

**Lessons from the OECD workshop on  
« Accounting for implicit pension liabilities » (Paris, June 4, 2004)**

**François Lequiller (July 2004)**

The proposals by a national accounts international task force (also called “EDG”, led by the IMF) to extend the borderline of the recognition of liabilities in the core system of national accounts to “implicit” or “quasi liabilities” of unfunded pension schemes has major implications, in particular for general government accounts. Headline aggregates, such as the net lending/borrowing of the general government would be significantly changed. As the national accounts framework is more and more used for the monitoring of public finances, especially in Europe, it is essential that these proposals are presented and discussed by the economists who are the main users of these data. The workshop organized by the OECD on June 4, 2004 had precisely this objective.

The workshop began with several presentations: (1) a summary of the new principles proposed by national accountants and of the implementation issues linked to these principles (joint presentation by OECD-STD and IMF-STA), (2) a summary of the views of public accountants (presentation by the OECD Public Governance Directorate), (3) the principles of business accounting illustrated in the case of the UK FRS 17 (presentation by the chair of the UK ASB), (4) a summary of the ongoing discussions among the members of the IFAC-PSC (oral presentation by the chair of IFAC PSC), (5) a discussion of the principles by economists (OECD Economics Directorate). I would like first to thank all the presenters. The presentations are available on the OECD web site<sup>1</sup>.

The reactions of the economists to the proposals were quite varied, with many of them doubting that the proposals of the task force were realistic. However, some of them supported the proposed changes. The objective of this personal memo is to forward to the community of statisticians the reactions of these users, and to propose a set of possible solutions to accommodate the main criticisms that were expressed.

These solutions are based on two major new personal proposals that I submit to the statistical community: (1) abandon the idea of separating the cases of “employer schemes” and “social security schemes” and try to include both systems in the new proposals; (2) avoid including the massive imputations, implied by the proposals, in the core accounts by developing special tables devoted to the treatment of these quasi-liabilities.

The first new proposal is essential to maintain a minimum of international comparability. The second one will be seen by some as a bad half-baked compromise that will satisfy neither of the parties. However, I think it answers a strong message from economists not to introduce too many imputations in the core national accounts. Both these solutions

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have as their main objective to allow for national accounts to be more comparable on an international basis, which is obviously one of our main concerns at the OECD.

### **I. The current proposals of the task force.**

The new principles proposed for implementation in the next SNA (scheduled for 2008) can be summarized by the following bullet points:

1. Abandon the criterion of funded/unfunded to recognize the pension liability in the SNA
2. Replace it with the concept of “constructive obligation” as the basis for the recognition of a liability. This concept lies between contractual liabilities and contingent liabilities. It is directly inspired by business accounting standards (IAS 19).
3. At present, the task force proposes to separate the case of employer schemes (which includes the general government as an employer) and the case of collective schemes, often called “social security schemes”: recognise, in a first step, the liabilities of the former; discuss, in a second step, the recognition of the liabilities of the latter. This two step procedure obviously allows for the situation that the second step would not result in the recognition of liabilities for social security schemes. This is the main proposal that I suggest, in the present paper, to modify.
4. Record contributions and property income flows generated by the recognition of the liability on an actuarial basis.
5. Allocate net assets of pension schemes to the sponsor.

Even when restricted to employer schemes (but including general government schemes) these proposals lead to changes of between 0.5 to 2% of the net lending/borrowing of the general government for countries where unfunded schemes are the rule for civil servants. In Europe, this would obviously need an adaptation of the Maastricht criterion of 3% government deficit to GDP.

### **II. Main reactions by economists**

Participants at the workshop included many representatives of the OECD Economics Directorate’s network of experts on the impact of ageing populations. Their reactions were split into two groups. The first one, including representatives from continental Europe, was strongly opposed (Belgium) or very prudent (France) regarding the proposals. It is fair to say that the EU DG-ECFIN share very serious concerns about the proposals, as is the case with some economists from the OECD Economics Directorate. The second group includes countries such as Australia, USA, Norway who support the change.

The main arguments from the critical camp were:

1. Official economists from OECD countries already make, under the aegis of the OECD network on ageing, complete projections to analyse the impact of aging on the sustainability of government pension and social security schemes. These projections are significantly richer, in terms of informational content, than what is proposed for the national accounts. They include the timing, year by year, of the potential problems. They include future obligations, while national accountants limit themselves to the present value of future benefits created by past obligations. What is, in this context, the usefulness of the proposed change in the national accounts?
2. Can one consider that there is a real liability for pension obligations when these obligations can be changed by a reform? Such reforms were made recently in France and Belgium. They resulted in changing future benefits of past services. It was not therefore a liability, by definition.
3. There is no difference for a government between future pension obligations and future health cost obligations. What is the rationale that allows national accounts to focus on the first and ignore the second?
4. The proposed recording of pay as you go schemes as if they were a saving scheme introduces an asymmetry between the recognition of the liability (the future benefits) and the non recognition of an asset (the future contributions or taxes).
5. The proposal could lead to a difference in the treatment of “social security systems” and “employer schemes”, and in particular general government employer schemes. This difference appears artificial in countries such as Belgium or France. All recent reforms concerned government employees and employees of the private sector who participate in the social security scheme. In fact, in some cases, it is difficult to find any difference between the commitments to pay future benefits in the two cases. This means that simple administrative changes, for example changing the administrative arrangement of the general government employer scheme to make it part of the social security system, would have the strange impact of eliminating the very large liabilities that were recorded when it was an “employer scheme”. This could indeed call for creative accounting, making the headline aggregates of the national accounts useless for policy monitoring.
6. The actuarial estimations would introduce into the national accounts estimates of a very doubtful quality, subject to arbitrary big changes. This could lead to economists demanding data excluding these estimates. A solution would be to avoid affecting the core accounts with these estimates, but reserve them for satellite tables.

### **III. Discussion of some of the criticisms**

I will discuss now what are, in my view, the three main criticisms: (1) point # 2, (2) point # 5, and (3) point # 6.

*# 2: Are liabilities that can be changed real liabilities?*

The discussion showed that national accountants should clarify the precise situation when they would want to recognize a liability. Some experts, as reported by the OECD Public Governance directorate, interpret “accrual” accounting (the SNA is supposed to be an accrual accounting system; accrual accounting means accounting for rights and obligations as they occur) as only recognizing as liabilities those obligations that are *enforceable by law and/or those where individual rights cannot be changed retroactively, but only for future periods*. Under this interpretation of liabilities, the pension obligations of the French government to its civil servants are not liabilities, as they have been changed recently (changes were made to future obligations resulting from past rights). With this interpretation, the amount of recorded liabilities would be narrow.

Should that be the view adopted by national accounts? I think not. First, this interpretation is not the one adopted by private business accounting. The recognition of a liability in the balance sheet of private business does not depend on whether the obligation can or cannot be changed retroactively. There are even clauses in the accounting standards that precisely describe what to do when there is a change of the benefits structure (i.e. generating a change of the liability). The second argument is that the narrow definition would introduce a too “legalistic” criterion in the compilation of national accounts. National accounts are not completely bound by legalities. To confirm that such and such an obligation can be enforceable before a court, would put national accountants in the situation of legal experts, and thus would be difficult to implement. It would also probably put in danger the international comparability of the accounts, as some minor differences in legal arrangements would dominate the choice of whether or not to recognize a liability. It is better to adopt a more economic criterion.

This criterion proposed is the concept of “constructive obligation”. It is inspired directly by the concept used in the international accounting standards (IAS 19). A constructive obligation is “*an obligation that derives from an enterprise action where: (a) by an established pattern of past practices, published policies, or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept certain responsibilities; and, (b), as a result, the enterprise has created a valid expectation on the part of other parties that it will discharge these responsibilities.*” This definition is less narrow than the one based purely on legalities. It does not exclude those liabilities which may change in value over time by a reform. Under such a definition, the pension obligations of the French government, even if changeable through reform, would be recorded as liabilities. Seen from a macro-economic point of view and also in terms of international comparability of households’ assets, this seems a reasonable result.

In any case, whether they accept or not this definition, national accountants should clarify their position on this criterion.

# 5: *Is it appropriate to separate employer schemes from social security schemes?*

It appears to me that there are two extreme groups of OECD countries regarding the organization of pension schemes. The first one comprises countries such as the USA, Australia, Canada, UK, the Netherlands, where the pension arrangements are centered on

employer schemes, with, in addition, a ‘safety net’ collective system called “social security”.

By construction, these countries have no second thoughts about the current proposal of the national accounts task force to (potentially) limit the recognition of liabilities to “employer schemes”. It seems normal for them to record all the liabilities of employer schemes, including the general government as an employer, and, possibly, to not recognize the liability of the so-called “social security” which could be considered in fact “social assistance”.

At the extreme opposite, there are countries such as Belgium and France where the global pension arrangements are based on one major collective system. This system is also called “social security”, but it is not the same as the one for the first group of countries. In this second group of countries, pure employee schemes are minor (except for general government). In a country such as France, all private employees are part of the social security system that can be seen therefore as a global multi-employer scheme, but organized within the control of the general government. Because of history, only government employees’ pension obligations are organized outside the social security system.

It therefore appears strange to these countries to recommend recognition of the quasi liabilities of the employer schemes but not those of social security schemes. This would mean that the civil servants would be shown as having an asset but not private employees. The situation would look even more arbitrary within general government, because central government employees are all in an employer scheme and some local government employees are attached to the social security system.

As can be seen, for the second group of countries, the borderline between “social security” and “employer schemes” is not the same as it is for the first group. In this context, “social security” is a poor and insufficiently precise terminology for systems that differ in their content. In the first group, there is a difference in content and in commitment between employer-based pension schemes and social security schemes. In the second group, the difference between the two is based on administrative arrangements. It is not impossible, for example, that the French government could decide to create a special unit, attached to the social security system, to administer the pensions of its employees. This would mean that, if the national accounts were to have a borderline for liability recognition based on “employer scheme” versus “social security”, it would result, as if by a miracle, in the disappearance of a massive public debt (civil servants pension debt is estimated to be 50% of annual GDP).

It is unsustainable to introduce such an arbitrary borderline in the national accounts. This arbitrary borderline would also seriously hamper international comparability of the macro accounts, because it is based on administrative arrangements and not on the commitment of the sponsors vis à vis the beneficiaries.

I think therefore that the current strategy of two steps (the first on employer schemes and the second on social security) is inappropriate. My proposal is to link the two steps, and to accept from the start an extension of the borderline to include the liabilities of social security schemes.

The proposal can be expressed as: base the recognition of the liability on the existence of “constructive obligations” whether or not this obligation is organized under a pure employer system, or a multi-employer system called “social security”. Some may consider that this is too ambitious, and that this extension would unduly include in the borderline obligations for which the commitment of the sponsor is really too low. It is possible to imagine better definitions of the borderline. One possibility may be to record all obligations linked directly (through an employer scheme) or indirectly (through a collective system or multi employer scheme) to the deferment of employee compensations. But, in any case, the strategy to accept potentially that “employer schemes” and “social security schemes” be treated separately is unsustainable.

My solution is to encompass all systems in the proposed change. It will increase by an enormous amount the pension liabilities in the macro-accounts. But its advantage is a better rationale and better international comparability.

*# 6: Should these liabilities be recorded in the core accounts?*

The impact of the envisaged change for countries with big unfunded employer schemes can be massive: the amount of unfunded general government implicit liabilities reaches, for example, 20% of annual GDP in Australia and Canada, and 50% for France. If, as proposed in the previous section, the borderline is extended to all schemes, including social security, the numbers become frightening, something from 200% to 400% of annual GDP!

This therefore focuses attention on the quality of these estimates and their reliability. The discussions at the workshop showed that, first, the estimates depended on parameters that can be arbitrary (discount rate) and/or not fully mastered (population of beneficiaries, life expectancies, etc.). There is therefore a real concern regarding the quality of the flows that will be recorded in the accounts.

There will be two major non-financial flows affected by the change: (1) the actuarially based contributions, (2) the imputed property income (obtained as the stock of debt multiplied by the nominal interest rate). It may be seen as very disturbing to put these estimates on the same level as flows that are really observed, with the implications that it could have on the credibility of the headline aggregates of the national accounts, in particular for general government. Of course, when the actuarial calculations are made by professional actuaries, national accountants would be on a safer ground. But this will not happen immediately for all schemes, and in particular for social security schemes.

It would be therefore more prudent to separate the entries that would result from the new proposals from the core accounts. The idea is not however to consider that these

calculations would be pure memorandum items. The problem with memorandum items is that they are generally not compiled by national accountants (in fact, the current SNA already recommends to compile implicit liabilities of unfunded defined benefits schemes as memorandum items, but nobody does it).

My proposal is a mixture of core financial accounting, by creating a specific category of “pension quasi liabilities” in the core financial accounts, and of satellite accounting, by creating a special table, below the line of net lending/borrowing, where the flows linked to the newly created “pension quasi liabilities” would be recorded completely separately. Such a system would have the advantage of being able to deliver to economists both sets of data, the one excluding “pension quasi liabilities” and the one including “pension quasi liabilities”. Other presentations are possible, including the one which would create completely parallel accounts, one in “cash” accounting and one in “accrual” accounting.

This proposal may be seen as a bad, half-baked compromise, which finally does not decide on what is the really “good” treatment. However, it addresses a strong message in the workshop which asked statisticians to avoid including too many imputations in the core accounts or, at least, to allow economists to be able to “debundle” the two types of figures. Also, my proposal includes the creation of new balancing items which would be strictly equal to those generated by a fully fledged recognition of pension liabilities, thus satisfying those who think it is the way forward. These figures would be preferable for international comparability than the existing ones.

I give below two examples of the recording under the system that I propose. The first one covers the example of an unfunded employer system, where the pension scheme is non autonomous. Its accounts are therefore embedded in the employer’s accounts. The second one covers the case of a pay as you go social security system. Both these examples use the same basic data. They illustrate a case where the current cash flows (contributions, pensions) underestimate the “accrual” flows, thus a situation of greater deficit in “pure accrual” accounting.

#### *Case 1: unfunded employer system*

The first table illustrates the current SNA accounting framework for an unfunded employer scheme.

The account starts by the employer “paying” an imputed pension contribution of 11 (D122). This amount is included in the compensation paid to its employees (households). These employees pay back to the employer (i.e. in fact to the embedded pension scheme of the employer) this contribution (D612) and also their own “employee” contribution (D6112). The employer then pays the pensions of 11<sup>2</sup>. The net lending/borrowing (B9A)

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<sup>2</sup> One can note that, in this example, I have taken the imputed contributions (D122) as equal to pensions paid (D62). However, this is not an important assumption in the context of this account. I could have taken another amount. The result would have been the same on net lending borrowing because D122 is mechanically compensated by D612.

of the scheme is a “cash” figure, equal to -9.5. In the financial accounts, only one entry is recorded: the corresponding cash movements (pensions paid (11) minus employee contributions (1.5)).

The second table illustrates my proposal. All flows above B9A are strictly equal to the previous ones. Thus net lending/borrowing is not changed compared to the current SNA, it remains a “cash based” net lending/borrowing. But I create, below the line of B9A, a “special account for pension quasi liabilities”. In this account one finds on the use side the amounts that correspond to full accrual accounting regarding the quasi-liabilities. First an amount of 14 for actuarial contributions, which is here superior to actual pension paid, illustrating the change in the demographics of this pension scheme. Then there is an amount of 6 for the imputed property income, which is generated by the existence of the pension quasi-liability. On the resources side of the account, one finds an “adjustment for cash recording” which corresponds to the opposite number of the cash-based B9A.

I introduce a special balancing item (B9S) for this special account. This item exactly corresponds to the addition to the net lending borrowing of the change in the pension quasi liabilities.

In the financial accounts, one records a specific line which I called “F6X” which corresponds to the estimate of the change of the pension quasi liability towards households. Its value is equal to accrued rights (14) + reinvestment of imputed property income (6) + employee contributions (1.5) – payments of pensions (11).

The financial accounts end with two balancing items: the traditional one, B9B, excluding quasi liabilities, and a new one, B9X, which is equal to the sum of the cash B9B and the quasi-liability B9S. One can note that B9S is exactly equal to the net lending borrowing that would result from the implementation of the proposed changes in the core accounts. The advantage of this presentation is that economists have both sets of numbers at the same time: the traditional one, excluding quasi-liabilities, and the new ones, including quasi-liabilities.

#### *Case 2: pay as you go social security.*

Case 2 illustrates, using more or less the same numbers, a pure pay as you go social security system. This unit receives contributions from employers<sup>3</sup> and employees, and pays pensions. The “cash” net lending/borrowing of the scheme, as recorded in the current SNA, is equal to +1.5, the difference between the actual flows received and the pensions paid.

I show then the new accounts, under my proposal. As in the previous case, nothing is changed above the line of B9A: the numbers remain “cash” accounting. As in the previous case, a special account for pension quasi liabilities is created. It includes, on the use side, the amount of “actuarial addition to cash contributions” (i.e. the difference between the current contributions and the actuarial contributions), which is equal to 3 in

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<sup>3</sup> In this system, employers have completely discharged their debt on pension by paying their contribution.  
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PSC New Delhi November 2004

my example (14-11), and the amount of imputed property income generated by the recognition of the quasi liability (6). On the resource side, appears the number opposite to the “cash” B9. The balancing item B9S shows a deficit of 10.5, corresponding to the increase in the debt in pension quasi liabilities. The financial accounts record the cash movements, and the line F6X, the change in pension quasi liabilities, which is obtained exactly as in the employer’s scheme example. The accounts show the new balancing item B9S, equal to -9, the sum of the “cash” surplus of the social security (+1.5) and the “pure accrual deficit” of -10.5.

Why is this number (-9) different from the first case (-20)? The answer is that we have here separated the unit organizing the system from its “sponsors”. The implicit net lending borrowing of the sponsors is equal to 11, the amount of employers’ contributions. If we add both deficits, thus consolidating the accounts, we obtain -20.

**Case 1. Unfunded employer system.**

Current SNA recording

	<i>Imputed flows are in italics</i>	<b>Employer</b>	
		Uses	Resources
D122	<i>Imputed employer contributions</i>	11	
D6112	Employee contribution		1.5
D612	<i>Employer contribution</i>		11
D62	Pensions	11	
<b>B9A</b>	<b>Net lending/ net borrowing</b>	<b>-9.5</b>	
	<i>Financial accounts</i>	$\Delta$ Assets	$\Delta$ Liabilities
AF2	Cash	-9.5	
<b>B9B</b>	<b>Net lending/ net borrowing</b>		<b>-9.5</b>

New recording

	<i>Imputed flows are in italics</i>	<b>Employer</b>	
		uses	Resources
D122	<i>Imputed employer contributions</i>	11*	
D6112	Employee contribution		1.5
D612	<i>Employer contribution</i>		11*
D62	Pensions	11	
<b>B9A</b>	<b>Net lending/ net borrowing</b>	<b>-9.5</b>	
	<i>Special account for pension quasi liabilities</i>		
	<i>Adjustment for cash recording</i>		9.5
	<i>Actuarial contributions</i>	14	
	<i>Imputed property income</i>	6	
	<b>B9S</b>	<b>-10.5</b>	
	<i>Financial accounts</i>	$\Delta$ Assets	$\Delta$ Liabilities
AF2	Cash	-9.5	
	<i>Pension quasi liabilities</i>		10.5
<b>F6X</b>			(14+6+1.5-11)
<b>B9B</b>	<b>Net lending/ net borrowing excluding quasi liabilities</b>		<b>-9.5</b>
<b>B9X</b>	<b>Net lending borrowing including quasi liabilities</b>		<b>-20 (-9.5-10.5)</b>

\* I have avoided to record as the imputed contributions the actuarial contributions of 14, to avoid complicating the debate. However, it is possible to record 14 here rather than 11. This does not change anything in the financial accounts or for net lending borrowing. It would raise GDP in the case the employer is the government, and reduce gross operating surplus in the case of private business.

**Case 2: social security system**

Current SNA recording

<i>Imputed flows are in italics</i>		<b>Social security</b>	
		Uses	Resources
D6112	Employee contribution		1.5
D612	Employer contribution		11
D62	Pensions	11	
<b>B9A</b>	<b>Net lending/ net borrowing</b>	<b>+1.5</b>	
<i>Financial accounts</i>		$\Delta$ Assets	$\Delta$ Liabilities
AF2	Cash	+1.5	
<b>B9B</b>	<b>Net lending/ net borrowing</b>		<b>+1.5</b>

New recording

<i>Imputed flows are in italics</i>		<b>Social security</b>	
		uses	Resources
D6112	Employee contribution		1.5
D612	Employer contribution		11
D62	Pensions	11	
<b>B9A</b>	<b>Net lending/ net borrowing</b>	<b>+1.5</b>	
	<i>Special account for pension quasi liabilities</i>		
	<i>Adjustment for cash recording</i>		-1.5
	<i>Actuarial additions to contributions</i>	3	
	<i>Imputed property income</i>	6	
	<b>B9S</b>	<b>-10.5</b>	
<i>Financial accounts</i>		$\Delta$ Assets	$\Delta$ Liabilities
AF2	Cash	+1.5	
<b>F6X</b>			10.5 (14+6+1.5-11)
<b>B9B</b>	<b>Net lending/ net borrowing excluding quasi liabilities</b>		<b>+1.5</b>
<b>B9X</b>	<b>Net lending borrowing including quasi liabilities</b>		<b>-9.0 (+1.5-10.5)</b>

From: Matthew Bohun [MatthewBohun@ifac.org]  
Sent: Thursday, September 16, 2004 10:49 AM  
To: John Dunckley  
Cc: Paul Sutcliffe  
Subject: RE: Impairment

Dear John,

Paul and I have discussed this and he has asked me to respond to you because I am managing the PSC's impairment project. At this stage our standard is still subject final review by the subcommittee and Chair. We anticipate having our position formally finalized by mid-October unless the sub-committee identifies a fatal flaw. I am not sure how this fits with your timing. However the major features of the impairment IPSAS have been finalized.

The PSC is still to determine the application date of its IPSAS on impairment of non-cash-generating assets. In respect of paragraph 6.4 the second block should refer to the imminent release of an IPSAS rather than and ED. The third block is okay as far as it goes. However on release of the IPSAS there will be additional guidance. You may wish to contemplate including in your guidance something along the lines that the forthcoming IPSAS which deals with impairment of non-cash-generating assets will:

- 1) define recoverable service amount;
- 2) establish indicators of impairment; and
- 3) prescribe the basis on which an impairment loss is to be determined.

Matthew Bohun CPA  
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-----Original Message-----

From: John Dunckley [mailto:john.dunckley@dtz.co.nz]  
Sent: Wednesday, September 15, 2004 2:11 PM  
To: psutcliffe@ifac.org  
Cc: Tissier Marianne (E-mail)  
Subject: Impairment

Hi Paul,

I am in the process of trying to finalise the IVSC public sector standard. We have a section which refers to impairment and Kevin Simpkins has deflected my enquiry to you as the holder of the latest IFAC draft. I attach the draft and would be very grateful if you could review the IPSAS linkages and in particular section 6.4 to make sure they are in line with your latest document. Kevin has reviewed an earlier draft.

If you would rather just give me a ring on +6421326189, as we need to finalise our position urgently,

Kind regards,

John <<PublicSectorApplicationVancouver1 ex MM aug 2004.doc>>

**From:** Paul Sutcliffe [psutcliffe@ifac.org]  
**Sent:** Tuesday, August 03, 2004 9:12 AM  
**To:** Sonny Loho  
**Subject:** RE: PSC IFAC plan on IPSASs

Dear Mr Loho.

Thank you for this note. I have discussed it with Philippe Adhemar the PSC Chair. We are delighted to learn that KSAP is intending to develop accrual standards based on IPSASs for application by governments in Indonesia. As you note the IPSASs are based on IASs/IFRSs to the extent that the IASs/IFRSs are relevant for the public sector. The PSC has issued 21 accrual IPSASs on this basis. There are of course some differences between IPSASs and IASs to reflect the public sector environment where necessary and to reflect that public sector entities provide some services at no or nominal cost to recipients, rather than sell their services for the objective of making a profit (as do the entities who are the primary focus of the IASB standards). In addition, the IASB has updated a number of its standards recently and has issued a number of standards that have not yet been dealt with by the PSC. The PSC has a long term objective of converging with IASs/IFRSs, and the PSC is currently updating the 11 IPSASs affected by the IASB improvements project as part of that long term objective. We intend to issue an omnibus Exposure Draft of these improvements in 2005.

The PSC will also deal with other IASB standards going forward as our resources allow. The PSC is also progressing a number of public sector specific issues for which International standards do not exist under the accrual (or cash) basis of reporting. These include accounting for taxes, social policy obligations, budget reporting, public sector conceptual framework and convergence with statistical bases of financial reporting. These public sector specific issues will be our first priority in the short term. The converging of IPSASs with IASB standards, while still important, will be our second priority and will be progressed as resources become available. I hope this response is useful. Please let me know if we can be of any further assistance.

Best Regards Paul

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-----Original Message-----

**From:** Sonny Loho [mailto:[sloho@cbn.net.id](mailto:sloho@cbn.net.id)]

**Sent:** Friday, July 30, 2004 1:34 AM

**To:** [padhemar@ccomptes.fr](mailto:padhemar@ccomptes.fr); [psutcliffe@ifac.org](mailto:psutcliffe@ifac.org); [jerrygutu@ifac.org](mailto:jerrygutu@ifac.org)

**Cc:** Binsar H. Simanjuntak; Puspa Sumadji

**Subject:** PSC IFAC plan on IPSASs

Jakarta, 29 July 2004

To: PSC Chairman, Philippe Adh mar - [padhemar@ccomptes.fr](mailto:padhemar@ccomptes.fr)  
Director, Public Sector Accounting Standards, Paul Sutcliffe -  
[psutcliffe@ifac.org](mailto:psutcliffe@ifac.org)  
Technical Manager, Jerry Gutu - [jerrygutu@ifac.org](mailto:jerrygutu@ifac.org)

From: Secretary of Government Accounting Standards Committee of Indonesia (KSAP)

Dear Sir,

First, I would to introduce that I'm the Secretary of the Government Accounting Standards Committee (KSAP) of Indonesia. KSAP is an independent committee responsible to develop the government accounting standards for central and local governments in Indonesia. KSAP is planning to develop accrual base accounting standards following the best international practices, and intending to use the IPSASs from PSC-IFAC as the main references. KSAP is preparing a strategy either to adopt or adapt the IPSAS for implementation in 2008.

Since the IASs have been substantially changed to the International Financial Reporting Standards (IFRSs), while IPSASs in some extent adopt IASs, KSAP is curious if the IPSASs would be adjusted to the changes.

We would really appreciate if you can inform KSAP the PSC's plan on the existing IPSASs due to changes of the IASs. It will be very critical for KSAP strategy to adopt or adapt the IPSASs for government accounting standards of Indonesia.

Yours truly,

Sonny Loho  
Secretary of KSAP

**From:** Jim Sylph [jimsylph@ifac.org]

**Sent:** Tuesday, September 14, 2004 8:38 AM

**To:** ianball@ifac.org; paulsutcliffe@ifac.org; Matthew Bohun; russellguthrie@ifac.org; Sylvia Barrett; 'Michael Nugent (E-mail)'; 'Alta Prinsloo'; 'Bryan Hall'; 'James Gunn'; Jan Tyl; 'Jane Mancino'; 'Ken Siong'

**Subject:** FYI

**PAKISTAN (September 3):**

Prime Minister Shaukat Aziz has said that a new public management framework is required to implement the government's "broadbased structural reforms agenda", which would require a "thorough revamping of the government's management policies and systems." The managers – the ministers, the secretaries and all other government functionaries – will have clear goals to achieve. They'll be appointed strictly on merit; they'll be empowered to meet the challenges of the day; and they'll be held accountable against those goals, he said while inaugurating the first assembly of the Association of Government Accounts Organization of Asia (AGAOA) and International Conference of Controllers General Accounts of Asia.

He said that goals would be reviewed quarterly, thus ensuring accountability and transparency. It would also enable the government to assess the success of its plans and enhance its productivity, he added. He called the Public Accounts Committee an effective check-and-balance mechanism and appreciated the parliamentarians for actively contributing to its work. Mr. Aziz said the government was strengthening internal controls in the ministries to improve financial reporting and fiscal discipline and increase transparency of government transactions.

"The government is committed to ensuring that the citizens of Pakistan and all other stakeholders are provided with correct financial information about its operations," he added. He said the establishment of an independent office of the Controller General of Accounts in 2001, as a part of overall financial sector reforms, was the first step toward institutionalizing easy access to financial information. He said the Project for Improvement of Financial Reporting and Auditing (PIFRA) aimed at reforming budgeting, financial reporting and auditing systems. He said the New Accounting Model being implemented under PIFRA would lead to "accrual accounting", capable of providing necessary information and analytical tools required by the government and the legislature to hold public sector managers accountable. The prime minister said that accountability, transparency and disclosure went together. Accountability, he said, was much more than merely fighting corruption and that the modern state perceived accountability in a much more positive sense – to demonstrate the government's achievements with regard to accelerating economic growth and resourcefulness.

**James M. Sylph**

International Federation of Accountants

Technical Director

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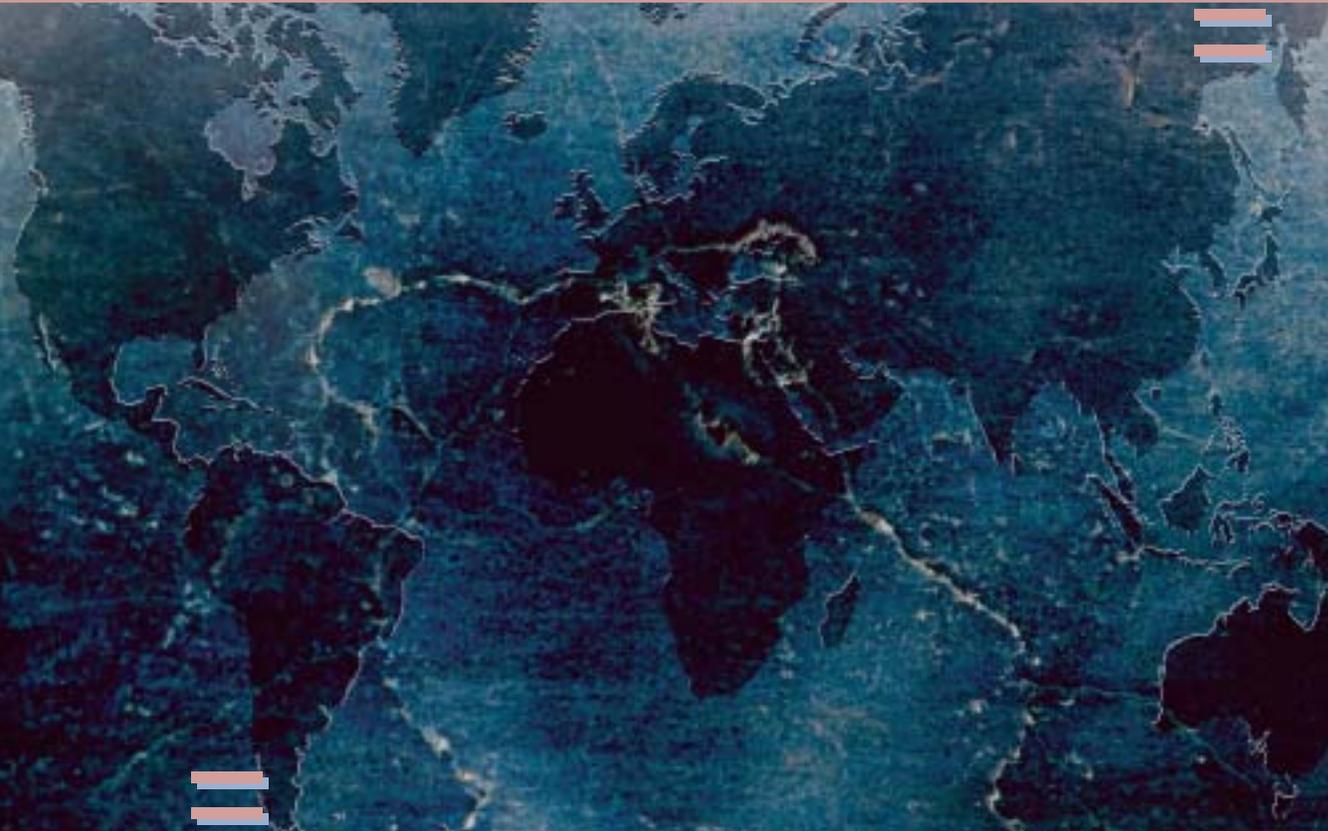
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SEPTEMBER 2004



CHALLENGES AND SUCCESSES IN  
IMPLEMENTING INTERNATIONAL STANDARDS:  
ACHIEVING CONVERGENCE TO IFRSs AND ISAs

# INTRODUCTION

BY PETER WONG



Peter Wong, a former member of the Board of the International Federation of Accountants (IFAC), was commissioned by IFAC to study the challenges and successes in adopting and implementing international standards.

A financial reporting system supported by strong governance, high quality standards, and sound regulatory frameworks is key to economic development. Indeed, high quality standards of financial reporting, auditing, and ethics underpin the trust that investors place in financial and nonfinancial information and, thus, play an integral role in contributing to a country's economic growth and financial stability.

As the forces of globalization prompt more and more countries to open their doors to foreign investment and as businesses themselves expand across borders, both the public and private sectors are increasingly recognizing the benefits of having a commonly understood financial reporting

framework supported by strong globally accepted auditing standards.

The benefits of a global financial reporting framework are numerous and include:

- Greater comparability of financial information for investors;
- Greater willingness on the part of investors to invest across borders;
- Lower cost of capital;
- More efficient allocation of resources; and
- Higher economic growth.

Before these benefits can be fully realized, however, there must be greater convergence to one set of globally accepted high quality standards. International convergence is a goal that is embraced in IFAC's mission, shared by IFAC member bodies, the international standard setters, and many national standard setters, and supported by international regulators. Achieving international convergence, however, requires more than theoretical support. It requires reaching consensus as to the international standards that will serve as the foundation for financial reporting and auditing globally, determining how to facilitate

the adoption of those standards, and, ultimately, taking the actions necessary to encourage implementation. This report is a significant step in that process.

In November 2003, the IFAC Board agreed that there was a need to identify more clearly the challenges to adopting the international standards and to communicate successful examples of how the international standards have been and are being implemented. As a former IFAC Board member, past president of the Hong Kong Institute of Certified Public Accountants, and a Chartered Accountant who has worked with both national and international standards for many years, I was asked to lead this project.

The project, defined in more detail on page 4, entailed the collection of views from a cross-section of the international financial reporting community: representatives from regional and national professional accountancy organizations; IFAC committees and permanent task forces; national standard setters; users of financial statements; regulators; and professional accountants from a variety of backgrounds.

This report details my findings and proposed actions for addressing the identified challenges.

The objective of this report is to stimulate further discussions and actions on the adoption and implementation of the international standards so that we

may move closer to the goal of international convergence. Based on the successes of adoption and implementation in some countries, I believe it is a goal that is achievable over time. Given the significant public interest benefits, it is also a goal that I believe we cannot afford to put aside.

Serving the public interest is one of the greatest challenges facing our profession. To do so effectively, we must all demonstrate that we follow high profes-

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**THE** *objective of this report is to stimulate further discussions and actions on the adoption and implementation of international standards so that we may move closer to the goal of international convergence.*

sional standards. The public will not and should not accept anything less. If there are any impediments to our ability to follow

professional standards, IFAC, together with international and national standard setters, regulators, governments, and others identified in this report, must work together to address them head-on.

I am grateful for the help of the regional and national accountancy organizations that assisted in the arrangement of discussion groups, for those who took the time to participate in the discussions or to complete written submissions, and for the dedication of the IFAC staff in supporting me in this project.

Finally, I must state that the views in this report are my personal views and do not necessarily reflect the views of any of the organizations with which I am affiliated.

*Peter Wong signature*

**PETER H.Y. WONG**

Peter Wong was a member of the Board of the International Federation of Accountants from 2000 to 2003 and is currently a member of the board of the Global Reporting Initiative, which sets the Guidelines for Sustainability (Environment, Social & Economic) Reporting. He retired as Senior Tax Partner of Deloitte Touche Tohmatsu – Hong Kong in May 2002 and is currently a consultant to the firm. A past president of the Hong Kong Institute of Certified Public Accountants, he is now the chairman of the Business & Professionals Federation of Hong Kong.

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## BACKGROUND



As the world continues to globalize, discussion of convergence of national and international standards has increased significantly. All major capital markets are now actively discussing or pursuing efforts of

convergence towards a single set of globally accepted accounting and auditing standards. IFAC, in an effort to facilitate international convergence, commissioned this study to explore the challenges and successes involved in adopting and implementing international standards. It is joined by international regulators, including the Basel Committee on Banking Supervision, the European Commission, the Financial Stability Forum, the International Association of Insurance Supervisors, the International Organization of Securities Commissions, and the World Bank, in recognizing that global capital markets require high quality, globally consistent, and uniform regulatory and standards regimes.

### *The Benefits of Globally Accepted International Standards*

Globally consistent and uniform financial systems provide cost-efficiencies to business and greater safeguards to the public. The public is entitled to have confidence that, regardless of where a business activity occurs, the same high quality standards were applied. It is widely recognized that investors will be more willing to diversify their investments across borders if they are able to rely on financial information based on a similar set of standards. Thus, adherence to international standards, such as those developed by the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB) can ultimately lead to greater economic expansion.

### *Support for International Convergence*

The Financial Stability Forum (FSF)<sup>1</sup> included the International Financial Reporting Standards (IFRSs) issued by the IASB and the International Standards on Auditing (ISAs) issued by the IAASB in its *12 Key Standards for Sound Financial Systems*. The FSF indicated that these 12 Key Standards are most likely to make the greatest

contribution to reducing vulnerabilities and strengthening the resilience of financial systems.

The report on *Rebuilding Public Confidence in Financial Reporting – An International Perspective*, issued in July 2003, provided further support for IFRSs and ISAs becoming the worldwide standards. The report was developed by the Task Force on Rebuilding Public Confidence in Financial Reporting – an independent group commissioned by IFAC to address, from an international perspective, the loss of credibility in financial reporting and approaches to resolving the problem. The task force recommended that convergence of national and international standards be achieved as soon as possible, viewing this as a significant public interest issue.

IFAC has committed itself to the achievement of global convergence of national standards with IFRSs and ISAs. This is evidenced both in its mission statement and in its Statements of Membership Obligations (SMOs). Published in April 2004, the SMOs formally capture IFAC's longstanding requirement that its member bodies support the work of the IASB and IAASB by using their best endeavors to incorporate the IFRSs and ISAs in their national requirements (or where the responsibility for the development of national standards lies with third parties, to persuade them on a best endeavors basis to do so) and to assist with the implementation of IFRSs and ISAs, or national standards that incorporate IFRSs and ISAs.

As countries increasingly commit to converging national standards with IFRSs and ISAs, there is a need to ensure international convergence is approached in a systematic and, where possible, consistent way across jurisdictions. It also has made it necessary for interested parties, such as IFAC, the international and national standard setters, and international regulators, to understand the challenges in adopting and implementing the international standards so that they can be addressed at an early stage.

### *Scope and Project Methodology*

This study seeks to explore those issues that affect the adoption and implementation of IFRSs and ISAs, provides examples of successful adoption and implementation to serve as models for other countries, and proposes actions to be taken by relevant stakeholders.

Numerous questions were addressed as part of this study. How do we move towards international convergence? What obstacles need to be overcome? What systems

<sup>1</sup> The FSF is an organization that brings together senior financial representatives of national financial authorities, international financial institutions, international regulatory and supervisory groupings, committees of central bank experts, and the European Central Bank to promote international financial stability.

and processes can help to facilitate international convergence? What roles can the IASB and IAASB and national standard setters play in ensuring that international convergence is approached in a systematic and, where possible, consistent way? This report attempts to answer these questions based on input from a cross-section of the international financial reporting community.

Peter Wong, a former IFAC Board member with extensive international experience, was appointed by the IFAC Board to oversee the development of this study and address these questions among a variety of groups: those that develop the international standards, those that use the standards, and those that rely on work performed based on the standards.

The major fact-gathering process was as follows:

- A series of focus group meetings with members of regional and national professional accountancy organizations;
- A series of interviews with representatives of national standard setters, preparers, auditors, and users of financial statements, including regulators, and other interested parties;
- An invitation to IFAC member bodies to submit written responses; and
- Limited library research, focused on recent studies undertaken with regard to the adoption and implementation of the international standards.

Nine focus group meetings were held, approximately 20 interviews were conducted, and 29 responses to the invitation were submitted to IFAC. Those who participated in focus groups or interviews or submitted written responses are hereinafter referred to as “participants” in this study. The participants represented a broad range of perspectives – regulators, standard setters, preparers from entities of various sizes, auditors from large and small accounting firms, and investment professionals – and shared a combination of organization-wide and personal views.

Appendix 1 contains a list of focus groups, interviews, and respondents to the invitation to submit written responses. Appendix 2 contains a list of questions covered in these meetings, interviews, and the invitation to submit written responses.

Peter Wong, with the assistance of senior IFAC staff members, engaged in discussions regarding the following potential challenges in adopting and implementing the international standards:

- Issues of incentives – the various factors which might encourage or discourage national decision-makers from their adoption.
- Issues of regulation – regulatory challenges in their adoption.
- Issues of culture – challenges arising from cultural barriers in their adoption and implementation.
- Issues of scale – implementation barriers associated with the relative costs of compliance for small- and medium-sized entities and accounting firms.
- Issues of understandability – their complexity and structure.
- Issues of translation – the ease of their translation and the resources available to undertake the translation.
- Issues of education – the education and training of students and professional accountants in the international standards.

Subsumed in the above are issues related to the legitimacy and authority of the international standards and the integrity of those who have to implement them, i.e., to comply with the substance and form of the standards.

These challenges are explored throughout this report. The report also reflects reported successes in adopting and implementing the international standards. As more countries seek to adopt the international standards, experiences from those countries already well advanced in their adoption and implementation are of immense value to those that are still in the process, or are considering the steps to be taken.

The evidence contained in this report is anecdotal, as opposed to quantitative. Given the diversity of groups involved in the study and the consistency in responses, the study provides a clear indication of the challenges to be addressed to facilitate the adoption and implementation of the international standards.

It should be noted that the project focused on the adoption and implementation of IFRSs and ISAs. Where participants noted matters relating to the pronouncements issued by IFAC committees other than the IAASB, for example, matters relating to ethics, education, or financial reporting in the public sector, these matters have been communicated to the relevant committee. □

## SUMMARY OF PRINCIPAL FINDINGS AND BASIC ASSUMPTIONS



Generally, participants were positive about the adoption and implementation of the international standards and confirmed that the IASB and the IAASB were the appropriate bodies

to develop them.

Participants cited similar challenges related to the adoption and implementation of both IFRSs and ISAs. They were inclined to spend more time, however, discussing the international accounting standards than the international auditing standards. A participant (from industry) gave the following explanation for this:

*“The international accounting standards have a direct effect on far more people than the international auditing standards. The complexity of the international auditing standards might flow through into the audit fee an entity pays, but the entity does not itself have to read, interpret, and implement the standards.”*

The principal challenges identified by those involved in adopting and implementing IFRSs and ISAs are described in the following sections of this report:

- Understanding the Meaning of International Convergence
- Translation of the International Standards
- Complexity and Structure of the International Standards
- Frequency, Volume, and Complexity of Changes to the International Standards
- Challenges for Small- and Medium-sized Entities and Accounting Firms
- Potential Knowledge Shortfall
- Implications of Endorsement of IFRSs

This report explores these challenges in detail and includes success factors demonstrating how some countries and organizations have addressed or overcome some of the challenges. Additionally, proposed actions that are based on an analysis of the findings and participants’ recommendations are included for each of the

challenges. A list of proposed actions by each stakeholder group is featured at the end of the report. Although not agreed or endorsed by any formal group of IFAC or any other international organization, these proposed actions have been developed to further the goal of international convergence.

The proposed actions are premised on the following:

- Successful adoption of the international standards is dependent on the development of high quality standards.
- Integrity in the application of the international standards is essential. Preparers, auditors, and users of financial statements must encourage and support compliance with the substance and form

of the international standards.

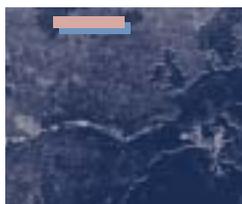
- The adoption and implementation of the international standards require action at both the national and international levels. At the national level, it is important that governments, regulators, and national standard setters place inter-

national convergence as a priority on their agendas. At the international level, it is important that the international standard setters establish processes and procedures that facilitate national input and lead to the development of high quality standards that are globally accepted.

Finally, it is clear that to achieve international convergence, action is necessary at all points along the information supply chain that delivers financial reporting. Boards of directors and management, who have the primary responsibility for financial reporting, as well as auditors, standard setters, regulators, and other participants in the financial reporting process, such as lawyers, investment bankers, analysts, credit rating agencies, and educators, all have important roles to play in achieving international convergence. □

**TO** achieve international convergence, action is necessary at all points along the information supply chain that delivers financial reporting.

## UNDERSTANDING THE MEANING OF INTERNATIONAL CONVERGENCE



### What Does “Adoption” Mean?

The question, “*To what degree do you consider that the international standards have been adopted in your country?*” gave rise to varied responses largely because there was no universally accepted definition of “adoption.” Participants referred to “adoption,” “harmonization,” “transformation,” etc. without clearly defining what those terms meant. For example, what does it mean to be “largely harmonized?” One written submission noted that the national standards have been “based on” the international standards, and that the national accounting standards are at least 80% identical to IFRSs and the national auditing standards are at least 95% identical to ISAs. International convergence is a process, with adoption as the end result. However, without a universally accepted definition of “adoption,” it is difficult to measure progress towards international convergence.

The World Bank, in preparing the Reports on the Observance of Standards and Codes (ROSCs), encountered similar diversity regarding the concept of adoption. It found that the adoption of IFRSs could be categorized as: full adoption of IFRSs; full adoption of IFRSs, but with time lag; selective adoption of IFRSs; and national standards “based on” IFRSs. The adoption of ISAs could

be categorized similarly, but with one addition: adoption of a summarized version of the ISAs. Furthermore, in all the ISA categories the adopted ISAs may contain additional national requirements.

The time lag in adopting the international standards is due mainly to translation of the standards. For example, in one country a five-year time lag was experienced due to the need for translation of the ISAs.

Selective adoption of the international standards is due mainly to the complexity of the standards, the incompatibility thereof with national culture, or potential implementation problems. For example, in one country the ISAs were summarized in 33 pages, as the complete standards were felt to be “overwhelming.” The implementation of these summarized ISAs was intended to be a first step to full adoption; however, that country is now in the sixth year of this temporary stage.

According to paragraph 14 of International Accounting Standard (IAS) 1, *Presentation of Financial Statements*, financial statements shall not be prescribed as complying with IFRSs unless they comply with all the requirements of IFRSs. Paragraph 53 of the exposure draft of the proposed revised ISA 700, *The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements*, states that the auditor’s

report should only refer to the audit having been conducted in accordance with ISAs when the auditor has complied fully with all of the ISAs relevant to the audit. This leaves the preparers and auditors of financial statements in countries that have not fully incorporated the IFRSs and ISAs in their national standards with a dilemma. Although the national standards have been developed with reference to the international standards, they may not fully incorporate them and, consequently, the financial statements and auditor’s report should not refer to compliance with IFRSs and ISAs.

Furthermore, a reference to national standards that are “materially the same” or “substantially the same” as IFRSs or ISAs is confusing and potentially misleading.

## A MODEL OF CONVERGENCE

In March 2004, the Accounting Standards Board (ASB) in the United Kingdom issued a discussion paper, *UK Accounting Standards: A Strategy for Convergence with IFRS*. The paper set out the ASB’s views on the future development of national accounting standards. Specifically, it stated that the ASB believes that there can be no case for the use in the United Kingdom of two sets of wholly different accounting standards in the medium term, and it should not seek to issue new standards that are more demanding or restrictive than IFRSs. These propositions require a concerted effort from the ASB to bring national accounting standards into line with IFRSs. The ASB intends to achieve this as quickly as possible while avoiding the burden of excessive changes in any one year and, in particular, minimizing the cases in which an entity using national accounting standards may be required to make successive changes of accounting policy in respect of the same matter.

### *Amendments for National Specificities*

The adoption and implementation of the international standards in a country takes place in an environment that is affected by factors unique to that country, for example, the economy, politics, laws and regulations, and culture. A reason cited by participants for not fully incorporating IFRSs and ISAs is that countries find it necessary to amend the international standards to provide for national specificities. Projects undertaken by the Fédération des Experts Comptables Européens (FEE), the Auditing Practices Board (APB) in the United Kingdom, and the Australian Accounting Standards Board (AASB) further confirm this situation.

In March 2004, FEE issued *ISA+ in the EU: A Summary of Country-specific Audit Requirements*, which categorizes additional national requirements as: additional explicit reporting required by law or regulation; additional exception reporting required by law or regulation; additional reporting required by national auditing standards; and significant additional procedures required by national auditing standards. National law, regulation, and auditing standards gave rise to many divergences from ISA 700, *The Auditor's Report on Financial Statements*. In addition, 11 of the 30 countries included in the summary identified one or more significant procedures not contained in the ISAs.

In June 2004, the APB issued an exposure draft on proposed *International Standards on Auditing (UK and Ireland)*. The APB is proposing to revise the existing national auditing standards to ensure that they, at a minimum, meet the requirements of the ISAs. In developing the exposure draft, the APB reviewed all the national standards to identify instances where it was of the view that the national standards contained higher standards than those contained in equivalent ISAs. Where material was considered to be relevant and helpful, such material was incorporated in the ISAs for application in the United Kingdom.

The AASB has adopted the IFRSs with minimum amendments to accommodate national laws and regulations, eliminate some options, make the standards sector neutral, make conforming amendments to the terminology in some of the IFRSs that have not recently been revised, and retain a small amount of guidance that is in the existing AASB standards.

Similarly, many other countries are finding it necessary to incorporate national legal and regulatory requirements and national practice in their adopted international standards or to eliminate international requirements because of "legal obstacles." In the future, however, this practice may no longer be acceptable.

In accordance with the European Commission's *Proposal for a Directive of the European Parliament and of the Council on Statutory Audit of Annual Accounts and Consolidated Accounts and Amending Council*

*Directives 78/660/EEC and 83/349/EEC* (March 16,

2004), European Union (EU) member states will be allowed to impose additional audit procedures only if these follow from specific requirements relating to the scope of the statutory audit.

Furthermore, EU member

states will have to communicate these additional procedures to the Commission.

In addition to national specificities such as national laws, regulations, and practice, the tax driven nature of the national accounting regime was also identified as a barrier to international convergence. For example, in some countries one of the primary objectives of the national accounting standards traditionally has been to determine taxable income. Financial statements prepared in accordance with IFRSs are intended primarily to serve the needs of the capital markets, which may differ significantly from the needs of the tax authorities.

**SIMILARLY**, many other countries are finding it necessary to incorporate national legal and regulatory requirements and national practice in their adopted international standards.

### *Date of International Convergence and Effective Dates of Adopted International Standards*

In some instances, participants reported that their countries have adopted the international standards in issue at a particular date, but have not kept up-to-date with new and revised international standards issued subsequent to that date.

In other instances, it was found that the national standards have different effective dates and transitional provisions from those of the international standards on which they are based.

This leaves the preparers and auditors of financial statements in the same dilemma as discussed earlier. Any reference to compliance with the international standards should be made only if there was full compliance with all the international standards effective at that date.

### *Accessibility to the International Standards*

Limited accessibility to some or parts of the international standards was identified as a barrier to international convergence. Some participants, particularly those from developing countries, were concerned that fees are being charged to obtain the IFRSs. Similarly, participants from the EU, who will have free-of-charge access to parts of the IASB literature, were concerned that guidance essential for proper implementation of IFRSs would not be available free of charge.

### *Conclusions and Proposed Actions*

It is evident that international convergence is a process. This process could be enhanced by IFAC through greater clarification of the end result, i.e., the meaning of “adoption,” and by the development of a more consistent and globally recognized measurement of international convergence. While consideration needs to be given as to how best to accommodate national laws and regulations, greater consistency in approach by those adopting the international standards is needed. Governments and regulators are encouraged to establish legal and regulatory environments that provide for compliance with the international standards, with no or very limited additional national requirements. Governments are also encouraged to acknowledge the differing roles of tax accounting and financial reporting.

National standard setters are encouraged to make international convergence the core of their work and the focus of their resources, and to interface with the international standard setters on behalf of their national constituencies. International standard setters need to continue to recognize the unique challenges faced by national standard setters and to provide sufficient opportunity for national standard setters to provide input to the international standard-setting processes.

## SUCCESS FACTORS

Factors that contributed to national standard setters' success in adopting and implementing the international standards include:

- The development of and commitment of all stakeholders to a formal international convergence policy that clearly states the fundamental principles of international convergence, the convergence process, the roles and responsibilities of all stakeholders, and the timeframe for international convergence.
- The establishment of good relationships with and cooperation among all stakeholders, including preparers, auditors, and users of financial statements, governments, and regulators.
- The consideration of the effect that international convergence may have on small- and medium-sized entities and accounting firms.
- The establishment of a formal translation process, which involves both professional translators and professional accountants.
- The alignment of national standard-setting agendas and processes with those of the international standard setters.
- The devotion of significant resources to working with and influencing the work of the international standard setters.

To achieve the above, national standard setters are encouraged to publish formal international convergence strategies, addressing matters such as the fundamental principles of convergence, the convergence process, the roles and responsibilities of the various stakeholders, and a timeframe for implementating their strategies. Translation issues (see next page) should also be addressed.

National standard setters are further encouraged to cover the criteria for additional national requirements as a fundamental principle in their formal international convergence strategies. Such additional requirements should be limited to those necessary as a result of national laws and regulations.

National best practices not dealt with in the international standards should be communicated to and considered by the international standard setters.

In addition, national standard setters should consider how best to incorporate the additional national requirements in the adopted international standards. Varied approaches have been reported. For example, the exposure draft of the UK APB clearly differentiates additional material from the ISA content, while in the case of the French and German auditing standards, which incorporate the ISAs, the additional material is not separately differentiated. Clear differentiation of the additional national

requirements is preferred since it facilitates easy maintenance of the adopted international standards and of the additional national requirements, and enables preparers or auditors who wish to comply with IFRSs or ISAs to distinguish the additional national requirements from the IFRSs or ISAs.

It is also recommended that regional professional accountancy organizations take actions to facilitate the adoption and implementation of the international standards. It has been recognized that the adoption and implementation of international standards often has similar consequences for countries in the same region,

and thus, solutions may be found at a regional level.

Well organized and resourced regional professional accountancy organizations could assist national professional accountancy bodies and national standard setters by combining efforts to adopt and

implement the international standards. They could facilitate input to the international standard-setting processes, translation of the international standards, and the education and training of preparers, auditors, and users of financial statements. □

**NATIONAL** *standard setters are encouraged to make international convergence the core of their work and the focus of their resources.*

## TRANSLATION OF THE INTERNATIONAL STANDARDS



The translation of the international standards is a major challenge in the adoption and implementation of the standards. Translators often find it difficult to convey the real meaning of the English text in the translated standards. Issues that were noted by participants as contributing to the difficulty of translation were the following:

- The use of lengthy English sentences;
- Inconsistent use of terminology;
- The use of the same terminology to describe different concepts; and
- The use of terminology that is not capable of translation. For example, international standards use words such as “shall” and “should” and the present tense to indicate different levels of obligations, while many languages are not capable of using the same indicators.

Most participants also felt that the international standards should be written in simple English that can better accommodate translations.

Another issue with respect to translations is the consistent use of terminology in the translated standards. To address this issue, some translators, in the first instance, have translated the international standard setters’ glossary of terms, or some other list of key words. Some participants, however, were of the view that the IAASB’s glossary of terms did not contain all the words that were thought to be “key.” Mention was made of such concepts as “significant” or “material” which might well have different nuances in different languages, as well as being concepts that might be subject to cultural differences and influences.

### *Impact of Funding*

Participants reported that donor funding is frequently used to support the translation of the international standards. Since this funding sometimes covers a one-time or specific project, organizations do not always have the resources to support the translation of new and revised international standards. Considering the frequency and volume of changes to the international standards, the translated standards soon become outdated, and preparers and auditors of financial statements can no longer claim compliance with the IFRSs and ISAs respectively.

### *Timetable for Translations*

Concern was expressed that IFRSs endorsed by the European Commission and effective in the EU on January 1, 2005 may not all be translated in a time-frame that will allow for proper implementation. The Commission has indicated that it may take nine months from the publication of an IFRS by the IASB until the translated standard is available in the Official Journal of the Commission.

Participants also raised timing issues with respect to the international exposure drafts. Some national standard setters issue the international exposure drafts, or national exposure drafts incorporating the international exposure drafts, at the same time that they are issued by the international standard setters. This enables them to consider the comments received on a national level and to respond to the international standard setter. However, this may not be possible where the time allowed for submitting comments is short and does not take account of the time required to translate these exposure drafts.

### *Involvement of Professional Accountants*

The majority of participants emphasized the importance of involving professional accountants in the translation of the international standards. There was also a concern that, should a translation of the international standards not involve the developers or users of the international standards, it may compromise the quality of the translation.

### Conclusions and Proposed Actions

The International Accounting Standards Committee (IASC) Foundation has established a translation process for IFRSs, and in July 2004, the IFAC Board approved a Policy Statement on *Translation of Standards and Guidance Issued by the International Federation of Accountants*. It is hoped that these initiatives will facilitate high quality translations of the international standards. In addition, it was recommended that IFAC establish on its website a forum through which issues pertaining to translation might be reported and solutions shared, and that future exposure drafts of proposed international standards ask whether any issues might arise regarding translation of the standards.

To ensure consistency in translations and maximize available resources, countries that speak the same language are encouraged to coordinate their efforts and, over time, eliminate the existence of multiple translations of international standards into the same language. The French translation of the ISAs led by the Institut der Bedrijfsrevisoren – Institut des Reviseurs d'Entreprises (Belgium) and involving representatives of its counter-parts in France, Canada, and more recently

Luxembourg and Switzerland, have proved beneficial to all parties in achieving a common understanding and translation of key words.

With respect to translations of international exposure drafts, it was recommended that consideration be given to adding a 30-day period between when an international exposure draft is made available to national standard setters and when it is issued both internationally and nationally. This would allow national standard setters to translate the international exposure draft, insert a preface, and incorporate the necessary additional national requirements. Comments received on the exposure draft could then be considered at both a national and international level.

A national standard setter reported that it performs “rough” translations of proposed ISAs before final approval of the ISAs by the IAASB. This facilitates earlier implementation.

Finally, it is recommended that regional professional accountancy organizations take an active role in the facilitation of translations. Their involvement could help prevent duplication of effort and contribute to the release of timely and high quality translations. Additionally, efforts on their part to secure funding for translations could help make translated standards more broadly available. □

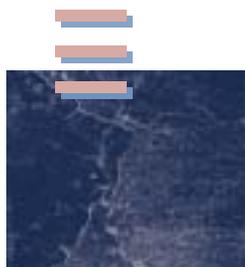
**MOST** participants felt that the international standards should be written in simple English that can better accommodate translations.

## SUCCESS FACTORS

Factors that contributed to national professional accountancy bodies' success in translating the international standards include:

- The development of a formal translation plan and establishment of a translation team that includes professional accountants.
- To ensure the consistent use of terminology, the translation of a list of key words in the first instance and, where appropriate, obtaining the input of translators of the international standards in other countries that speak the same language.
- Actively seeking and securing donor or other funding that not only covers the initial translation of the international standards, but also the translation of new and revised standards.
- The establishment of a translation process that provides for the early translation of proposed and final international standards, enabling earlier implementation of the standards.

## COMPLEXITY AND STRUCTURE OF THE INTERNATIONAL STANDARDS



Participants were of the view that the international standards are increasingly becoming longer, more complex, and rules-based, and that the structure and complexity of the standards are affecting, largely in an adverse way, both their adoption and implementation. In particular, reference was made to the international accounting standards on financial instruments and the international auditing standards on audit risk, fraud, and quality control. Despite the comments on length and level of detail, a need for more implementation guidance was generally supported.

The international regulators, however, appeared to be supportive of the longer and more detailed ISAs issued recently. The length of and detail in the ISAs provide for a tighter regulatory environment and consistent application of the ISAs.

Participants emphasized the importance of applying a principles-based approach in international standard setting. It was felt that standards that are long, complex, and rules-based are difficult to implement and are likely to result in a compliance and avoidance mentality.

Participants reported that the international standard setters appear to have little or no sympathy for the fact that some countries need to incorporate their adopted international standards in national law or regulation. The international standards are not written in the form of law or regulation and, therefore, have to be “transformed” by the national standard setters. Or, as is the case in another country that incorporates the ISAs in its national auditing standards, the obligations are incorporated in national law or regulation and the explanatory text is incorporated in pronouncements issued by the national professional accountancy body.

A participant cautioned national standard setters against the above-mentioned approach since it may affect the authority of the national standards. For example, the obligations incorporated in national law or regulation may be authoritative, while the explanatory text published elsewhere may not be authoritative. It is, therefore,

important to consider the hierarchy of national standards in comparison with the authority attached to the international standards.

Participants also had difficulties understanding the ordering of text in the international auditing standards since the logic of the structure was not always clear to them. An example cited was the practice in ISAs of placing an obligation on the auditor, followed by definitions of terminology included in the obligation, and then explaining the obligation. Some participants felt that these steps should be treated in a different order.

Adding to the complexity of IFRSs is the IASB’s move towards a fair value model. Many participants were of the view that fair value is a subjective concept and is difficult to measure accurately – different interpretations could lead to different conclusions. However, the investment professionals, who believe that the IASB is not going far enough in its fair value model, were of the view that the matter could be overcome by explaining the effect that fair valuation has on the financial position and results of

operations in the financial statements. For example, the volatility caused by fair valuation could be disclosed in a separate section of shareholders’ funds. The market (and regulators) will then know how to deal with this.

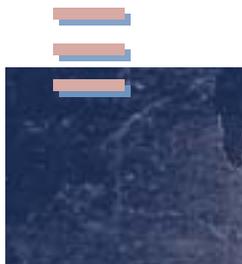
### *Conclusions and Proposed Actions*

It is recommended that the international standard setters become more attuned to the challenges national standard setters and preparers, auditors, and users of financial statements face in adopting and implementing the international standards. In particular, participants recommended that international standard setters develop standards that continue to be principles based, the text of which is not complex, and the structure of which lends itself to incorporation in national law or regulation and to implementation.

The IAASB has taken a first step in this regard. It has undertaken a project to clarify the language and style of its pronouncements. The objective is to issue pronouncements that are understandable by those who perform the relevant engagements and are clear and capable of consistent application. □

**PARTICIPANTS** *emphasized the importance of applying a principles-based approach in international standard setting.*

## FREQUENCY, VOLUME, AND COMPLEXITY OF CHANGES TO THE INTERNATIONAL STANDARDS



It has clearly been a very challenging time for preparers, auditors, and users of financial statements – not only as a result of new and revised international standards, but also because of the many new requirements emanating from parties

other than the accounting and auditing standard setters. Participants questioned whether the cumulative effect of these changes on the preparers, auditors, and users of financial statements is being monitored by those who set the requirements. A participant recommended that the following question should be asked about every change: Will the value added exceed the cost to implement the change?

The frequency, volume, and complexity of the changes to the international standards are evidenced by the following:

- The IASB's Improvements Project, which gave rise to 13 standards being amended simultaneously with consequential amendments to many others (598-page document issued by the IASB in December 2003).
- Repeated changes of the same standards, including changes reversing IASB's previous stand and changes for the purpose of international convergence. These include changes to the international accounting standards on presentation of financial statements; accounting policies, changes in accounting estimates and errors; property plant and equipment; the effects of changes in foreign exchange rates; and financial instruments.
- Complex changes requiring considerable technical expertise. These include changes to the international accounting standards on financial instruments, impairment of assets, and employee benefits.
- Changes to the IAASB's audit risk model, which gave rise to three new international auditing standards and consequential amendments to many others.

- New international standards on quality control, dealing with quality control at the accounting firm and audit engagement levels.
- A revised international auditing standard on the auditor's responsibility to consider fraud in an audit of financial statements, published in February 2004, while a previous revision of the same standard became effective for audits of financial statements for periods ending on or after June 30, 2002.

Given the above, national standard setters may decide not to adopt international standards that are subject to change in the near future. For example, the UK ASB proposes not to incorporate certain IFRSs in its national accounting standards. There are a number of different

reasons for its decision. On cost/benefit grounds it does not wish to issue a national accounting standard that incorporates a relevant international standard, which is likely to change significantly in the near future.

Furthermore, as discussed earlier, in some countries the adopted inter-

national standards are incorporated in national law or regulation. Consequently, national law or regulation has to be revised every time the international standards are revised.

Also, due to frequent changes to the international standards, "real life examples" of best practice are not readily available to users of these standards.

Participants acknowledged that the international standard setters are working diligently to improve the international standards as soon as possible, with January 1,

*It is equally important for the international standard setters to strike a balance between the need to improve the international standards on a priority basis and the need to address the practical issue of providing countries with the time they need to adopt and implement these standards.*

2005 as an important target date for the IASB. However, they reported that it is equally important for the international standard setters to strike a balance between the need to improve the international standards on a priority basis and the need to address the practical issue of providing countries with the time they need to adopt and implement these standards. For example, allowing a short period of time to implement a complex IFRS that requires significant changes to an entity's financial reporting system or a complex ISA that requires changes to audit methodologies and training can undermine progress towards international convergence.

### *Conclusions and Proposed Actions*

It is recognized that the international standards need to be responsive to market changes, the needs of investors, and diverse and complex financial products. However, given the frequency, volume, and complexity of changes to the international standards, the international standard setters should consider how they can effectively and efficiently accommodate national efforts to adopt and implement these standards.

The IASB and IAASB is considering a “quiet period” for adoption and implementation of the international standards. This quiet period will provide users of the international standards a time during

which no new or revised international standards will become effective. While both the IASB and IAASB will continue to develop new or revise existing international standards, those issued during the quiet period will become effective no earlier than the end of the quiet period.

Going forward, it is recommended that the international standard setters collect information regarding a realistic adoption and implementation timetable for national standard setters and preparers, auditors, and users of financial statements. This should be factored into their standard-setting processes and the determination of the effective dates of new and revised international standards.

Furthermore, the implementation of the international standards is not only an accounting issue – it is also a business issue. Consequently, anticipated changes to the international standards should be considered at an early stage by the preparers of the financial statements and the potential effect thereof discussed with all interested parties, including those charged with governance of the entity. □

### **SUCCESS FACTOR**

Matters relating to the frequency of changes to the international standards are being addressed. In preparing their international convergence timetable, national standard setters delay the adoption of those international standards that are under revision until such time as they are finalized. This prevents changes to a national standard shortly after incorporation of an international standard.

## CHALLENGES FOR SMALL- AND MEDIUM-SIZED ENTITIES AND ACCOUNTING FIRMS



In most countries, many or even all entities are required by national law or regulation to prepare financial statements that conform to a required set of generally accepted accounting principles, and for these financial statements to

be audited in accordance with a required set of generally accepted auditing standards. These audited financial statements are normally filed with a government agency and thus are available to creditors, suppliers, employees, governments, and others. A large number of these entities are small- and medium-sized entities. In Europe, for example, it is estimated that there are about 7,000 public interest entities and more than one million private entities. (While the European Commission is calling for only listed entities that prepare consolidated financial statements to comply with IFRSs, it is possible that all 1,007,000 entities will be audited under ISAs beginning in 2007.)

Virtually all participants raised issues concerning the relevancy and appropriateness of the international standards to small- and medium-sized entities and accounting firms. Key concerns expressed were as follows:

- Length and complexity of the international standards;
- Cost of compliance with IFRSs versus benefits obtained;
- Inconsistent application of the international standards;
- Perceived focus on large-entity issues; and
- Lack of sufficient small- and medium-sized entity and practice representation on the international standard-setting boards.

Comments on these issues are described further below.

Some national standard setters already seem to be working individually to determine how best to provide for financial reporting by small- and medium-sized entities in their national laws, regulations or standards. These individual national approaches were not viewed

as efficient and participants suggested that they would only pose a risk to international convergence. Additionally, comparability and consistency would be compromised if alternative approaches exist. Consequently, participants felt that it was very important for the IASB's project to develop international accounting standards for small- and medium-sized entities to progress rapidly, with sufficient and appropriate input from small- and medium-sized entities.

With respect to ISAs, participants were of the view that the focus of ISAs has changed from the audits of financial statements of entities of all sizes to the audits of financial statements of large, complex, public interest, and often multi-national entities. The ISAs are progressively becoming more difficult to apply to the audits

of financial statements of small- and medium-sized entities. The international auditing standards dealing with audit risk were mentioned as an example.

There was also a sense that the international standard setters do not recognize

*VIRTUALLY all participants raised issues concerning the relevancy and appropriateness of the international standards to small- and medium-sized entities and accounting firms.*

or appreciate the effect that changes in the fundamental principles of the international standards have on small- and medium-sized entities and accounting firms. The financial statements of small- and medium-sized entities are often used as the basis for tax preparation, banking covenants, and other reporting requirements. A whole re-education process, which extends beyond the preparers and auditors of financial statements to users, such as investors, lenders, tax authorities, and regulators, is necessary as a result of these changes.

A participant indicated that the small- and medium-sized segment needs to be further segmented to distinguish the very small from the rest. “IFRS light” or “ISA light” may not be appropriate for very small entities. Consequently, a different set of standards may have to be developed for a third segment – where financial reporting is mainly for tax authorities and banks.

### *Conclusions and Proposed Actions*

In June 2004, the IASB issued a discussion paper on *Preliminary Views on Accounting Standards for Small- and Medium-Sized Entities*. The purpose of the discussion paper is to invite comments on the IASB’s preliminary views on its basic approach to develop international accounting standards for small- and medium-sized entities.

The IASB’s project was recognized as a significant step in addressing the needs of small- and medium-sized entities and participants encouraged the IASB to progress this project rapidly.

National standard setters and preparers, auditors, and users of financial statements of small- and medium-sized entities are encouraged to respond to the above-mentioned IASB discussion paper and to comment on relevant proposed pronouncements issued by the IASB and IAASB.

The IAASB has established a process to obtain the input of IFAC’s Small and Medium Practices Permanent Task Force on small- and medium-sized entity audit considerations to be incorporated in new and revised pronouncements.

The November 2004 European Congress for Small- and Medium-sized Practices and Entities, sponsored by FEE and featuring speakers from the IASB and IFAC, along with European leaders, is another important action. Activities such as these that provide a forum for dialogue between the international and national standard setters and small- and medium-sized entities and practices are encouraged and much needed.

Finally, but most significantly, on an ongoing basis, the international and national standard setters should ensure that the needs of small- and medium-sized entities and practices are addressed in the development of the international standards. For example, a participant recommended that ISAs be written with the simplest audit in mind and considerations for large, complex public interest entities should be added where necessary. Involving representatives from small- and medium-sized entities and practices in the standard-setting process is seen as critical. □

## SUCCESS FACTORS

Factors that contributed to addressing successfully the needs of small- and medium-sized entities include:

- National standard setters including representatives from small- and medium-sized entities and accounting firms on their boards.
- National standard setters and professional accountancy bodies liaising with governments, regulators, and other interested parties to provide for differential reporting by small- and medium-sized entities.
- National standard setters developing national accounting standards for small- and medium-sized entities in consultation with all interested parties.
- Small- and medium-sized accounting firms using the longer and more detailed ISAs to train their staff and to implement the ISAs.

## POTENTIAL KNOWLEDGE SHORTFALL



### *Awareness, Knowledge, and Skills*

The increasing proliferation and complexity of global issues, transactions, financial products, and standards present new challenges to the accountancy profession to ensure that it has the requisite knowledge and skills to carry out its responsibilities. In particular, there appears to be a potential knowledge shortfall with respect to the international standards.

Education and training were considered major challenges by most of the participants. They were of the view that only very few professional accountants have a detailed knowledge of IFRSs and the requisite skills to apply them.

For example, the results of a survey of members from business and practice conducted by the Institute of Chartered Accountants in England and Wales in June 2003 on the awareness of, and preparation for, the introduction of the international accounting standards revealed the following:

- A third of the respondents were either “not very aware” or “not aware at all” of the publication of the European Commission’s regulation on the application of the international accounting standards;<sup>2</sup>
- Less than half of the respondents felt they were aware of the effect that the international accounting standards would have on their organization or its financial statements;
- Two thirds of the respondents were either “not very aware” or “not aware at all” of the IASB’s project timetable; and
- Only a quarter of the respondents knew what the UK ASB’s views and aims were in relation to the international convergence process.

The results of a recent PricewaterhouseCoopers survey<sup>3</sup> of more than 300 European companies show that just 10% of survey participants are confident they

have the right people and skills in place to complete the transitions to IFRSs in the EU on time. Smaller entities, in particular, are finding it difficult to commit full-time resources to the implementation of IFRSs. The concern for entities is whether the people they need will be available as the demand for IFRS specialists reaches its peak in 2004/2005.

Some participants were concerned about over-reliance on the technical expertise in accounting firms. Entities that do not have the technical expertise are becoming more dependent on their auditors to interpret the IFRSs.

Implementation of the ISAs by networks of accounting firms should be easier due to the development and implementation of global audit methodologies and training programs incorporating ISAs as well as global internal inspection programs to monitor compliance with the standards.

Although many countries have incorporated the international standards in the education and training of students, a participant was concerned about educators’ knowledge of the international standards since they normally are not involved in the implementation of these standards.

Another participant was of the view that the volume and speed of changes made it impossible for students to develop the skill and ability to apply the international standards. This participant reported a decline in students’ ability to deal with problems critically and analytically. Students should be taught how to apply a framework of principles to different circumstances – for the detail, they could refer to the handbooks of international standards.

Participants were also concerned about the knowledge of analysts and the media. Participants representing professional investors, however, were of the view that analysts will be prepared for the transition to IFRSs.

### *A Need for Interpretations*

There is a need for an easier and quicker way to resolve matters of interpretation of IFRSs. Participants commented on the need for the IASB and, in particular, the International Financial Reporting Interpretations Committee (IFRIC), to be more cooperative in this regard.

**URGENT** *attention should be given to the development of implementation guidance that is widely available to all in need of such guidance.*

<sup>2</sup> Regulation (EC) No 1606/2002, July 19, 2002

<sup>3</sup> International Financial Reporting Standards: Ready to Take the Plunge?, May 2004

Participants were of the view that, at present, some IFRSs are open to varying interpretations and competitors are “shopping” for more favorable interpretation on common issues. To prevent this, some industries have started to organize forums where leading entities could discuss their approaches to common issues.

#### *A Need for Implementation Guidance*

Participants reported a need for implementation guidance. They were of the view that implementation guidance is of particular importance when the international standards are applied for the first time, when there are translation issues, and when there is a lack of technical expertise and “real life examples” of best practice. In addition, reference was made to the implementation of the international standards in the context of, for example, national legal and regulatory frameworks and cultures.

#### *Conclusions and Proposed Actions*

National professional accountancy bodies are encouraged to continue to create an awareness and expand the knowledge of professional accountants and others of the international standards.

Educational institutions are encouraged to provide the educators with education and training in the international standards. They should also offer programs of accounting and auditing that produce accounting graduates familiar with the international standards.

For entities that are implementing IFRSs, an understanding of the standards is necessary from the top down – from those responsible for the governance of the entity to those responsible for financial and operational reporting by individual business units. Consequently, training programs should involve individuals at all levels of the entity and should continue after the initial transition to IFRSs.

There is also a need to make analysts and journalists aware of the effect that the transition to IFRSs may have on entities’ financial statements. Participants encouraged entities to provide analysts with the information necessary to interpret their entities’ financial positions and results of operations.

The international standard setters are encouraged to establish processes, or enhance existing processes, to respond to requests for interpretations in a timely manner.

Furthermore, urgent attention should be given to the development of implementation guidance that is widely available to all in need of such guidance.

There was no consensus as to who should develop the implementation guidance. Possibilities include: the international standard setters, national standard setters, national professional accountancy bodies, and large accounting firms. However, if the guidance is developed by anyone other than the international standard setters, there may be a lack of international coordination and a corresponding lack of consistency. □

## SUCCESS FACTORS

Factors that contributed to addressing successfully the potential knowledge shortfall include:

- National professional accountancy bodies offering training to their members by way of seminars, and large entities and accounting firms providing compulsory training to their staff.
- National professional accountancy bodies educating analysts and journalists on the effect that the transition to IFRSs may have on an entity’s financial statements. This includes the issuance of press releases and posting of information on websites.
- Educational institutions involving staff from accounting firms in teaching the international standards.
- International organizations that represent industries, such as financial institutions, providing training to their members by way of seminars.
- Industries organizing forums where leading entities can discuss challenges and solutions to implementing specific IFRSs.

## IMPLICATIONS OF ENDORSEMENT OF IFRSs



As those in the EU and other countries continue to prepare to meet their upcoming deadlines for the adoption of the international accounting standards, they are faced with unique challenges, some of which are discussed in more detail below.

### *Two Sets of Accounting Standards*

It is possible that after January 1, 2005 two very different sets of accounting standards may apply in the same EU member state, i.e., IFRSs and national accounting standards. The European Commission's regulation on the application of international accounting standards<sup>4</sup> limits the adoption of IFRSs to listed entities that prepare consolidated financial statements. However, it provides for EU member states to decide whether to adopt IFRSs for other entities.

Some EU member states are amending national law or regulation to provide for compliance with IFRSs or national accounting standards by other entities, while others have decided to continue to require compliance with national accounting standards.

Although national laws or regulations were cited as one reason for maintaining national accounting standards, the existence of two sets of standards has potential negative implications. Most obvious is the use of national accounting standards in the individual financial statements and IFRSs in the consolidated financial statements of the same entity. Also, students and preparers, auditors, and users of financial statements will have to know two sets of accounting standards.

### *Limited Application to Listed Entities*

As discussed earlier, the European Commission's regulation limits the adoption of IFRSs to listed entities that prepare consolidated financial statements. Participants were concerned about other public interest entities, such as financial institutions, that may not be listed.

### *Potential Late Endorsement or Non-endorsement of IFRSs*

Participants indicated that the European Commission's potential late endorsement or non-endorsement of the international accounting standards on financial instruments is creating uncertainties for preparers, auditors, and users of financial statements.

There are serious implications if non-endorsement of some IFRSs result in a European standard in one or more areas. FEE cites the following implications in its *FEE Position – Call for Global Standards: IFRS* (June 2004):

- Extra disclosures to explain differences from IFRSs, for reasons of transparency.
- Entities would no longer be able to claim that their financial statements were prepared in accordance with IFRSs, with related consequences for the audit and the auditor's report.
- The effect that any unique European standard may have on financial reporting systems. For example, changes with regard to the recognition, measurement, and disclosure of complex financial instruments.
- A risk that some entities, such as financial institutions, that apply or want to apply the non-endorsed IFRS will be seriously disadvantaged.
- Access to capital markets could be restricted or made more expensive.
- A loss of opportunity to converge IFRSs and U.S. accounting standards and possible effect on other elements of transatlantic dialogue.
- A risk of setting a precedent.

Referring to the potential late endorsement or non-endorsement of the international accounting standards on financial instruments, participants were concerned about the politician's role in international standard setting. This concern is well summarized in a speech of Bob Herz, chair of the U.S. Financial Accounting Standards Board (FASB) at a conference of the American Institute of Certified Public Accountants and the U.S. Securities Exchange Commission held in December 2003 (his references are to both the IASB and FASB): *"All our constituents, including politicians, have a very legitimate interest in our activities. But I believe that*

<sup>4</sup> Regulation (EC) No 1606/2002, July 19, 2002.

*interest must be in our properly fulfilling our mission of establishing sound, neutral accounting standards and not in trying to bias our activities and decisions through pressure and threatened intervention into our independent and, we believe, objective process ... Standard setting should not be a political process because the primary objective must be on the relevance, reliability, and usefulness of reported information and not on trying to satisfy the favored economic, business, social, or political goals of particular interest groups ...”*

**Preparedness for the Adoption of the International Standards**

The results of the recent PricewaterhouseCoopers survey<sup>5</sup> of more than 300 European companies indicate that, given the greater risks involved, large entities have made more progress towards implementation of the IFRSs than smaller ones. Also, financial services companies were slightly further advanced with their preparations. According to the survey results, this could be because they are intensely affected by the international accounting standards on financial instruments.

The results of the survey set out seven steps that entities need to work through in order to embed IFRSs, and indicates the degree to which those surveyed have achieved them.

In Australia, which is also working towards the implementation of IFRSs on January 1, 2005, a survey of 122 corporations conducted by the Institute of Chartered Accountants in Australia (ICAA) in July 2004, has revealed that less than half of those surveyed (49%) have commenced the implementation process for IFRSs. However, the percentage of respondents preparing for the IFRSs would grow to 84% within the next six months.

One of the most critical issues for entities will be explaining to investors and analysts how their financial position and results of operations will differ under IFRSs compared with their previously applied national accounting standards. The PricewaterhouseCoopers survey found that 80% of entities had not organized their communications plans. According to the ICAA survey, only 35% of respondents have started to communicate to stakeholders the effect of IFRSs on the financial position and results of their entities.

The Committee of European Securities Regulators (CESR) has recommended that entities provide markets with appropriate and useful information in a phased process. For example, it is recommended that a narrative of IFRS transition progress and key accounting differences between IFRSs and previously applied national accounting standards be included with the 2003 financial statements.

STEP	ACTION	PROGRESS
1	Assess the high-level impact of IFRSs on the business (at least preliminary assessment)	75%
2	Decide on accounting policies (at least for high priority areas)	46%
3	Identify the missing data	26%
4	Enhance systems to collect data (at least for high priority areas)	11%
5	Put processes in place to ensure data collected is robust	10%
6	Design internal controls to demonstrate reliability of data	10%
7	Embed IFRSs and use for internal management reporting	11%

<sup>5</sup> International Financial Reporting Standards: Ready to Take the Plunge?, May 2004

### *Conclusions and Proposed Actions*

As the deadline for the adoption of IFRSs approaches in the EU and other countries, such as Australia, it is critical for all stakeholders to identify and address any outstanding matters.

Referring to the discussion paper on *UK Accounting Standards: A Strategy for Convergence with IFRS* as an example, a participant recommended that national standards setters in countries that offer entities other than listed entities the option to comply with IFRSs or national accounting standards should have formal international convergence strategies. Working towards one set of accounting standards, they should evaluate their national accounting standards to identify differences between IFRSs and the national accounting standards, and actively contribute to the international standard-setting process. (This could equally be applied to countries that do not offer the option, as the ultimate goal should be international convergence – i.e., one set of globally accepted accounting standards.)

Regulators should consider the application of IFRSs to public interest entities that are not listed and that do not prepare consolidated financial statements.

**REGULATORS** *should consider the application of IFRSs to public interest entities that are not listed and that do not prepare consolidated financial statements.*

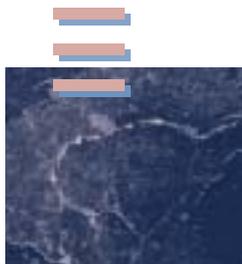
Ongoing dialogue regarding any delay in the endorsement or non-endorsement of a particular international standard is necessary so that all stakeholders could plan accordingly and a contingency plan, addressing concerns of regulators and the relevant international standard setter, could be developed and agreed.

Furthermore, entities that are planning to or have adopted IFRSs are encouraged to actively contribute to the international standard-setting process, in particular to identify practical implementation issues.

Entities that are planning to adopt IFRSs are encouraged to identify differences between IFRSs and the previously applied national accounting standards, design and implement an IFRS transition program, and address required financial reporting system changes. They should also provide training to staff at all levels.

Additionally, professional accountancy bodies, national standard setters, and entities that are planning to or have adopted IFRSs should clearly communicate to the users of the financial statements, including analysts and journalists, the effect of the adoption of IFRSs on entities' financial positions and results of operations. Local seminars could be held in this regard. □

## PROPOSALS FOR ACTIONS BY STAKEHOLDERS



Action is necessary at all points along the information supply chain that delivers financial reporting. Governments, regulators, international and national standard setters, reporting entities, and

auditors, as well as other participants in the financial reporting process, have important roles to play in international convergence.

Actions needed to support international convergence are highlighted below.

### *Governments*

- Establish a legal environment that provides for compliance with all the international standards, with no or very limited additional national requirements.
- Write or revise laws to reflect the international standards and international best practice.
- Designate financial reporting laws as a high priority and act within a reasonable period of time.
- Establish efficient and effective enforcement mechanisms to increase the consistency and quality of compliance with the international standards.

### *Regulators*

- Establish a regulatory environment that provides for compliance with all the international standards, with no or very limited additional national requirements.
- Write or revise regulations to reflect the international standards and international best practice.
- Designate financial reporting regulations as a high priority and act within a reasonable period of time.
- Establish efficient and effective enforcement mechanisms to increase the consistency and quality of compliance with the international standards.

### *International Standard Setters (IASB and IAASB)*

- Establish a process, or enhance the existing process, whereby national standard setters, in aligning their agendas with that of the international standard setters, have an opportunity to actively contribute to the international standard-setting processes.
- As a matter of urgency, develop standards in a manner that takes account of small- and medium-sized entity financial reporting and audit consid-

erations. In addition, provide for greater small- and medium-sized entity and accounting firm representation.

- Address concerns about the complexity and structure of the international standards.
- Write standards in simple English that is understandable, clear, and capable of translation and consistent application.
- In developing the international standards and setting effective dates, be cognizant of the fact that proposed and final standards are being translated in some countries that are adopting them.
- In considering changes to the international standards, be cognizant of the cost v. the benefits of the proposed changes.
- Establish a process, or enhance the existing process, to respond to requests for interpretations in a timely manner.
- Consider the development of implementation guidance.
- Provide, or continue to provide, unlimited access to all authoritative pronouncements and implementation guidance.
- Institute a “quiet period” for the adoption and implementation of the international standards.

### *National Standard Setters*

- Develop a formal international convergence strategy and obtain the commitment of all stakeholders.
- Develop an active standard-setting agenda, which is aligned with that of the international standard setters and aimed at eliminating existing differences with the international standards. This should be achieved within a reasonable period of time.
- Establish a process, or enhance the existing process, to actively contribute to the international standard-setting processes, including the development of international standards for small- and medium-sized entities and accounting firms.

### *Reporting Entities*

- Design and implement an IFRS transition program and allocate the necessary resources. This includes obtaining the commitment from the top down, i.e., from those charged with governance to those responsible for financial reporting by individual

business units. Also consider the interdependencies between the transition to IFRSs and other financial reporting projects, such as compliance with national laws and regulations.

- Prepare to implement IFRSs by identifying differences and addressing required financial reporting system changes.
- Develop an external communications strategy.
- Design and implement plans to change management reporting used to monitor the performance of the business from the previously applied national accounting standards to IFRSs.
- Provide IFRS training for staff at all levels affected by the transition to IFRSs.
- Actively contribute to the international standard-setting process, in particular to identify practical implementation issues.
- Consider at an early stage anticipated changes to the international standards and discuss with all interested parties their potential effect on the financial statements.

#### *Auditors*

- Raise an awareness of the international standards among clients.
- Align audit methodologies and training with the international standards.
- Provide IFRS and ISA training to staff at all levels.

#### *Analysts and Investors*

- Promote convergence of the national standards with the international standards.
- Actively contribute to the international standard-setting processes, in particular to identify users' needs.
- Provide IFRS training to staff at all levels.

#### *International Federation of Accountants*

- Study and further develop the concept of “international convergence,” i.e., when has a country achieved convergence of its national standards with the international standards.
- Establish a process that facilitates translation of the international standards.

- Monitor and enforce compliance with IFAC's Statements of Membership Obligations.
- Assist member bodies with the development of action plans to ultimately achieve compliance with the Statements of Membership Obligations.

#### *Regional Professional Accountancy Organizations*

- Coordinate contributions to the international standard-setting processes, translations of the international standards, and training in the international standards at a regional level.

#### *National Professional Accountancy Bodies*

- Facilitate the adoption and implementation of the international standards through compliance with IFAC's Statements of Membership Obligations.
- In line with the Statements of Membership Obligations, assist government, regulators, and the national standard setters in formulating and enacting convergence of the national and international standards, and in addressing impediments to international convergence (e.g., tax reporting v. financial reporting).
- Support the preparation of high quality translations of the international standards.
- In line with the Statements of Membership Obligations, create awareness and expand the knowledge of students, professional accountants, and others of the international standards.
- Establish processes that facilitate maximum contribution to the international standard setting processes – representing the views of professional accountants and others on all relevant issues.

#### *Educational Institutions*

- Educate and train the educators in the international standards.
- Offer programs of accounting and auditing that produce accounting graduates familiar with the international standards.

## SUMMARY AND CONCLUSIONS



Listening to national standard setters and preparers, auditors, and users of financial statements, it is clear that there are many challenges to achieving international convergence.

As mentioned earlier in the report, all those involved in the financial reporting process will need to take action. Much of this action is highlighted in the Proposals for Action by Stakeholders section on pages 23 and 24.

As progress on international convergence continues, particularly in the EU, it is vital that there be frequent open and ongoing dialogue between regulators, international standard setters, and national standard setters and that these groups continue to listen to the concerns and needs of those who will have to implement the standards. Significant consideration should be given to the effect of international convergence on small- and medium-sized entities and accounting firms.

The greatest challenge for the participants was “preparing or preparedness for the adoption of the international standards.” What must be done nationally? What support, if any, can be expected from the international standard setters? How will national initiatives to achieve international convergence affect the reporting entities in a country, and what actions should be taken nationally

to address these effects, and who should take these actions? How can the education and training of professional accountants keep pace with the changing environment in which the international standards are being set? Who will keep investors, analysts, journalists and members of the public informed of these changes and their consequences?

As international convergence progresses, questions like these will continue to be raised. All those working to achieve international convergence – from IFAC to regional and national professional accountancy organizations to international and national standard setters and international and national regulators – can and should help to resolve the challenges.

Most importantly, we all need to remember that convergence to a single set of globally accepted high quality standards is ultimately in the best interests of the public, contributing to efficient capital flows within countries

and across borders. In the views of the majority of participants, international convergence is vital to economic growth. Thus, while the challenges are great, the rewards are potentially even greater. □

*WE all need to remember that convergence to a single set of globally accepted high quality standards is ultimately in the best interests of the public.*

## APPENDIX 1: LIST OF FOCUS GROUP MEETINGS, INTERVIEWS, AND RESPONDENTS

Written submissions were received from:

Association of Chartered Certified Accountants  
 Association of Professional Accountants and Auditors  
 of the Republic of Moldova  
 Auditing Standards Committee of the Institute of  
 Chartered Accountants in Ireland  
 Britannia Building Society (United Kingdom)  
 Certified General Accountants Association of Canada  
 Chartered Institute of Public Finance  
 and Accountancy  
 Consiglio Nazionale dei Dottori Commercialisti  
 (Italy)  
 Federación Argentina de Consejos Profesionales de  
 Ciencias Económicas (Argentina)  
 Föreningen Auktoriserade Revisorer (Sweden)  
 KHT-yhdistys - Föreningen CGR ry (Finland)  
 Hong Kong Institute of Certified Public Accountants  
 Howarth Central America  
 HTM-tilintarkastajat ry (Finland)  
 Institut der Wirtschaftsprüfer (Germany)  
 Institute of Certified Public Accountants in Israel  
 Institute of Certified Public Accountants of Singapore  
 Institute of Chartered Accountants in Australia and  
 CPA Australia  
 Institute of Chartered Accountants in England  
 and Wales  
 Institute of Chartered Accountants of India  
 Institute of Professional Accountants of Russia  
 Instituto de Censores Jurados de Cuentas  
 de España (Spain)  
 Instituto Mexicano de Contadores Públicos,  
 A.C. (Mexico)  
 Instituut der Bedrijfsrevisoren – Institut des  
 Réviseurs d'Entreprises (Belgium)  
 Japanese Institute of Certified Public Accountants  
 Koninklijk Nederlands Instituut van Register-  
 accountants (The Netherlands)  
 Malaysian Institute of Accountants  
 Malaysian Institute of Certified Public Accountants  
 National Board of Chartered Accountants of the  
 Accountants Association in Poland  
 PricewaterhouseCoopers

Focus group meetings were arranged by the following:

Chartered Institute of Management Accountants  
 Confederation of Asian and Pacific Accountants  
 Eastern Central and Southern African Federation  
 of Accountants  
 Fédération des Experts Comptables Européens –  
 Audit Working Party  
 Fédération des Experts Comptables Européens –  
 Financial Reporting Policy Group  
 IFAC Small and Medium Practices Permanent  
 Task Force  
 Instituto dos Auditores Independentes  
 do Brasil (Brazil)  
 Inter-American Accounting Association  
 United Kingdom Resident Members of the Analyst  
 Representative Group

Interviews were held with representatives from  
 the following:

Accounting and Auditing Standard Setters  
 in Australia  
 Accounting and Auditing Standard Setters  
 in Canada  
 Accounting and Auditing Standard Setters  
 in Denmark  
 Accounting and Auditing Standard Setters  
 in South Africa  
 Accounting Standard Setter in the United Kingdom  
 Basel Committee on Banking Supervision  
 Professional Oversight Board for Accountancy  
 (United Kingdom)  
 Transnational Auditors Committee  
 World Bank

## APPENDIX 2: LIST OF QUESTIONS COVERED IN FOCUS GROUP MEETINGS, INTERVIEWS, AND WRITTEN SUBMISSIONS



These questions were asked in relation to both the pronouncements issued by the International Accounting Standards Board (IASB) and the pronouncements issued by the International Auditing and Assurance Standards Board (IAASB).

- To what degree do you consider that the international standards have been adopted in your country?
- Has the structure or complexity of the international standards affected their adoption or implementation? If so, how?
- Does the legal process for adoption of the international standards in your country cause any impediment to adoption? If so, to what extent?
- Is there enough lead time to allow for adoption of the international standards?
- If you have had to translate the international standards from English, have there been issues of clarity of the original text? If so, how have these been addressed?
- Are there any issues pertaining to the applicability of the international standards to listed entities, small- and medium-sized enterprises, and not-for-profit organizations? What issues have been raised and how have they been addressed?
- To what extent do you think that professional accountants are knowledgeable of the content of the international standards? Are there any concerns that need to be addressed? If so, how?
- Are there any concerns regarding students' knowledge of the content of the international standards? How is this being addressed?
- Are the consequences of adopting the international standards acceptable to users?



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Printed in U.S.A.

**From:** Paul Sutcliffe [psutcliffe@ifac.org]  
**Sent:** Friday, September 03, 2004 6:44 PM  
**To:** William Connell; padheman@ccomptes.fr  
**Cc:** Robin Mathieson  
**Subject:** RE: PAIB discussion paper on the public sector

Hi Bill

Thank you for this paper and for initiating this discussion of the public sector dimensions of the work of the PIAB with your Committee members. I haven't had the chance to discuss this with Philippe but my initial reaction is that what you propose seems fine. The only additional comments I would make are that I think that given the expertise that your Committee commands, the following two areas are ones that the PAIB could add very significant value in the short term to matters with a very clear and specific public sector perspective: 1. guidance on the management, IT, resource (both human and physical capital), "project management" and other issues that governments will face in migrating from cash to accrual basis of accounting. The ongoing issues faced in these areas will be encompassed by other broad issues you have identified; and 2. non-financial or semi financial performance indicators in a government non-profit environment to provide the essential link from the financial characteristics of performance to the service delivery/service achievement aspects.

I hope this is helpful. Regards Paul

---

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-----Original Message-----

**From:** William Connell [mailto:bill.connell@virgin.net]

**Sent:** Wednesday, September 01, 2004 10:37 PM

**To:** padheman@ccomptes.fr

**Cc:** psutcliffe@ifac.org; Robin Mathieson

**Subject:** PAIB discussion paper on the public sector

I am asked occasionally what we are doing for the public sector accountants in the PAIB. I therefore volunteered at the last meeting to pen a position paper for discussion at the next PAIB meeting.

I would welcome your views and I have attached this for your comments.

Hopefully it is self explanatory.

Our next meeting is in NY on 13th to 15th of September. If it is possible (and I apologise for the short notice) I would appreciate your views before the end of this Friday ( the 3rd Sept) as our second batch of papers go out then.

If you cannot do this please copy Robin in your reply as I will be travelling next week without access to my em.

I look forward to hearing from you,  
regards bill.



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**FOR IMMEDIATE RELEASE**

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**IAASB PROPOSES ENHANCEMENTS TO ITS DUE PROCESS AND  
WORKING PROCEDURES**

*(New York/July 15, 2004)* – As part of its ongoing commitment to develop high quality international standards, the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) has issued an exposure draft (ED) proposing certain enhancements to its due process and working procedures. The ED also proposes to expand the present description of IAASB’s due process and working procedures to reflect more fully the practices that are being followed.

In developing the proposal, the IAASB considered its current working procedures and the IFAC reforms\*, and drew upon best practices followed by other standard setters. The enhancements are designed to increase confidence that the activities of the IAASB are properly responsive to the public interest and will lead to the establishment of high quality international standards.

To further strengthen its deliberative process and to enhance its responsiveness to comments made on proposed standards, the IAASB proposes that its due process and working procedures provide for:

(more)

- Public forums or roundtables, or the issue of consultation papers, where wider or further input would be appropriate.
- Enhanced meeting agenda material and easier access to comment letters to assist in its deliberative process.
- An expanded description of the process by which the IAASB considers the need to re-expose a draft IAASB international standard or practice statement.
- The possibility of issuing a separate document explaining its basis for conclusions on final IAASB international standards or practice statements where necessary.
- A process to address circumstances where issues over due process are raised with the IAASB.

### **How to Comment**

The ED, *Proposed Amendments to the Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services – IAASB Due Process and Working Procedures*, may be viewed by going to [www.ifac.org](http://www.ifac.org). **Comments on the ED are requested by October 15, 2004.** Comments may be submitted to [EDComments@ifac.org](mailto:EDComments@ifac.org). They can also be faxed to the attention of the IAASB Technical Director at +1-212-286-9570 or mailed to the IAASB Technical Director at 545 Fifth Avenue, NY, NY 10017, USA. All comments will be considered a matter of public record and will ultimately be posted on IFAC's website.

### **About the IAASB**

The IAASB's role is to improve auditing and assurance standards and the quality and uniformity of practice throughout the world, thereby strengthening public confidence in the global auditing profession and serving the public interest. The IAASB is part of the International Federation of Accountants (IFAC), which is dedicated to serving the public

(more)

interest, strengthening the worldwide accountancy profession, and contributing to the development of strong international economies. Its current membership consists of over 150 professional accountancy bodies in 118 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce.

# # #

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**Note to Editors:** A series of reforms, developed with the input of worldwide regulators, were unanimously approved by the IFAC Council in November 2003 and are in the process of being implemented. The reforms include: (1) the establishment of a Public Interest Oversight Board to oversee IFAC’s standard setting and compliance regimes; (2) increased transparency with respect to IFAC governance and its international standard-setting activities; (3) broad-based public participation in IFAC standard-setting activities; and (4) a more formal process for maintaining ongoing dialogue with international regulators.

**From:** Paul Sutcliffe [psutcliffe@ifac.org]  
**Sent:** Wednesday, September 08, 2004 9:11 AM  
**To:** JerryGutu; 'philippe Adhémar'  
**Cc:** mbohun@ifac.org  
**Subject:** RE: FACILITATING A WORKSHOP ON IPSASs  
[Hi Philippe and Jerry](#)

Sounds like a good opportunity. Seems to me Erna, Freeman and Terence should be our first port of call. Maybe also Marianne Brown who has undertaken similar work for the world bank. I wonder also whether we should not be contacting the accounting firms to assist in the promotion/education campaign. I can appreciate that the Malawi society and many similar bodies around the world has limited funds, and just cannot commission a separate education program. However, I worry that we ask our members a great deal (Freeman is already doing a similar presentation for us) and that we do not have the funds to support the costs. It may also be something that we should draw the aid agencies into - it seems to me that there may be great benefit in the aid agencies putting together a program that could then be used by consultants around the world.

Philippe, maybe this is something we should raise with Ian Ball in the first instance and then you could also raise at the IFAC Board in November. We could also talk to Ron Points about this in Delhi. I feel we are going to be getting more and more of these requests. Realistically, too many to service. Regards Paul

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-----Original Message-----

**From:** JerryGutu [<mailto:jerrygutu@ifac.org>]  
**Sent:** Wednesday, September 08, 2004 2:33 AM  
**To:** 'philippe Adhémar'; 'Paul Sutcliffe'  
**Cc:** mbohun@ifac.org  
**Subject:** FW: FACILITATING A WORKSHOP ON IPSASs

Philippe and Paul,

This is wonderful opportunity to promote the IPSASs both Cash and Accrual. Perhaps we should ask Terence, Erna or Freeman to do this on behalf of PSC. Let me know what you think. Thank you.

Jerry Gutu  
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Public Sector Committee  
International Federation of Accountants  
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New York, NY 10017

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-----Original Message-----

**From:** SOCAM [mailto:socam@malawi.net]  
**Sent:** Thursday, September 02, 2004 10:17 AM  
**To:** jerrygutu@ifac.org  
**Subject:** FACILITATING A WORKSHOP ON IPSASs

The Society of Accountants in Malawi (SOCAM) is keen to help the Malawi Government establish accounting systems which can improve the way that the Government records and reports its financial results.

In this respect we intend to organise a workshop for key Accounting Personnel in all Government Ministries where they can be trained on how this can be achieved. Meanwhile we have ordered 200 IPSAS Handbook from IFAC. What we need is someone who can explain how these standards can be implemented and what they intend to achieve. The presenter would then have to particularly explain how the current Cash Basis can be improved to achieve same results whilst aiming to adopt the IPSASs in the long run.

The ideal period for the workshop would be anytime from October 2004 but not later than February 2005.

I discussed this with Andy Wynne who referred me to you. Would you please indicate if you can assist us facilitate such a workshop and if so how long would you want it to be and the costs that we would be expected to meet.

Your prompt response will be appreciated.

Yours sincerely

Hennox Mazengera  
The Society of Accountants in Malawi  
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Translation of Standards and  
Guidance Issued by the  
International Federation of  
Accountants



The mission of the International Federation of Accountants (IFAC) is to serve the public interest, strengthen the accountancy profession worldwide and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant.

This Policy Statement has been prepared by IFAC.

The approved text of this Policy Statement is published in the English language.

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**POLICY STATEMENT**  
**TRANSLATION OF STANDARDS AND GUIDANCE ISSUED BY THE**  
**INTERNATIONAL FEDERATION OF ACCOUNTANTS**

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## Purpose

1. Although the official working language of the International Federation of Accountants (IFAC) is English, IFAC recognizes that it is important that preparers and users of financial statements, auditors, regulators, lawyers, academia, students and other interested groups in non-English speaking countries have access to the standards and guidance published by IFAC in their native language. The purpose of this policy statement is to outline IFAC's policy with regard to translation of a selected group of standards and guidance issued by an IFAC board or committee and published by IFAC, and covers the following:
  - (a) Responsibilities of the Translating Body.
  - (b) Design and implementation of a translation process.
  - (c) Translation of key words.
  - (d) Consideration of the Translating Body's translation process.
2. This policy statement also outlines IFAC's policy with regard to the consideration of an existing translation process.
3. This policy statement is intended to enable the Translating Body to state that its process for translating a selected group of standards and guidance published by IFAC was considered by IFAC and that the translation was conducted in accordance with this policy statement.
4. This policy statement does not apply when a Translating Body intends to translate:
  - (a) Standards or guidance that do not fall in the group(s) of standards and guidance issued by an IFAC board or committee and published by IFAC (see paragraph 5(f) and Appendix 1);
  - (b) One or more, but not all, the standards and guidance in a group of standards and guidance issued by an IFAC board or committee and published by IFAC (see paragraph 5(f) and Appendix 1); or
  - (c) Any other publication of IFAC.

In the case of (a), (b) and (c) above, the Translating Body should obtain permission from IFAC to translate the individual standards or guidance.

## Definitions

5. In this policy statement, the following terms have the meaning attributed below:
  - (a) "Principal translator" means the translator with the final responsibility for the translation of the selected group of standards and guidance. The principal translator is appointed by the Translating Body. Where the translation of the selected group of standards and guidance is conducted jointly by two or more Translating Bodies

TRANSLATION OF STANDARDS AND GUIDANCE ISSUED BY  
THE INTERNATIONAL FEDERATION OF ACCOUNTANTS

of countries sharing the same language, two or more principal translators may have final responsibility for the translation.

- (b) “Another translator” means the translator or translators responsible for translating the selected group of standards and guidance in accordance with the principal translator’s requirements. The other translator is appointed either by the Translating Body or the principal translator.
- (c) “Translating Body” means the body that has decided to translate a selected group of standards and guidance. Translating Bodies include IFAC Member Bodies, professional accountancy bodies, national standard setters or any other organization that decides to translate any of the groups of standards and guidance. The translation of the selected group of standards and guidance may be conducted jointly by two or more Translating Bodies of countries sharing the same language.
- (d) “Key words” means the words and phrases contained in the list of key words prepared by the IFAC board or committee whose standards and guidance are being translated. For example, the list of key words could be the Glossary of Terms prepared by that IFAC board or committee.
- (e) “Responsible staff member” means the IFAC staff member responsible for considering the translation processes of Translating Bodies.
- (f) “Group of standards and guidance” means all the standards and guidance designated as a group by the IFAC board or committee that issues the standards and guidance. IFAC will only consider the Translating Body’s translation process if the Translating Body intends to translate all the standards and guidance in a selected group of standards and guidance. Appendix 1 contains a list of relevant IFAC board and committees and an indication of what is considered to be their individual “group(s) of standards and guidance.”
- (g) “Selected group of standards and guidance” means the group of standards and guidance the Translating Body intends to translate. The Translating Body may translate more than one group of standards and guidance.

### **Responsibilities of the Translating Body**

- 6. The Translating Body is responsible for appointing a principal translator. The principal translator, in consultation with the Translating Body, is responsible for developing a translation plan. At a minimum, the translation plan should outline the following:
  - (a) The group(s) of standards and guidance published by IFAC which is to be translated.
  - (b) The language(s) into which the selected group(s) of standards and guidance is to be translated.
  - (c) The translation process to be followed in translating the selected group(s) of standards and guidance.

TRANSLATION OF STANDARDS AND GUIDANCE ISSUED BY  
THE INTERNATIONAL FEDERATION OF ACCOUNTANTS

- (d) The translation process to be followed in translating new or revised standards and guidance in the selected group(s) of standards and guidance, or an indication that the Translating Body plans to translate the selected group(s) of standards and guidance published at a specified date.
  - (e) The timeframe within which the principal translator intends to finalize the translation of the selected group(s) of standards and guidance.
  - (f) Procedures for maintaining the list of key words.
  - (g) The budget available to translate the selected group(s) of standards and guidance and, where applicable, the annual budget available to translate any new or revised standards and guidance in the selected group(s) of standards and guidance.
7. When the translation of the selected group(s) of standards and guidance is conducted jointly by two or more Translating Bodies of countries sharing the same language, the translation plan should include a process for approval of the translation by such bodies.
8. The translation plan should be considered throughout the translation process. The principal translator, in consultation with the Translating Body, may have to revise the translation plan during the translation process as a result of changes in circumstances or unexpected results of translation procedures.

### **Design and Implementation of a Translation Process**

9. The complete text of all the standards and guidance in a selected group of standards and guidance should be translated.
10. The principal translator, in consultation with the Translating Body, should design and implement a translation process that will enable a faithful translation, with no omission or addition (other than translation footnotes as discussed in paragraph 12), of the selected group of standards and guidance. A faithful translation respects the intent, tone and the organization of the selected group of standards and guidance. Appendix 2 covers important aspects of a translation process that meets these criteria.

### **Translation of Key Words**

11. The principal translator should translate the key words, and maintain the translated list of key words. In translating the key words, it is important that the principal translator seeks to understand the intent of the original drafters of the selected group of standards and guidance so that misunderstandings do not arise because of a literal translation of the English text.
12. The principal translator should ensure that the key words are used as consistently as possible in the translation of the selected group of standards and guidance and, where applicable, in the translation of new and revised standards and guidance in the selected group of standards and guidance. Translation footnotes may be used to refer to the prevalent usage in a country when the key word retained differs from that usage.

13. Since more than one translation into the same language of the selected group of standards and guidance may exist, the Translating Body should consider publishing the list of key words with the translated selected group of standards and guidance.

### **Consideration of the Translating Body's Translation Process**

14. The Translating Body should submit its translation plan (see paragraph 6) for consideration by the responsible staff member prior to the commencement of the translation. Any subsequent changes to the translation plan (see paragraph 8) should be communicated to and considered by the responsible staff member.
15. A Translating Body will be able to state that its process for translating the selected group of standards and guidance was considered by IFAC and that the translation was conducted in accordance with this policy statement if:
  - (a) The translation plan has been prepared in accordance with this policy statement, and:
    - (i) The responsible staff member has considered and agreed to the plan prior to the commencement of the translation; and
    - (ii) Where applicable, significant changes to the translation plan have been communicated to and agreed with the responsible staff member.
  - (b) The translation process for translating the selected group of standards and guidance and, where applicable, new and revised standards and guidance in the selected group of standards and guidance, has been implemented.
  - (c) The key words have been used as consistently as possible in the translation of the selected group of standards and guidance and, where applicable, in the translation of new and revised standards and guidance in the selected group of standards and guidance.
  - (d) A letter of representation is received from the Translating Body on an annual basis. The letter of representation should confirm the Translating Body's compliance with (a), (b) and (c) above. The letter of representation should be signed by the chief executive officer (or equivalent) of the Translating Body and the principal translator.
16. A statement that a Translating Body's process for translating a selected group of standards and guidance was considered by IFAC and that the translation was conducted in accordance with this policy statement does not mean that IFAC warrants the translation as being accurate, consistent or complete. It is an acknowledgment that a Translating Body has used its best efforts to translate a selected group of standards and guidance accurately and consistently with due regard to a faithful interpretation of the original English text.
17. To avoid multiple translations of a selected group of standards and guidance into the same language, IFAC will use its best efforts to make Translating Bodies aware of other

TRANSLATION OF STANDARDS AND GUIDANCE ISSUED BY  
THE INTERNATIONAL FEDERATION OF ACCOUNTANTS

Translating Bodies' intention to translate the selected group of standards and guidance into the same language, or of the existence of translations of the selected group of standards in that language.

### **Existing Translation Process**

18. Translating Bodies that have already established processes to translate selected groups of standards and guidance and wish to make a statement in line with paragraph 3, should submit the following for consideration by the responsible staff member:
  - (a) A translation plan.
  - (b) A comparison of the translation process followed to date to the requirements of this policy statement and the aspects dealt with in Appendix 2, indicating any compensating procedures where differences exist.
  - (c) Confirmation of the consistent use of the key words.

### **Effective Dates of Translated Standards and Guidance**

19. The translated standards and guidance cannot have an effective date later than the effective date of the English pronouncement.

### **English Text Prevails**

20. In the event of any dispute as to the meaning of a translated word or phrase, IFAC will refer to the English meaning thereof.

### **Publication of Translated Standards and Guidance**

21. In publishing the translated standards and guidance, Translating Bodies should follow the policies and procedures of IFAC, including those relating to copyright.
22. In addition, the following text should be printed on each translated standard or statement:

“This [insert title of standard or guidance] published by the [insert name of IFAC board or committee that prepared the standard or guidance] of the International Federation of Accountants (IFAC) in [insert month and year] in the English language, has been translated into [insert language] by [insert name of Translating Body] in [insert month and year], and is reproduced with the permission of IFAC. The process for translating the [insert collective name of group of standards and guidance] was considered by IFAC and the translation was conducted in accordance with “Policy Statement—Translation of Standards and Guidance Issued by IFAC.” The approved text of all [insert collective name of group of standards and guidance] is that published by IFAC in the English language.”

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23. When the Translating Body indicated that it plans to translate a selected group of standards and guidance published at a specified date (see paragraph 6(d)), that is, it does not plan to translate new and revised standards and guidance in the selected group of standards and guidance published after that specified date, this fact should be stated in addition to the text in paragraph 22.

## Appendix 1

### List of IFAC Board and Committees and Groups of Standards and Guidance

**IFAC Board or Committee**    **Group of Standards and Guidance**

*(All the standards and guidance of the IFAC board or committee listed below fall within that board's or committee's "group of standards and guidance" and should be translated should the Translating Body select that group of standards and guidance.)*

Education Committee            International Education Standards for Professional Accountants

Ethics Committee                Code of Ethics for Professional Accountants

International Auditing and Assurance Standards Board    Group A:

- International Standards on Quality Control
- International Standards on Auditing
- International Auditing Practice Statements

Group B:

- International Standards on Quality Control
- Assurance Framework
- International Standards on Assurance Engagements
- International Assurance Engagements Practice Statements

Group C:

- International Standards on Quality Control
- International Standards on Review Engagements
- International Review Engagements Practice Statements

Group D:

- International Standards on Quality Control
- International Standards on Related Services
- International Related Services Practice Statements

Public Sector Committee        • International Public Sector Accounting Standards

- Study 14, "Transition From Cash Basis to Accrual Basis of Accounting"

## Appendix 2

### Important Aspects of a Translation Process

#### Translation of Key Words

1. To facilitate the accurate and consistent translation of the key words, the principal translator establishes a translation group. The members of the translation group ordinarily are native speakers of the language in question, have an excellent knowledge of English and are experienced in the use of the specific standards and guidance published by IFAC. It is recommended that the translation group consists of the following:
  - (a) Current or past members or technical advisors of the IFAC board or committee whose standards or guidance are being translated.
  - (b) Individuals involved in, or affected by, the translation process, for example, professional translators or key members from the National Professional Accountancy Body and regulators.
  - (c) Professional accountants experienced in the use of the standards and guidance published by IFAC.
2. The translation group reviews the principal translator's translation of the key words.
3. Principle translators are encouraged to liaise with other Translating Bodies that intend to or has translated the selected group of standards and guidance into the same language to reach agreement on the translation of the list of key terms and, ultimately, to work towards one translation of the selected group of standards and guidance into that language.
4. Where the work of another translator will be used, the principal translator discusses the translation of the key words with the other translator prior to commencing the translation. In addition, the principal translator monitors the use of the key words throughout the translation process. The other translator is requested to indicate the use of key words in the proposed translated text, for example by three asterisks (\*\*\*)
5. The principal translator, in consultation with the translation group, may consider it necessary to modify the original translation of a key word in the light of the use of the word in the translated text. It is critical that the key words are translated consistently throughout the standards and guidance. Monitoring the use of key words throughout the translation process, and modifying the translation of these words as considered necessary, serves as confirmation that the original translation of the key words, that is, without the context in which the word is to be used, was realistic and is beneficial in circumstances when the timeframe of the original translation of the key words was quite narrow.

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6. The Translating Body communicates any proposed clarifications or amendments to the English text of the list of key words to the responsible staff member.

**Using the Work of Another Translator**

7. When using the work of another translator, the principal translator considers the following matters:
  - (a) The professional competence of the other translator in the context of the specific assignment, i.e. the other translator's professional qualifications, professional knowledge, translation skills in the specific language combination and ability to translate pronouncements in the field of ethics, auditing, assurance, education, accounting, etc.
  - (b) The reputation and infrastructure of the organization that the other translator is associated with.
  - (c) Past experience of working with the other translator.
8. The principal translator performs a review or revision of the quality of the other translator's work.

# **EXPOSURE DRAFT OF PROPOSED INTERNATIONAL VALUATION GUIDANCE NOTE – VALUATION OF SPECIALISED TRADING PROPERTY**

*Comments to be received by 31 October 2004*

This Exposure Draft is published by the International Valuation Standards Committee (IVSC) for comment only.

Comments should be submitted in writing so as to be received by **31 October 2004**.

All replies may be put on public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@ivsc.org** or addressed to:

**International Valuation Standards Committee**

**12 Great George Street, Parliament Square, London SW1P 3AD**

**United Kingdom**

**Fax: +44 (0) 1442 879306**

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# Exposure Draft of Proposed International Valuation Guidance Note

## Specialised Trading Property

*This Guidance Note should be read in the context of the background material contained in General Valuation Concepts and Principles and implementation procedures required under International Valuation Standards 1,2 and 3*

### **1.0 Introduction**

- 1.1 Specialised Trading Properties (STPs) are individual properties, such as hotels, gas or petrol stations, and restaurants that usually change hands in the marketplace as operating entities. These entities include not only the usual elements of land and buildings, but also fixtures and fittings (furniture, fixtures and equipment) and a business component made up of intangible assets and goodwill.
- 1.2 Known as Specialised Trading Properties or Properties with Trading Potential in Commonwealth countries, STPs are often referred to as Going Concerns in the U.S.A. However, their valuation differs. In the U.S.A. the valuation premise adopted is that of a going concern, whereas an STP valuation excludes the personal circumstances of the owner. Although in both cases the value estimated is Market Value, the methodologies for valuing STPs and Going Concerns deal with different sets of assets.
- 1.3 This Guidance Note provides direction on valuation approaches for STPs as operating entities as well as the componentisation of STP entity value into its main constituents. Component values are usually required for depreciation and tax purposes. This Guidance Note should also be read in conjunction with the Guidance Notes cited in para. 2.1 below.
- 1.4 The concepts involved in the valuation of an entire business must be distinguished from those involved in the valuation of *Specialised Trading Property*.

## **2.0 Scope**

2.1 This Guidance Note focuses on STP valuation. For further insight into the application of valuation principles, the following IVS Guidance Notes should be consulted:

- 2.1.1 GN 1, Real Property Valuation,
- 2.1.2 GN 3, Valuation of Plant and Equipment,
- 2.1.3 GN 4, Valuation of Intangible Assets,
- 2.1.4 GN 5, Valuation of Personal Property,
- 2.1.5 GN 6, Business Valuation,
- 2.1.6 GN 10, Discounted Cash Flow Analysis.

## **3.0 Definitions**

3.1 *Capitalisation.* At a given date the conversion into the equivalent capital value of net income or a series of net receipts, actual or estimated, over a period.

3.2 *Discounted Cash Flow.* A financial modeling technique based on explicit assumptions regarding the prospective income and outgoings of a business or property. The most widely used applications of DCF analysis are the Internal Rate of Return (IRR) and Net Present Value (NPV).

3.3 *Goodwill:*

3.3.1 *That intangible asset* that arises as a result of name, reputation, customer patronage, location, products or similar factors, which generate economic benefits.

3.3.2 *Goodwill.* Goodwill that is property-specific and inherent within the property. This is an intangible but sustains the Market Value of the asset based on the probability that customers will continue to return to the same premises.

3.4 *Reasonably Efficient Operator, or Average Competent Management.* A market based concept whereby a potential purchaser, and thus the Valuer, assess the maintainable level of trade and future profitability that can be achieved by a competent operator of such a business, acting in an

efficient manner. The concept involves the trading potential rather than the actual level of trade under the existing ownership.

3.5 *Specialised Trading Property.* Property with trading potential, such as hotels; gas, or petrol, stations; restaurants; or the like, the *Market Value* of which may include assets other than land and buildings alone. These properties are commonly sold in the market as a going concern, or with regard to their trading potential that may make separate identification of the value of the land, building, personal property, intangible assets, and business itself difficult.

#### **4.0 Relationship to Accounting Standards**

4.1 Under the provisions of International Financial Reporting Standards (IFRSs), the Fair Value components of STPs may need to be separately determined under the requirements of IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets, the latter including elements of purchased goodwill, licenses, etc.

4.2 In preparing financial statements, it may be necessary to apportion the value of STPs among asset components to enable the allocation for depreciation, tax purposes, and/or to satisfy accounting requirements.

#### **5.0 Guidance**

5.1 This Guidance Note describes that category of property referred to as STPs and explains how STPs are valued in accordance with International Valuation Standard 1, Market Value Basis of Valuation.

5.2 When performing an STP valuation, the Valuer should refer to IVA 1, Valuation for Financial Reporting, and the six Guidance Notes cited in para. 2.1 above.

5.3 STPs are considered individual trading entities and typically are valued on the basis of their Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), usually on the basis of DCF methodology or by use of a capitalisation rate.

- 5.4 The valuation assumes that the business is run by a “Reasonably Efficient Operator”. Profit generated, over-and-above market expectations that may be attributed to the owner is not included. The owner’s particular tax position, depreciation policy, borrowing costs and capital invested in the business are not considered for the purpose of establishing a common basis to compare different properties under different owners.
- 5.5 Although the concepts and techniques are similar to those used in business valuation, to the extent that the valuation of an STP does not consider actual tax, depreciation, borrowing costs and capital invested the business, the valuation is based on inputs somewhat different from those of a business valuation.
- 5.6 The valuation conclusion usually needs to be broken down between the different components for the purposes of financial reporting, for ad valorem taxation or, when required, for property lending purposes. This process enables the Valuer to arrive at an indication of the value of the underlying real estate component. The components of STP entity value are:
- 5.6.1 working capital;
  - 5.6.2 land;
  - 5.6.3 buildings;
  - 5.6.4 fixtures and fittings (furniture, fixtures and equipment), including software; and
  - 5.6.5 intangible assets, including goodwill/business value.
- 5.7 An estimation of the individual values of the components can only represent an apportionment, unless direct market evidence is available for one or more of these components to isolate component value from the overall STP value. There is substantial literature on the subject of componentisation/allocation.
- 5.8 **Working Capital.** Most business Valuers would define working capital, in this circumstance, as current assets (cash, accounts receivable, inventory and prepaid expenses) less current liabilities (accounts payable and accrued expenses). The impact of financing liabilities, such as the current portion of long term debt, is not considered. Working capital assets are tangible assets whose value can normally be taken directly from the balance sheet of the STP. It is important to note

whether or not some of these assets are included in the market analysis that was used to estimate the Market Value of the whole. Depending on whether or not such assets were included, appropriate adjustments must be made. The allocation for working capital is part of the business valuation. See GN 6 for a full discussion.

- 5.9 **Land and Building.** These are tangible assets that are normally valued by reference to the market for comparable assets. In some cases, the income approach, usually discounted cash flow analysis, is also used to arrive at an estimate of Market Value. The allocation to land and buildings is what constitutes the real property. See GN 1 for a full discussion.
- 5.10 **Fixtures and Fittings (Furniture, Fixtures and Equipment).** These are tangible assets. They are normally valued with reference to the market for comparable items, suitably adjusted for age, condition, etc. The proper analysis includes adjustments for all forms of depreciation, i.e., physical deterioration, functional obsolescence and economic (external) obsolescence. The allocation process must clearly define what part of this group of assets might be included with the building, and what cannot be. The allocation for fixtures and fittings includes plant and machinery. See GN 3 and GN 5 for a full discussion.
- 5.11 **Intangible Assets.** These assets are often a combination of the Trademark, Name, Franchise, Workforce (more properly called “trained workforce”) and Goodwill. Most business Valuers define goodwill as the sum of all the non-identified intangible assets. It is important to note whether or not some of these assets are included in the market analysis that was used to estimate the Market Value of the whole. The techniques used to value these assets are typically versions of discounted cash flow and capitalization of cash flow. In some cases, the cost to recreate (duplicate) the intangible asset(s) can also be successfully used as a methodology. Key to the income approach is determination of the cash flow that should be allocated to each of these assets. The allocation for intangible assets is part of the business valuation. See GN 4 and GN 6 for a full discussion.
- 5.12 **Cash Flow Allocation.** In applying the income approach, it is necessary to allocate the overall cash flow/income stream to the STP entity so as to arrive at valid estimates of the value of the asset components involved. The following pointers indicate how the cash flow/income stream might be allocated to each asset component.

### 5.12.1 **Tangible Assets.**

5.12.1.1 **Land.** The allocation of cash flow to land is what would be received in rents if the land were vacant and under lease.

5.12.1.2 **Land Improvements.** The allocation of cash flow to land improvements is what an investment analysis would estimate as the return expected from entering into a capital construction project.

5.12.1.3 **Building.** The allocation of cash flow to the building is what would be received in additional rents if the building were available for leasing.

5.12.1.4 **Fixtures and Fittings.** The allocation of cash flow to fixtures is what an investment analysis would estimate as the return expected from entering into a capital project.

5.12.1.5 **Machinery & Equipment.** Often included under the heading of Fixtures and Fittings, the allocation of cash flow to machinery and equipment is normally what would be received in rents if the machinery and equipment were to be leased.

5.12.1.6 **Working Capital.** Conceptually, the cash flow allocated to working capital is the weighted average of the return expected on each individual asset type (e.g., cash might be expected to earn about 2% to 3% in a money market fund) less the weighted average of the cost required to borrow the money that is loaned by suppliers in the form of accounts payable and accrued expenses.

### 5.12.2 **Intangible Assets.**

5.12.2.1 **Name.** The allocation of cash flow to a name is the excess of cash flow that would be earned by an operation, which was allowed to use the name, over the cash flow that would be earned by an operation, which was not allowed to use the name. It could also be the royalty that would be charged to use the name.

5.12.2.2 **Franchise.** The cash flow allocated to a franchise is calculated the same way as the cash flow allocated to a name.

5.12.2.3 **Workforce.** The cash flow allocated to the workforce is the excess of cash flow that would be earned by an operation, which was allowed to use the trained workforce, over the cash flow that would be earned by an operation, which was not allowed to use the workforce.

5.12.3 **Goodwill.** After all cash flow is allocated to individually identified assets, any remainder is normally allocated to goodwill. It should be noted that the sum of the cash flows to all the individual assets must not exceed the entire cash flow of the STP entity.

5.13 **STP Value Allocation.** In general the conceptual process involved in the allocation is fairly straightforward. The market cash flow allocated to each individual asset is discounted to present value at the appropriate market discount rate. Two of the asset categories are discussed in the section below.

5.13.1 **Working Capital.** In concept a discount rate is developed as the weighted average of the discount rates for each of the constituent assets or liabilities. That discount rate is applied to the cash flow allocated to the working capital to arrive at the Market Value of the working capital. In practice, the current assets and current liabilities that make up working capital are normally stated on the balance sheet of an STP at amounts that closely correspond to Market Value.

5.13.2 **Goodwill.** Since the allocation of cash flow to goodwill is the residual after the overall value of the STP has been allocated to all the other assets, the value of the goodwill will be the amount that is left after the values of all the other assets are subtracted from total STP value. To estimate the value of goodwill, the discount rate to be applied to the residual must be determined and the present value must be calculated. Typically, goodwill is a riskier asset than any of the other STP assets because if something starts to go badly for the STP, goodwill is the first to be affected, and its value will decline more rapidly than the value of any of the other asset components. While the tangible assets can normally be sold as used assets in a liquidation sale, intangible assets typically cannot. Moreover, goodwill can never be sold separately from the business that generates it. As a result, the discount rate applied to the value of the goodwill must be higher than any of the other discount rates, usually by several percentage points.

## 5.14 Methodology and Expertise

5.14.1 In practice, the income approach may not be the best methodology for estimating the Market Values of each of the assets discussed above. In some cases the market comparison approach may be a better alternative; in others the cost approach may be superior. Each of the individual assets, however, needs to be valued to arrive at an accurate allocation of the Market Value of the STP.

5.14.2 It may be advisable to have a business Valuer estimate the Market Value of the entire business enterprise, while the real property Valuer estimates the Market Value of the land and building. The Market Value of the machinery and equipment should be estimated by someone skilled in that type of asset valuation, and a Valuer with expertise in the valuation of intangible assets should estimate the Market Values of those assets.

## 6.0 Effective Date

6.1 This International Valuation Guidance Note became effective.....



# NEWS ALERT

FOR IMMEDIATE RELEASE (16 August 2004)

## **‘Deloitte IFRS Model Financial Statements support International Valuation Standards’**

Deloitte has published model financial statements to illustrate the typical disclosures of a UK listed company reporting under International Financial Reporting Standards (IFRSs) for 2005. The notes to the accounts for Property, Plant and Equipment and for Investment Property carry the statement: *‘The valuation conforms to International Valuation Standards.’*

Material that has been included to meet specific UK requirements has been highlighted in the model financial statements. Otherwise, Deloitte considers that the model statements are appropriate for entities following IFRSs in any country. Globally, thousands of companies will be moving to IFRS as their primary basis of financial reporting as from 2005. The use of IFRSs becomes mandatory for listed companies in the 25 European Union member states in 2005. About 70 other countries will also be using IFRSs directly or aligning national standards with IFRSs.

John Edge, IVSC Chairman welcomed the publication, “The IVSC has long maintained that use of International Valuation Standards can help in the rigorous and consistent application of International Financial Reporting Standards (IFRS). Valuers who are called upon to prepare a valuation for IFRS accounts should be aware that the auditing profession may require the valuation under International rather than national valuation standards.”

END

## NOTES TO EDITORS

1. For further details, please contact:

John Edge - IVSC Chairman, Tel +44 (0)207 629 8171  
Email: john.edge@knightfrank.com

Marianne Tissier - Executive Director, IVSC Tel: +44 (0)1442 879306;  
Email: mtissier@ivsc.org

2. The International Valuation Standards can be freely viewed on the IVSC web site ([www.ivsc.org](http://www.ivsc.org)), representing the commitment by the International Valuation Standards Committee to ensure that all valuers, from both developed and emerging economies, have access to its standards. The printed version is available at a cost of US\$50 (inclusive of postage and handling charges) and can be ordered on-line.
3. The IFRS Model Financial Statements can be viewed on the Deloitte web site – [www.iasplus.com](http://www.iasplus.com).
4. Relevant extracts from the Model Financial Statements read as follows:

### **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 20XX**

#### **Significant accounting policies**

##### **Property, Plant and Equipment**

*Land and buildings held for use in the production or supply of goods or services, or for administrative purposes, are stated in the balance sheet at their revalued amounts, being the fair value at the date of revaluation, determined from market-based evidence by appraisal undertaken by professional valuers, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations are performed with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair values at the balance sheet date.*

##### **Investment Property**

*Investment property, which is property held to earn rentals and/or for capital appreciation, is stated at its fair value at the balance sheet date. Gains or losses arising from changes in the fair value of investment property are included in profit or loss for the period in which they arise.*

#### **16. Property Plant and Equipment**

*Land and buildings were revalued at 31 December 20XX by Messrs. Lacey & King, independent valuers not connected with the Group, on the basis of market value. The valuation conforms to International Valuation Standards and was based on recent market transactions on arm's length terms for similar properties.*

#### **17. Investment property**

*The fair value of the Group's investment property at 31 December 20XX has been arrived at on the basis of a valuation carried out at that date by Messrs R P Trent, independent valuers not connected with the Group. The valuation, which conforms to International Valuation Standards, was arrived at by reference to market evidence of transaction prices for similar properties.*



Fédération des Experts  
Comptables Européens

# Press Release

Ref : PR50

*For immediate publication: 27 September 2004 16:30*

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## **EUROPEAN PUBLIC SECTOR SIGNALS MOVE TO INTERNATIONAL STANDARDS**

*Brussels, 27 September 2004:* International Public Sector Accounting Standards (IPSASs) are essential to the development and strengthening of financial reporting by governments - that was the conclusion of a high-level conference organised jointly by the European Commission and FEE, the representative body of the European accountancy profession.

"Across Europe the public sector is responsible for about 40% of GDP. Hence, as the public sector moves from cash-based reporting to the introduction of accruals accounting, robust standards oriented to the circumstances of the public sector are essential. The International Federation of Accountants (IFAC) has developed a set of high quality standards to allow sound financial reporting by governments," said FEE President David Devlin, speaking at today's conference.

FEE, the European Federation of Accountants, which represents more than 500,000 accountants in Europe, has been a long time supporter of the move to accruals accounting. The key benefit is more transparent and meaningful financial information about the operations and financial performance of government and other public sector organisations.

Cash-based accounting has significant weaknesses, not least because information about assets and liabilities is frequently very limited and there is the lack of an effective balance sheet. Accruals brings to account commitments to spend rather than waiting until the bills are paid, as in cash accounting.

Supporting the move towards IPSASs, Mr. Brian Gray, Deputy Director General, and Chief Financial Officer of the European Commission, advocated closer co-operation between the profession and the public sector, noting, "private sector techniques properly adapted have much to offer the public sector. In turn the accountancy profession has much to learn from the complexity of the public sector- in particular the public sector's focus on stewardship and accountability."

Member states are at different stages of implementing accruals accounting and reporting in the public sector. The European Commission and other EU institutions are working towards its adoption in 2005. The purpose of the conference was to discuss issues raised by adopting accruals accounting and reporting; to share ways of overcoming potential problems, and to review the progress achieved in different member states.

Commitment from the political leadership is an important factor in the successful introduction of accruals based reporting. FEE welcomes Budget Commissioner Schreyer participation at today's conference, organised by the Commission with assistance from FEE. By giving the keynote address, the Commissioner is clearly demonstrating the importance attached to accruals reporting at the highest political level," added Caroline Mawhood, FEE Public Sector Committee Chairman.

- Ends -

*Page 1 of 2*

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**Notes for Editors:**

1. For more information about the conference *Accruals Accounting in the Public Sector - Progress and Achievements* visit: <http://www.fee.be/secretariat/PSC%20Conference.htm>
2. The **Fédération des Experts Comptables Européens** (FEE) is the representative organisation for the accountancy profession in Europe. FEE's membership consists of 41 professional institutes of accountants from 29 countries. FEE member bodies represent more than 500,000 accountants in Europe. Roughly 45% of these accountants work in public practice, providing a wide range of services to clients. The other 55% work in various capacities in industry, commerce, government, the wider public sector and education.

From: Helene Kennedy [hkennedy@kennedycomm.com]  
Sent: Thursday, September 30, 2004 12:44 PM  
To: 'Paul Sutcliffe'  
Subject: RE: 0409feepr.pdf

Paul

Today we had a call from a reporter for Reuters (the newswire) in Brussels. She was doing a piece on International Public Sector Standards. She had questions about our standards as well as what was going on in the EU. Ian spoke with her and I also arranged for Philippe to speak with her tomorrow. We felt Philippe would be appropriate as there was a European Focus to the story. He is calling her tomorrow morning from Boston. You may want to send him the attached.

Thanks. I will keep you in mind for interviews as well. Just wanted to keep you up to date.  
Helene

-----Original Message-----

From: Paul Sutcliffe [mailto:psutcliffe@ifac.org]  
Sent: Wednesday, September 29, 2004 9:37 PM  
To: Joanne Scott; Matthew Bohun IFAC; LiLi Lian  
Cc: Ian Ball; Helene Kennedy; Paul Sutcliffe IfAC  
Subject: 0409feepr.pdf

LiLi

Good pick-up. It certainly should. Matthew add something on this for Ian's paper. Regards Paul



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### **LAS NORMAS CONTABLES PARA EL SECTOR PÚBLICO AHORA DISPONIBLES EN ESPAÑOL**

*(Nueva York/Septiembre 21, 2004)* – Las Normas Contables Internacionales para el Sector Público (International Public Sector Accounting Standards - IPSASs), elaboradas por el Comité del Sector Público de la Federación Internacional de Contadores se encuentran ahora disponibles en español. La Fundación del Comité de Normas Internacionales para Prácticas Contables (International Accounting Standards Committee Foundation -IASCF) tradujo las IPSAS de acumulaciones 1-20, el *Glosario de Términos Definidos en las IPSAS 1 a IPSAS 20* y las exhaustivas IPSAS sobre base de efectivo, *Información Financiera en el marco de la Contabilidad con Base de Efectivo*, como parte del acuerdo del Comité del Sector Público con la IASCF. El proceso de traducción es similar al empleado para la traducción de las normas publicadas por la Junta Internacional de Normas Contables (International Accounting Standards Board -IASB).

Las IPSAS establecen los requerimientos para información financiera por parte de gobiernos y de otras entidades del sector público distintas de las empresas comerciales gubernamentales. Las IPSAS de acumulaciones están basadas en las normas del IASB

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en la medida en que los requerimientos en esas normas son aplicables al sector público.

“Estas traducciones forman parte del compromiso del PSC de hacer a las IPSAS más accesibles para nuestros miembros del mundo no angloparlante,” afirma el Presidente del PSC Philippe Adhémar. “Así incrementaremos nuestra capacidad de contribuir a mejorar la información financiera por parte de gobiernos en todo el mundo, así como la administración financiera y la responsabilidad de estos gobiernos.”

Las traducciones al francés están en proceso de realización.

Tanto la versión en inglés como la versión en español de las IPSAS pueden descargarse gratuitamente del sitio web de la IFAC visitando [www.ifac.org/publicsector](http://www.ifac.org/publicsector). El inglés sigue siendo la lengua oficial de las normas.

La IFAC se halla dedicada a servir el interés público, fortaleciendo la profesión de prácticas contables en todo el mundo, y contribuyendo al desarrollo de sólidas economías internacionales. Su actual conjunto de miembros consiste en 157 organismos contables profesionales en 118 países, que representan a más de 2,5 millones de contadores en la práctica pública, la educación, los servicios gubernamentales, la industria y el comercio. Además de establecer normas contables para el sector público, la organización fija normas internacionales de auditoría y garantía, educación y estándares éticos.

# # #



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**INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS  
NOW AVAILABLE IN SPANISH**

*(New York/September 21, 2004)* -- International Public Sector Accounting Standards (IPSASs), developed by the Public Sector Committee of the International Federation of Accountants, are now available in Spanish. The International Accounting Standards Committee Foundation (IASCF) translated accrual IPSASs 1-20, the *Glossary of Defined Terms in IPSAS 1 to IPSAS 20* and the comprehensive cash basis IPSAS, *Financial Reporting Under the Cash Basis of Accounting*, as part of the Public Sector Committee's arrangement with the IASCF. The translation process is similar to that used for the translation of standards issued by the International Accounting Standards Board (IASB).

IPSASs set out the requirements for financial reporting by governments and other public sector entities other than government business enterprises. The accrual IPSASs are based on IASB standards to the extent that the requirements in those standards are applicable to the public sector.

"These translations are part of the PSC's commitment to make IPSASs more accessible to our constituents in the non-English speaking world," states the PSC Chair

(more)

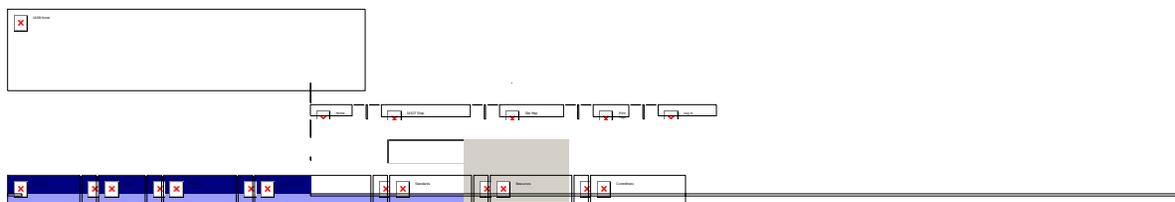
Philippe Adhémar. “This will enhance our capacity to contribute to the improvement in financial reporting by governments around the world, and to enhance their financial management and accountability.”

French translations are currently in process.

Both the English and Spanish versions of the IPSASs may be downloaded free of charge from the IFAC website by going to [www.ifac.org/publicsector](http://www.ifac.org/publicsector). English remains the official language of the standards.

IFAC is dedicated to serving the public interest, strengthening the worldwide accountancy profession, and contributing to the development of strong international economies. Its current membership consists of 157 professional accountancy bodies in 118 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce. In addition to setting public sector accounting standards, the organization sets international, auditing and assurance, education, and ethics standards.

# # #



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## Meetings Diary

WSS - September 2004

27th Sep 2004

As a convenience for IASB's constituents, meetings of the IASB are open to public observation.

Latest Revision: 2004/08/20

Times: Various - see running order

Location: London, UK

Venues: Renaissance London Chancery Court Hotel

### Agenda and running order

#### Agenda:

- Consolidation
- The IASB's *Framework*
- IASCF Education initiatives
- Leases
- National standard-setters: challenges to the adoption of IFRSs
- The role of the national standard-setter in relation to the IASB

### Running order

Approximate starting times are shown in [square brackets]

#### Monday 27 September

Meeting with World Standard-setters  
Renaissance Chancery Court Hotel  
252 High Holborn London WC1V 7EN

Public gallery opens at 1330

[1400] *Welcome and introduction*

[1415] *IASCF education initiatives*

[1415] *The role of the national standard-setter in relation to the IASB*

[1600] *National standard-setters: challenges to adoption of IFRSs - round-table discussion*

[1800] *Session Ends*

#### Tuesday 28 September

Meeting with World Standard-setters

Public gallery opens at 0830

[0845] *Keynote address*

*Donald T Nicolaisen, Chief Accountant, US Securities and Exchange Commission*

[0930] *The IASB's Framework*

[1030] **Consolidation and control** - introduction

[1130] **Consolidation and control** - break-out sessions followed by report-back and summary

[1315] Lunch

[1415] **Leases** - introduction followed by break-out sessions

[1615] **Leases** - report-back and summary

[1700] **Concluding remarks**

[1715] Session Ends

**Observer Registration and Guidelines for Observers**

**The next meeting of the national standard-setters will be held in London on 27 and 29 September 2004. If you wish to observe these meetings, please complete the Observer Registration Form and send it by fax or e-mail to Ms. Ana Nobre:**

Facsimile: 44 (020) 7246 6411

**e-mail: [anobre@iasb.org.uk](mailto:anobre@iasb.org.uk)**

We will then confirm your seat or inform you that no seat is available.

London

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**IFAC INVITES COMMENTS ON INDEPENDENCE GUIDANCE IN  
REVISED CODE OF ETHICS**

*(New York, October 4, 2004)* – The Ethics Committee of the International Federation of Accountants (IFAC) has released an exposure draft *Revised Code of Ethics for Professional Accountants*, clarifying independence requirements for professional accountants in public practice who perform assurance engagements.

The changes are designed to conform the Code to the *International Framework for Assurance Engagements*, issued by the International Auditing and Assurance Standards Board; and definitions contained in International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance Related Services Engagements*.

In addition, the ED proposes a requirement to rotate the individual responsible for the engagement quality review in an audit of a listed entity. The Ethics Committee believes that in an audit of a listed entity the person responsible for the engagement quality review be subject to the same rotation requirements as the engagement partner.

(MORE)

In July 2003, the Ethics Committee released an ED in which it proposed fundamental principles of professional ethics for professional accountants and a conceptual framework for applying those principles. The Ethics Committee has now finalized the Code based on comments received on this earlier ED.

“The July exposure draft also proposed extending the Code from a model on which to base national ethical guidance to an international standard to be followed by member bodies and firms. Respondents to the ED were strongly supportive of this approach,” emphasizes Ethics Committee Chair Marilyn Pendergast. “This demonstrates the profession’s commitment to establish a global ethical benchmark and raise the quality of practice worldwide.”

The Ethics Committee is re-issuing the entire Code in this exposure draft to enable readers to understand the independence section in the context of the entire Code. An explanatory memorandum is being issued with the ED which provides background on recent changes to the Code and the areas on which comments are now being sought.

This new ED of the revision to the *Code of Ethics for Professional Accountants* and the explanatory memorandum may be downloaded from the IFAC website by going to [www.ifac.org](http://www.ifac.org). Comments are requested by November 30, 2004. They may be submitted to [Edcomments@ifac.org](mailto:Edcomments@ifac.org) or faxed (+1-212-286-9570) or mailed to the attention of Jan Munro at IFAC, 545 Fifth Avenue, 14<sup>th</sup> Floor, New York, NY 10017. All comments will be considered a matter of public record.

IFAC is the worldwide organization for the accountancy profession dedicated to serving the public interest, strengthening the worldwide accountancy profession, and

(MORE)

contributing to the development of strong international economies. Its current membership consists of 157 professional accountancy bodies in 118 countries, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce. The organization sets ethics, auditing and assurance, education, and public sector accounting standards.

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