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Corporate reporting:
Trends and tensions in convergence
Contribution to the International Corporate Governance Network (ICGN) 2008 Yearbook

Jeff Willemain, Global Managing Partner, Regulatory & Risk, Deloitte, recently contributed to the International Corporate Governance Network (ICGN) 2008 Yearbook which was distributed at the ICGN Conference in Seoul, June 2008. The paper, "Corporate reporting: Trends and tensions in convergence," focuses on the evolution of accounting standards and the issues associated with convergence and adoption of International Financial Reporting Standards (IFRS).

Today we are witnessing a unique and monumental undertaking: global convergence around the IFRS promulgated by the International Accounting Standards Board (IASB). We are moving toward one global accounting language answering the most basic needs of investors worldwide: enhancing transparency and comparability of reported financial information, helping expand opportunities for all investors, and furthering economic growth through more efficient capital allocation.

The changes in accounting standards over the past few years have been nothing short of astounding. Less than a decade ago, accounting standards were set almost exclusively by national standard-setters operating under local regulations, with little comparability across jurisdictions. The European Union's successful adoption of IFRS in 2005 spurred a sea-change in attitudes toward common standards of reporting. Today, more than 100 countries report under the international standards. Although the United States (US), the world's largest capital market, has not yet adopted IFRS, important steps in the right direction have already been taken. Foreign issuers of securities will be allowed to use IFRS for reporting in the US. The US Securities and Exchange Commission (SEC) is actively considering a proposal to allow US companies the option of reporting under IFRS. The US accounting standard-setter, the Financial Accounting Standards Board (FASB), has announced that it will hold a public forum to discuss a blueprint for moving US companies to IFRS. Taken together, the writing on the wall is clear: the debate over *whether* to move toward convergence of accounting standards has given way to a discussion of *how* to move to global standards.

The US has the opportunity to set a date-certain for full transition to IFRS. Hopefully, this opportunity will be embraced by the SEC, accompanied by a thorough plan calling for commitment of all stakeholders to address the substantial challenges of transition. Then, the stage will be set for a new era in global business: a world in which all capital market stakeholders speak a uniform accounting language, in which investors can confidently move their money to the areas of greatest opportunity.

In order to realize the full benefit of this new era, we must keep the interests of investors front and center. Implementing a single set of international standards needs to be accomplished in a fashion which inspires investor confidence.

To date, the adoption of IFRS has not been uniform across the globe. Some countries have adopted the core IFRS, but added their own modifications to the standards as promulgated by the IASB. The International Organization of Securities Commissions (IOSCO) has addressed this issue with a recommendation urging publicly-traded companies to provide clear and accurate information about the accounting standards used in preparing their financial statements. This will be helpful to investors in better understanding the financial reporting frameworks companies are using, but it is not a long-term solution. Investors and other market participants need to continue to push for acceptance of one and only one set of standards as set by the IASB, without national or jurisdictional modifications.

The IASB is truly unique in that its success is dependent on the endorsement of its work by governmental bodies with the authority to require the use of the standards it develops. To support endorsement of its standards by additional governmental bodies, the IASB needs to effectively demonstrate, and possibly evolve, its process in two areas: transparency in a standard-setting process all stakeholders understand; and accountability to those governmental bodies to set standards of the highest quality with a commitment to investor interests. It is vital that all stakeholders work collaboratively in support of the IASB to ensure success in this mandate.

In addition to the adoption of a common framework, to create one global accounting language the following underlying factors must also be aligned: the judgments of those preparing financial statements, the judgments of those auditing the statements, and the judgments of those within the national regulatory and oversight systems. Each of these powerfully impacts the integrity of financial reporting. The development of a framework for the application of professional judgment—agreed by the parties who prepare, audit, oversee and regulate—would substantially enhance the integrity of the financial reporting system. In jurisdictions where the previous environment was largely driven by the evolution of detailed accounting rules, as some would describe the US, a framework for the application of professional judgment is arguably essential to transition to IFRS.

The IASB is embracing a "principles-based" approach to standards. A principles-based reporting framework that produces financial information that accurately represents the company's underlying transactions requires company preparers to understand the guidelines of the framework and the economic realities of the transactions themselves. In many instances, this will oblige people outside the core accounting functions to be drawn into discussions of and collaboration on accounting treatments. For example, sales people crafting agreements with customers or real estate managers pursuing new store locations may need to work with the accounting team to help them understand the business rationale for certain transactions and how they should be reflected and, when necessary, commented on in the financial statements.

Adopting new financial reporting standards will thus require substantial practical training—in academia for young people aspiring to the accounting and auditing professions, in the form of continuing professional education for those already in their careers as professionals, and in companies among employees with financial responsibilities. New professional standards may drive these training processes, but application in practice will require support by companies, regulators, auditors, and other capital market stakeholders.

Investor confidence is also rooted in uniform audit quality across jurisdictions, and therefore, it is vital we converge to a common set of auditing standards. Many countries have auditing standards rooted in International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). Additionally, the largest global auditing networks have global auditing methodologies rooted in ISAs. Global convergence to ISAs will promote consistency in audit processes and will also facilitate convergence of other areas, such as regulation and oversight.

Deeply connected to auditing standards are professional and ethical standards adhered to by auditors and preparers of financial information. Investors must be assured that financial information prepared from country to country is being done in a common manner and under common ethical guidelines. In the same vein, common standards of auditor independence and ethics remove the market confusion caused by standards that differ from jurisdiction to jurisdiction and the conflicts they often produce. Common standards also aid accounting and auditing firms in monitoring conduct and educating professionals in their responsibilities by reducing levels of complexity and conflict of rules.

Finally, in order for investors to enjoy full confidence in the financial reports prepared and audited across jurisdictions, we should continue to strive for greater uniformity in the regulatory environment and the national regulatory oversight systems. Regulators everywhere share at least one basic objective: ensuring that investors are protected and that the capital markets function effectively.

Achieving comparability in regulatory functions such as registration, inspection, and discipline of auditors and audit firms would reduce the costs of oversight and compliance without reducing protections for investors. Progress is being made toward mutual recognition amongst the audit overseers and while there is no "one best answer" for all nations and all circumstances, there can be progress toward enforcement principles that are comparable across jurisdictions.

By taking these steps to promote uniformity and comparability across jurisdictions in terms of professional judgment, audit standards, professional and ethical standards, and regulatory environments, we can realize the full benefit of the process begun with the move toward global adoption of IFRS.

There is no doubt that such a process enjoys the deep support of stakeholders around the world. A recent survey, sponsored by the ICGN and conducted among its members, in cooperation with the six largest global auditing networks, showed that more than 80 percent of respondents believe that convergence to a single set of accounting standards would benefit share owners and other users of financial information. More than 80 percent of respondents also believe that convergence of auditing standards would be beneficial. Overall, these broad expressions of support indicate that the respondents—in this survey, investors—understand the value of the uniform presentation of financial information and the many processes that contribute to it.

As the convergence process moves forward, investors need to stay center stage and actively engaged in the process. It is worrisome that the same survey found that 80 percent of respondents believe that investors are not involved enough in the accounting standard-setting process and 60 percent believe investors are not consulted enough by regulators when developing and implementing new audit regulations. Financial reporting is meant, first and foremost, for those investing capital in and lending resources to companies. Their engagement in promoting a common financial reporting framework and the processes that support it will help make sure that the right types and mix of financial and non-financial information are reported by companies.

It is not possible for regulators, standard-setters, or auditors to accurately guess what investors want and need. Auditors operate within existing standards and regulations. Investors have the power to help shape this framework by working with auditors, preparers, regulators, and standard-setters toward a common objective of high-quality, reliable, and comparable corporate reporting. Ultimately, our capital markets, the allocation of scarce investment resources, and the health of our economies depend upon its success.

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