

IOSCO assessment

A view from within¹

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THEMA

1 Introduction

Let me begin by saying what a pleasure it is to be asked to speak at such a distinguished university at an event honoring the career of such a fine man. As you know, Gijs Bak has worn many different hats during his career. I have had the pleasure of getting to know him through his work as an advisor to the Dutch securities regulator, the Securities Board of the Netherlands (STE). In that capacity, Prof. Bak represents the STE on Working Party No. 1 of the International Organization of Securities Commissions' (IOSCO) Technical Committee.

When I joined the Working Party I quickly developed views on the effectiveness of various members, some of which have been borne out over time, some of which have changed dramatically. But, from the very beginning it was clear that Prof. Bak is an extraordinary person. He speaks when there is a need, not just a desire. He brings to the group an extraordinary depth of knowledge and experience with both accounting literature and accounting practice. And, perhaps most importantly, he brings the quality that we all aspire to: *judgment*. Professor Bak has contributed substantially to the Technical Committee's work on international accounting standards. When the time comes and he completes his tenure on the WP, IOSCO, like the University of Tilburg today, will be losing one of the best of the best. We will miss him sorely.

2 IOSCO and the IASC

Now, I realize I have spoken about the Technical Committee and IOSCO as if everyone should know what they are and why Prof. Bak has worked with them. Let me briefly describe IOSCO and its

work that is relevant to today's seminar. IOSCO, the International Organization of Securities Commissions, is comprised of over 90 securities regulators from around the world. The organization carries out its work through various committees, including the Technical Committee, which represents the regulators of the world's larger and more sophisticated markets. The STE is a member of the Technical Committee.

The Technical Committee has taken up work on a variety of issues of importance to securities regulators, including the possible use of international accounting standards by multinational issuers on a cross-border basis. The Technical Committee carries out its work through working parties comprised of experts drawn from its members. Accounting and disclosure issues are addressed by the Technical Committee's Working Party No. 1, in which Prof. Bak and I both participate.

The Technical Committee's current work on international accounting standards began in earnest in July 1995, when the Technical Committee and the International Accounting Standards Committee announced what is now known as the 'core standards project.' Essentially the Technical Committee and the IASC agreed on a list of

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standards that the IASC would need to complete before the Technical Committee would assess the standards for possible use by foreign issuers on a cross-border basis. The overall project covers 34 standards. The current status of the project is that the IASC is expected to vote on a proposed final standard for the remaining major project: Financial Instruments. The IASC then will need to complete two additional projects: Investments Properties and Events After the Balance Sheet Date².

When the IASC and the Technical Committee initially announced the core standards project in July 1995, the IASC expected that it would complete its work by June 1999. In March 1996, the IASC's Board, with the encouragement of certain IOSCO members, decided to accelerate its work program on the core standards project so that those standards would be completed by March 1998. The IASC's decision to expedite its standard-setting work may have had the unintended effect of causing the IASC and outside commentators to put undue focus on timing, which creates risks for the substance of the standards.

As the Technical Committee begins its assessment of the IASC core standards, it is important to keep in mind that the standards issued by the IASC are not themselves the product of a joint IOSCO-IASC project. The agreement between the Technical Committee and the IASC related to identifying topics that needed to be addressed and the Technical Committee's commitment to consider a complete package. The standards, however, were written and voted on by the IASC, not the Technical Committee. The Technical Committee has participated in the process by having Working Party 1 submit written comment letters and attend IASC Board meetings as a non-voting observer. The opportunity to have input has proven extremely useful, but, in the end, the standards have been approved by the IASC based on the views of its members, which, at times, have been different than the views of the Technical Committee and its members.

3 The IOSCO assessment process...

The Technical Committee's evaluation is focused specifically on whether it should recommend endorsement of the IASC core standards to its members for use by foreign issuers in cross-border listings and offerings. The IASC standards clearly are different than the standards currently

used in many advanced markets, but that is not the focus of IOSCO's evaluation. Instead, the Technical Committee will focus on whether the core standards, both as written and as they are likely to be implemented, are of sufficiently high quality to warrant a jurisdiction permitting foreign issuers to use them to access its capital markets as an alternative to domestic standards. Since the Technical Committee is comprised of the regulators from the world's largest and most sophisticated markets, this process will be testing the quality of the IASC core standards to ensure that the integrity of those markets is preserved.

The Technical Committee's work project with the IASC is focused on the 'core set' of 34 standards that the Technical Committee considered to be the necessary components of a comprehensive body of accounting principles for issuers undertaking cross-border securities offerings and listings. The core standards project is not intended to affect standards for domestic issuers, particularly since domestic standards usually apply to a much broader range of companies than would be expected to engage in cross-border offerings and listings. The core standards project also does not include standards related to specific industries; companies in those industries would look to national standards.

In the near term the IASC will complete its work on the core standards, at which point all eyes will turn to the Technical Committee. What the world will see is a group of securities regulators prepared to undertake an extensive and rigorous review of the IASC's work to see whether use of the standards can be recommended while satisfying the overarching need to protect the interests of investors. As the chair of the Working Party, I do not enter into that work with any preconception about the outcome. Assessment is not a process used to justify a predetermined outcome. I do know, however, that we are facing an extremely difficult task. Sixteen of the core standards are new or significantly changed and not yet required to be used in countries that already accept IASC standards. As a result, we do not have the benefit of seeing how the standards have worked in practice. In carrying out our review, we do have the benefit of being able to look back at the WP's extensive library of written comments that IOSCO and its members have submitted to the IASC. This is somewhat of a mixed blessing, however, since the comments fill a thick notebook of comment letters – over 80

letters totaling over 700 pages in length – in addition to turning back to the substantial body of work that is the IASC standards themselves.

Based on just a summary review of the prior comment letters, some of the issues involving individual IASC standards that the Technical Committee and its members will need to grapple with in the assessment process include:

- the true and fair view override in IAS 1;
- the revaluation of property plant and equipment in IAS 16;
- transition provisions without minimum obligation requirements for employee benefit accounting (IAS 19);
- capitalization of costs for internally generated intangible assets (IAS 38);
- unlimited lives for goodwill and other intangibles (IAS 22 and 38);
- remeasuring impaired assets at the higher of values in use or fair value (IAS 37); and
- a modified form of basis adjustments for cash flow hedges, including anticipated transactions and firm commitments (IAS 39).

There are other issues as well, many of which also involve differences of views within the Working Party. Indeed, I think it is safe to say that this assessment process is quite possibly the most difficult task that IOSCO has faced. We have started the review process, even as the IASC works on its remaining standards, and we will need to work hard to make sure that the assessment process is both comprehensive and credible. All interested parties need to realize that there is simply too much at stake to permit otherwise. After all, the convergence of accounting standards for use on a cross-border basis – whether through the core standards project or otherwise – will only benefit investors, issuers and the markets if the resulting accounting standards are of high quality such that no regulator in an advanced market is forced to choose between permitting foreign issuers to use the core standards and maintaining high standards for accounting.

3.1 Relationship of IOSCO's Work to the G-7's Concerns about Emerging Market Countries

It also is useful to keep in mind what the Technical Committee's assessment of IASC

standards does not cover. Specifically, the Technical Committee is not evaluating the IASC standards to see whether it is good public policy to promote the use of IASC standards in emerging market countries. The recent financial crisis in Asia has focused attention on the fact that domestic issuers in many emerging market countries provide low quality financial and non-financial disclosures. One possible solution to this problem is to push for adherence to certain minimum standards for disclosure as a means for raising the floor for emerging markets. At the same time there must be recognition that such minimum standards may not satisfy the more demanding needs of well developed markets.

In contrast to the G-7's focus on setting a floor for emerging market countries, the Technical Committee's assessment of the IASC's core standards will focus on use of these standards in developed markets by entities engaged in cross-border offerings and listings. Nonetheless, many jurisdictions pattern their domestic standards on IASC standards, and the Technical Committee's evaluation will help identify both the strengths and weaknesses of the IASC's current standards and promote further improvements in those standards.

4 ...and beyond

The IOSCO assessment of the IASC's standards will not be the beginning or the end of the process of accounting convergence that is occurring internationally. Clearly convergence is a goal for standard setters, both in their independent projects and in their joint projects with their international colleagues. It is useful that the IASC, using the work of its Strategy Working Party, is now looking at its structure and its due process and will be soon seeking public comment on how to make improvements for the future. The results of the IASC's own self-assessment will be key to that organization's future ability to be a credible standard setter. But, regardless of how important convergence, or even explicit agreement on a specific set of standards, may seem, they may be overshadowed by the changes needed to support real improvements in the quality of financial reporting world-wide.

Put simply, good standards alone are not enough. Infrastructure and implementation are

critically important. There needs to be a process, free of conflict of interest, to develop, interpret and enforce these standards on an on-going basis. Similarly, there is a pressing need for adequately trained private sector preparers and auditors. It is an open question whether, on a world wide basis, companies and their auditors have sufficient experience and expertise to apply IASC standards. Finally, regardless of the standards used, there is a need to have robust regulatory systems where financial statements are reviewed, questionable accounting treatments challenged, and appropriate enforcement actions taken.

5 Conclusion

The Technical Committee, drawing on accounting experts like Professor Bak, has begun its assessment of the IASC's core standards. There is much at stake in this process, including the overarching need of securities regulators to do their utmost to ensure that they act in the best

interests of investors. The convergence of accounting standards clearly can serve those interests, but it is not simply a question of making a decision with respect to a particular set of standards at a particular point in time. Therefore, we will need to consider both the standards themselves and the likely impact their use will have on the quality of financial reporting.

NOTES

1 The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed here are those of the author and do not necessarily reflect the views of the Commission, or of the authors' colleagues on the staff of the Commission.

2 In the meantime IAS 39 on Financial Instruments and IAS 10 (revised 1999) on Events After the Balance Sheet Date have been published (editor).