disclosure in Pakistan. It was conducted in cooperation with the Institute of Chartered Accountants of Pakistan.[37] The study utilizes the ISAR benchmark and the general methodology employed by earlier corporate governance country case studies and annual reviews conducted by the UNCTAD secretariat.[38]

The objectives of this study are to: (a) provide a brief overview of key developments in Pakistan related to corporate governance disclosure and (b) present and analyse the results of the review of corporate disclosure practices among leading enterprises in Pakistan. The overview of recent developments is provided in section I, which also examines the statutory framework in Pakistan related to corporate governance and rules and regulations related to corporate practices. Section II presents and analyses the results of the review, looking in detail at disclosure rates for each item in the ISAR benchmark.

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37 This document was prepared and edited by the UNCTAD secretariat on the basis of research conducted by Saira Nasir of the Institute of Chartered Accountants of Pakistan.

38 See for example: 2007 Review of the implementation status of corporate governance disclosures: case study Egypt (TD/B/COM.2/ISAR/CRP.7) and 2008 Review of the implementation status of corporate governance disclosures: an examination of reporting practices among large enterprises in 10 emerging markets (TD/B/C.II/ISAR/CRP.1), both of which are available at www.unctad.org/isar.

The findings of this study show that 22 of the indicators recommended in UNCTAD's *Guidance on Good Practices in Corporate Governance Disclosure* are reported by two thirds or more of the enterprises in the study, and 10 of the items are disclosed by all of the enterprises in the study. A number of recommended items in the ISAR benchmark were also subject to low rates of disclosure, with 10 items not disclosed by any of the companies in the study. The absolute number of disclosure items found for each company ranged from 21 to 33.

The study concludes that while the KSE-30 (the Karachi Stock Exchange 30, a popular equity index in Pakistan) has relatively good rates of disclosure for some topics, questions exist about the overall compliance of many companies with the disclosure requirements embodied in Pakistani law. Policy options discussed include: (a) increasing the number of explicit disclosure items that might formerly have been implicitly disclosed using general compliance statements and (b) strengthening the capacity-building and training activities targeted at directors to raise awareness about disclosure obligations and build the technical capacities necessary for producing high quality corporate governance disclosure.

I. Overview of developments in corporate governance disclosure in Pakistan

A. Overview of statutory framework in Pakistan

The concept of corporate governance has become increasingly important in Pakistan in recent years. The subject has attracted greater attention from policymakers who are reforming its arrangements across the private and public sector.

The main law that determines most aspects of the corporate legal framework is the Companies Ordinance of 1984. Below is an overview of this law and other major laws or codes affecting the governance of companies in Pakistan:

(a) Companies Ordinance, 1984: All financial statements are prepared in accordance with the requirements of the Companies Ordinance, 1984 and the IAS/IFRS as applicable in Pakistan;

(b) Securities and Exchange Ordinance, 1969: This ordinance provides for the protection of investors, regulates markets and provides guidance in dealing with securities;

(c) Income Tax Ordinance: This ordinance deals with the taxation of companies;

(d) Listing Regulations: These regulations are issued by the stock exchanges (Pakistan has three stock exchanges) and are applicable to all companies listed on the exchanges;

(e) Central Depository Act, 1997: The act ensures the smooth and risk-free settlement of security transactions. It provides for the establishment and operation of book entry systems for the transfer of securities by central depository companies;

(f) Code of Corporate Governance, 2002: This establishes a framework of good corporate governance whereby listed companies are managed in compliance with best practices and

in exercise of the powers conferred by the Securities and Exchange Ordinance, 1969. The code calls on all listed companies to publish and circulate a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance set out above. The code further calls on listed companies to ensure that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors, where such compliance can be objectively verified, before publication by listed companies;

(g) Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Regulations, 2008: The Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance 2002 (Takeovers Ordinance) seeks to provide a fair, transparent and efficient system for the acquisition of substantial voting shares and takeovers of listed companies in the interest of investors.

B. Development of corporate governance in Pakistan

1. The Pakistani Code of Corporate Governance and regional efforts

One of the main developments in corporate governance in Pakistan has been the formulation of a Code of Corporate Governance. The All Pakistan Chartered Accountants' Conference held in December 1998 resolved to take an initiative to evolve and recommend a Code of Good Corporate Governance. This endeavour sought to build on comprehensive codes developed outside of Pakistan, by developing a new code tailored to the circumstances of the Pakistani economy.

For this purpose, the Institute of Chartered Accountants of Pakistan (ICAP) constituted a committee comprising its elected past presidents, the presidents of the three stock exchanges in Pakistan, the President of the Institute of Cost and Management Accountants of Pakistan and a nominee of the Securities and Exchange Commission of Pakistan (SECP) to undertake the task of formulating recommendations for the code. After due deliberations extending over 18 months between 1998 and 1999 and consideration of the responses, observations and comments from a large number of institutions, representative bodies and informed professionals and intellectuals, this ICAP committee formulated a draft Code of Corporate Governance in Pakistan that was presented by ICAP to its members and published on the ICAP website.

The then-President of ICAP in consultation with the Chairman of the SECP constituted a task force to assist the SECP in reviewing the recommendations arising from the discussions held subsequently with other institutional bodies. The exposure and the consultative process continued for a period of over six months. The task force, after due consideration of various comments and observations and after consultations with the SECP, developed a Code of Corporate Governance. The SECP introduced the code in March 2002 and it was subsequently incorporated in the Listing Regulations of the Pakistani Stock Exchanges, applicable to all listed companies.

Developments in Pakistan also take place within the context of broader regional efforts to harmonize corporate governance practices in South Asia. The South Asian Federation of Accountants (SAFA) conducted a project on developing best practices in corporate governance supported by a small group composed of representatives from its member bodies: Bangladesh, India, Nepal, Pakistan and Sri

Lanka (the SAFA region). The group was assigned the tasks of carrying out a comparative study of the existing corporate governance regimes in each member country, identifying the areas that need further improvement and developing best practices that should be followed by listed entities and other public interest entities (such as banks, insurance companies and large-sized entities). The aim was to develop broad-based principles for the governance of corporate entities, considering international best practices as well as the particular business environment in the SAFA region.

2. Awareness and training activities

A number of institutions in Pakistan have engaged in awareness and training activities to strengthen corporate governance and disclosure in the country. ICAP has taken several steps in its effort to improving good corporate governance disclosure. For example, to promote accountability and transparency through the publication of information that is factual, transparent and reader friendly, ICAP along with the Institute of Cost and Management Accountants of Pakistan, began recognizing best practices among companies. In 2005, public sector entities were evaluated for the first time for the Best Presented Report Awards. A joint committee of ICAP and the Institute of Cost and Management Accountants of Pakistan has also been organizing the competition for Best Corporate Governance Awards.

The Pakistan Institute of Corporate Governance (PICG) is charged with promoting good corporate governance practices in Pakistan. The PICG is involved in conducting training and education, creating awareness, undertaking research and publishing guidelines and other resource material. It provides a central forum in Pakistan for discussions on corporate governance.

Corporate governance is crucial to enterprise development and directors are ultimately responsible for corporate governance, therefore the PICG encourages all directors to keep up-to-date their knowledge of rules, regulations and best practices. To achieve this objective it offers a Board Development Series directors' education programme. The certificate is internationally accredited as the Director Education Programme by the Risk Metrics Group, a leading shareholder services provider and corporate governance rating firm based in the United States. The Board Development Series allows due recognition by rating companies when evaluating a participant's organization. Making the acquisition of this certification mandatory for directors in Pakistan is currently under consideration.

3. Strengthening corporate governance in the banking sector

Multiple reforms in Pakistan have sought to improve the corporate governance practices of banks. The fundamental change targeted by these reforms is the effectiveness of the board. The implementation of "fit and proper" criteria, for example, is aimed at ensuring that board members are well equipped to carry out their responsibilities. The criteria are also a measure aimed at excluding unscrupulous individuals from being elected to the board of directors.

The State Bank of Pakistan (SBP) has played a particularly strong role in promoting good corporate governance in the financial industry. As the regulator and supervisor of banks and other financial institutions, the SBP has sought to implement a comprehensive corporate governance regime for banks, driven by a robust legal and regulatory framework, risk-based supervision and overarching banking sector reforms, notably privatization, liberalization and consolidation. The SBP also requires banks to

appoint auditors from a panel of pre-approved auditors maintained by the SBP. The objective is to ensure the credibility of the audited financial statements of banks.

4. Corporate governance in family-owned enterprises

As in many other emerging markets, family ownership of listed companies is a common feature of domestic capital markets in Pakistan. Powerful families directly or indirectly (through holding companies or other structures) continue to own a high percentage of the largest companies in the country. Family ownership of large enterprises can pose a number of challenges for corporate governance and disclosure. Family members appointed to the board of directors can sometimes lack sufficient qualifications and experience outside of the family business. Informal hierarchies within family units can sometimes conflict with formal structures of management and governance, and family cartels in a corporation can provide an opportunity for collusion, which can in turn undermine the rights of minority shareholders. To address these and other issues arising out of family ownership, the PICG together with the Centre for International Private Enterprise and ICAP have developed the Corporate Governance Guide for Family-Owned Companies to help directors of large family-owned companies.

High rates of family-controlled enterprises, and the complex range of relations between controlling families that can result from marriage, create specific challenges for identifying and dealing with related party transactions. Recent changes in the Listing Regulations of Pakistan have introduced the requirement that transactions with related parties be placed before the Board of Directors for review and approval. Details of the same must be placed before the Audit Committee. The related party transactions that are not executed under "arm's length" pricing will also be reviewed separately at each board meeting, and the board shall approve the pricing methods.

C. Ongoing efforts

Good corporate governance is essential in establishing an attractive investment climate characterized by competitive companies and efficient financial markets. It is thus imperative that Pakistan's corporate sector develops and implements good governance practices, in order to boost economic growth and development. This is particularly true in the midst of a globalized world, wherein enterprises compete on a global stage for investment capital.

Pakistan's developments in the area of corporate governance and capital market development have been recognized by the World Bank in its research. The World Bank's 2007 report on *Doing Business in South Asia* observes that "Pakistan provides relatively strong protections for minority shareholders against the misuse of corporate assets." The report ranks Pakistan nineteenth out of 175 countries on the issue of protecting investors. In its report *Getting Finance in South Asia 2009* the World Bank ranked Pakistan first among five South Asian countries in the area of corporate governance, performance and efficiency. The report, however, also highlights a number of areas that require further attention, including greater transparency and disclosure, greater accountability, further disclosure to beneficial ownership, safeguards for stakeholders rights and further improvements to the responsibilities of the board.

As noted earlier, one of the major developments in corporate governance in Pakistan has been the development of the Code of Corporate Governance. However, professionals in Pakistan recognize that that no code or set of good practices is complete or perfect and the Code of Corporate Governance in Pakistan is no exception. Many lessons have been learned since the adoption of the code in 2002 regarding its

implementation in Pakistan's business environment. These lessons are now being incorporated into a revision of the code. The PICG constituted a task force to review the code in the conceptual context and its implementation in practice in light of feedback from relevant stakeholders. It is intended that the revised code address the ground realities of the corporate environment in Pakistan and, in addition to that, facilitate the alignment of corporate governance practices in Pakistan with global best practices.

Strengthening the code must also be complemented by strengthening the skills of directors and other key actors in corporate governance. A major barrier to improving corporate governance practices in Pakistan has traditionally been the lack of qualified professionals to help with the implementation of corporate governance practices. In this context, the ongoing training activities of a number of Pakistani institutions is critically important and it is expected that the revised code will provide the basis for more such activities in the country.

II. Status of implementation of good practices in corporate governance disclosure in Pakistan

A. Background and methodology

The purpose of this study is to evaluate the level of implementation of good practices in corporate governance disclosure in Pakistan. The reader should note that, as in UNCTAD's previous annual reviews and country case studies on this subject, this study is not intended as a measure of the quality of the disclosure of individual items, but rather a measure of the existence of the selected disclosure items. The study was undertaken by ICAP in cooperation with the UNCTAD secretariat. The study examines the disclosure practices of the companies of the KSE-30, a popular equity index in Pakistan. The disclosure made by these companies was compared with the ISAR benchmark of 52 disclosure items. This benchmark is based on the recommendations of the Group of Experts found in the UNCTAD publication *Guidance on Good Practices in Corporate Governance Disclosure.* The 52 disclosure items cover the following five broad categories:

(a) Ownership structure and exercise of control rights;

(b) Financial transparency and information disclosure;

(c) Auditing;

(d) Corporate responsibility and compliance;

(e) Board and management structure and process.

The 52 indicators were tested against the actual reporting practices of 30 leading enterprises from Pakistan. The sample used in this study is comprised of the 30 companies that make up the KSE-30. The KSE-30 index is designed to provide investors with a general indication of the performance of large capitalization companies within Pakistan's equity market. As indicated in table IV.1, the companies in the KSE-30 belong to a range of industrial sectors.

Table IV.1. Distribution of KSE-30 enterprises by sector

Sector	Number of Companies
Bank	8
Oil and gas	5
Financial service provider	2
Fertilizer	2
Cement	2
Securities	2
Textile	2
Insurance	2
Paper	1
Information technology	1
Chemical	1
Communication	1
Power generation	1

KSE-30 companies typically represent the largest enterprises in Pakistan, making the most significant contribution to the country's economy. Table IV.2 provides an overview of the aggregate financial data for the KSE index.

Table IV.2. KSE-30 financial overview
(In millions of Pakistani rupee, 2007 data)

Description	Average	Maximum	Minimum
Sales	478 506 542	12 308 604 885	927 810
Assets	1 995 504 856	33 696 112 116	1 593 096
Liabilities	987 961 886	24 127 735 334	299 935
Equity	982 344 916	18 074 588 378	293 073
Net income	220 443 623	3 934 880 345	355 120

Note: Using the 2007 average exchange rate, $1 equals 60.58 Pakistani Rupees.

The study was carried out by reviewing the annual reports and other publicly available company disclosures. The data in this report is based primarily on the information available from 2007 annual reports; during the data gathering phase of this project, 2008 reports were not yet widely available.

B. Main outcomes of the study: overview of all disclosure items

Table IV.3 provides an overview of the corporate governance disclosure items in the ISAR benchmark. The disclosure items are organized into five thematic groups. Next to each disclosure item is the number of KSE-30 companies found to be disclosing this item. It is again noted that the findings below are not an indication of the quality of disclosure found among the enterprises, but only whether or not some disclosure exists for each of the disclosure items listed below.

Table IV.3. Main findings of review of KSE-30 corporate governance disclosure

Disclosure items by category	Number of enterprises disclosing this item (max. = 30)
Ownership structure and exercise of control rights	
Ownership structure	30
Process for holding annual general meetings	30
Availability and accessibility of meeting agenda	29
Control and corresponding equity stake	28
Control structure	26
Changes in shareholdings	21
Control rights	1
Rules and procedures governing the acquisition of corporate control in capital markets	0
Anti-takeover measures	0
Financial transparency	
Financial and operating results	30
Critical accounting estimates	30
Nature, type and elements of related party transactions	30
Board's responsibilities regarding financial communications	30
Company objectives	23
The decision-making process for approving transactions with related parties	16
Impact of alternative accounting decisions	6
Rules and procedures governing extraordinary transactions	2
Auditing	
Duration of current auditors	30
Auditors' involvement in non-audit work and the fees paid to the auditors	30
Process for appointment of external auditors	29
Board confidence in independence and integrity of external auditors	29
Process for interaction with internal auditors	21
Internal control systems	9
Process for appointment of internal auditors / Scope of work and responsibilities	5
Process for interaction with external auditors	3
Rotation of audit partners	0
Corporate responsibility and compliance	
A code of ethics for the board and waivers to the ethics code	30
A code of ethics for all company employees	29
Policy and performance in connection with environmental and social responsibility	19
Impact of environmental and social responsibility policies on the firm's sustainability	19
The role of employees in corporate governance	4
Policy on "whistle-blower" protection for all employees	0
Mechanisms protecting the rights of other stakeholders in business	0
Board and management structure and process	
Determination and composition of directors' remuneration	30
Composition of board of directors (executives and non-executives)	29
Duration of directors' contracts	29
Independence of the board of directors	25

Disclosure items by category	Number of enterprises disclosing this item (max. = 30)
Material interests of members of the board and management	16
Governance structures, such as committees and other mechanisms to prevent conflict of interest	14
Composition and function of governance committee structures	14
Risk management objectives, system and activities	14
Role and functions of the board of directors	13
Qualifications and biographical information on board members	9
Types and duties of outside board and management positions	9
Number of outside board and management position directorships held by the directors	7
Professional development and training activities	3
"Checks and balances" mechanisms	1
Existence of plan of succession	0
Compensation policy for senior executives departing the firm as a result of a merger or acquisition	0
Existence of procedure(s) for addressing conflicts of interest among board members	0
Availability and use of advisorship facility during reporting period	0
Performance evaluation process	0

As shown in table IV.3, the group with the highest average rate of disclosure is "Financial transparency", followed by "Ownership structure and exercise of control rights". The weakest area of disclosure proved to be the "Board and management structure and process". Disclosure rates for the category of "Auditing" stand out in particular as being relatively strong. A consistent finding of UNCTAD's annual corporate governance reviews has been that the category of "Auditing" is typically subject to the lowest rates of disclosure among emerging market enterprises around the world. The situation in Pakistan is different, however, where the category is subject to comparatively higher disclosure rates.

The average KSE-30 enterprise discloses about half of the items in the ISAR benchmark. Twenty-two of the items in the ISAR benchmark were disclosed by more than two thirds of the enterprises in the study, and 10 of the items in the ISAR benchmark were disclosed by all of the KSE-30 companies. A number of recommended items in the ISAR benchmark were subject to low rates of disclosure, with 10 items not disclosed by any of the companies in the study.

To put these findings into the Pakistani context, it is worth noting that a number of the disclosure items in this study that are not recognized as "disclosed" might nevertheless be said to be the subject of an indirect form of disclosure. Many of these items fall under the mandatory compliance requirement of Pakistan's Code of Corporate Governance, and companies disclose their compliance with this code through a statement in their annual reports. Furthermore, external auditors are required to give their opinion on the statement of compliance and identify any deficiencies in compliance. Therefore, many companies appear to believe that there is no need to disclose explicit information about these things because they are covered by the general compliance statement. However, for those not familiar with the code (such as foreign investors) and for those items in the code for which compliance might take different forms, the use of general compliance statements is not a sufficiently informative substitute for explicit disclosure. While the code indicates in a general way what should happen, the purpose of corporate disclosure is to report explicitly what actually

happened. The disclosure of actual practices is more relevant for an enterprise's stakeholders, as it assures, among other things, that the enterprise (at a minimum) meets the relevant rules and regulations. It also provides stakeholders with information on company-specific practices, which may differ from other companies while still falling within the general framework of the code.

The above findings are subject to additional analysis in the sections below.

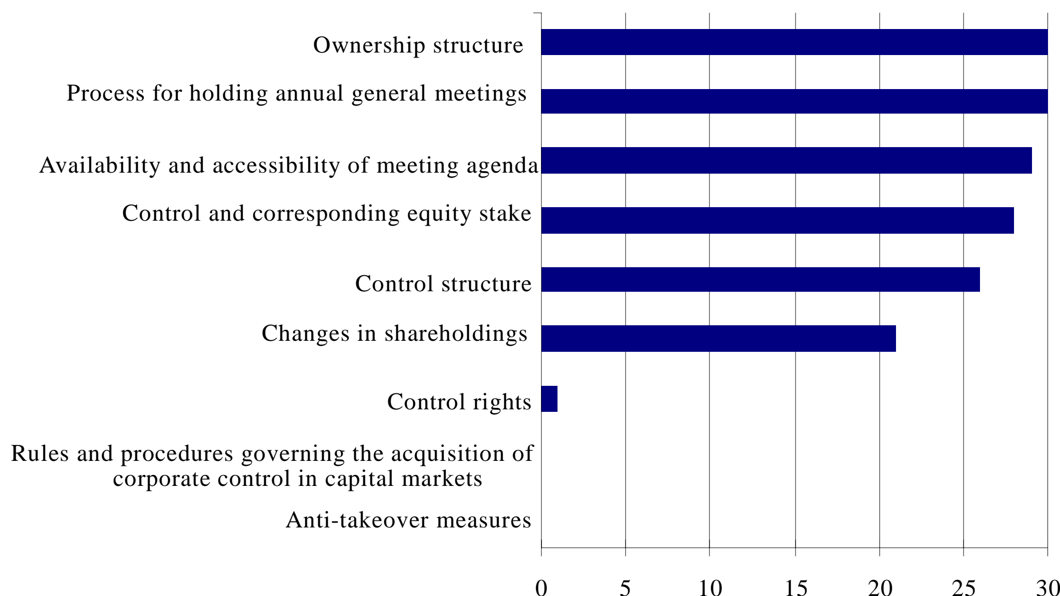
1. Ownership structure and exercise of control rights

As noted above, disclosure items from the ownership structure category were among the most prevalent within the reports of the KSE-30 companies. Figure IV.1 provides a graphical view of the disclosure items in this group. Two of the items are disclosed by all of the companies in the study, and two of the items are not disclosed by any of the companies. Four items are commonly reported, with more than 20 of the 30 companies disclosing them.

The two items not disclosed by any of the companies were "Rules and procedures governing the acquisition of corporate control in capital markets" and "Anti-takeover measures". Lack of disclosure on the first item, "Rules and procedures", may result from companies relying on widespread awareness of how these procedures are defined under Pakistani law. The failure to disclose this information, however, increases the information acquisition costs of foreign investors and decreases awareness of any company-specific practices that exist within the legal framework. Regarding the disclosure of anti-takeover measures, compliance with procedure laid down in existing Pakistani law requires that public disclosure is made only in the event of an acquisition attempt. Such conditional disclosure, however, does not provide enough advance information to investors and other stakeholders to allow them to forecast company performance under various scenarios (including takeover scenarios). UNCTAD's CG Guidance recommends that companies disclose whether or not anti-takeover measures exist, and the nature of those measures, regardless of whether or not the company faces an imminent takeover attempt.

The disclosure item on control rights was also subject to extremely low levels of disclosure (only one company in the KSE-30 disclosed this item). To put this into the Pakistani context, control over a company is, under Pakistani law, directly linked to equity stake. Under the takeover/substantial acquisition law, control is defined as the right to appoint a majority of directors or to control management or policy decision by virtue of shareholding, management rights, a shareholding agreement, a voting agreement or otherwise. Pakistani companies may therefore believe that an assessment of the control rights can be established through the pattern of shareholding disclosed in the annual reports. Any significant change in ownership or control is also required to be made public henceforth under the Code of Corporate Governance through notices to the Stock Exchanges and Securities and Exchange Commission of Pakistan. UNCTAD's CG Guidance, however, recommends that explicit description of control rights be made in a company's annual report, to ensure that stakeholders are aware whether any special control rights exist (e.g. government ownership of special shares or special legal restrictions on control).

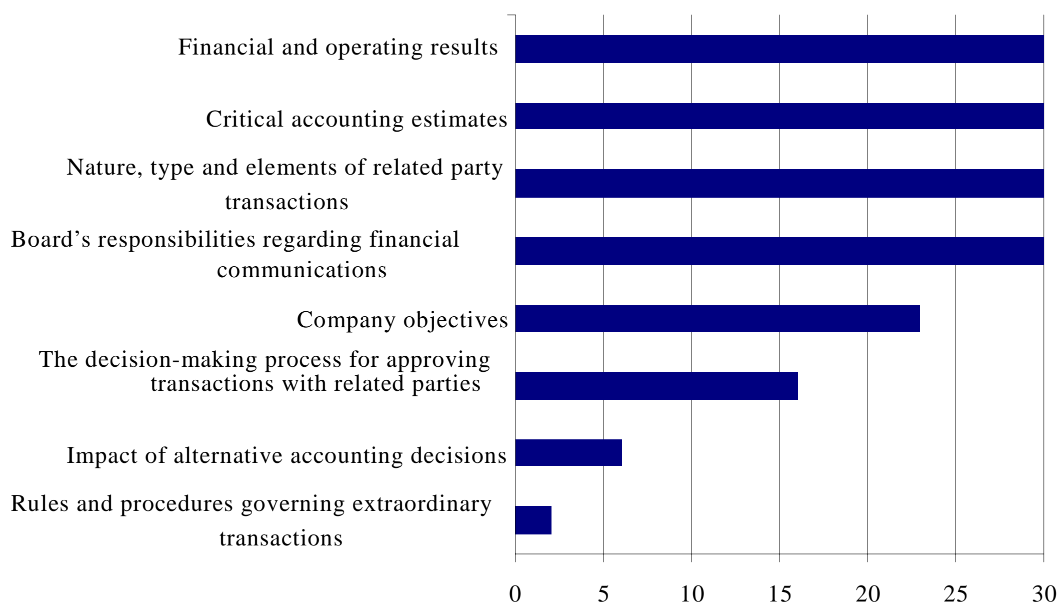
Figure IV.1. Ownership structure and exercise of control rights
(Number of KSE-30 enterprises disclosing each item)



2. Financial transparency

The most prevalent group of disclosure items was financial transparency. However, only six companies disclosed information on the "Impact of alternate accounting decisions" and only four companies disclosed information pertaining to "Rules and procedures governing extraordinary transactions". Disclosing the financial impact of alternative accounting decisions with respect to accounting policy options would provide users of financial statements with a better picture of the financial performance and position of the reporting entity. The lack of disclosure of this item by many companies may indicate the need for further work in Pakistan on providing users of financial statements with further insights into management's decision-making among alternative accounting policy options. The "Rules and procedures governing extraordinary transactions" are covered by the Code of Corporate Governance and Pakistani law. The lack of disclosure of this item by most of the KSE-30 companies in this study may result from the assumption that these rules are sufficiently well defined and accessible in the code and Pakistani law. As noted earlier, however, general rules and laws are not an adequate substitute for explicit descriptions of company-specific practices.

Figure IV.2. Financial transparency
(Number of KSE-30 enterprises disclosing each item)



3. Auditing

On the subject of auditing, five of the nine items were subject to relatively high rates of disclosure. Four of the items, however, were subject to low rates of disclosure; these items are discussed in more detail below.

The disclosure item "Process of interaction with external auditors" was disclosed by less than five of the KSE-30 companies. The process that this disclosure item refers to is generally straightforward in most Pakistani companies. The Audit Committee of every listed company is required to meet with the external auditors without the Chief Financial Officer (CFO) and the Head of Internal Audit being present, at least once a year. A Management Letter is to be written by the external auditors to the Board of Directors within 30 days from the date of the audit report and serves as a useful source of communication between the external auditors and the board.

The disclosure item "Process for appointment of internal auditors / Scope of work and responsibilities" was also subject to a very low level of disclosure, with only five companies reporting information on this item. The process that this disclosure item refers to is also generally straightforward in most Pakistani companies. The Code of Corporate Governance states that appointment, remuneration and terms and conditions of employment of the head of internal audit of a listed company shall be determined by the Chief Executive Officer (CEO) with the approval of the Board of Directors.

Both of the above disclosure items are examples of processes that are generally well understood and regulated in Pakistan, even if they are not widely reported on by enterprises. They are also examples of items that might be considered to be the subject of indirect disclosure via the statement of compliance with the Code of Corporate Governance.

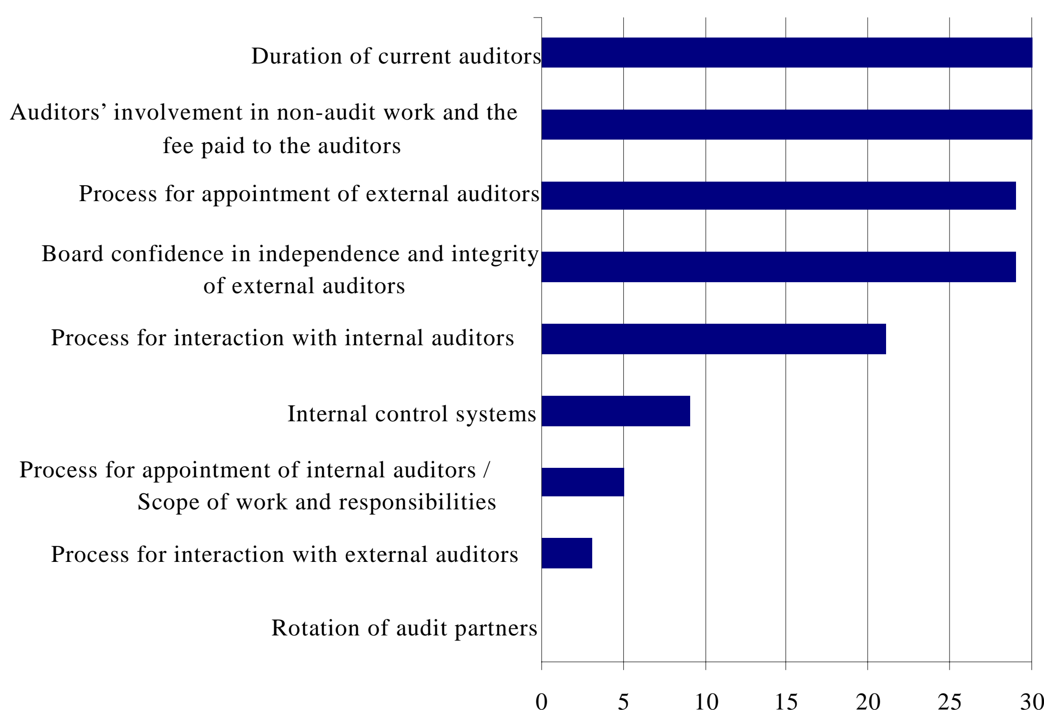
The disclosure item on "Internal control systems" was found in less than one third of the companies' reports. The directors of listed companies are entrusted with the important responsibility of making sure that a sound internal control system is in place. A disclosure on the subject should normally be given in the directors' report or in the statement of compliance with the Code of Corporate Governance in the annual

report. Disclosure on this subject should normally also be reviewed by the external auditors to ensure consistency with their audit results.

Information on the rotation of audit partners was not disclosed by any of the companies in the study. This result, however, must be considered in the Pakistani context where listed companies are required, at a minimum, to rotate the audit engagement partner after every five years. The low level of disclosure for this item may be a consequence of rules in Pakistan that make the change in audit partner every five years mandatory; thus many companies may treat such rotation as assumed knowledge and not disclose this information, or companies may assume that the issuance of compliance statement vis-à-vis the code provides indirect disclosure of this item. It should also be noted that all of the companies in the study did disclose the duration of current auditors.

Figure IV.3. Auditing

(Number of KSE-30 enterprises disclosing each item)



4. Corporate responsibility and compliance

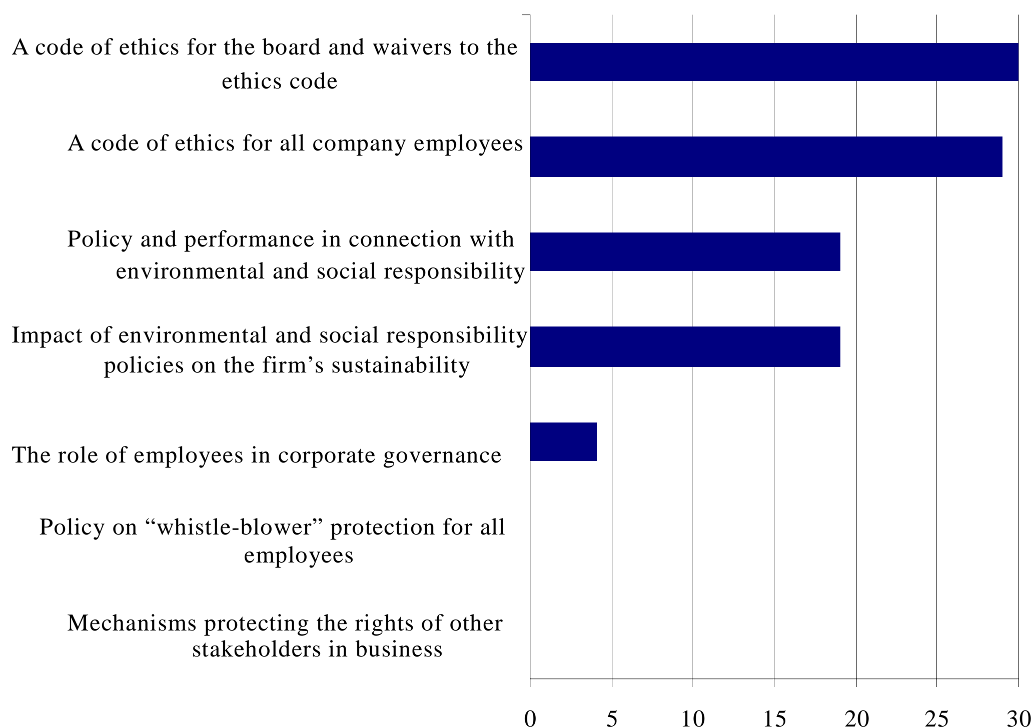
The category of corporate responsibility and compliance had a mix of disclosure rates, with two items disclosed by all or nearly all enterprises, two items disclosed by at least half of the enterprises and three items that were disclosed by less than five enterprises (or none). Some of this disclosure is driven directly by the Code of Corporate Governance in Pakistan and should be viewed in that context.

A code of ethics for the board and a code of ethics for all company employees appear to be commonplace in Pakistan and are regularly disclosed by most of the companies in the study. Information on "Policy and performance in connection with environmental and social responsibility" and "Impact of environmental and social responsibility on the firm's sustainability" is reported by more than half of the companies in the study. The disclosure of these items may stem from the code under which the board of directors of listed companies are to adopt an overall corporate strategy for the company that includes policies on health, safety and environment.

Information on the role of employees in corporate governance is disclosed by less than five of the companies in the study. UNCTAD's annual studies on corporate governance disclosure have found that this information is rarely disclosed except in countries where employees have legally proscribed roles in corporate governance, such as an employee representative on the board of directors.

None of the companies in the study disclosed information on a "whistle-blowing" or "speak up" programme. Similarly there is no disclosure on the subject of protecting the rights of other stakeholders (in addition to shareholders).

Figure IV.4. Corporate responsibility and compliance
(Number of KSE-30 enterprises disclosing each item)



5. Board and management structure and process

Many of the items in the disclosure category of "board and management structure and process" were subject to low levels of disclosure among the KSE-30 companies. While four of the 19 disclosure items in this category were found in more than two thirds of company reports, 14 of the items were found in less than half, with five the items not found in the reports of any KSE-30 company.

Concerning the disclosure item "Governance structure, such as committees and other mechanisms to prevent conflict of interest", under the Code of Corporate Governance every listed company is required to have an audit committee with powers and responsibility (as identified in the code) that should address issues of conflict of interest. Also if there are committees for this purpose other than the audit committee of the board, their existence should be disclosed in the annual report. Such information, however, was only found for 14 of the KSE-30 companies.

Under the code, sufficient checks and balances mechanisms should be maintained in the structure of the board and the management. Disclosure of the separation of the positions of CEO and Chairman of the Board, the role of non-executive directors, along with relevant board committees and mechanisms (including the roles of the internal auditors and the external auditors) can address this issue.

The role and function of the board of directors was disclosed by less than half the companies in the study. In most Pakistani companies, the directors perform their function and derive their power and authority from the Companies Ordinance, the Code of Corporate Governance and the articles of association of the company. Disclosure on this item can be provided by simply publishing the articles of association on the company's website and making reference to it in the annual report.

Information on the material interests of members of the board and management were found for just over half the companies in the study. Under section 214 of the Companies Ordinance, directors have to disclose any interest they hold in any undertaking or company. Such disclosures have to be made in a meeting of the board. Similarly, the Code of Corporate Governance makes it obligatory for any director, CEO, CFO or any executive of the company to disclose any interest held by them or their spouses in the company's shares. Based on the aforesaid law, shares held by directors (including their spouse and children), CEO, CFO, Company Secretary and the executive should be shown separately in the pattern of shareholding annexed to the annual report as a requirement of the code.

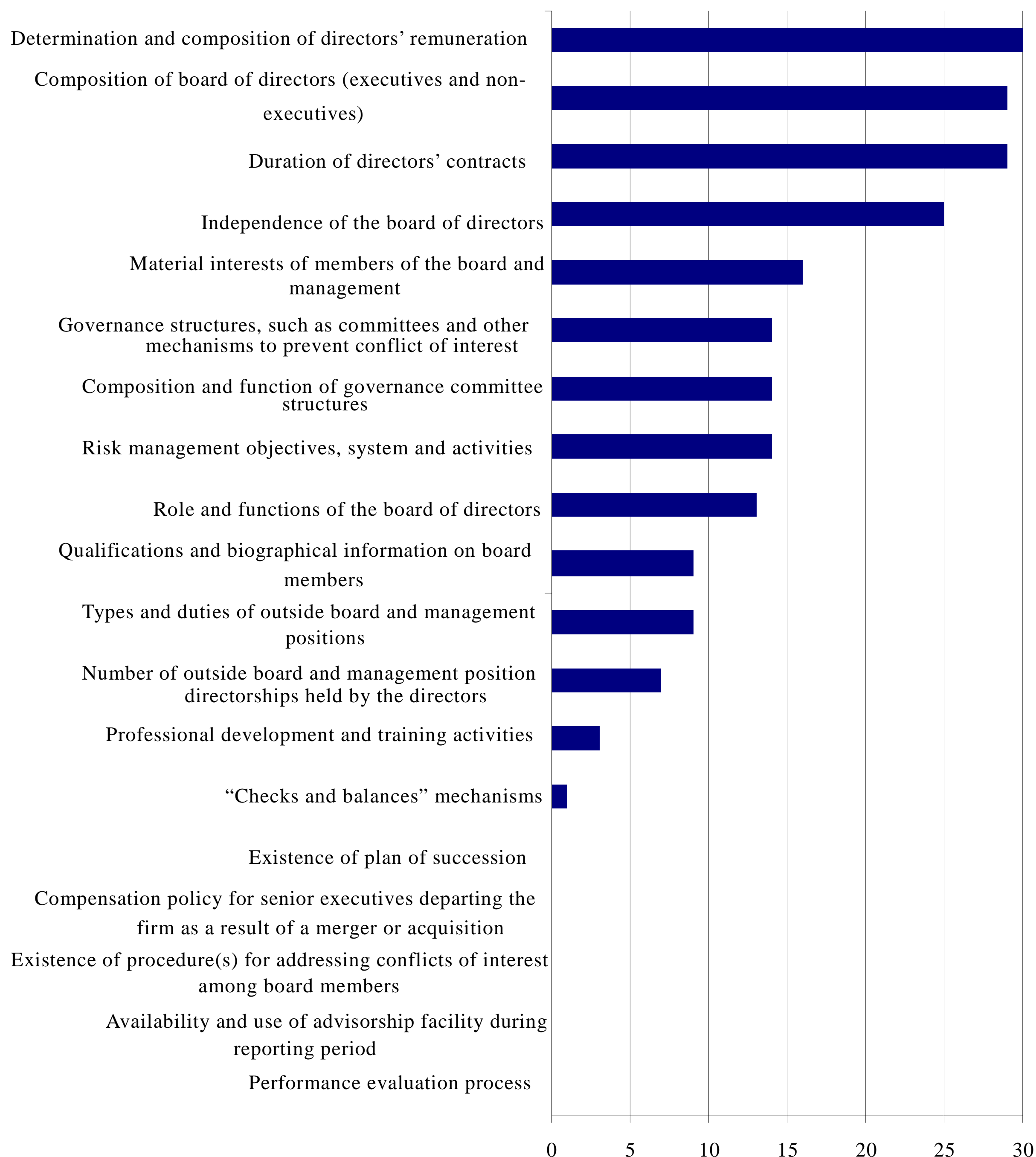
The compensation policy for senior executives departing the firm as a result of a merger or acquisition was not disclosed by any of the KSE-30 companies. It should be noted that there is no requirement in Pakistan for such disclosure. However, remuneration to executives (collectively) and CEO remuneration are disclosed in the annual accounts. The disclosure of the determination and composition of directors' remuneration was found in the reports of all the KSE-30 companies.

Less than one third of the companies in the study provided information on the types and duties of outside board and management positions, and the number of outside board and management position directorships held by the directors. Under the Companies Ordinance, directors are required to disclose to the board of directors the names of all such undertakings or associations where a director holds any directorships or any other interest. This should also be submitted to the SECP. Further, to be eligible to sit on a board of directors, no listed company in Pakistan shall have as a director a person who is serving as a director in more than 10 listed companies.

No disclosure was found among any of the companies containing information on the existence of procedures for addressing conflicts of interest among board members. Pakistan's Companies Ordinance prohibits directors from participating or voting in proceedings of directors for any contract or arrangements where the director has a direct or indirect material interest. Any violation of this law should be reflected in a company's Statement of Compliance with the Code of Corporate Governance. The specific procedures that companies adopt to ensure compliance with this law can vary from company to company, however, and should be disclosed.

The disclosure items "Professional development and training activities", "Availability and use of advisorship facility" and "Performance evaluation process" were subject to little or no disclosure. It should be noted that these items are covered under the Code of Corporate Governance and could be considered the subjects of indirect disclosure under the umbrella statement of compliance with the code.

Figure IV.5. Board and management structure and process
(Number of KSE-30 enterprises disclosing each item)

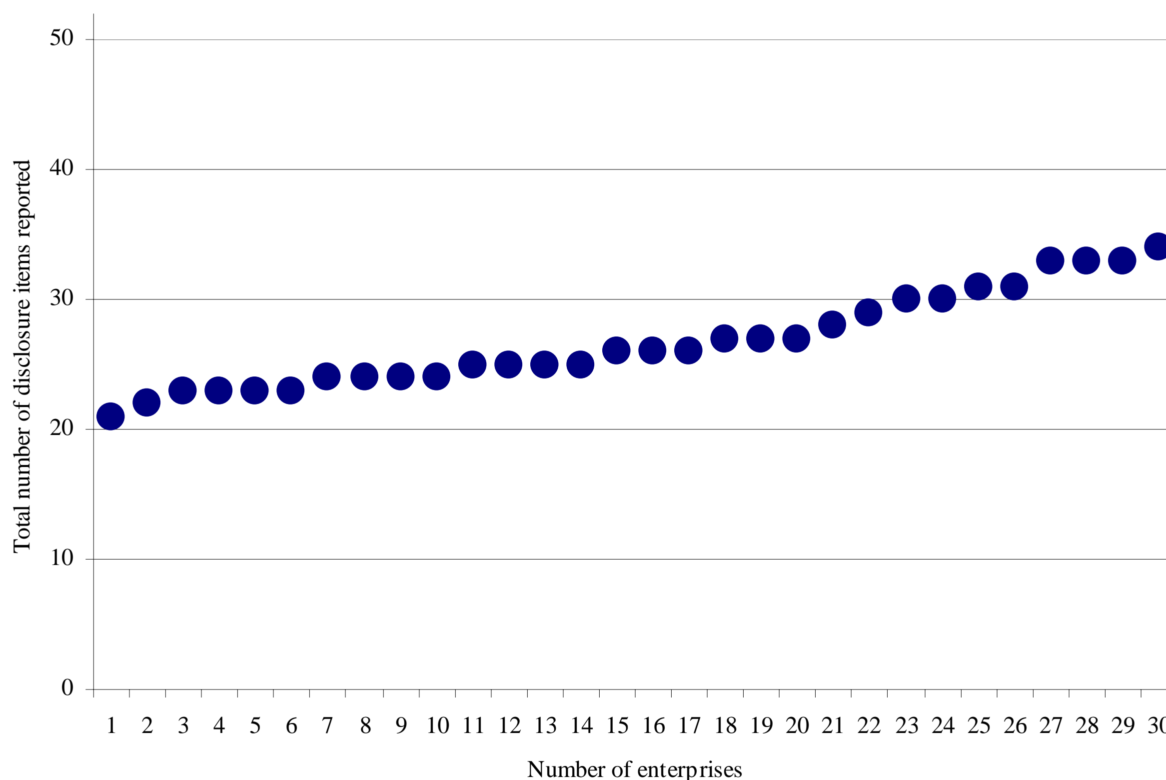


6. Reporting by enterprise: total number of disclosure items

The findings presented in this study have so far focused on the disclosure rates of individual items in the ISAR benchmark among the enterprises of the KSE-30. Figure IV.6 focuses not on individual disclosure items, but on the total number of disclosure items reported by the enterprises in the study. This is intended to provide a general overview of the disclosure rates for individual enterprises. What the figure shows is that all of the KSE-30 enterprises reported within a relatively consistent range from a minimum of 21 disclosure items to a maximum of 34. The relatively consistent disclosure practices within the group suggest a market with established best practices among the leading enterprises.

This data should also be considered in the context of a separate UNCTAD study of corporate governance disclosure in emerging markets, which found that 40 of the items in the ISAR benchmark are required to be disclosed by enterprises listed on the KSE.[39] In this context, the data raises questions about corporate compliance with disclosure requirements in Pakistan.

Figure IV.6. Reporting by enterprise
(Total number of disclosure items reported by each enterprise of the KSE-30)



III. Conclusions

The purpose of this study was to evaluate the level of implementation of corporate governance disclosure among leading enterprises in Pakistan. The reader should again note that, as in UNCTAD's previous reviews on this subject, this study is not intended as a measure of the quality of the disclosure of individual items; rather, it is a measure of the existence of the selected disclosure items. The study examined the disclosure practices of the companies that make up the KSE-30, a popular benchmark of capital market performance in Pakistan. The disclosures made by these companies were compared with the ISAR benchmark of corporate governance disclosure, which includes 52 disclosure items across five broad categories. This study finds relatively consistent rates of corporate governance disclosure among the KSE-30 enterprises, with the average enterprise disclosing about half of the items in the ISAR benchmark. Twenty-two of the items in the ISAR benchmark were disclosed by more than two thirds of the enterprises in the study, and 10 of the items in the ISAR benchmark were disclosed by all of the KSE-30 companies. A number of recommended items in the ISAR benchmark were subject to low rates of disclosure, with 10 items not disclosed by

[39] UNCTAD (2007). 2007 Review of the implementation status of corporate governance disclosures: an inventory of disclosure requirements in 25 emerging markets. TD/B/COM.2/ISAR/CRP.6. Geneva.

any of the companies in the study. The absolute number of disclosure items found for each company ranged from 21 to 34.

A question of disclosure that emerges from this study concerns the role of the statement of compliance with the Code of Corporate Governance. It is generally understood in Pakistan that by giving a statement of compliance with the code in the annual report, the company provides assurance to stakeholders on all of the items in the code, unless there are weaknesses highlighted in the company's statement or the external auditor's statement. There is a flaw in the logic of this approach however. The code covers a broad range of potential disclosure items, many of which are explicitly disclosed in company reports, while others are not explicitly disclosed. To argue that the compliance statement is sufficient disclosure for those things not explicitly disclosed, is also to say that the compliance statement is sufficient disclosure for all things contained in the code. This does not seem to be correct. For any code of corporate governance, or any company law, there are always a range of different, company-specific governance mechanisms and practices that would be in compliance. Shareholders and other stakeholders will best be served through the provision of company-specific information. Foreign shareholders in particular (who may not be familiar with the code) will require explicit disclosure of issues related to international best practices in corporate governance disclosure.

The data in this study suggests that many companies are not, at present, in compliance with all disclosure rules. The key responsibility for the administration and performance of a company's affairs remains with the directors. It is also the responsibility of the directors to ensure that the company complies with the disclosure requirements set out in Pakistan's laws, regulations and listing requirements. In this regard, there is an urgent need to create awareness amongst directors of the obligations and benefits of corporate governance disclosure and the need to strengthen disclosure in certain areas. This could be part of ongoing training programmes focused on company directors. Policymakers and institutions active in the development of corporate governance in Pakistan may wish to further encourage explicit disclosure on particular items to help facilitate greater corporate transparency in accordance with international best practice.

Annex IV.I. List of enterprises in the study

- Adamjee Insurance
- Arif Habib Limited
- Arif Habib Securities
- Askari Bank
- Attock Refinery Limited
- Azgard Nine
- B.O. Punjab
- Bank Al-Falah
- D.G.K. Cement
- EFU General Insurance
- Engro Chemicals
- Fauji Fertilizer
- Fauji Fertilizer Bin Qasim
- Habib Bank Limited
- Hub Power
- Jahangir Siddiqui and Company
- Lucky Cement
- MCB Bank Limited
- National Bank Limited
- Netsol Technologies
- NIB Bank
- Nishat Mills Limited
- Oil and Gas Development Company Limited
- P.T.C.L.A.
- Packages Limited
- Pak Petroleum Limited
- Paki Oil fields Limited
- Pervez Ahmed Securities Limited
- PSO
- United Bank Limited

Chapter V

2009 Review of Corporate Responsibility Reporting: the Largest Transnational Corporations and Climate Change-related Disclosure

Summary of discussions

The Chair introduced the agenda item, and gave the floor to a member of the UNCTAD secretariat who presented the findings of the "2009 Review of corporate responsibility reporting: the largest transnational corporations and climate change-related disclosure" (TD/B/C.II/ISAR/CRP.7). The paper provided an overview of climate change-related reporting among the 100 largest transnational corporations, taken from UNCTAD's *World Investment Report 2008.*

Following this presentation, the Chair introduced an invited expert from the University of Fortaleza, who presented the findings of a joint UNCTAD/Fortaleza paper entitled "2009 Review of the reporting status of corporate responsibility indicators: case study Brazil" (TD/B/C.II/ISAR/CRP.4). The report used ISAR's *Guidance on Corporate Responsibility Indicators in Annual Reports* as a benchmark to study the reporting practices of large Brazilian companies.

After the panellists had made their presentations, the Chair opened the floor and a general discussion on the subject of environmental and social reporting ensued. A number of delegates highlighted the urgent need for more work on climate change and carbon emissions reporting, with a view to improving and harmonizing reporting on environmental issues, and urged ISAR and UNCTAD to continue to work in this space.

Introduction

Corporate responsibility reporting has been a focus of ISAR's work for a number of years. Complementing this general area, ISAR has also addressed environmental reporting, for example in the 1999 publication *Accounting and Financial Reporting for Environmental Costs and Liabilities* and the 2003 publication *A Manual for the Preparers and Users of Eco-Efficiency Indicators*. Since ISAR began its work in this area, environmental reporting (and especially disclosure on climate change-related emissions) has become increasingly important. At UNCTAD XII, member States called on UNCTAD to analyse voluntary enterprise policies on corporate social responsibility, in particular by transnational corporations (TNCs), and, through ISAR, to continue to contribute to the field of environmental reporting.[40] Environmental issues are

[40] Accra Accord paragraphs 152 and 156.

recognized as an important feature of corporate responsibility. Among the range of environmental issues that companies and communities face, reducing climate change-related emissions has been identified by the United Nations as a particularly urgent goal. As member States worked towards a new international agreement on climate change at the United Nations Climate Change Conference in Copenhagen (7–18 December 2009), environmental reporting takes on a renewed sense of practical importance. Implementing any agreement on climate change emissions will require high quality reporting practices.

This study provides an overview of the current environmental reporting practices adopted by the world's largest TNCs. The report focuses on corporate reporting related to environmental issues generally and climate change issues more specifically. The study examines the reporting practices of the 100 largest TNCs as identified in UNCTAD's *2008 World Investment Report*.[41] The data and analysis presented in this study were prepared by the UNCTAD secretariat in cooperation with the Ernst and Young EMEIA CSR (Corporate Social Responsibility) Knowledge Centre and the CSR Management and CSR Auditing Programme at Erasmus University, Rotterdam.

The objective of this report is to present and analyse the results of the secretariat's study of climate change reporting among the world's 100 largest TNCs. The findings of this study show that a large majority of the TNCs are disclosing information on environmental performance and climate change issues. At least some information related to environmental issues is reported by 98 of the 100 TNCs, with 87 of the enterprises providing explicit data on greenhouse gas (GHG) emissions. Distinct policies on GHG emissions are disclosed by 75 of the enterprises, while 73 make use of the International Standards Organization (ISO) 14000 environmental management system and 72 reference the Global Reporting Initiative (GRI) sustainability guidelines. The United Nations Global Compact is cited in the reports of 63 of the 100 TNCs and 69 of the companies have board-level responsibility for environmental performance.

The overall picture that emerges from the research is that while questions about the quality and consistency of reporting remain, the world's largest TNCs have already begun to adopt a range of voluntary practices to address issues of climate change and make related information available in their public reports. Complete findings of the study along with a detailed analysis are presented in section I.

I. Status of TNC disclosures on climate change

A. Background and methodology

1. Selected climate change disclosure items

This study examines the environmental reporting practices of TNCs, with special reference to climate change issues. Table V.1 shows the 14 disclosure items that were selected as a benchmark to gauge the reporting practices of TNCs in this area. These 14 items were selected from among the existing range of international, industry and civil society standards, practices and guidance tools. This is intended to be a representative sample of mainstream tools and practices, but should not be considered

[41] Slight modifications have been made to the list found in the *2008 World Investment Report* to account for merger and acquisition activity in the time since the data was originally compiled; these are indicated by a footnote in annex V.I. For a complete list of companies in this study see annex V.I.

an exhaustive list of all possible disclosures in this area, nor should it be considered a recommended list of disclosure items.

Table V.1. Selected climate change disclosure items, by category

International guidance frameworks
Reference to United Nations Global Compact
Reference to OECD (Organization for Economic Cooperation and Development) Guidelines for Multinational Enterprises
Policy, management and governance
Policy on GHG emissions
ISO 14000 certification[42]
GHG emissions reduction targets
Board-level responsibility for environmental performance
Climate change risk assessment (impact of climate change on the reporting entity)
Offsets through the Clean Development Mechanism (CDM) and joint implementation (Kyoto Protocol)
Performance measurement
GHG emissions data
Country-specific GHG emission data
Reporting framework and assurance
Reference to the GRI
External assurance statement for environmental reporting
Reference to the Carbon Disclosure Project (CDP)
Reference to the GHG Protocol Corporate Standard[43]

2. Sample studied

The present study uses the 100 most international non-financial corporations in the world (as ranked by foreign assets) found in UNCTAD's *2008 World Investment Report*. The sample is composed of corporations from a range of home countries and sectors (see annexes V.I and V.II); however, more than half of the sample comes from just six sectors: motor vehicles (13 companies); petroleum (10); electrical and electronic equipment (9); telecommunications (8); pharmaceuticals (6); and electricity, gas and water (5). Due to the unequal sector weighting in the sample, this study did not test for sector effects on disclosure practices, but the possibility of such effects should be considered and possibly incorporated into future research on this subject. Twenty different countries are the home countries for the TNCs in the sample, however more than half of the sample comes from just three countries: France (16 companies); the United Kingdom (15); and the United States (21). Over 90 of the corporations have developed countries as home countries. Due to the unequal home country weighting in the sample, this study did not test for home country effects on disclosure practices, but the possibility of such effects should be considered and possibly incorporated into future research on this subject.

Selecting the world's largest transnationals as a sample for study allows for a better understanding of the way in which global issues (e.g. climate change) are

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[42] Refers to any of the standards within the ISO 14000 family of environmental management standards. The standards ISO 14001:2004 and ISO 14004:2004 deal with environmental management systems (EMS). ISO 14001:2004 provides the requirements for an EMS and ISO 14004:2004 gives general EMS guidelines. The other standards and guidelines in the family address specific environmental aspects, including labelling, performance evaluation, life cycle analysis, communication and auditing.

[43] The Greenhouse Gas Protocol Corporate Standard, produced by the World Resources Institute and the World Business Council for Sustainable Development, is an international accounting tool for companies and other organizations preparing a GHG emissions inventory. It covers the accounting and reporting of the six greenhouse gases covered by the Kyoto Protocol: carbon dioxide (CO_2); methane (CH_4); nitrous oxide (N_2O); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); and sulphur hexafluoride (SF_6). Additional information can be obtained from www.ghgprotocol.org.

addressed by global corporations. TNCs are also prime actors in the transmission of new business practices across borders. Examining the disclosure practices of TNCs, therefore, can provide not only a better understanding of what leading large companies are doing today, but also a suggestion of what may emerge in the near future as standard business practice around the world.

3. Research questions and sources of information

The primary research question applied to the sample enterprises was: How many of the selected climate change-related disclosures are reported by each enterprise? To answer this question, the study examined a range of publicly available corporate reports including annual reports, environmental reports and other information available from company websites.[44] These company reports were then compared with the 15 selected disclosure items to gauge what information on climate change-related issues enterprises were disclosing. Additional research questions applied to the sample include: the location of sustainability information in corporate reports; the level of GRI reporting used; and the use of GHG Protocol Scopes 1, 2 and 3.[45]

It should be noted that this study makes no indication of the quality of disclosure found among the enterprises. The study asks only whether or not some information is reported on each of the disclosure items listed below. Thus the study is limited to an examination of the existence of corporate reporting on certain topics, and not an examination of the quality of corporate reporting.

In total, the review considered more than 1,400 individual data points. This is comprised of the 14 disclosure items explained above, multiplied by the 100 TNCs that make up the sample studied. The main findings of this study are presented in section B. Section C presents a detailed analysis of reporting practices by subject area, along with additional data from secondary research questions.

B. Disclosure practices of the largest 100 TNCs: overview of findings

Table V.2 displays the results of the study, giving the number of enterprises disclosing each item from the sample of 100 TNCs. The information is presented within each of the four subject areas discussed in section A.1 above. This grouping of the disclosure items allows readers to draw their own conclusions based on the importance they assign to a particular category or subject area and, within that category, a particular disclosure item. Within each category, the disclosure items are presented in order from most often disclosed to least often disclosed. It is again noted that the findings below make no indication of the quality of disclosure found among the enterprises, only whether or not some disclosure exists for each of the disclosure items listed below.

A significant finding of this study is that 87 of the 100 enterprises provide at least some data on GHG emissions. More than two thirds of the enterprises reference the GRI sustainability reporting guidelines. Also more than two thirds of the TNCs indicate use of the ISO 14000 environmental management system for part or all of their operations. Sixty-three of the 100 TNCs are signatories of the United Nations Global Compact and more than two thirds of the companies have assigned responsibility for environmental performance at the level of their board of directors. Taken together, the

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[44] Corporate reporting on a consolidated basis for 2008 was used in this study; when information for 2008 was not yet available, 2007 reporting was examined.

[45] Please see section C.3 for an explanation of the GHG protocol and the concept of "scopes" along with definitions for Scopes 1, 2 and 3.

results indicate substantial adoption among TNCs of voluntary enterprise policies related to corporate social responsibility and climate change.

Table V.2. Information disclosed by world's largest 100 TNCs
(Number of enterprises disclosing this item)

Disclosure items by category	No. of enterprises (max. = 100)
International guidance frameworks	
Reference to United Nations Global Compact	63
Reference to OECD Guidelines for Multinational Enterprises	21
Policy, management and governance	
Policy on GHG emissions	75
ISO 14000 certification	73
GHG emissions reduction targets	69
Board-level responsibility for environmental performance	69
Climate change risk assessment (impact of climate change on the reporting entity)	40
Offsets through the CDM and joint implementation (Kyoto Protocol)	19
Performance measurement	
GHG emissions data	87
Country-specific GHG emission data	21
Reporting framework and assurance	
Reference to GRI	72
External assurance statement for environmental reporting	49
Reference to the CDP	28
Reference to the GHG Protocol	25

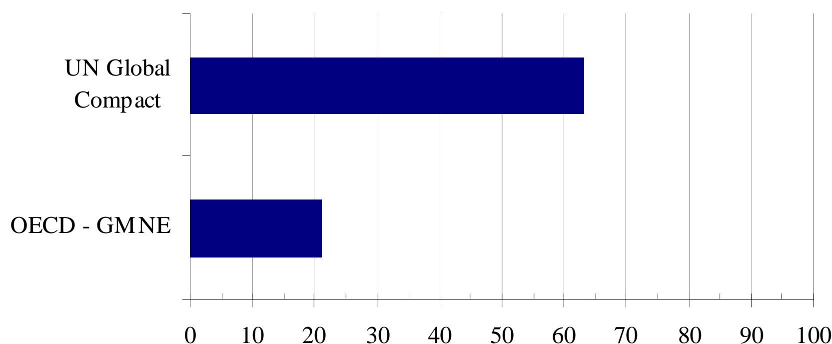
C. Disclosure practices by subject area

1. International guidance frameworks

There are two international guidance frameworks on corporate responsibility, including environmental responsibilities, that are often used by companies: the United Nations Global Compact and the Guidelines for Multinational Enterprises produced by the OECD (OECD-GMNE).

The United Nations Global Compact is a voluntary initiative for businesses and other organizations that are committed to aligning their operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption. By doing so, business can help ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere. Since its official launch on 26 July 2000, the initiative has grown to more than 6,700 participants, including over 5,200 businesses in 130 countries around the world. The findings show that the Global Compact is a widely adopted policy framework, with 63 of the 100 TNCs reporting that they are signatories to the compact. The study made no distinction between general references to the Global Compact and a Global Compact progress report (a concise yet standardized means of reporting progress on each of the Global Compact's 10 principles).

Figure V.1. Number of enterprises referencing international guidance on corporate responsibility

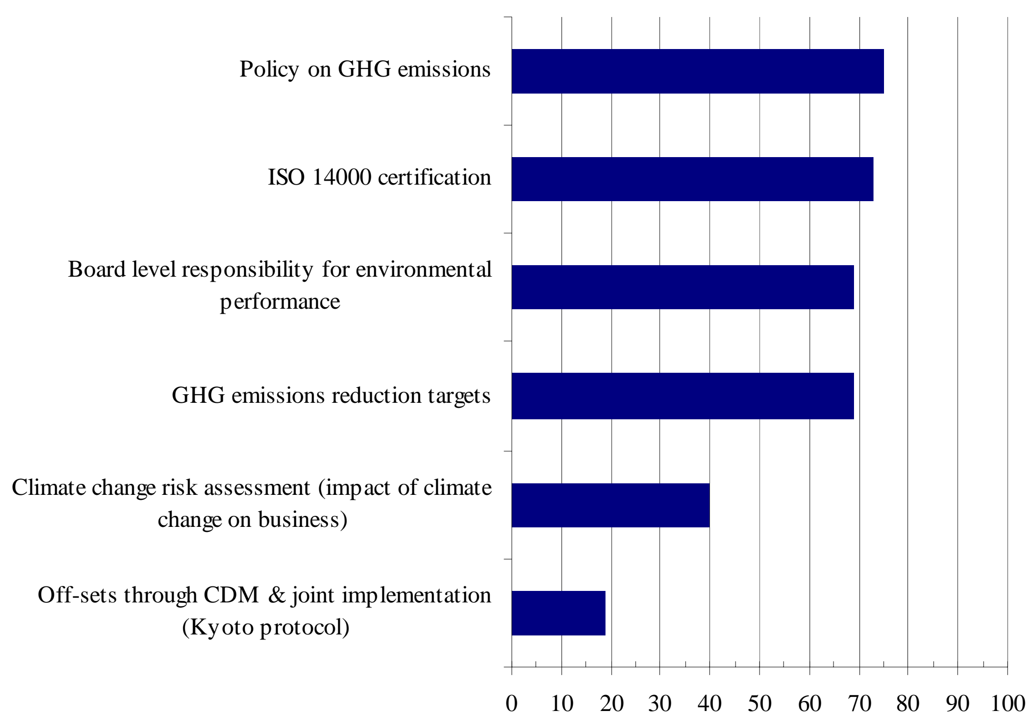


The OECD-GMNE are recommendations addressed by the OECD member States to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition and taxation. For the companies studied, reference to the OECD-GMNE is less widespread than the Global Compact.

2. Policy, management and governance

This subject area covers general policies on GHG emissions, disclosure on environmental management systems, tools or mechanisms (e.g. ISO 14000, risk assessments, reduction targets, offset mechanisms and joint implementation practices), and the disclosure of board responsibilities for environmental performance. The disclosure rates for each of the selected disclosure items in this category are depicted in figure V.2.

Figure V.2. Number of enterprises disclosing climate change-related information on policy, management and governance



One of the most common disclosure items in this category was a statement of policy on GHG emissions. Three quarters of the companies disclosed this information. Such disclosures vary from a general policy statement on the role of the organization with regard to climate change, to a more detailed policy statement that provides information on how the organization will move forward to reduce its carbon footprint. More detailed policy statements are often combined with long-term reduction targets. Such GHG emissions reduction targets are themselves the subject of disclosure for a significant majority of firms.

Also widely reported on among the TNCs studied was a reference to the use of the ISO 14000 environmental management system standard. Over 70 of the companies in the study indicated the use of ISO 14000 for all or part of their operations. While ISO 14000 does not indicate any absolute level of environmental performance, it does indicate a high quality management system that allows enterprises to identify the sources and quantity of emissions, and on the basis of this, take corrective action.

The disclosures on board-level responsibility for environmental performance and climate change issues vary from company to company. Information reported on this topic ranges from a general acknowledgement of responsibility by the board stated in the company's annual report, to the identification of a designated board member who is explicitly responsible for sustainability issues and the risks associated with climate change. In some cases, the disclosure identifies a special board committee that is responsible for environmental issues. As the board is the primary interface between investors and management, the disclosure of responsibility at the level of the board of directors provides important information for investors concerned with climate change issues. The fact that a clear majority of the enterprises in the study have board-level responsibility for environmental issues is an indication of the relevance of topics such as climate change for the long-term sustainability of the firm, as well as the materiality of such topics for a growing number of investors.

The reporting of a climate change risk assessment by companies is less widespread, but not uncommon (40 of the 100 TNCs). This disclosure item may become more widespread in the future as the large number of companies with policy statements on GHG emissions move to the additional step of preparing a risk assessment: all companies with a risk assessment also have a policy statement, but not all companies with a policy statement have a risk assessment, which suggests a certain logical sequence between the two items. New voluntary and legislated initiatives may also increase the number of enterprises for whom climate change is a material issue, and thus drive increased disclosure of associated risk assessments. Where companies do disclose a climate change risk assessment, the format of disclosure and the amount of information on this topic varies considerably between companies. Such inconsistencies stem in part from the degree of comprehensiveness of a company's risk assessment. Though this study does not test for industry-specific effects on this disclosure item, it seems likely that variations in risk assessments may also be related to the industry in which the company operates (which can have different levels of risk exposure to climate change issues). Inconsistencies may also reflect the absence of a commonly adopted and standardized climate change risk assessment tool. To illustrate current company practices, box V.1 contains a selection of excerpts from company reports on climate change risk assessment.

The offsets refer to the CDM and joint implementation, both arrangements under the Kyoto Protocol allowing industrialized countries with a GHG reduction commitment (known as "Annex B" countries) to invest in projects that reduce emissions in developing countries as an alternative to more expensive emission

reductions in their own countries. Companies do disclose qualitative information or business cases on offset projects; however, quantitative performance data is less common.

Box V.1. Climate change risk assessments in corporate reports (selected excerpts)

Climate change, climate change regulations and greenhouse effects may adversely impact Alcoa's operations and markets.

Alcoa (Extraordinary times, extraordinary measures – Taking decisive action through the downturn, 2008 Annual Report and Form 10-K, p. 32)

There is growing recognition that energy consumption is a contributor to global warming, greenhouse effects and potentially climate change. A number of governments or governmental bodies have introduced or are contemplating regulatory change in response to the potential impacts of climate change. There is also current and emerging regulation, such as the mandatory renewable energy target in Australia, or potential carbon trading regimes that will affect energy prices. Alcoa will likely see changes in the margins of greenhouse gas-intensive assets and energy-intensive assets as a result of regulatory impacts in the countries in which the company operates. These regulatory mechanisms may be either voluntary or legislated and may impact Alcoa's operations directly or indirectly through customers. Inconsistency of regulations may also change the attractiveness of the locations of some of the company's assets.

Climate change risk

Bhpbilliton (Resourcing the future – Sustainability report 2008, p. 95)

Our businesses assess the potential impacts of climate change through our enterprise-wide risk management process. The potential physical impacts of climate change on our operations are highly uncertain and will be particular to the geographic circumstances. These may include changes in rainfall patterns, water shortages, changing sea levels, changing storm patterns and intensities, and changing temperature levels. These effects may adversely impact the cost, production and financial performance of our operations.

Physical risks

Xstrata (Sustainability report 2008, p. 59)

It is anticipated that weather patterns will be affected by climate change, which may pose a risk to Xstrata operations. For example, a study completed in 2007 indicated that climate change could increase the frequency, length and severity of droughts, resulting in potential water shortages with a consequent impact on our operations in arid areas. … The transport networks we use will come under increasing pressure if extreme weather events become more common and sea levels rise.

Climate change risks and opportunities

Ford Motor Company (Blueprint for Sustainability – Sustainability Report 07–08, p. 11)

The past year has seen a seismic shift in the significance of the climate change issue in public awareness, political debate and government action, magnifying the risks and opportunities to Ford posed by the issue. These risks and opportunities include the following:

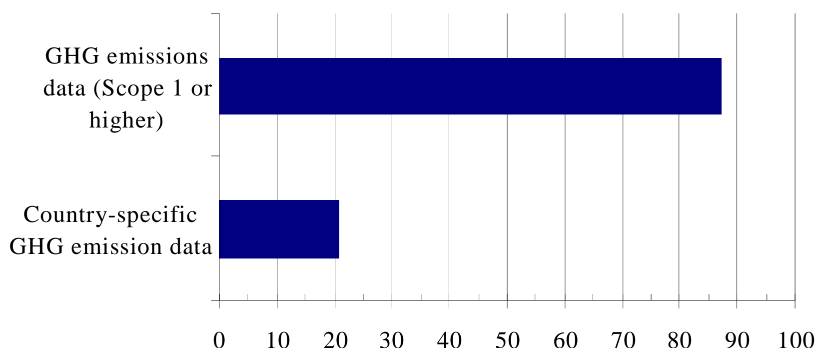
Markets: Worldwide, record oil prices continue to drive buyers to shift from larger vehicles and light trucks to smaller vehicles, cars, crossovers and diesel-powered vehicles. Energy security is also a major concern in several markets in which we operate. … These market shifts are very significant to our company. Everywhere we operate, the future financial health of our

company depends on our ability to predict market shifts of all kinds and to be ready with the products and services our customers demand.
Regulations: The regulation of GHG emissions affects many areas of our business, including our manufacturing facilities and the emissions from our vehicles. For example, in Europe, GHG emissions from manufacturing facilities are regulated through a combination of emission limits and market-based mechanisms. … We have established global roles, responsibilities, policies and procedures to help ensure compliance with emissions requirements and participate in trading initiatives worldwide. We are also participating in the development of policies affecting our facilities and products … .
Investment community: Both mainstream investment analysts and those who practice socially responsible investing are assessing companies in the auto sector for their exposure to climate risks and their positioning to take advantage of opportunities created by the issue. Thus, providing climate change-relevant information to investors and shaping our business strategy with climate change in mind are important elements of maintaining access to capital.
Physical risks: Extreme weather disrupts the production of natural gas, a fuel necessary for the manufacture of vehicles. Supply disruptions raise market rates and jeopardize the consistency of vehicle production. To minimize the risk of production interruptions, Ford has established firm delivery contracts with natural gas suppliers and installed propane tank farms at key manufacturing facilities as a source of backup fuel. Higher utility rates have prompted Ford to revisit and implement energy efficiency actions that previously did not meet our internal rate of return.

3. Performance measurement

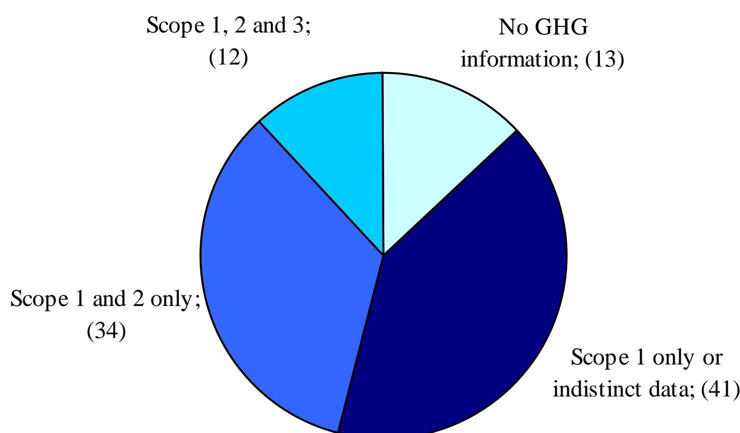
Performance in the reduction of absolute levels of GHG emissions is central to efforts to reduce climate change effects. Disclosure of absolute levels of emissions were found for a large majority of the companies in the sample (87). Less often disclosed was country-specific information on GHG emissions, for example a breakdown of a TNC’s global emissions by country of origin. About one fifth of the companies in the sample provided this information. Given the global nature of climate change, it is probably true that aggregate global figures are most relevant to most stakeholders. Because of the increasing number of national initiatives to curb GHG emissions, however, country-specific data can provide investors and other key stakeholders with useful insights into the future performance of certain business practices in certain jurisdictions. In a similar vein, country specific data can also assist regulators in better understanding the effects of national voluntary and legislated initiatives, and thus provide them with useful examples upon which to base future policy decisions.

Figure V.3. Number of enterprises disclosing performance data related to GHG emissions



The Greenhouse Gas Protocol, created by the World Resources Institute and the World Business Council for Sustainable Development, introduced the concept of "scope" for greenhouse gas information. Three scopes are defined for GHG accounting and reporting purposes to help delineate direct and indirect emission sources, improve transparency and provide utility for different types of organizations and different types of climate policies and business goals. Scope 1 emissions are direct GHG emissions that occur from sources that are owned or controlled by the company. An example of Scope 1 emissions would be gases emitted directly from factory processes. Scope 2 emissions are indirect GHG emissions from the generation of electricity produced by an independent entity and consumed by the company. Scope 3 emissions are other (not electricity-related) indirect emissions that are a consequence of the activities of the reporting company, but occur from sources not owned or controlled by the company. Examples of Scope 3 items would include emissions from suppliers to the reporting entity, specifically related to work done for the reporting entity. Figure V.4 shows the level of detail of GHG emissions data, broken down into the three scopes.

Figure V.4. Use of GHG Protocol scopes in emissions reporting
(Number of enterprises)



As noted in figure V.4, 87 of the 100 TNCs in the study reported at least some information on GHG emissions. This finding alone suggests that GHG disclosure among large TNCs is a mainstream practice. Questions remain, however, about the quality and comprehensiveness of the reporting. Nearly half of the 87 companies

reporting GHG emissions data did so at Scope 1, or with indistinct data. Indistinct data are measurement figures on GHG emissions without a clear distinction as to the source of the emissions. This study grouped all indistinct reporting with Scope 1 information on company direct emissions only. To clearly distinguish between different scopes, company reports must include information on such things as whether electricity generation or other sources of fuel are included, whether all business units are included and how the emissions are calculated. Often missing, this information is crucial to providing investors, policymakers and other stakeholders with a complete understanding of the nature of a company's emissions and the potential impact of GHG reduction mechanisms on a company's operations.

A third of the companies in the study also reported on Scope 2 emissions, which are the emissions derived from purchased electricity. This demonstrates an important awareness among the companies about the environmental impact of electricity suppliers. It further underscores what has become a key tenet in corporate responsibility, that companies must consider the social and environmental impacts of their suppliers (in this case, electricity suppliers). This is particularly important in a world where there are various technologies for electricity generation, each of which has different levels of GHG emissions. In the future, all else being equal, companies may prioritize investment in locations that have not only affordable energy supplies, but also cleaner energy supplies.

Finally it should be noted that a small number of companies in the study (12) reported on all three scopes' outline in the GHG Protocol. Scope 3 reporting in particular demonstrates not only a highly sophisticated reporting system, but a very in-depth knowledge of company operations. While all TNCs require good skills in value chain management, the Scope 3 level of reporting arguably reflects those companies that have a greater than average knowledge of their value chain. This knowledge, and the information conveyed in Scope 3 reports, can help companies to properly evaluate risks to the entire value chain that might stem from changing GHG emissions regimes. In a world where TNCs are typically highly dependant upon vast value chains, such information becomes crucially important to effective risk management and evaluation of the sustainability of the enterprise.

4. Reporting framework and assurance

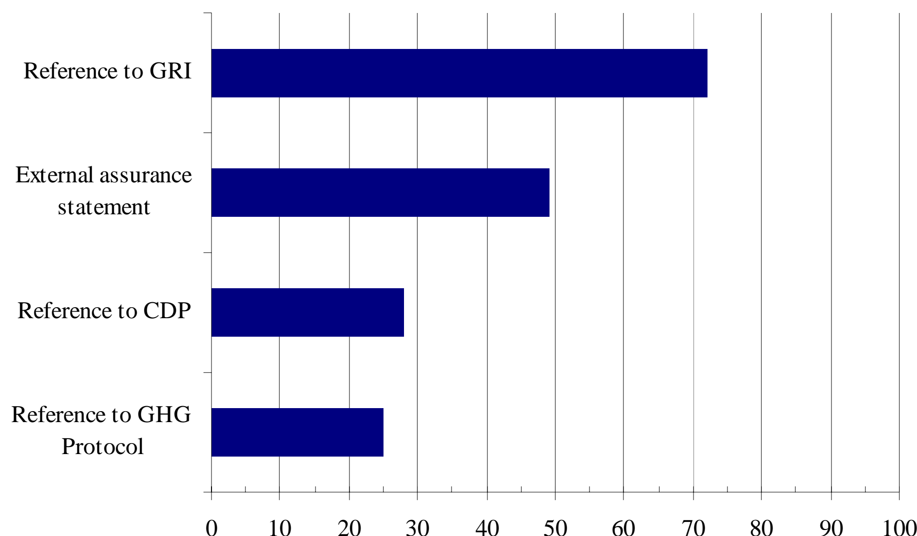
Producing high quality, consistent and comparable reports requires a standardized reporting framework. Providing additional assurance to a report can enhance its credibility. A number of reporting frameworks and assurance standards exist in the area of CSR and environmental reporting. This study looks at one general CSR reporting framework (GRI) that also includes environmental (and specifically climate change) issues. Also examined in this study are the use of two other reporting frameworks, both of which focus more specifically on GHG emissions and climate change.

The first climate change-specific framework examined is the Carbon Disclosure Project (CDP), which conducts annual questionnaires of companies on carbon emissions and is also the secretariat for the Carbon Disclosure Standards Board, a multi-stakeholder group that seeks to harmonize existing practices in GHG emissions disclosure. The CDP is an independent not-for-profit organization that holds the largest database of corporate climate change information in the world. The data is obtained from responses to CDP's annual information requests asking companies for information on their GHG emissions. The information requests are issued on behalf of institutional investors, purchasing organizations and government bodies. More than

1,550 responding companies participated in the sixth year of this data request (or CDP6) in 2008. These companies vary in size and include constituents of the Global 500, FTSE 350 and S&P 500 indices.

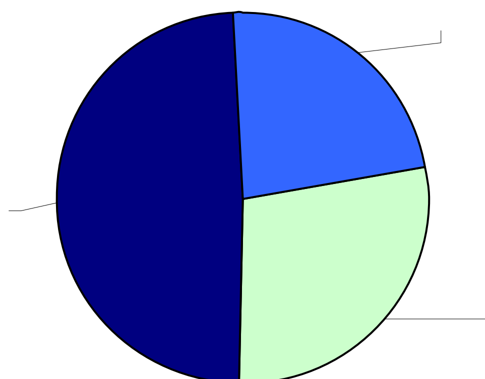
The second climate change-specific framework examined is the GHG Protocol, already explained above. Finally, the reports of the 100 TNCs were examined to determine if they contained assurance statements related to their environmental reporting.

Figure V.5. Number of enterprises referencing reporting frameworks and including assurance statements



Of the 100 TNCs in the study, 72 referenced GRI sustainability reporting guidelines. This finding reinforces the generally held view that the GRI reporting framework is the single most commonly used sustainability reporting framework among large enterprises. It is noted, however, that not all enterprises reference the GRI in the same way. As depicted in figure V.6, nearly half the enterprises use a GRI index or make a reference to the GRI guidelines in their reports. In some cases, the GRI indicators are referenced as the basis for a company's own modified set of indicators, or a company selects and reports on a subset of GRI indicators. Almost a quarter of the companies, however, have taken the additional step of declaring themselves to have an application level of "A+" (the most comprehensive level of reporting in GRI's three-level scale that runs from C to A, with an added "+" at any level indicating external assurance). Keeping in mind that the current version of the GRI guidelines was launched in 2006, that GRI application levels were only introduced in 2006 and that this study focuses primarily on 2008 reports, it is significant to see that nearly a quarter of the companies in this study have so rapidly adopted this reporting framework and its process for self-declaring an application level. This suggests a strong demand from large global enterprises for a commonly recognized standard in sustainability reporting.

Figure V.6. Details of reference to GRI guidance
(Number of enterprises)



A quarter of the enterprises in the study made reference to the GHG Protocol, with slightly more making reference to the CDP. Although only 25 of the TNCs referred explicitly to the GHG Protocol, it was noted in section 3 that a significant proportion of companies are categorizing their GHG emissions data according to the three scopes recommended by the GHG Protocol. While this may be a case of the GHG Protocol simply reflecting existing best practice, it may also be the case that reporting frameworks like the GHG Protocol can influence company reports, even if report preparers do not reference the reporting framework.

Companies sometimes choose to add credibility to their reported information by asking for assurance on this information. There are various assurance standards in use, including the two most frequently used: AA1000AS produced by AccountAbility and the International Standard on Assurance Engagements (ISAE3000) produced by the International Accounting and Auditing Standards Board. This study did not test for the exact assurance standard used, only whether or not an assurance statement of any kind accompanied the company's sustainability reporting. Some level of assurance was provided for nearly half of the reports in this study.

II. Conclusions

This study focused on the climate change reporting practices of the world's 100 largest TNCs. The study makes no judgment on the quality of reporting, rather it simply determines whether or not information is reported for selected topics. The results of the study show that a number of voluntary enterprise responses to environmental issues and climate change specifically have become common place. Of the 15 disclosure items tested in this paper, seven of the items were reported on by more than half of the companies. Key examples include: policies on GHG emissions, which are in place in three quarters of the companies studied; environmental management systems and governance mechanisms, which are in place in well over half the companies; and reporting on GHG emissions, at least at a basic level, which was found among the reports of most of the companies in the study.

Taken together, these disclosure practices reveal a rough image of current best practice among large global enterprises when it comes to addressing climate change issues: companies create a policy, adopt appropriate management systems and governance mechanisms, and report on their progress. Such activities provide all the essential elements of a typical "plan-do-check-act" loop (also known as the "Deming cycle") that characterizes most modern management systems. This suggests that TNCs are applying their existing management practices to newer areas such as controlling GHG emissions.

However, this study noted in a number of places inconsistencies in reporting practices between enterprises and different degrees of comprehensiveness in reporting. In the absence of fully developed management tools for some tasks, inconsistencies are likely to continue. The disclosure of GHG emissions, for example, would benefit from a harmonized approach to the way companies explain, calculate and define emissions. Wider adoption of one of the existing generally accepted frameworks for emissions reporting might improve the transparency of calculations and the comparability between companies.

While questions about the quality and consistency of reporting remain, this study finds that most of the world's largest TNCs have already begun to adopt a range of voluntary practices to address issues of climate change and make related information available in their public reports. Future work in this area could usefully be focused on continuing to measure the use and usefulness of existing tools, and where possible, strengthening their quality.

Annex V.I. List of enterprises included in the study

	Corporation	Home economy	Industry
1.	AES Corporation	United States	Electricity, gas and water
2.	Alcoa	United States	Metal and metal products
3.	Altria Group Inc	United States	Tobacco
4.	Anglo American	United Kingdom	Mining and quarrying
5.	Anheuser Busch Inbev[46]	Netherlands	Consumer goods/brewers
6.	Arcelor Mittal[47]	Netherlands	Metal and metal products
7.	BAE Systems Plc	United Kingdom	Transport equipment
8.	Barrick Gold Corp.	Canada	Gold mining
9.	BASF AG	Germany	Chemicals
10.	Bayer AG	Germany	Pharmaceuticals/chemicals
11.	Bertelsmann	Germany	Retail
12.	BHP Billiton Group	Australia	Mining and quarrying
13.	BMW AG	Germany	Motor vehicles
14.	British American Tobacco Plc	United Kingdom	Tobacco
15.	British Petroleum Company Plc	United Kingdom	Petroleum expl./ref./distr.
16.	Carrefour SA	France	Retail
17.	Cemex S.A.	Mexico	Non-metallic mineral products
18.	Chevron Corporation	United States	Petroleum expl./ref./distr.
19.	Christian Dior SA	France	Textiles
20.	Coca-Cola Company	United States	Beverages
21.	Compagnie De Saint-Gobain SA	France	Non-metallic mineral products
22.	ConocoPhillips	United States	Petroleum expl./ref./distr.
23.	CRH Plc	Ireland	Lumber and other building materials dealers
24.	Daimler AG[48]	Germany	Motor vehicles
25.	Deutsche Post World Net[49]	Germany	Transport and storage
26.	Deutsche Telekom AG	Germany	Telecommunications
27.	Diageo Plc	United Kingdom	Beverages
28.	Dow Chemical Company	United States	Chemicals
29.	E.On	Germany	Electricity, gas and water
30.	Eads	Netherlands	Aircraft and parts
31.	Electricité de France	France	Electricity, gas and water
32.	Endesa	Spain	Electric utilities
33.	Eni Group	Italy	Petroleum expl./ref./distr.
34.	Exxonmobil Corporation	United States	Petroleum expl./ref./distr.
35.	Fiat Spa	Italy	Motor vehicles
36.	Ford Motor Company	United States	Motor vehicles
37.	France Télécom	France	Telecommunications
38.	GDF Suez[50]	France	Electricity, gas and water
39.	General Electric	United States	Electrical and electronic equipment
40.	General Motors	United States	Motor vehicles
41.	Glaxosmithkline Plc	United Kingdom	Pharmaceuticals
42.	Hewlett-Packard	United States	Electrical and electronic equipment

[46] Formerly "Inbev SA" in the *2008 World Investment Report*.
[47] Formerly "Mittal Steel Company NV" in the *2008 World Investment Report*.
[48] Formerly "DaimlerChrysler" in the *2008 World Investment Report*.
[49] Formerly "Deutsche Post AG" in the *2008 World Investment Report*.
[50] Formerly "Suez" in the *2008 World Investment Report*.

	Corporation	Home economy	Industry
43.	Hitachi Ltd	Japan	Electrical and electronic equipment
44.	Holcim AG	Switzerland	Non-metallic mineral products
45.	Honda Motor Co Ltd	Japan	Motor vehicles
46.	Hutchison Whampoa Limited	Hong Kong, China	Diversified
47.	Hyundai Motor Company	Republic of Korea	Motor vehicles
48.	IBM	United States	Electrical and electronic equipment
49.	Johnson & Johnson	United States	Pharmaceuticals
50.	Lafarge SA	France	Non-metallic mineral products
51.	L'Air Liquide Groupe	France	Chemicals
52.	Liberty Global Inc	United States	Telecommunications
53.	Linde AG	Germany	Industrial trucks, tractors, trailers and stackers
54.	Marubeni Corporation	Japan	Wholesale trade
55.	McDonald's Corporation	United States	Food and beverages
56.	Metro AG	Germany	Retail
57.	Mitsubishi Motors Corporation	Japan	Motor vehicles
58.	Mitsui & Co Ltd	Japan	Wholesale trade
59.	National Grid Transco	United Kingdom	Energy
60.	Nestlé SA	Switzerland	Food and beverages
61.	Nissan Motor Co Ltd	Japan	Motor vehicles
62.	Nokia	Finland	Telecommunications
63.	Novartis	Switzerland	Pharmaceuticals
64.	Panasonic[51]	Japan	Electrical and electronic equipment
65.	Pernod Ricard SA	France	Beverages
66.	Petronas - Petroliam Nasional Bhd	Malaysia	Petroleum expl./ref./distr.
67.	Pfizer Inc	United States	Pharmaceuticals
68.	Philips Electronics	Netherlands	Electrical and electronic equipment
69.	Pinault-Printemps Redoute SA	France	Wholesale trade
70.	Procter & Gamble	United States	Diversified
71.	Renault SA	France	Motor vehicles
72.	Repsol YPF SA	Spain	Petroleum expl./ref./distr.
73.	Rio Tinto Alcan[52]	Australia, Canada	Metal and metal products
74.	Roche Group	Switzerland	Pharmaceuticals
75.	Royal Dutch/Shell Group	United Kingdom, Netherlands	Petroleum expl./ref./distr.
76.	RWE Group	Germany	Electricity, gas and water
77.	SAB Miller	United Kingdom	Consumer goods/brewers
78.	Samsung Electronics Co., Ltd.	Republic of Korea	Electrical and electronic equipment
79.	Sanofi-aventis	France	Pharmaceuticals
80.	Schlumberger Ltd	United States	Other services
81.	Siemens AG	Germany	Electrical and electronic equipment
82.	Singtel Ltd.	Singapore	Telecommunications
83.	Sony Corporation	Japan	Electrical and electronic equipment
84.	StatoilHydro[53]	Norway	Petroleum expl./ref./distr.

[51] Formerly "Matsushita Electric Industrial Co., Ltd" in the *2008 World Investment Report*.
[52] Formerly "Alcan" in the *2008 World Investment Report*.
[53] Formerly "Statoil Asa" in the *2008 World Investment Report*.

	Corporation	Home economy	Industry
85.	Telefonica SA	Spain	Telecommunications
86.	TeliaSonera AB	Sweden	Telecommunications
87.	Thomson Reuters[54]	Canada	Media
88.	Thyssenkrupp AG	Germany	Metal and metal products
89.	Total	France	Petroleum expl./ref./distr.
90.	Toyota Motor Corporation	Japan	Motor vehicles
91.	Unilever	United Kingdom, Netherlands	Diversified
92.	United Technologies Corporation	United States	Transport equipment
93.	Veolia Environnement SA	France	Water supply
94.	Vivendi Universal	France	Diversified
95.	Vodafone Group Plc	United Kingdom	Telecommunications
96.	Volkswagen Group	Germany	Motor vehicles
97.	Volvo AB	Sweden	Motor vehicles
98.	Wal-Mart Stores	United States	Retail
99.	WPP Group Plc	United Kingdom	Business services
100.	Xstrata PLC	United Kingdom	Mining and quarrying

[54] Formerly “Thompson Corporation” in the *2008 World Investment Report*.

Annex V.II. Breakdown of industrial sectors, by frequency

Sector	Number of enterprises
Motor vehicles	13
Petroleum expl./ref./distr.	10
Electrical and electronic equipment	9
Telecommunications	8
Pharmaceuticals	6
Electricity, gas and water	5
Diversified	4
Metal and metal products	4
Non-metallic mineral products	4
Retail	4
Beverages	3
Chemicals	3
Mining and quarrying	3
Wholesale trade	3
Consumer goods/brewers	2
Food and beverages	2
Tobacco	2
Transport equipment	2
Aircraft and parts	1
Business services	1
Electric utilities	1
Energy	1
Gold mining	1
Industrial trucks, tractors, trailers and stackers	1
Lumber and other building materials dealers	1
Media	1
Other services	1
Pharmaceuticals/chemicals	1
Textiles	1
Transport and storage	1
Water supply	1

Chapter VI

2009 Review of the Reporting Status of Corporate Responsibility Indicators: Case Study of Brazil

I. Introduction

Corporate responsibility reporting has been a focus of work for ISAR for a number of years. Since the twentieth session of ISAR, the group of experts has recognized the demand among preparers and users of corporate reports for improved comparability and relevance in corporate responsibility reporting. At its twenty-fourth session, the group agreed on a voluntary technical guidance on corporate responsibility reporting within corporate annual reports (TD/B/COM.2/ISAR/42). This was published by UNCTAD in 2008 as the *Guidance on Corporate Responsibility Indicators in Annual Reports*.

At its twenty-fourth session, the group of experts suggested that case studies on corporate responsibility reporting be conducted to provide practical feedback on the status of corporate responsibility reporting around the world. This case study presents the reporting practices of 39 large Brazilian enterprises. The data and analysis presented in this study were prepared in cooperation with Universidade de Fortaleza and Universidade Federal do Ceará, both of Brazil.[55]

Socio-economic and environmental information disclosed by enterprises may be qualitative and or quantitative and typically covers subjects related to key stakeholders, including business partners, employees, the environment and society at large. Disclosure is usually done through social reports or sustainability reports, but may also be done through annual reports.

With the increasing recognition of the usefulness of corporate social responsibility information, social reports and sustainability reports and annual reports containing CSR indicators are becoming more common around the world in both developed and developing countries. Most Brazilian companies use the reporting framework developed by the Institute of Social and Economic Analysis (IBASE). In other countries, a variety of models is available, but the most popular is the framework developed by the Global Reporting Initiative (GRI). UNCTAD's own guidance in this area is based in part on GRI indicators, but is differentiated by a much smaller set of 16 core indicators and the use of an exclusively quantitative reporting methodology to improve comparability and benchmarking.

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[55] This report was prepared by the UNCTAD secretariat on the basis of a draft developed by Marcelle Colares Oliveira (Universidade de Fortaleza and Universidade Federal do Ceará), Marcia Martins Mendes De Luca (Universidade Federal do Ceará), Vera Maria Rodrigues Ponte (Universidade Federal do Ceará) and João Ésio Pontes Júnior (Universidade de Fortaleza). Funding for this study was provided by Banco do Nordeste do Brazil.

The objective of this study is to analyse the disclosure of social information by selected Brazilian companies using as a benchmark the 16 indicators recommended in the *UNCTAD Guidance on Corporate Responsibility Indicators*. The results are compared to UNCTAD's *2008 Review of the Reporting Status of Corporate Responsibility Indicators*.[56] That study examined the corporate responsibility reporting practices of 100 enterprises from 10 emerging markets.

By identifying how Brazilian companies are responding to stakeholders' social information needs through annual reports and other forms of communication, the present study seeks to contribute to the understanding of rapidly evolving CSR reporting practices around the world.

I. Overview of corporate responsibility reporting in Brazil

In 1978, the Foundation Institute of Social and Business Development, proposed a social reporting model for Brazil. Since 1976, the foundation has carried out CSR studies in partnership with the Brazilian Christian Company Directors Association (ADCE).[57] In 1984 Nitrofértil, a state-owned company in Bahia, voluntarily submitted what is considered the country's first social report. In subsequent years other large companies, such as Telebrás and Banespa, chose to increase transparency by submitting similar reports (IBASE, 2008).

In the 1990s, the publication of social and environmental reports became a more common practice among Brazilian companies. A campaign encouraging the submission of such reports was launched by IBASE in 1997 with the support of domestic and foreign companies, and the Brazilian Securities and Exchange Commission (CVM) and Gazeta Mercantil, an influential Brazilian newspaper specialized in economics (Bonatto *et al.*, 2007; IBASE, 2008).

Another institution directly involved in the disclosure of social information by Brazilian companies is the Ethos Institute for Business and Social Responsibility founded by Oded Grajew in 1998. Two years after its foundation, the Ethos Institute published a guide for CSR reporting based on frameworks adopted in Brazil and abroad. Until 2006 the structure and contents of this guide were based on GRI and ISEA social reporting frameworks, the Ethos Institute's own CSR indicators and the model proposed by IBASE. However, in 2007 the Ethos Institute adopted the GRI "G3" guidelines – the third generation of GRI's social reporting guidelines that were launched in 2006 (Instituto Ethos, 2007).

A value added statement (VAS) can be useful for showing the additional value created throughout the production process and services provided, and the distribution of the value added to the various stakeholders.[58] In 1992, through Advisory Statement #24/92, the CVM proposed the submission of a VAS and later, in 2000, through CVM/SNC/SEP Memorandum #01/00, companies were encouraged to submit a VAS using a model developed by the Financial, Accounting and Actuarial Research Institute Foundation (FIPECAFI) of the São Paulo University (USP). In 2005, Resolution #1.010

[56] TD/B/C.II/ISAR/CRP.2.

[57] Associacao de Dirigentes Cristaos de Empresas do Brasil (ADCE-Brazil), a branch of the International Christian Union of Business Executives.

[58] Value added refers to the additional value created throughout the production process and services provided, and the contribution of the factors of production, i.e. land, labour and capital, to raising the value of a product. It is the value which an enterprise adds to the goods and services it buys in. The added value is the result of the combined efforts of everyone participating in the activities of the enterprise, i.e. employees, providers of capital and public authorities. The added value in enterprises is measured by the difference between the revenue from the goods and services produced and the costs of goods and services bought in.

of the Federal Accounting Council instituted VAS disclosure under Brazilian Accounting Technical Norm #3.7. In 2007, Law #11.638 (which introduced changes in the accounting sections of the Brazilian Corporate Law) obliged companies listed on the stock exchange to disclose VAS. In 2008, the Accounting Pronouncements Committee (CPC) of the Federal Accounting Council published Technical Statement #9 regarding VAS, later sanctioned by CVM Resolution #557 on 12 November the same year.

IBASE's 1997 social reporting framework has been revised three times but is still contained on a single page, preserving two of its main characteristics: comparability and simplicity. The framework presently features 51 indicators, of which only eight are qualitative. These indicators cover two years of company exercise and are disposed in seven categories: basic financial data, internal social indicators, external social indicators, environmental indicators, workforce indicators, information on the exercise of corporate citizenship and other relevant information (IBASE, 2008).

The basic financial indicators are net revenues, operational outcome and gross salaries. The internal social indicators include both mandatory and voluntary investments to the benefit of workers, such as food, labour taxes, social security, health care, education, culture, professional training/development, child day-care services and participation in profits. External social indicators cover investments benefiting society, such as schooling, culture, health and sanitation, sports, food security and child day-care services (IBASE, 2008).

The environmental indicators reflect investments in technological innovation or environmental awareness programmes implemented by the company to compensate for potentially negative environmental impacts or to help preserve the environment in general. They also make it possible to report investments in environmental actions or programmes not directly related to the company's area of activity and to observe the company's goals related to eco-efficiency (IBASE, 2008).

The workforce indicators show how companies deal with issues like employment creation and outsourcing, as well as ratios describing the relative number of female, Afro-Brazilian or handicapped professionals in management positions. Information concerning the exercise of corporate citizenship encompasses company actions directed toward specific target groups, especially internal stakeholders. Other relevant information may include statements of non-use of child or forced labour or show how CSR practices are implemented by businesses (Instituto Ethos, 2007).

In 2000, BOVESPA[59] launched the "New Market" listing segment for companies that voluntarily agreed to comply with higher standards of corporate governance and disclosure than normally required by law. The listing rules of the New Market segment have strengthened not only corporate governance disclosure in Brazil, but also corporate responsibility reporting.[60] In 2005, BOVESPA launched the Corporate Sustainability Index (ISE), which recognizes Brazilian companies with good practices in the area of corporate responsibility and sustainable business practices. The ISE utilizes a number of measures in its compilation, including the corporate responsibility reporting of Brazilian enterprises. The effect of the ISE has been to encourage broader uptake of corporate responsibility reporting in Brazil.

[59] Brazil's main stock exchange. Following a merger in 2008 it is now formally known as BM&F BOVESPA.

[60] See for example UNCTAD's 2009 inventory of disclosure requirements (TD/B/C.II/ISAR/CRP.8), where it is observed that companies listed on the Novo Mercado in Brazil are required to report on their policy and performance in connection with environmental and social responsibility.

II. Corporate responsibility reporting in Brazil

A. Background and methodology

1. Corporate responsibility indicators

The purpose of this study is to analyse the status of corporate responsibility reporting among Brazilian companies using as a benchmark the 16 corporate responsibility indicators identified in the 2008 UNCTAD publication *Guidance on Corporate Responsibility Indicators in Annual Reports*.[61] The 16 indicators found in that publication are grouped into six subject areas, as seen in table VI.1.

Table VI.1. ISAR indicators on corporate responsibility

Group	Indicator
Trade, investment and linkages	1. Total revenues 2. Value of imports vs. exports 3. Total new investments 4. Local purchasing
Employment creation and labour practices	5. Total workforce with breakdown by employment type, employment contract and gender 6. Employee wages and benefits with breakdown by employment type and gender 7. Total number and rate of employee turnover broken down by gender 8. Percentage of employees covered by collective agreements
Technology and human resource development	9. Expenditure on research and development 10. Average hours of training per year per employee broken down by employee category 11. Expenditure on employee training per year per employee broken down by employee category
Health and safety	12. Cost of employee health and safety 13. Work days lost due to occupational accidents, injuries and illness
Government and community contributions	14. Payments to government 15. Voluntary contributions to civil society
Corruption	16. Number of convictions for violations of corruption related laws or regulations and amount of fines paid/payable

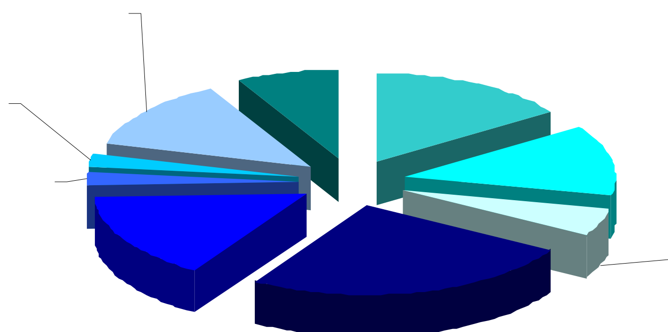
2. Sample selection

The actual reporting practices of 39 leading enterprises in Brazil were tested against the 16 indicators identified in the *UNCTAD Guidance on Corporate Responsibility Indicators*. The sample used in this study is comprised of Brazilian companies in the New Market listing segment of the BOVESPA stock market until April 2008. The Brazilian companies of the New Market are subject to higher corporate governance and reporting standards. The 39 companies included in this case study represent various sectors of activity. Sector classification followed the model proposed by the CVM comprising 25 sectors, five of which were not represented in the New Market listing segment of the BM&F BOVESPA at the time the study was initiated. Of the remaining 20 sectors, nine are represented in this case study. These new sectors were chosen randomly from the 20 that have companies listed in the New Market and all companies from these nine sectors were researched. These 39 companies comprise

[61] This UNCTAD publication is based on the ISAR document TD/B/COM.2/ISAR/41.

all the companies in the randomly selected nine sectors that belong to the New Market (figure VI.1).

Figure VI.1.Distribution of the 39 enterprises by sector[62]
(Number of companies)



3. Sources of information and research method

The documents reviewed were annual social and sustainability reports and investor-related information posted on company websites (such as the standard annual financial information supplied on BOVESPA's home page). All documents were for the year 2007. These corporate reports were checked to determine the prevalence of the 16 indicators recommended in the *UNCTAD Guidance on Corporate Responsibility Indicators*. The main findings of this research are presented in section B.

In the analysis presented in section C, the reporting of the corporate responsibility indicators was classified as either "full" or "partial". This classification reflects the different ways in which enterprises report on the same matters, with some enterprises reporting more completely on each indicator, and others providing some but not all of the information recommended in the *UNCTAD Guidance on Corporate Responsibility Indicators*. For example, when considering the indicator "employee wages and benefits", an enterprise that reports on the total amount of employee wages, but not on the value of benefits, would be considered to have had partial disclosure.[63]

B. Reporting practices of 39 Brazilian enterprises

Among the 39 companies included in the study, 20 used no specific social reporting framework, while 19 used one or more frameworks. Of these, three companies used three frameworks (IBASE framework, VAS and G3), eight companies used two frameworks (IBASE+VAS=6; G3+VAS=2) and eight used a single framework (IBASE=2; VAS=6). In other words, VAS was used by 17 companies, BS-IBASE was used by 11 and G3 was used by five. The 20 companies that did not use any of the frameworks described in the study disclosed social information through administrative

[62] Sector classification follows the model proposed by the CVM, which defines 25 distinct sectors.
[63] For details of full disclosure for each of the 16 indicators, please see the UNCTAD publication *Guidance on Corporate Responsibility Indicators in Annual Reports.*

reports, notes to the annual statements, institutional websites and specific BOVESPA documents. Such documents were also used for complementary disclosure by the 19 companies using standard reporting frameworks.

1. Overview of main findings

The main findings on the prevalence of the selected indicators are displayed in table VI.2, which provides an overview of the number of enterprises that disclose quantitative information on each of the 16 ISAR indicators on corporate responsibility.

Table VI.2. Reporting of ISAR corporate responsibility indicators among 39 Brazilian enterprises
(Number of enterprises reporting each indicator, both full and partial disclosure)

Corporate responsibility indicators by category	No. of enterprises (max. = 39)
Trade, investment and linkages	
Total revenues	39
Value of imports vs. exports	16
Total new investments	39
Local purchasing	2
Employment creation and labour practices	
Total workforce with breakdown by employment type, employment contract and gender	32
Employee wages and benefits with breakdown by employment type and gender	25
Total number and rate of employee turnover broken down by gender	14
Percentage of employees covered by collective agreements	5
Technology and human resource development	
Expenditure on research and development	19
Average hours of training per year per employee broken down by employee category	13
Expenditure on employee training per year per employee broken down by employee category	17
Health and safety	
Cost of employee health and safety	14
Work days lost due to occupational accidents, injuries and illness	6
Government and community contributions	
Payments to government	39
Voluntary contributions to civil society	30
Corruption	
Number of convictions for violations of corruption-related laws or regulations and amount of fines paid/payable	2

The main findings show that the five most frequently disclosed indicators by the companies included in this study were, in decreasing order: (1) total revenues; (2) total new investments; (3) payments to government; (4) total workforce with breakdown by employment type, employment contract and gender; and (5) voluntary contributions to civil society. With the exception of voluntary contributions, the same indicators were found to be the most frequently reported in UNCTAD's *2008 Corporate Responsibility Review*, which examined the disclosure practices of 100 enterprises from 10 emerging markets.

The five least frequently disclosed indicators by the companies included in this study were, in decreasing order: (1) average hours of training per year per employee broken down by employee category; (2) work days lost due to occupational accidents, injuries and illness; (3) percentage of employees covered by collective agreements; (4) local purchasing; and (5) number of convictions for violations of corruption-related laws or regulations and amount of fines paid/payable. The first two of these are not among the five least frequently disclosed indicators in UNCTAD'S *2008 Corporate Responsibility Review*.

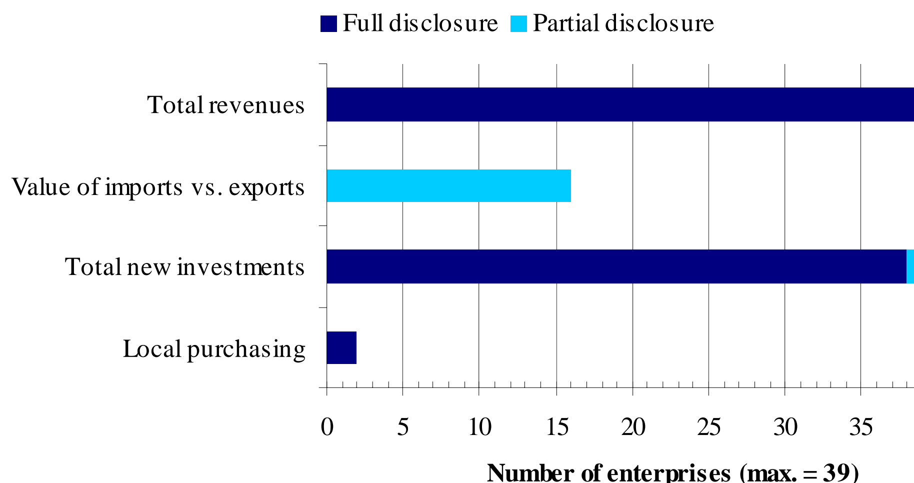
About half of the companies in the study (20 of the 39) reported information on eight or more of the 16 indicators recommended in the *UNCTAD Guidance on Corporate Responsibility Indicators*. A significant proportion of the reporting contained partial disclosures, suggesting that the *UNCTAD Guidance on Corporate Responsibility Indicators* provides for further details of reporting than many companies are currently using. The findings of the study are explored in more detail in section C.

C. Reporting practices by subject area

1. Trade, investment and linkages

Figure VI.2 shows the number of enterprises disclosing the four indicators of the category "trade, investment and linkages".

Figure VI.2. Number of enterprises reporting on trade, investment and linkages indicators
(Number of enterprises reporting each indicator)



In this category, total revenues were disclosed by all of the enterprises in the study. This is likely a result of Brazilian accounting requirements that enterprises report their revenues in their annual financial reports. The least disclosed indicator in this category was "local purchasing", probably because it is not a requirement in financial reports or complementary documents submitted to BOVESPA or the CVM. The only two enterprises disclosing local purchasing were transnational corporations in the energy industry; one is controlled by a French-Belgian group, the other is Portuguese and one of the largest European companies in the sector.

In addition to total revenues, 17 companies disclosed value added and its distribution to employees, investors, shareholders, the government, etc. The relatively high number (just under half) of companies in this sample disclosing information on value added suggests that this indicator is not uncommon among company reports and

should be considered for inclusion in future guidance on corporate responsibility reporting.

In spite of the importance of the "value of imports vs. exports" as an indicator of a company's contribution to the balance of payments of the country, only 16 companies disclosed this information, at least in part. Three companies disclosed the value of their imports and 13 companies disclosed the value of their exports. No company disclosed both. The remaining 23 companies provided no information related to this indicator.

New investments can have a positive economic and social impact and lead to the development of productive capacity and the reduction of poverty while improving the image of the company. This fact may explain the finding that all 39 of the companies in the study disclosed some information on this subject, with 38 companies disclosing information on their investments with the level of detail recommended by the *UNCTAD Guidance on Corporate Responsibility Indicators*.

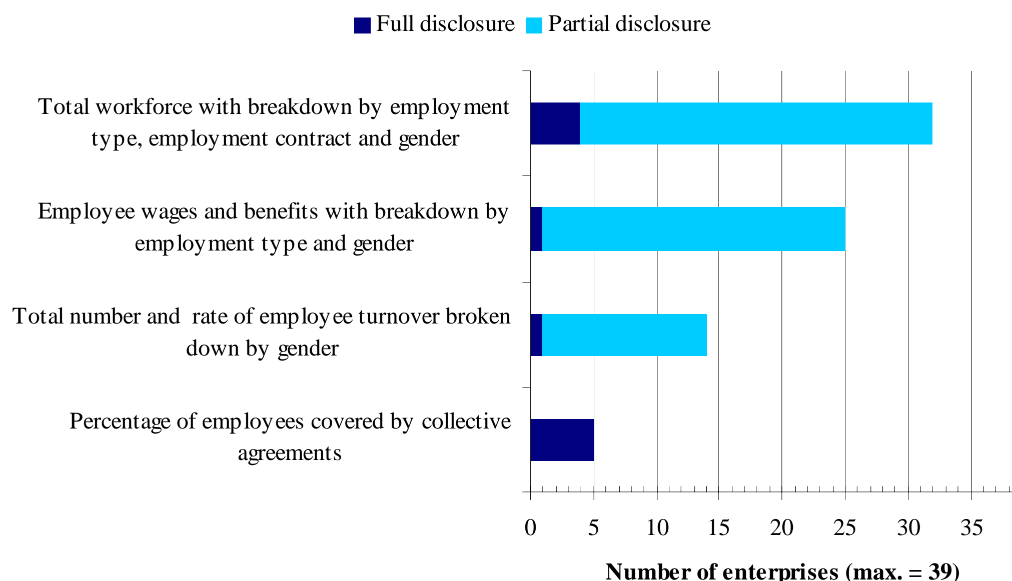
As for the two most commonly disclosed indicators, total revenues are generally reported in compliance with the law, while new investments are disclosed in view of their positive impact on the company image. The two least frequently disclosed indicators (value of imports vs. exports and local purchasing) are rarely disclosed because they are not required by law. This may explain why value added statements, which like total revenues are expected to soon be an item of mandatory disclosure in Brazil, are disclosed by almost half the companies included in the study.

The findings for disclosure of trade, investment and linkages are consistent with the findings of UNCTAD's *2008 Corporate Responsibility Review*, which examined the disclosure practices of 100 large enterprises in ten emerging markets. In that study, 100 per cent of the companies disclosed total revenues, 92 per cent disclosed new investments and 25 per cent declared the value of imports vs. exports, while only 10 per cent reported local purchasing. In addition, many companies provided only partial disclosures for the last three of these indicators. Although the findings of that study and this review of Brazilian companies are similar, it should be observed that a smaller proportion of the Brazilian enterprises studied reported value of imports vs. exports and local purchasing.

2. Employment creation and labour practices

Figure VI.3 shows the number of enterprises disclosing the four indicators of the category "employment creation and labour practices".

Figure VI.3. Number of enterprises reporting on employment creation and labour practices indicators



One of the most significant positive economic and social contributions of an enterprise is the creation of jobs. As shown in figure VI.3, the majority of the enterprises in the study (32 of 39) reported numbers of employees. Among these, four broke down information by employment type, employment contract and gender, while the remaining 28 companies provided at least partial information on this subject.

Twenty-four companies disclosed information on employee wages and benefits, but only one provided a breakdown by employment type and gender.

The employee turnover rate reflects, inter alia, job security, employment practices and skills retention in a company. However, only 14 of the 39 companies studied disclosed any information related to this indicator. This is not unlike the findings of UNCTAD's *2008 Corporate Responsibility Review* in which 15 of 100 enterprises reported turnover rates, only nine of which with details on gender and reason for turnover.

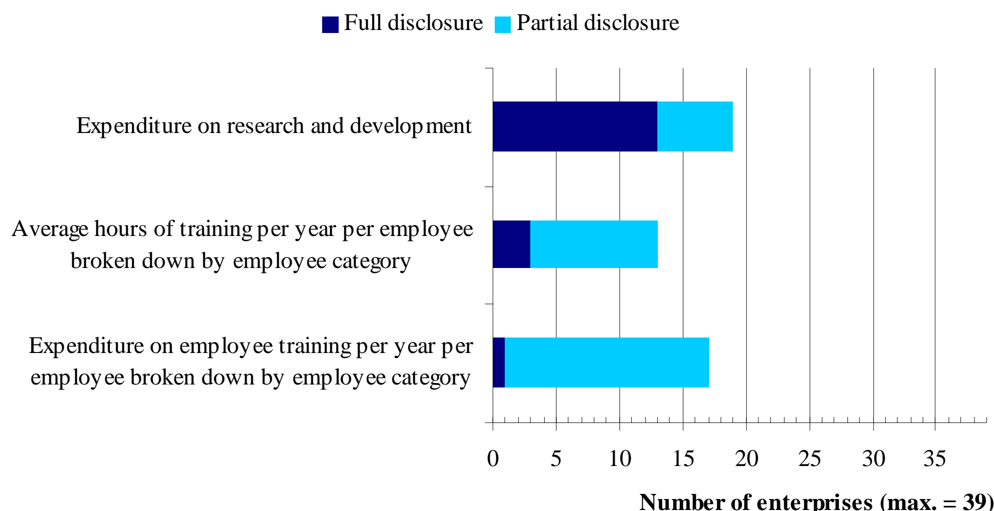
The percentage of employees covered by collective agreements indicates the workers' ability to bargain individually or collectively with their employer and the ensuing positive social impact of the business. Among the Brazilian companies studied, only a small number of companies (five) reported this information.

The indicators "total workforce" and "employee salaries and benefits" were some of the most frequently reported by the companies in the study. The relatively high disclosure rates for these indicators likely reflects the relation of this subject area to requirements found in financial reporting rules. On the other hand, the indicators least related to conventional financial reporting are subject to the lowest disclosure rates.

3. Technology and human resource development

Figure VI.4 shows the number of enterprises disclosing the three indicators of the category "technology and human resource development". The indicator "expenditure on research and development" was reported by 19 of the 39 companies studied, 13 of which with all the details recommended by UNCTAD. This finding is in line with UNCTAD's *2008 Corporate Responsibility Review* in which approximately half the enterprises (49 per cent) disclosed such expenditures.

Figure VI.4. Number of enterprises reporting on technology and human resource development indicators

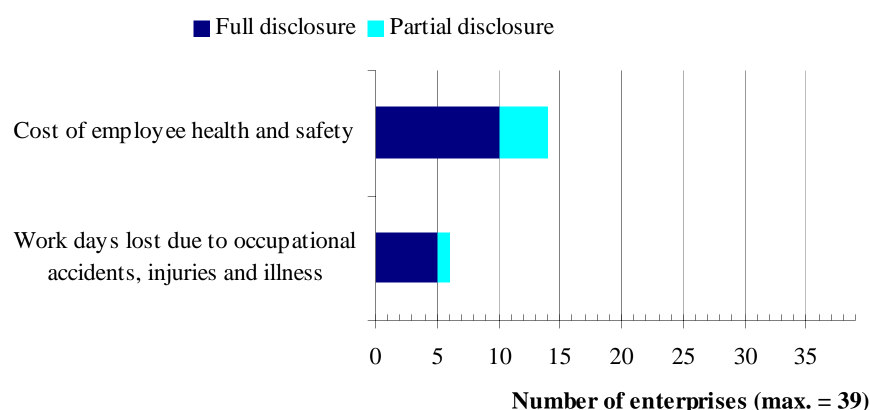


The *UNCTAD Guidance on Corporate Responsibility Indicators* contains two indicators of human resource development: "average hours of training per year per employee" and "expenditure on employee training per year per employee". Thirteen enterprises in the study reported the former and 17 disclosed the latter. Of this total, only three and one, respectively, included all the details recommended by ISAR in the *UNCTAD Guidance on Corporate Responsibility Indicators*.

4. Health and safety

As shown in figure VI.5, less than half of the companies in the study provided information on "cost of employee health and safety". Only six of the 39 companies examined provided information on "work days lost due to occupational accidents, injuries and illness".

Figure VI.5. Number of enterprises reporting on health and safety indicators



5. Government and community contributions

Payments to government were reported by all 39 companies, while voluntary contributions to civil society were reported by 30. Compared to UNCTAD's *2008 Corporate Responsibility Review*, a greater proportion of the companies in this study disclosed these two indicators (39/39 companies vs. 88/100 and 30/39 companies vs. 60/100, respectively). In Brazil, the first of these indicators is mandatory in conventional financial reports.

6. Corruption

The least reported indicator was the one in the category of "corruption". A single company reported details of legal infractions plus fines paid. One other company provided less detailed non-quantitative information on this subject. Low reporting of this item was also observed in UNCTAD's *2008 Corporate Responsibility Review,* which found only eight of 100 emerging market enterprises reporting information on corruption.

III. Conclusions and policy options

This report is a case study of corporate responsibility reporting in Brazil and uses as a benchmark the indicators identified in the *UNCTAD Guidance on Corporate Responsibility Indicators*. The study has focused on the disclosure practices of 39 Brazilian enterprises taken from Brazil's New Market listing segment of the BOVESPA Stock Exchange.

The companies in this case study were found to disclose most of the indicators recommended by ISAR in the *UNCTAD Guidance on Corporate Responsibility Indicators.* The findings of this study suggest that the most frequently disclosed corporate responsibility indicators are those most closely related to the reporting requirements of conventional financial reports, or in the most commonly used guidance for the preparation of social reports (e.g. the VAS, GRI "G3" and the Brazilian IBASE framework).

While corporate responsibility reporting remains a relatively novel concept in many countries, the findings of this study suggest that it has become a somewhat common practice among leading large enterprises in Brazil. This situation can be credited, at least in part, to the more thorough reporting requirements of the New Market listing segment of the BOVESPA Stock Exchange. The depth of corporate responsibility reporting, however, can vary. As this report finds, some corporate responsibility indicators are widely reported while others are the subject of much less frequent disclosure. It has also been noted that many indicators of corporate responsibility are not the subject of the kind of full and detailed disclosure recommended by ISAR. Thus room for the harmonization of reporting practices exists.

Policymakers may wish to consider additional steps to advance the voluntary reporting by enterprises of corporate responsibility information. Additional steps might seek to standardize such information around a single set of high quality indicators, such as the core set of quantitative indicators recommended by ISAR, or the broader set of both quantitative and descriptive indicators found in the guidelines of the Global Reporting Initiative. Policy options already practiced in some countries include:

(a) Recognition by a securities exchange regulator or stock exchange of a single recommended standard for voluntary reporting of corporate responsibility information;

(b) Adoption by a securities exchange regulator or stock exchange of a "report or explain" approach whereby listed enterprises could voluntarily report corporate responsibility information to the recommended standard, or explain why they do not;

(c) Adoption by a stock exchange of a separate listing segment that has higher standards of environmental, social and governance disclosure; enterprises could voluntarily choose to list on this segment;

(d) Promotion of investable stock indices compiled on the basis of corporate responsibility reporting (in addition to traditional financial reporting) that recognize companies with best practices in the area of corporate responsibility.

Annex VI.I. List of Brazilian enterprises in the study

Açucar Guarani
American Banknote
B2W
Banco do Brasil
Banco Nossas Caixa
BR Malls
Brasil Ecodiesel
Brasilagro
Cia Providência
Cosan
CPFL Energia
CSU Cardsystem
Drogasil
EDP - Energia do Brasil
Embraer
Equatorial Energia
General Shopping
Heringer
Iguatemi
JBS
LIGHT
Localiza
Lojas Renner
Lupatech
M.Dias Branco
Marfrig
Metalfrios
Minerva
MPX Energia
Natura Cosméticos
Perdigão
Redecard
Renar Maçãs
Romi
São Martinho
SLC Agrícula
Tractebel Energia
WEG
Marisa

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IBASE (2008). Balanço social, dez anos: o desafio da transparência. Rio de Janeiro. Available at: http://www.ibase.br/modules.php?name=Conteudo&pid=2414. Acessed on 18 September 2009.

Instituto Ethos (2007). Guia para elaboração de balanço social e relatório de sustentabilidade. São Paulo. Available at: http://www.ethos.org.br/_Uniethos/Documents/GuiaBalanco2007_PORTUGUES.pdf. Acessed on 18 September 2009.

Chapter VII

Practical Implementation Issues of IFRSs in Nigeria: Fair Value Measurement as a Challenging Matter[64]

I. Introduction

The Nigerian Accounting Standards Board (NASB) was following its own approach to accounting standards setting. It adhered to an extensive due process in the development of its standards. This process was considered essential for ensuring that all parties were given ample opportunity to express their views and to ensure that the standards, practices and guidelines so developed, were relevant, consistent and logically derived. The NASB had always been directed by the Governing Council drawn from organizations having an operational interest in financial reporting. The constituents that made up the board were expected to use their best endeavour to persuade their members and the organizations they deal with to comply with all relevant accounting standards. They were also permitted to administer their own punitive measures on entities that failed to comply with the standards.

II. Practical IFRS implementation challenges for Nigeria

The adoption and implementation of IFRSs in a country takes place in an environment that is affected by factors that are specific to that country. Such factors include the economy, politics, laws and regulations, and culture. Many countries have been adopting and implementing IFRSs as issued by the IASB. However, a number of countries have also been implementing IFRSs by adapting them to fit their specific national environment. Developing countries, such as Nigeria, face a number of practical challenges in implementing IFRSs pertaining to the establishment and strengthening of key institutions, creating a coherent legal framework, enforcing standards, and building the necessary technical capacity needed for implementing the standards.

Section 335-1 of the Companies and Allied Matters Act of Nigeria that was issued in 1990 required that all financial statements issued in Nigeria comply with accounting standards laid down in the Statements of Accounting Standards issued by the NASB. Other regulators and institutions such as the Central Bank of Nigeria, the Securities and Exchange Commission, the Nigerian Stock Exchange, the Nigeria Deposit Insurance Corporation and the Institute of Chartered Accountants of Nigeria supported the requirement for complying with accounting standards issued by the NASB. This approach initially yielded good results.

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[64] This article was contributed by Jim Osayande Obazee, Technical Director at the Nigerian Accounting Standards Board, Nigeria. Views expressed in this article are those of the author and do not necessarily represent the views of UNCTAD-ISAR.

The collective efforts of the relevant institutions ensured that all of the persons who belong to the accounting profession or have operational interest in financial reporting shared the common concern that financial statements should ideally meet an acceptable level of quality and comparability. However, the respective laws that established the relevant institutions discussed above required them to exercise authority over varying aspects of monitoring of compliance with Statements of Accounting Standards, without clearly vesting the power on any one entity. This fragmentation made the situation very confusing. It is not surprising that in the midst of the confusion, compliance monitoring was not satisfactorily done and worse still, none of these organizations was clearly assigned accountability for damages that could occur due to lack of compliance with applicable accounting standards. Thus, many significant accounting and reporting inadequacies and departures from norms passed unnoticed.

In the midst of these developments, it became clear that the Nigerian Government needed to engage in wide-ranging reviews that recognize the importance of reassuring the markets and the public at large that corporate reporting and governance frameworks in Nigeria are sufficiently robust. In the recent past, the Nigerian Government introduced major reforms aimed at promoting confidence in corporate reporting and governance. The pursuit of these reform mandates gave rise to such government measures as the establishment of the Fiscal Responsibility Bill, the implementation of the New Oil and Gas Unit, parastatals support unit, the setting up of Economic and Financial Crimes Commission, the Independent and Corrupt Practices Commission and the Nigeria Extractive Industries Transparency Initiative. It also attracted development partner coordination flag bearers, such as the World Bank Group and the United Kingdom's Department for International Development (DFID). The promulgation of the NASB Act 2003 and the setting up therein of the NASB Inspectorate Unit came as a better version of an evolutionary approach by government to strengthen compliance with accounting standards and enhance reliance.

A major omission however was that company law in Nigeria was not reviewed in the light of these developments. Company law in Nigeria is predicated on the assumption that Nigeria is a "standards setter", creating its own financial reporting standards, rather than a "standards taker", – accepting standards created elsewhere. However, in light of the recent widespread implementation of IFRSs around the word, it is debatable whether this is an appropriate model in the short run or in the long run

The practical challenges discussed above need to be addressed in order to benefit fully from the introduction of IFRSs. A committee of relevant regulatory agencies and stakeholders is being constituted in Nigeria to develop a road map for the adoption of IFRSs and to address the specific challenges that Nigeria is facing. The road map will emphasize issues pertaining to preparers, users, auditors, regulators and other stakeholders. One of the practical implementation issues that Nigeria is currently facing is in relation to fair value measurement requirements in IFRSs. This shall be discussed in section III.

III. Practical implementation of fair value accounting in Nigeria

A number of countries including Nigeria have been implementing fair value measurement requirements for a long time. In the United States of America, fair value measurements have been part of the Generally Accepted Accounting Principles (GAAP)

for more than 50 years. GAAP's first appearance in Nigeria was in Statement of Accounting Standard No. 3 (Accounting for Property, Plant and Equipment) issued in 1984. Accounting standards that require or permit fair value accounting have increased considerably in number and significance in recent years. In September 2006, the Financial Accounting Standards Board (FASB) issued an important and controversial new standard, Statement of Financial Accounting Standards No. 157, Fair Value Measurements, which provides significantly more comprehensive guidance to assist companies in estimating fair values. They have since followed this with (FSP) FAS 157-e and 157-4 (Determining Fair Value when the Volume and Level of Activity for the Assets or Liability have Significantly Decreased and Identifying Transactions that are not Orderly). In May 2009, the IASB also published an Exposure Draft on the subject of fair value measurement. The application is also requested by many International Accounting Standards especially IFRS 1, IFRS 2, IFRS 3, IFRS 7, IAS 18, IAS 19, IAS 32, IAS 37, IAS 39, IAS 40 and IAS 41.

What is fair value accounting?

IFRS defines fair value as "The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction." IAS 39 AG 69 stresses that "Fair value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale." There is a rebuttable presumption that the fair value of all financial instruments can be reliably obtained.

FAS 157 defines fair value as "The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

FAS 157 clarifies that the fair value estimate is intended to convey to investors the value of an asset or liability at the measurement date (a current value), not the potential value of the asset or liability at some future date (for example, the amount a reporting entity expects to realize on settlement or maturity).

For an asset, the fair value estimate is determined by reference to the price that would be received in an orderly transaction for the asset at the measurement date (an exchange price notion), not, as some have asserted, the price that would be received in a fire sale or forced liquidation transaction for the asset at the measurement date. An orderly transaction is one that involves market participants that are willing to transact and allows for adequate exposure to the market before the measurement date. In contrast, a fire sale or forced liquidation transaction is one that involves market participants that are compelled to transact (under duress) and allows for little (or no) exposure to the market before the measurement date.

The goal of fair value measurement is for firms to estimate as best as possible the prices at which the positions they currently hold would change hands in orderly transactions based on current information and conditions. To meet this goal, firms must fully incorporate current information about future cash flows and current risk-adjusted discount rates into their fair value measurements. When market prices for the same or similar positions are available, FAS 157 generally requires firms to use these prices in estimating fair values. The rationale for this requirement is that market prices are capable of reflecting all publicly available information about future cash flows, including investors' private information that is revealed through their trading, as well as current risk-adjusted discount rates.

When fair values are estimated using unadjusted or adjusted market prices, they are referred to as "mark-to-market" values. If market prices for the same or similar positions are not available, then firms must estimate fair values using valuation models. FAS 157 generally requires these models to be applied using observable market inputs (such as interest rates and yield curves that are observable at commonly quoted intervals) when they are available, and unobservable firm-supplied inputs (such as expected cash flows developed using the firm's own data) otherwise. When fair values are estimated using valuation models, they are referred to as "mark-to-model" values.

Under fair value accounting, firms report the fair values of the positions they currently hold on their balance sheets. When fair value accounting is applied fully, firms also report the periodic changes in the fair value of the positions they currently hold, referred to as unrealized gains and losses, on their income statements. Unrealized gains and losses result from the arrival of new information about future cash flows and from changes in risk-adjusted discount rates during periods. Current international conclusion requires fair value accounting to be applied in an incomplete fashion for some positions, with unrealized gains and losses being recorded in accumulated other comprehensive income, a component of owners' equity, not in net income.

The main issue with fair value accounting is whether firms can and do estimate fair values accurately and without discretion. When identical positions trade in liquid markets that provide unadjusted mark-to-market values, fair value generally is the most accurate and least discretionary possible measurement attribute, although even liquid markets get values wrong on occasion. Fair values typically are less accurate and more discretionary when they are either adjusted mark-to-market values or mark-to-model values. In adjusting mark-to-market values, firms may have to make adjustments for market illiquidity or for the dissimilarity of the position being fair valued from the position for which the market price is observed. These adjustments can be large and judgmental in some circumstances. In estimating mark-to-model values, firms typically have choices about which valuation models to use and about which inputs to use in applying the chosen models. All valuation models are limited, and different models capture the value-relevant aspects of positions differently. Firms often must apply valuation models using inputs derived from historical data that predict future cash flows or correspond to risk-adjusted discount rates imperfectly. The periods firms choose to analyze historical data to determine these inputs can have very significant effects on their mark-to-model values.

In principle, fair value accounting should be the best possible measurement attribute for inducing firms' managements to make voluntary disclosures and for making investors aware of the critical questions to ask managements. When firms report unrealized gains and losses, their managements are motivated to explain in the Management Discussion and Analysis section of financial reports and elsewhere what went right or wrong during the period and the nature of any fair value measurement issues. If a firm's management does not adequately explain their unrealized gains and losses, then investors at least are aware that value-relevant events occurred during the period and can prod management to explain further.

The applicability of these standards are been tested by extreme market conditions evident in the ongoing global financial crisis. In recent times, some parties (generally financial institutions) have criticized fair value accounting, including FAS 157's measurement guidance. Those criticisms have included:

(a) Reported losses are misleading because they are temporary and will reverse as markets return to normal;

(b) Fair values are difficult to estimate and thus are unreliable;
(c) Reported losses have adversely affected market prices yielding further losses and increasing the overall risk of the financial system;
(d) Marking-to-market is not feasible because of lack of observable data; prices can also be artificially depressed, sales distressed and there is the possibility of buy-to-hold.

While some of the criticisms have some validity, others seem misplaced or overstated in important respects.

The critical question is whether fair value accounting provides more useful economic information, compared to alternative accounting approaches, to permit informed judgment and decision-making by users of the information. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. The argument over recent years is that fair value accounting is the best way to meet this objective.

Under the IFRS framework, what makes financial information useful is understandability, reliability, comparability and relevance. More importance has been given to relevance in recent years. Fair value accounting is deemed to make financial information relevant.

This is why proponents of fair value accounting argue that it benefits investors because:

(a) It is grounded in economic reality;
(b) It facilitates informed investment decisions capable of strengthening capital markets;
(c) It improves transparency and contributes to investors' understanding of risk;
(d) It requires or permits companies to report amounts that are more accurate, timely and comparable than the amounts that would be reported under existing alternative accounting approaches, even during extreme market conditions;
(e) It requires or permits companies to report amounts that are updated on a regular and ongoing basis;
(f) It limits companies' ability to manipulate their net income because gains and losses on assets and liabilities are reported in the period they occur, not when they are realized as the result of a transaction;
(g) Gains and losses resulting from changes in fair value estimates indicate economic events that companies and investors may find worthy of additional disclosures.

Where is fair value currently used in financial reporting?

Fair value is required principally for financial assets. Whether and when fair value is required depends on the types of financial assets that are the subject of the accounting and, to varying degrees, the reporting entity's intent with respect to those assets. Further, when fair value is required, it is not always required on an ongoing basis (so called mark-to-market accounting). For example:

Fair value is used on an ongoing basis principally for derivatives (with certain exceptions for hedges), trading securities and available-for-sale securities. Of those items, changes in fair value go through earnings only for the derivatives and trading securities. Changes in the fair value of available-for-sale securities are reported in other comprehensive income.

Fair value also is used to recognize impairments, that is, declines in the value of financial assets in down markets. Available-for-sale securities and held-to-maturity debt securities are written down to fair value through earnings if impairment is other than temporary, and mortgage loans held for sale are reported at the lower of cost or fair value on an ongoing basis (a continuous impairment notion). Again, this is by no means new. The requirement to recognize impairments has been in place for many years and spans several periods in which there were down markets. While loans held for investment are subject to impairment, they are not necessarily written down to fair value. Instead, they are written down to other amounts (in many cases, the present value of expected future cash flows discounted at the loan's original effective interest rate).

With the issuance of FAS 159, a reporting entity can (with certain exceptions) elect to use fair value on an ongoing basis for financial assets and liabilities that are not reported at fair value (similar to the fair value option in IAS). In that case, changes in fair value go through earnings. Thus, the fair value election applies only at inception and is irrevocable.

Approaches to developing fair value estimates

FAS 157 establish a hierarchy of inputs into fair value measurements, from most to least reliable. Level 1 inputs are unadjusted quoted market prices in active markets for identical items. With a few narrow exceptions, FAS 157 explicitly requires firms to measure fair values using Level 1 inputs whenever they are available.

Level 2 inputs are other directly or indirectly observable market data. There are two broad subclasses of these inputs. The first and generally preferable subclass is quoted market prices in active markets for similar items or in inactive markets for identical items. These inputs yield adjusted mark-to-market measurements that are less than ideal but usually still reliable, depending on the nature and magnitude of the required valuation adjustments. The second subclass is other observable market inputs such as yield curves, exchange rates and empirical correlations. These inputs yield mark-to-model measurements that are disciplined by market information, but that can only be as reliable as the models and inputs employed.

Level 3 inputs are unobservable, firm-supplied estimates, such as forecasts of home price depreciation and the resulting credit loss severity on mortgage-related positions. These inputs should reflect the assumptions that market participants would use, but they yield mark-to-model valuations that are largely undisciplined by market information. Due to the declining price transparency during the financial crisis, many subprime positions that firms previously fair valued using Level 2 inputs inevitably had to be fair valued using Level 3 inputs.

While Level 2 inputs generally are preferred to Level 3 inputs, FAS 157 does not necessarily require firms to use Level 2 inputs over Level 3 inputs. Firms are to apply "the assumptions that market participants would use in pricing the asset or liability". When markets are illiquid, firms can make the argument that available Level 2 inputs are of such low quality that market participants would use Level 3 inputs instead.

If a fair value measurement includes even one significant Level 3 input, then it is viewed as a Level 3 measurement. FAS 157 sensibly requires considerably expanded disclosures for Level 3 fair value measurements.

Characteristics of the Nigerian business environment

Capital is essential for the conduct of business, absorption of risks and financing of investment in systems and training. Nigerian businesses, with few exceptions, tend to have comparatively low statutory paid up capital and solvency requirements compared with their peers internationally. The possible consequences of accumulating liabilities without adequate capital are better imagined.

Nigerian societies tend to be close-knit, with businesses structured on family ties. This is natural: in an environment where law does not yet fully replace personal trust, greater value is placed on family trust. The various businesses in conglomerates do business with each other that are not at arm's length. The disadvantage here is that the business of conglomerates is geared to serving the conglomerate, not its customers. The challenge here is how to understand the nature of the relationships and cross-exposures of conglomerates and their family ties.

Large long-established domestic companies offering traditional products dominate the Nigerian business environment. What is a concern is that these companies may have become set in their ways, with inefficient management and distribution structures and unwillingness to innovate. Some of these dinosaur companies are listed in the stock exchange with information asymmetry issues.

Characteristics of the Nigerian capital market

Undercapitalization

The Nigerian Capital Market is the long-term end for the financial market. It is made up of market and institutions that facilitate the issuance and secondary trading of long-term financial instruments. There are two markets within the Nigerian Capital Market, which can be broadly classified into the primary market (this is a market where new securities are issued. The mode of offer for the securities traded in this market includes offer for subscription, right issues, offer for sale, private placement) and the secondary market (this is the market for trading in existing securities. This consists of exchange and over-the-counter markets where securities are bought and sold after their issuance in the primary market).

The major instruments used to raise funds at the Nigerian Capital Market include equities (ordinary shares and preference shares), government bonds (federal, states and local governments) and industrial loans/debenture stocks and corporate bonds.

Major participants in the Nigerian Capital Market include: the Securities and Exchange Commission (which is responsible for the overall regulation of the entire market); the Nigerian Stock Exchange (a self-regulating organization in the market that supervises the operations of the formal exchange market); market operators, consisting of the issuing houses (merchant banks and stockbroking firms, stockbrokers, trustees, registrars, etc.); investors – banks, insurance companies, pension fund, unit trusts and individuals; specialized developmental institutions such as the Bank of Industry; and

regulators such as the Central Bank of Nigeria, Federal Ministry of Finance and the Nigerian Accounting Standards Board.

The listed securities are few compared to the developed markets, low volumes relative to market capitalization, no market makers, prices sensitive to very small trades and large blocs held by small number of shareholders because of the tycoon syndrome.

Weak regulatory environment

Despite weaknesses in the legal system in many countries, an active supervisory agency can make use of the available legal tools or seek a focused change, but this is only possible if adequate technical capacities exist at supervisory and industry levels. For specialized industries, regulators need to understand the concepts and the business risks if such industries are to be effectively supervised. Capacity-building is still required in fields such as law, actuarial science, financial accounting and valuation standards. Regulators in Nigeria have yet to fully recognize and understand the complexity of corporate transactions and capital and financial instruments, which may be used by shareholders to isolate themselves from commercial consequences of the company's operations.

Weak corporate governance

The OECD defines corporate governance as:

> the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

CEO and board selection and composition, executive compensation and risk management in Nigeria do not focus on long-term value creation, and shareholder activism is among the many corporate governance issues confronting the market.

Market response at variance with standard financial theory

Limited trading capacity and irrational investor behaviour (as market forces do not punish companies for poor disclosure; for example, when Cadbury Nigeria announced that their financial statements was falsified, their share price increased) mean there is really no self-enforcement of accounting standards by companies during the preparation of financial statements and current prices do not reflect all information in past price history.

Where trading volume is low and capital markets are not sufficiently liquid, obtaining reliable fair value for IFRS measurement purposes becomes difficult. Preparers face difficulty in obtaining reliable measures of and data for, among others: discount rates (in a volatile financial environment), cash flow trends, crop yields, loan yields, loan default rates and sector-wide benchmarks for determining fair value for some items.

There are however some positive developments:

(a) National accounting standards currently permit or require some categories of investments to be measured at "market value" or "net realizable value", which in real terms is very close to fair value accounting;

(b) There has been increased level of activity, market information awareness and sophistication on the Nigerian Stock Exchange recently;

(c) Pricing sources available for valuation purposes such as transactional prices, exchange prices, tradable bid/offer quotes, broker quotes, consensus prices, evaluated or model-based prices and counterparty marks are being explored.

Key accounting standards impacted by fair value that requires a response from the Nigerian community

- **IFRS 2 Share-based Payment** (Valuation of stock options)

Stock options must be valued when granted using market-based valuation methods. The most common option pricing methods are Black Scholes (Merton) and Binomial Trees (and lattice models), and no arbitrage/risk neutral is to be assumed. In the case of a small developing market like Nigeria, the possibility of estimating the related fair value reliably is an issue. The qualified professionals who can value stock options in Nigeria are few.

- **IAS 19 Employee Benefits** (Discount rates and fair value of plan assets)

Discount rates: Market yields at balance sheet date on high quality corporate bonds with same currency and term as the benefit obligations. If there is no deep market for high quality corporate bonds, use market yields (at the end of the reporting period) on government bonds with same currency and term as the benefit obligations.

In Nigeria, pension liabilities are usually very long (20–30 years or more), there is a limited active secondary market in government bonds, there is subjectivity in yield curve determination and few qualified practicing actuaries.

- **IAS 39 Financial Instruments: Recognition and Measurement**

This standard requires the initial recognition of all financial instruments and subsequent measurement of some financial instruments.

In order to fair value financial instruments, firms are to note that:

- Published price quotation in an active market is best indicator of fair value of a financial instrument, which must be used if available;
- An active market is one in which quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis;
- Quoted market prices may not be indicative of the fair value of a financial instrument if the activity in the market is infrequent, the market is not well established or only small volumes are traded.

Issues to consider in Nigeria with regard to fair value of financial instruments include:

(a) Are corporate bonds/government bonds traded in active markets?

(b) Capacity-building needed in the development of valuation models;

(c) Observable input variables may be hard to find for complex valuations required for measuring fair value of foreign exchange contracts (FECs), cross-currency interest rate (CCIR) swaps and other derivatives;

(d) Will regulators allow fair value measurements for financial instruments of entities performing fiduciary duties?

- **IFRS 3/SAS 26 Business Combinations:** Fair value of assets, liabilities and contingent liabilities acquired. In business combinations, some of the issues firms are to note include:

(a) Cost of acquisition is measured at fair value, including where equity instruments are issued in exchange for control;

(b) Identifiable assets, liabilities and contingent liabilities of the acquiree are measured at fair value when net assets are acquired as opposed to shares;

(c) Intangible assets must be recognized separately from goodwill where their fair value can be measured reliably.

Challenging matters to consider in Nigeria with regard to business combinations are:

(a) Fair value determination for customer contracts and customer relationships, customer lists, trademarks and trade names;

(b) Excess of acquired interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost (SAS 26:78. IFRS 3: IN 10). Recognition of a gain from bargain purchase in the Profit and Loss.

Other key accounting standards impacted by fair value include IAS-18 Revenue; Fair value of items in an exchange transaction; IAS 36-Impairment of Assets; Determination of fair value in impairment testing of non-financial assets; and IFRS 7-Financial Instruments: Disclosures: Significant disclosures of fair value of financial instruments.

Impact of recession on fair value in Nigeria

The main issue is whether firms can estimate fair value accurately and without discretion in a recession. During a recession, fair value is usually determined using mark-to-model values as market participants tend to disregard market prices. Fair values are typically less accurate and more discretionary when they are either adjusted mark-to-market values or mark-to-model values. In adjusting mark-to-market values, firms may have to make adjustments for market illiquidity or for dissimilarity of the position being fair valued from the position for which market price is observed. Adjustments can be and are usually large and judgmental. In estimating mark-to-model values, firms typically have choices as to which valuation model to use. Valuation models are limited and each one captures the value-relevant aspects of positions differently. Does this not impact comparability?

Another issue is whether even quoted prices of equities reflect fair value during a recession. Criticisms that seem to have credibility on impact of recession on fair value include:

(a) Distribution of unrealized gains and losses;

(b) Heavy exercise of judgements in fair value estimate in inactive/illiquid markets;

(c) Fair value determined during recessions may be unverifiable and unauditable;

(d) Firms are forced to record losses they may never incur.

In this regard, improvements are expected from accounting standards setters and regulators to at least provide additional guidance on how to determine when markets become inactive, how to determine whether a transaction or group of transactions is forced or distressed, how and when illiquidity should be considered in valuing an asset or liability, how to estimate the effect of a change in credit risk on the value of an asset or liability and how to confirm that assumptions used would be used by market participants and not just by a specific entity. Additional disclosure relating to assumptions and estimates made in determining fair value and sensitivity analysis should be required.

IV. Conclusion

Irvine (1999) has outlined an approach to understanding the social tradition of institutional theory. He claims that there are exogenous and endogenous forces acting on and in organizations, which tend to make them more homogenous over time. DiMaggio and Powell (1983) have divided these forces into coercive, mimetic and normative isomorphism. They suggest that institutions become more homogenous over time, due to the influence of the environment in which they operate.

In coercive isomorphism, external pressures such as the regulatory environment affect institutional choice. Mimetic isomorphism refers to the tendency of organizations to mimic the behaviour of successful and more powerful leaders in their field if there is a high degree of uncertainty in the environment. The more uncertain the relationship between the means and ends, the greater the extent to which an organization will model itself after organization it perceives as successful. The final endogenous factor influencing the accounting choices is normative isomorphism. This holds that when individuals are trained in the same educational settings and in similar disciplines and when they come from similar cultural and economic backgrounds and elect to work in similar institutional settings, they share a common understanding of “normal” behaviour and of what is acceptable and unacceptable.

With regard to the adoption of IFRSs, Nigeria may face coercive isomorphism being a net importer of capital, mimetic isomorphism because of the number of jurisdictions that have either adopted or in the process of adopting IFRSs and normative isomorphism because of the countries in Africa that are now fully IFRS adopters.

It appears that in spite of heavy criticisms, fair value accounting will survive the current global economic meltdown. The general consensus is that the economic meltdown is not caused by fair value accounting and that fair value accounting assumes deep and efficient markets. Application in developing markets like Nigeria will be difficult but not impossible; after all, fair value accounting is applied in less

sophisticated markets than Nigeria's. The Nigerian Accounting Standards Board in conjunction with actuaries and other valuation specialists shall set parameters for mark-to-model valuations. An increased disclosure in financial statements about how fair value is determined shall also promote investor confidence.

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Chapter VIII

Fair Value Accounting: a Perspective from Developing Nations[65][66]

I. Introduction

The use of fair value has been one of the most debated topics in the last years because it has a direct impact on how performance is measured when companies have to estimate "the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date".[67]

The decision to choose fair value or the alternative measurement basis, the historical cost, is usually a trade-off consensus between two main qualitative characteristics of accounting information: relevance and reliability. That choice is embodied in the reasons why in some cases historical cost is used and in others fair value is applied on a recurring or on an occasional basis.

One year after the peak of what is maybe the world's worst economic crisis, many people raised significant concerns regarding fair value accounting, and the discussion about its adoption and how it should be measured usually dominates the debate among standard setters, governments, academics, analysts and preparers.

In developed nations, a big issue raised after the "subprime crisis" was how to deal with the reliability of accounting information based on fair value and how to measure it in illiquid markets or when the market is so distressed or volatile that many believe that the prices were not following the fundamentals. An important question raised by many was if financial accounting "was part of the problem or just the messenger".

To address this issue, one important step taken by standard setters such as the IASB and the FASB was to conduct an extensive consultation and analysis including the setting up of a Financial Crisis Advisory Group, a task force formed by highly qualified experts from different parts of the world. The proactive attitude by the standard setters demonstrates how important the topic is and the ultimate results attempted to give more guidance on measurement as well as on disclosure.

The most important benchmark for fair value measurements was issued in 2006: the FASB's SFAS 157. It establishes a clearer definition of fair value, states that the price should consider a seller perspective and gives guidance on which characteristics a market participant should present. Overall, the three-level approach introduced by this SFAS, ranging from the use of observable inputs for identical items (mark-to-market) to unobservable inputs (mark-to-model), has helped companies in the process of measurement providing more comparable information.

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65 This article was contributed by Fábio Moraes da Costa (Fucape Business School) and Nelson Carvalho (University of São Paulo). The views expressed in this article are those of the authors and do not necessarily represent the views of UNCTAD-ISAR.

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67 Statement of Financial Accounting Standards 157 (SFAS 157).

Before the beginning of the crisis, empirical academic papers supported the adoption of fair value for banks[68] and more recent working papers showed that accounting information is relevant for the market for all the three levels applied.[69]

When the crisis began, many markets became illiquid, with none or just a few transactions. Therefore, the main issue was how to measure fair value in such illiquid markets. To deal with this topic, the IASB and the FASB have worked together to provide more guidance and clarify that observable inputs without adjustments should not be used in those situations. The challenge for many companies was how to introduce an adjustment on those quotes and how to provide appropriate disclosure about the premises that were applied.

Despite the criticism against fair value, it is not likely that using historical cost as an alternative would have been the best or even a better solution. When historical cost is used, it can delay even more the recognition of losses, resulting in a more challenging and potentially dangerous situation from the standpoint of supplying relevant information to decision makers. In a recent paper,[70] the authors argue that the use of historical cost could be worse and that improvements should be made to fair value measurement, instead of simply abandoning it. Similar conclusions were reached by the Financial Crisis Advisory Group.

The maintenance of fair value as the basis for a significant part of financial instruments and the Exposure Draft on Fair Value Measurements proposed by the IASB, based on the FASB's SFAS 157 and the final document presented by the Financial Crisis Advisory Group to the meeting of the G-20 Heads of State, demonstrate that despite the crisis, fair value is still being understood as a relevant measure for many assets and liabilities. The strategy is to improve the modelling for illiquid markets and to ensure minimum requirements on disclosure to provide useful and reliable data for financial statements' users.

II. The Latin American and Caribbean perspectives

A. Countries' characteristics and the adoption of IFRSs

The recent debate on fair value was focused on how to measure it for financial assets, mainly for financial institutions operating in developed countries. When the discussion is brought to emerging economies and countries in transition, different issues are identified. Therefore, this section seeks to present the main characteristics of the Latin American and Caribbean region and why those differences have an impact on the discussion regarding fair value implementation.

The Latin American and Caribbean countries are in different stages of development, but the main features are that they usually have opaque capital markets, the companies are mainly funded by credit from financial institutions and usually one or few investors control the majority of the voting rights. Many of the countries have a

[68] For example: Barth ME (1994). Fair value accounting: evidence from investment securities and the market valuation of banks. *The Accounting Review*. 69: 1.

[69] For example: Goh BW *et al.* (2009). Market pricing of banks' fair value assets reported under SFAS 157 during the 2008 economic crisis. Working paper. MIT Sloan School of Management and Singapore Management University.

[70] Laux C and Leuz C (2009). The crisis of fair value accounting: making sense of the recent debate. *Accounting, Organizations and Society.* 34.

civil law environment and, therefore, their domestic GAAPs are more rules-based and often heavily affected by tax requirements.

In such an environment, one of the most discussed topics is the adoption of the IFRSs in their jurisdictions. The countries are in different stages of implementation and following different strategies. For example, Bahamas and Barbados have adopted full IFRS for all the companies, the Plurinational State of Bolivia permits their use by domestic companies, and Argentina, Brazil and Mexico will require full IFRS for their public companies by 2011, 2010 and 2012, respectively.[71]

With a few exceptions, the countries are still discussing how to manage the convergence challenges to implement IFRSs and are still dealing with significant changes from current domestic GAAPs. Important topics are accounting for leases, business combinations, revenue recognition, intangible assets, financial instruments and impairment of assets. Fair value measurements is usually perceived as one more important topic, but attention to it is usually restricted to the "big business" enterprises and it is not extensively discussed at the same level as in the developed economies.

The countries are still facing the challenge of understanding a principles-based model, dealing with true and fair view and statements that are based on substance over form. Fair value is a new topic, because the standards that are being adopted bring new applications of this measurement basis instead of historical cost. Because of this, the perspectives in Latin American and Caribbean region regarding fair value application are to some extent different from those in the economically developed part of the world.

B. Fair value in Latin American and Caribbean region – the Brazilian case

Brazil has decided to adopt full IFRS for listed companies and financial institutions by 2010. Besides that, in 2005 the Brazilian Accounting Standards Committee (CPC)[72] was established in order to issue new standards that would convert the Brazilian GAAP into full IFRS. The overall goal is that by 2010 the Brazilian GAAP will be equivalent to the IFRS. The CPC is also now discussing the adoption of the IFRSs for SMEs recently issued by the IASB.

Specifically about fair value, the first challenge for countries like Brazil was to properly understand the meaning of the term (not to mention finding a proper translation for it, since it was and is such a brand new concept) and to start applying only this term in the relevant domestic standards. There were standards that applied terms like "market value" or "mark-to-market" with the same objective as the fair value measurement.

For example, since 2001 Brazilian banks had to "mark-to-market" financial instruments that are held-for-trading or available-for-sale. In practice, Brazilian banks used quotes, adjusted quotes or even own models to stipulate the value of their securities, similar to fair value application. Thus, an important step for the country was to apply fair value in their domestic GAAPs to enhance comparability.

A second issue is the migration towards the IFRSs. There are new assets and liabilities being recognized and others that have to be derecognized. As a code law country, Brazilian companies are still adjusting their business models and their financial reporting approaches in order to adapt to a principles-based accounting model. Instalments paid by the lessee on lease contracts, for example, were expensed under the old Brazilian GAAP. There were neither specific standards for intangible assets nor

[71] Information available on http://www.iasplus.com
[72] Comitê de Pronunciamentos Contábeis.

detailed guidance for business combinations. Therefore, usually the debate is still focused on the new recognition criteria for assets and liabilities. In this context, fair value tends to be just one more topic among several others and may not be treated as the major issue. The application of full IFRS and how to present the opening balance sheet at the date of transition according to IFRS 1 are dealt as the main challenges. The companies have to deal with the costs related to the migration, systems customization, auditing and staff training. In many jurisdictions, the tax effects of the convergence from local GAAPs to IFRSs remain an issue of concern.

Before the decision to migrate towards IFRSs, fair value (or other terms with similar meaning) were applied in Brazil just for a few situations: asset revaluations of property, plant and equipment (PPE) and financial instruments in financial institutions. Now other applications are being adopted, such as in valuing investment property and in impairment testing. Each new standard inspired in an IFRS can bring a new application of fair value on a recurring or occasional basis. Thus, the discussion about this topic is being made using a step-by-step approach.

As in other jurisdictions, the major application of fair value in Brazil is still focused on financial instruments (but now for all the companies and not only for banks). Despite a few quoted public companies with active markets, many assets and liabilities will have to be measured by proprietary models. One important issue that has to be highlighted is that illiquid markets are often naturally more common in developing than in developed economies.

It is probable that most of the fair value measurement in developing economies will be based on Levels 2 and 3. So, the short-term situation for developed countries facing the challenge on measuring fair value in illiquid markets can be the long-standing situation for emerging countries. Thus, the discussion on how to measure fair value in such situations and how companies are actually enhancing the valuation or measurement process will be an important benchmark for a large part of the world.

III. Conclusion

Fair value is widely used in IFRS and guidance provided by the new statements about how to measure and record it are helpful to enhance comparability and ensure adequate disclosure. However, it is important to highlight that IFRS adoption in general is still the top issue and that fair value is among other challenges such as derivatives, intangible assets and business combinations. It will take a significant amount of time for companies to manage such a significant amount of changes and to achieve an orderly convergence from their current domestic GAAPs to full IFRS.

Despite the challenges, developing nations could contribute to the actual debate, providing new models for financial instruments (Levels 2 and 3) as well as in other areas. The discussion about fair value is still focused on financial instruments, but developing nations could contribute to the debate in other types of application of this measurement basis. For example, Brazil can be an important benchmark in the application of fair value for biological assets. The country holds top positions in important agricultural products and Brazilian companies can be a valuable source of information on techniques and methodologies for other countries. The IAS 41 has just been adopted as a new Brazilian standard and its application should occur by 2010.

Overall, fair value accounting is an important feature of financial accounting information for many types of assets, liabilities and transactions. The choice of its

application is usually endorsed when there is a consensus that it results in relevant information for decision-making. The question is how to improve fair value accounting and the debate between different companies based in different regions of the world can bring significant contributions for financial reporting.

Overall, it is also important to state that accounting quality is not achieved only by the choices within the GAAPs, but depends on other factors such as corporate governance structures and the institutional environment.