

# THE FUTURE OF THE IASC AND THE IMPLICATIONS FOR UK COMPANIES

David Cairns

This article first appeared in *Financial Reporting Today - Current and Emerging Issues: The 1998 edition*, p115, and is reproduced by permission of the Institute of Chartered Accountants in England and Wales. Since publication, the IASC has completed its core standards and has been restructured. IOSCO has endorsed the core standards and the SEC has published its concept release on IASs. The European Commission has also published a further strategy document that proposes that EU listed companies should comply with IASs by 2005. There have also been a number of changes to UK GAAP.

## Introduction

The IASC's agreement with the International Organization of Securities Commissions (IOSCO) in July 1995 was described as a milestone that would lead to increased acceptance of International Accounting Standards (IAS) and considerable efficiencies for international companies and capital markets.

This article assesses the likelihood of the IASC reaching the next milestone - the successful completion of the agreement with IOSCO - and the implications for UK companies, the ASB and the IASC itself. It describes the aims, structure and achievements of the IASC and its relationship with national standard setting bodies<sup>1</sup> before examining the details of the IASC/IOSCO agreement and the criteria which need to be met before IOSCO endorses IASs. The chapter concludes with some thoughts on the future of the IASC after the completion of the IASC/IOSCO agreement.

The main messages to emerge for UK companies are as follows:

- IOSCO's endorsement of IASs is highly likely but not a foregone conclusion - the IASC has to do enough to satisfy regulators in Canada, Japan and the United States without losing the support of regulators in Australia, Europe and Hong Kong;
- following IOSCO's endorsement of IASs, those UK companies with US listings will be able to reconcile to either IASs or US GAAP - both reconciliations will be different from current UK GAAP/US GAAP reconciliations because of the likely changes in UK GAAP, US GAAP and IASs;
- as the UK member of IOSCO, the Securities and Investments Board (SIB) will become an increasingly important player in determining UK accounting requirements;
- the ASB will continue to work closely with other national standard setting bodies, particularly those in Australia, Canada, the United States and the European Union, as well as with the IASC but the IASC will not replace the ASB and IASs will not replace UK GAAP; and
- there will be major changes in the IASC's structure which will ensure that UK companies continue to contribute to and benefit from the efforts of both the ASB and the IASC to improve and harmonise financial reporting.

---

<sup>1</sup> A more detailed description of the evolution of the IASC and the IASC/IOSCO agreement can be found in Cairns, D 'The Future Shape of Harmonisation: A reply - The EU Versus the IASC Versus the SEC', *European Accounting Review*, 6 (2) pp 305-348 and in Cairns, D. 'The Evolution of the IASC's Structure and Organisation' [www.cairns.co.uk](http://www.cairns.co.uk).

## **The IASC - a Brief History**

The International Accounting Standards Committee (IASC) was set up in 1973 by 16 professional accountancy bodies in nine countries - Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and the United States of America. It now has member accountancy bodies in about 90 countries and many other countries make use of its work.

Since 1973, the IASC has extended well beyond its roots in the accountancy profession to involve in its work national standard setting bodies (both private sector and government), companies and other business groups, financial analysts and other users of financial statements, regulators and stock exchanges, development agencies, and governmental and intergovernmental bodies. The evolution has inevitably taken time and has sometimes been controversial.

## ***The IASC's Objectives***

The objectives of the IASC are:

- to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance; and
- to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements.

In 1990 the IASC agreed a set of aims which spelt out more specifically what it was trying achieve, particular in respect to its ongoing work with IOSCO (see below). These aims included, among other things:

- the IASC should develop IASs which meet the need for truly international standards of accounting and disclosure by capital markets and the international business community, and which are acceptable for use in the financial statements of all issuers of equity and debt securities;
- the IASC should seek to persuade stock exchanges and regulatory authorities to accept from foreign issuers financial statements prepared in conformity with IASs; and
- the IASC should work for greater compatibility between national accounting requirements (whatever their form) and IASs and the removal of existing differences between those requirements and IASs.

In 1995, in preparation for its agreement with IOSCO, the IASC decided to focus only on the second of these aims. It decided that it should 'aim to reach a major milestone in a reasonably short period of time, say three or four years' and that the appropriate target was 'the completion of a set of core standards so that IASs would be accepted by the major stock exchanges of the world as a basis for the preparation of financial reports by foreign companies'. It also agreed that once it had achieved this milestone, it would aim to 'secure uniformity in the accounting standards used by both domestic and foreign large companies in all countries of the world', that is it would refocus its efforts on the third of the 1990 aims.

## ***The IASC's Structure***

The key elements in the IASC's structure are the member bodies, the board, the consultative group and the advisory council. The member bodies of the IASC are the professional accountancy bodies which are members of the International Federation of Accountants (IFAC). Under the constitution no other body may be a member of the IASC although other types of organisations are represented on its board and are otherwise involved in its work.

The member bodies meet only every two and half years and their formal powers are limited to approving or rejecting proposed changes to the IASC's constitution. They do not appoint the board and do not approve IASs. However, by virtue of their control over board representatives, the member bodies represented on the board do have considerable *de facto* powers over financial, political and, to some extent, technical matters and they would have the final say on any substantive changes in the IASC's structure.

It is also important to recognise that the IASC was set up as a committee of its member accountancy bodies and that, for many years, these bodies had the powers and responsibilities which some might have expected to lie with the IASC. For example:

- the accountancy bodies chose their representatives without any input from, or control by, the IASC;
- the accountancy bodies, and not the IASC, were responsible for the translation, publication, interpretation and enforcement of IASs;
- the accountancy bodies, and not the IASC, received comments on IASC exposure drafts and were expected to summarise those comments before sending them to the IASC; and
- all contact between the IASC and national standard setting bodies, companies, stock exchanges, regulators and other organisations and individuals in any country had to be made through the appropriate accountancy bodies - the IASC was not allowed to make direct contact.

These arrangements have influenced the way that the IASC has worked, in particular its ability to communicate directly with its constituency. They meant, for example, that as recently as 1991 the Institute of Chartered Accountants in England and Wales believed that contact between the IASC and the newly formed Accounting Standards Board (ASB) in the UK should be made only through the CCAB's international accounting committee. Many, but not all, of these arrangements have now changed.

Subject to these constraints, the accountancy bodies have delegated all the powers and responsibilities associated with the work of the IASC to the IASC board. The board has the power to approve and issue IASs, exposure drafts and other documents and to raise the funds required for its work. The board initially consisted of the nine founder members and has expanded, in stages, to a maximum of 17 members plus observers from the European Commission, the FASB, IOSCO and China. The current members of the board and observers are shown in table 1. Each board member can nominate up to two representatives and a technical adviser which, with an additional place for the chairman, means a total of 52 people excluding observers and the IASC staff. Each member has only one vote irrespective of the number of its representatives and advisers.

The consultative group was set up in 1981 in recognition of both the growing complexity of the IASC's work programme and the widespread interest in the international harmonisation of accounting standards. As a result the IASC was anxious to ensure that it obtained input to its work from a wide range of users and preparers of financial statements at the early formative stages of the development of IASs.

As with the board, the consultative group has evolved over the years with some founder members transferring to the board, new members being added, and some members now participating as board observers. The current participants at group meetings are shown in table 2. Each organisation is responsible for choosing its own representatives and the comments of individuals do not bind their organisations. The group does not vote but instead provides input on technical projects, the IASC work programme and the IASC's broader strategy. Until recently the group met the board twice a year but as from 1997 the group meets only once a year and only with selected members of the board. Group members also participate in the work of IASC steering committees.

**Table 1: IASC Board as at July 1997**

**Countries represented by accountancy bodies**

- Australia
- Canada
- France
- Germany
- India and Sri Lanka
- Japan
- Malaysia
- Mexico
- Netherlands
- Nordic Federation (includes Denmark, Finland, Iceland, Norway and Sweden)
- South Africa and Zimbabwe
- United Kingdom (includes Ireland)
- United States of America

**Other organisations having an interest in financial reporting**

- International Association of Financial Executives Institutes
- International Co-ordinating Committee of Financial Analysts Associations
- Swiss Federation of Industrial Holding Companies

**Observers**

- European Commission
- Financial Accounting Standards Board (FASB)
- International Organization of Securities Commissions
- People's Republic of China

**Table 2: IASC Consultative Group as at July 1997**

Basle Committee on Banking Supervision  
European Commission  
Fédération Bancaire de la Communauté Européenne (European Banking Federation)  
Financial Accounting Standards Board  
IFAC Public Sector Committee  
International Association for Accounting Education and Research  
International Auditing Practices Committee  
International Banking Associations  
International Bar Association  
International Chamber of Commerce  
International Confederation of Free Trade Unions  
International Federation of Stock Exchanges  
International Finance Corporation  
International Organization of Securities Commissions  
Organisation for Economic Co-operation and Development  
The International Valuation Standards Committee  
The World Bank  
Transnational Corporations and Management Division of the United Nations Conference for Trade and Development

The IASC's structure was reviewed in 1992 when the IASC set up a working party under the leadership of former chairman Georges Barthes to:

- ensure that the IASC has the right structure and organisation to maintain and enhance its role as the recognised body for the development of IASs;
- ensure that the accountancy profession, through the IFAC and its member accountancy bodies and the regional bodies, continues to recognise and support the IASC and play a full part in the work of the IASC;
- ensure that the preparers and users of financial statements, national standard setting bodies, and other interested organisations play an appropriate and full part in the work of the IASC;
- ensure that the IASC has sufficient funds to carry out the necessary research and consultations that are essential to its work, and recruit and retain high quality staff; and
- consider the proposal to establish an international accounting standards foundation, the role of that foundation and the relationship between the foundation and the board.

The working party recommended the establishment of the advisory council which was set up in 1994 to:

- promote the acceptability of IASs;
- enhance the credibility of the IASC;
- review the IASC board's strategy and plans;
- prepare an annual report on the work of the board; and
- seek and obtain the funding that the IASC requires to carry out its work.

The members of the council are outstanding individuals in senior positions from the accountancy profession, business, other users of financial statements and other backgrounds. They are required to ensure that the independence and objectivity of the board in making technical decisions is not impaired and they are not allowed to participate in, nor seek to influence, those decisions.

The role of the advisory council is similar in many respects to that of the Financial Reporting Council in the UK but there is one important difference - the advisory council is not involved in the appointment of the IASC board. The foundation working party had recommended that the council should play a major part in ensuring a proper balance on the board and that each board country/organisation should consult the advisory council on their appointments to the board. The board rejected these recommendations; as a result, the accountancy bodies retained the freedom to appoint to the board whomsoever they wished.

### ***International Accounting Standards***

International Accounting Standards (table 3) deal with the majority of the topics which are important in the presentation of published financial statements. Ten of these standards were revised as result of the IASC's comparability and improvements project, which is referred to later, and a number of others have been revised since they were first published. The IASC has also approved a conceptual framework (the *Framework for the Preparation and Presentation of Financial Statements*) which is similar to the ASB's proposed statement of principles.

The IASC's current work programme, which has largely been determined by the needs of IOSCO, includes the development of nine new IASs and the revision of six existing IASs (table 4).

**Table 3: International Accounting Standards (as at July 1997)**

**Effective in 1997**

- IAS 1 *Disclosure of Accounting Policies*
- IAS 2 *Inventories*
- IAS 4 *Depreciation Accounting*
- IAS 5 *Information to be Disclosed in Financial Statements*
- IAS 7 *Cash Flow Statements*
- IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*
- IAS 9 *Research and Development Costs*
- IAS 10 *Contingencies and Events Occurring After the Balance Sheet Date*
- IAS 11 *Construction Contracts*
- IAS 12 *Accounting for Taxes on Income*
- IAS 13 *Presentation of Current Assets and Current Liabilities*
- IAS 14 *Reporting Financial Information by Segment*
- IAS 15 *Information Reflecting the Effects of Changing Prices*
- IAS 16 *Property, Plant and Equipment*
- IAS 17 *Accounting for Leases*
- IAS 18 *Revenue*
- IAS 19 *Retirement Benefit Costs*
- IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*
- IAS 22 *Business Combinations*
- IAS 23 *Borrowing Costs*
- IAS 24 *Related Party Disclosures*
- IAS 25 *Accounting for Investments*
- IAS 26 *Accounting and Reporting by Retirement Benefit Plans*
- IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*
- IAS 28 *Accounting for Investments in Associates*
- IAS 29 *Financial Reporting in Hyperinflationary Economies*
- IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*
- IAS 31 *Financial Reporting of Interests in Joint Ventures*
- IAS 32 *Financial Instruments: Disclosure and Presentation*
- IAS 33 *Earnings per Share*

**New and Revised Standards Effective in 1998 or later**

- IAS 1 *Presentation of Financial Statements*
- IAS 12 *Income Taxes*
- IAS 14 *Reporting Segment Information*

**Table 4: IASC Work Programme (July 1997)**

**New Standards**

Financial Instruments - recognition and measurement (with investments)  
Intangible Assets  
Impairment of Assets  
Discontinuing Operations  
Provisions (with contingencies)  
Interim Reporting  
Agriculture  
Insurance  
Reporting Financial Performance

**Revised Standards**

Investments (with financial instruments)  
Business Combinations (including goodwill)  
Research and Development  
Employee Benefits  
Leases  
Contingencies (with provisions)

IASs do not replace or override national accounting requirements. Instead countries decide for themselves how to incorporate them in their national laws or standards. Some countries use IASs directly as national standards while others adapt them to suit their national circumstances. Some require compliance with IASs by law and others have incorporated the principles in IASs into laws and other statutory requirements<sup>2</sup>.

While the greatest use of IASs has been made by countries which lack the resources to develop their own standards, increasingly countries with well developed standard setting procedures have used IASs as the basis of new and revised standards. It had, of course, been inevitable that in the early years IASs were based on existing standards in those countries which had their own standards. Now there is a two way process in which ideas are shared and projects are carried out jointly. For example, while the revised IAS on income taxes draws heavily on FAS 109 *Accounting for Income Taxes*, FAS 128 *Earnings Per Share* results from the deliberate effort of the FASB to conform its requirements with proposals which had been developed by the IASC in the early 1990s.

The UK has also contributed significantly to the development of many IASs and drawn on the work of the IASC. IAS 17 *Accounting for Leases* and the equivalent UK standard, SSAP 21, were developed at the same time and under the same chairman, Paul Rutteman. The former ASC adopted the IASC's *Framework for the Preparation and Presentation of Financial Statements* and the ASB has used that framework as the basis of its proposed statement of principles. The ASC worked with the IASC on intangible assets and the ASB is considering revisions to existing UK standards based on the IASC's proposals on segments and on its joint work with the FASB on earnings per share. The ASB and the IASC are currently developing common UK and international standards on provisions.

---

<sup>2</sup> More information on the use of IASs is included in chapter 5 of D. Cairns *Applying International Accounting Standards*, Butterworths, 1999 and in D. Cairns, *International Accounting Standards Survey 2000*, David Cairns, 2001. For further information on both books, see [www.cairns.co.uk](http://www.cairns.co.uk).

## ***The IASC's Relationship with Standard Setting Bodies***

In the early years, the IASC's links with national standard setting bodies were achieved through the professional accountancy bodies which are the members of the IASC. However, from the early 1980s, the IASC took a number of initiatives to work directly with national standard setting bodies. It established joint working parties on common problems such as deferred taxes and pension costs, and carried out a programme of visits to discuss issues of common interest.

The late 1980s and the early 1990s saw some important initiatives by the IASC to extend these links further:

- the IASC invited both the European Commission and the FASB to participate in the IASC consultative group and attend board meetings as observers (a similar invitation was extended to the Business Accounting Deliberation Council in Japan but was declined);
- the IASC started joint projects with the standard setting bodies in Canada (financial instruments), the United Kingdom (intangible assets) and the United States (earnings per share);
- the IASC, with the help of the FASB and the Fédération des Experts Comptables Européens (FEE), inaugurated an annual conferences of standard setting bodies; and
- the IASC started to consult standard setting bodies on its own proposals beginning with E32 *Comparability of Financial Statements*.

The IASC also began to play a role in the group now known as G4+1 which is the standard setting bodies in Australia, Canada, the United Kingdom and the United States plus the IASC. The IASC believes that such groups should lead to the improvement and harmonisation of financial reporting through both recommendations to the IASC and the adoption of common improvements in national standards. G4+1 is one of many groups of standard setting bodies which meet around the world and its work has been particularly helpful to the IASC. Its study on future events was prepared for an IASC conference of world standard setters and its study dealt on hedge accounting dealt with an issue on which several standard setting bodies had criticised the IASC's proposals in E48 *Financial Instruments*. The G4+1 study on provisions deals directly with one of IOSCO's criticisms of IASs - the measurement of provisions for contingencies - and has formed the basis of exposure drafts issued by both the IASC and the ASB.

The IASC's relationship with standard setting bodies was reconsidered by the Foundation working party which recommended that the IASC should continue to take direct action by sponsoring an annual meetings of standard setting bodies, encouraging co-operation among standard setting bodies (including the IASC itself) and involving standard setting bodies directly in its own work. The working party also recommended that the IASC should continue to work directly with other standard setting bodies in order to achieve common improvements in accounting standards as well as greater compatibility between national requirements and IASs and among the national requirements of different countries.

## ***The Future Evolution of the IASC***

The IASC has achieved a great deal in almost 25 years with a structure that has evolved to meet new challenges and changes in the environment in which it operates. It is currently reconsidering its strategy and its structure. Before dealing with the possible changes and their implications, it is helpful to explain the landmark agreement with IOSCO and the implications of that agreement for companies in the United Kingdom.

## **The IASC's Agreement with IOSCO**

The IASC and IOSCO have been working together since 1987 on one area of common concern - the accounting problems faced by multinational companies involved in cross border offerings and other foreign listings. In July 1995, the IASC and IOSCO agreed that if the IASC could complete a programme of core standards which are acceptable to the technical committee of IOSCO, any company would be able to use IAS financial statements as a passport to a listings of its securities on any foreign stock exchange.

The July 1995 agreement has the largest potential impact on foreign companies which wish to offer or list their securities in the United States. The implementation of an IOSCO endorsement of the core standards in the rules of the American Securities and Exchange Commission (SEC) would mean that such foreign companies would no longer have to present US GAAP financial statements or a US GAAP reconciliation. Instead, the SEC would accept IAS financial statements or a reconciliation from home country GAAP to IASs.

The intention of the IASC and IOSCO is that IOSCO will endorse the core standards and individual regulators will implement that endorsement in their own rules by the end of the century. In order to assess the likelihood of this happening, it is useful to understand what led to the agreement, the alternatives which were considered along the way, and the way in which the IASC and IOSCO have worked together for the past ten years<sup>3</sup>.

### ***IASC and IOSCO - the First Years***

IOSCO was created in its present form in 1986 and joined the IASC consultative group in 1987. It soon acknowledged that different national accounting standards were an impediment to multinational securities offerings and other foreign listings and that the agreement of mutually acceptable standards of accounting and disclosure was a critical goal. IOSCO saw IASs as the basis for these standards and the IASC as the appropriate body to set them.

IOSCO did not feel that existing IASs were good enough for its purposes, a view which did not surprise the IASC. Indeed, the IASC had already started its comparability project which was aimed at tackling one of the most obvious weaknesses in existing IASs, the number of free choices of accounting alternatives which were permitted by some of the standards. IOSCO gave its immediate support to the comparability project and participated fully in the development of E32 *Comparability of Financial Statements* and the subsequent *Statement of Intent on the Comparability of Financial Statements*. IOSCO also urged the IASC to make further improvements to IASs to ensure that they were sufficiently detailed and complete, contained adequate disclosure requirements, and were prepared with a visible commitment to the needs of the users of financial statements.

IOSCO's suggestions were influential in determining the IASC's work programme in the late 1980s and representatives of IOSCO played a major part in the work to improve existing IASs and develop new IASs. Nevertheless, progress towards IOSCO's acceptance of IASs was not as fast as many would have liked. The IASC found the improvement of its standards and the development of new IASs more difficult than it first imagined. It was also clear that individual members of IOSCO held significantly different views about what the IASC needed to do to improve IASs and some regulators were keener than others on the notion of allowing the use of IASs in financial statements used in cross border offerings and other foreign listings.

---

<sup>3</sup> A more detailed description of the evolution of the IASC/IOSCO agreement can be found in D. Cairns, 'The Future Shape of Harmonisation: A reply - The EU Versus the IASC Versus the SEC', *European Accounting Review*, 6 (2) pp 337-346

1993 proved to be a turning point. It saw a dramatic improvement in the channels of communication between the IASC and IOSCO with the establishment of direct links between the IASC and the members of the IOSCO technical committee and its working party on multinational securities offerings. In June of that year, IOSCO agreed a list of the 'core standards that should be included in the necessary components of a reasonably complete set of accounting standards' for financial statements which are used in cross border offerings and other foreign listings. It endorsed IAS 7 *Cash Flow Statements* for this purpose which meant that regulators would now accept an IAS 7 cash flow statement from any foreign issuer without the need for the issuer to reconcile or modify that cash flow statement to the host country's standards. Towards the end of 1993, the IASC approved ten revised IASs which had been developed with the help of IOSCO.

By the end of 1993, there was every confidence that there would be further IOSCO endorsement of IASs in 1994. Paul Guy, the secretary-general of IOSCO, had told the 1992 World Congress of Accountants that IOSCO should consider IASs one stage at a time and should consider the acceptability of the ten revised IASs when they were approved. Other senior IOSCO representatives echoed this call and even argued for IOSCO to endorse the IASC's process of setting IASs. For example:

- Michael Meagher, chairman of the IOSCO accounting subcommittee and former chief accountant of the Ontario Securities Commission, told a conference at Fordham University that he favoured piecemeal acceptance of IASs, that IOSCO should consider accepting all the revised IASs from the comparability/improvements project, and that new or revised IASs should be subject to review and acceptance by IOSCO as they are issued;
- Jean Saint Geours, chairman of the IOSCO technical committee and president of the Commission des Opérations de Bourse in France, told an IASC conference in 1993 that the results already obtained by the IASC were of tremendous importance and should be recognised by IOSCO without delay; and
- Edward Waitzer, the chairman of the Ontario Securities Commission and later the chairman of the IOSCO technical committee, argued in April 1994 that the endorsement by IOSCO of IASs should 'essentially be an endorsement of the processes by which those Standards are developed rather than an endorsement of the individual technical positions taken'.

A step by step approach had, of course, been adopted by those regulators (such as the London Stock Exchange) which already allowed foreign issuers to use IASs. The approach received a further boost in April 1994 when the SEC proposed that foreign issuers in the US could opt to follow IASs, rather than US GAAP, on the amortisation of goodwill, poolings, subsidiaries in hyperinflationary economies and, following IOSCO's earlier endorsement, cash flow statements. The SEC was thought to be opposed to a step by step approach but its proposal suggested otherwise.

In June 1994, IOSCO advised the IASC that it believed that a further fourteen IASs (including eight of the revised IASs) were acceptable and three IASs were unacceptable for the purposes of the core standards. IOSCO supported the IASC's reviews of seven IASs. There were two disappointments. First, IOSCO said that it would not endorse any further IASs (even those which it found acceptable) until the IASC had completed the core standards. In other words, IOSCO did not support the step by step endorsement which had been advocated by such senior figures as Guy, Meagher, Saint-Geours and Waitzer and which was being followed by some regulators. Second, IOSCO had found unacceptable two of the revised IASs which it had helped develop.

The IASC urged IOSCO to think again on step by step endorsement. At the same time, the IASC approved a revised work programme which took account of many of IOSCO's concerns and identified a number of areas where it wanted clarification about those concerns. The IASC's response was set out in a hard hitting speech by chairman Eiichi Shiratori at the 1994 IOSCO meeting which won the support of many of the regulators present. The response and the work programme were unanimously supported by the IASC board and formed the basis of the subsequent negotiations between the IASC and IOSCO.

## **The 1995 Agreement**

The July 1995 agreement reflects the outcome of those negotiations. In spite of the widespread support for a step by step approach, IOSCO insisted that it would not endorse any further IASs until the IASC had completed the core standards. IOSCO also refused to concede any ground on those areas on which the IASC had sought clarification. The IASC agreed to complete all the IOSCO core standards by 1999 (subsequently brought forward to 1998) and won the argument that it, and not IOSCO, should be responsible for the interpretation of IASs. Table 5 summarises IOSCO's core standards, the equivalent IASs and IOSCO's views on those IASs, and the IASC's work programme.

It is important to emphasise a number of general matters about the agreement some of which will need to be resolved before its successful implementation:

- the agreement relates only to cross border offerings and other foreign listings - it does not affect the requirements which apply to domestic issuers although there is nothing in the agreement to stop a regulator allowing all issuers, both domestic and foreign, to use IASs;
- the agreement allows, but does not require, foreign issuers to follow IASs - an issuer may opt to follow IASs or host country standards or the host regulator may allow the issuer to use its domestic standards (as would be case under the EU mutual recognition directive);
- a host regulator may impose requirements in addition to IASs in those areas not covered by the core standards - for example, the SEC may require a foreign issuer to follow US GAAP that relates to specialised industries;
- a host regulator may allow an issuer to use accounting treatments which are not permitted by IASs - for example, according to IOSCO, some host regulators may allow government grants to be credited directly to equity or exempt certain pension and severance arrangements from the requirements of IAS 19 *Retirement Benefit Costs*; and
- some IASs have both a benchmark and an allowed alternative treatment and IOSCO may require those foreign issuers following the allowed alternative treatment to reconcile to the benchmark treatment - for example, IOSCO may require companies using LIFO (the allowed alternative) to reconcile to FIFO (the benchmark) or companies which revalue property, plant and equipment (the allowed alternative) to reconcile to historical cost based measurements (the benchmark) .

## **The Next Steps**

The July 1995 agreement represents the strongest commitment yet by IOSCO to endorse, within the foreseeable future, the use of IAS financial statements for cross border offerings and other foreign listings. Nevertheless, as several regulators emphasise, IOSCO's endorsement of the core standards is not a foregone conclusion. Three things need to happen to make endorsement a reality:

- the IASC must complete the core standards;
- the IOSCO technical committee must decide that the core standards are acceptable and, therefore, recommend their endorsement; and
- individual securities regulators must implement the IOSCO endorsement in their national rules and so allow foreign issuers to present IAS financial statements without modification or reconciliation - implementation may require prior public or other consultations.

The IASC's completion of the core standards is not in doubt although it may be achieved a little later than the current deadline of April 1998. As of July 1997, the IASC still had to complete new or revised IASs on financial instruments, investments, intangible assets, research and development, goodwill, employee benefits, impairment of assets, leases, discontinuing operations, provisions and contingencies, interim reporting, and the reporting of financial performance. This is an ambitious programme which no national standard setting body would attempt in such a short time. The programme must be achieved without any loss in quality of the resulting IASs and without any further diminution in the IASC's due process.

<b>Table 5: IASC/IOSCO Agreement - July 1995</b>					
	<i>Status Before July 1995 Agreement</i>		<i>July 1995 Agreement</i>	<i>Current Status (after July 1997 IASC board meeting)</i>	
<i>IOSCO core standards</i>	<i>IASC</i>	<i>IOSCO</i>	<i>Changes in IASC Work Programme</i>	<i>IASC</i>	<i>IOSCO</i>
<b>General</b>					
Disclosure of accounting policies	IAS 1 + review	Support review		Revised IAS 1 approved 1997	
Changes in accounting policies	IAS 8	Accepted			Accepted 1994
Information to be disclosed in financial statements	IAS 5 + review	Support review		Revised IAS 1 approved 1997	
<b>Income Statement</b>					
Revenue recognition	IAS 18	Accepted			Accepted 1994
Construction contracts	IAS 11	Accepted			Accepted 1994
Production and purchase costs	IAS 2	Accepted			Accepted 1994
Depreciation	IAS 16	Accepted			Accepted 1994
Impairment	Proposed project	Accepted		E55 issued 1997	
Taxes	IAS 12 + review	Support review		Revised IAS 12 approved 1996	
Extraordinary items	IAS 8	Accepted			Accepted 1994
Government grants	IAS 20	Accepted			Accepted 1994
Retirement benefits	IAS 19 + review	Support review		E54 issued 1996	
Employee benefits	Current project			E54 issued 1996	
Research and development	IAS 9	Rejected	Review of IAS 9	E60 issued 1997	
Interest	IAS 23	Accepted			Accepted 1994
Hedging	IAS 32 + project			Discussion paper issued 1997	
<b>Balance Sheet</b>					
Balance sheet impact of income statement items	Various				
Property, plant and equipment	IAS 16	Accepted			Accepted 1994
Leases	IAS 17	Rejected	Review of IAS 17	E56 issued 1997	
Inventories	IAS 2	Accepted			Accepted 1994
Deferred taxes	IAS 12 + review	Support review		Revised IAS 12 approved 1996	
Foreign currency	IAS 21	Accepted			Accepted 1994
Investments	IAS 25 + project			Discussion paper issued 1997	
Financial instruments/ off balance sheet transactions	IAS 32 + project			Discussion paper issued 1997	
Joint ventures	IAS 31	Accepted			Accepted 1994
Contingencies	IAS 10	Rejected	Review of IAS 10	E59 issued 1997	
Event occurring after the balance sheet date	IAS 10	Rejected	Review of IAS 10	E59 issued 1997	
Current assets and current liabilities	IAS 13 + review	Support review		Revised IAS 1 approved 1997	
Business combinations (including goodwill)	IAS 22	Accepted	Review of goodwill	E61 issued 1997	Accepted 1994
Other intangibles	Current project			E61 issued 1997	

**Table 5: IASC/IOSCO Agreement - July 1995 (continued)**

	<i>Status Before July 1995 Agreement</i>		<i>July 1995 Agreement</i>	<i>Current Status (after July 1997 IASC board meeting)</i>	
<i>IOSCO core standards</i>	<i>IASC</i>	<i>IOSCO</i>	<i>Changes in IASC Work Programme</i>	<i>IASC</i>	<i>IOSCO</i>
<b>Cash Flow</b> Cash flow	IAS 7	Endorsed			Endorsed 1993
<b>Other Standards</b> Consolidated financial statements	IAS 27	Accepted			Accepted 1994
Subsidiaries operating in hyperinflationary economies	IAS 21 and IAS 29	Accepted			Accepted 1994
Associates/ equity accounting	IAS 28	Accepted			Accepted 1994
Segments	IAS 14 + review	Support review			
Interim reporting	Current project		New project	Revised IAS 14 approved 1997 E57 issued 1997 IAS 33 approved 1997	
Earnings per share	IAS 24	Accepted			Accepted 1994
Related party disclosures	IAS 8	Accepted			Accepted 1994
Discontinued operations - disclosure	Proposed project				
Discontinued operations - recognition and measurement	IAS 8	Accepted		E58 issued 1997	Accepted 1994
Fundamental errors	IAS 8	Accepted			Accepted 1994
Changes in estimates	IAS 8	Accepted			Accepted 1994

## **Satisfying IOSCO**

What may be in greater doubt is whether IOSCO will accept the resulting IASs and, perhaps to a lesser extent, whether individual regulators will implement the resulting IOSCO endorsement. Therefore, it is worth looking at IOSCO's decision making process, the criteria by which it will judge the acceptability of the core standards and the attitude of three countries whose support is vital - Canada, Japan and the United States.

IOSCO's decision will be taken by its technical committee which consists of the senior officials of the regulators in all the major securities markets around the world (table 6). The committee will be advised by its working party on multinational securities offerings which includes representatives from all the same regulators and which is chaired by the American SEC. The working party is assisted by an accounting sub-committee which is chaired by the chief accountant of the Ontario Securities Commission. The committee, the working party and the accounting sub-committee meet in private and do not issue their proposals for public comment. Their decisions require consensus so a minority can override the views of the majority (as was the case in July 1995 when Canada, Japan and the United States opposed the endorsement of further IASs).

**Table 6: IOSCO Technical Committee**

<i>Country</i>	<i>Member</i>
Australia	Australian Securities Commission
Canada - Ontario	Ontario Securities Commission
Canada - Québec	Commission des Valeurs Mobilières du Québec
France	Commission des Opérations de Bourse
Germany	Federal Securities Supervisory Office
Hong Kong	Securities and Futures Commission
Italy	National Commission of Companies and of the Exchange (CONSOB)
Japan	Securities Bureau of the Ministry of Finance
Mexico	Comisión Nacional Bancaria y De Valores
Netherlands	Securities Board of the Netherlands
Spain	Comisión Nacional del Mercado de Valores
Sweden	Swedish Financial Supervisory Authority
Switzerland	Commission Fédérale des Banques
United Kingdom	Securities and Investments Board
United States of America	Securities and Exchange Commission Commodity Futures Trading Commission

IOSCO's criteria for the endorsement of IASs have been very consistent over the last ten years - the IASC should get rid of free choices of alternative accounting treatments in its standards, improve the implementation guidance so that companies apply IASs in the same way, and improve the required disclosures. What has been less consistent is the way in which the criteria have been applied in determining the acceptability of individual IASs. There is clear evidence that the application of the criteria is heavily influenced by the existing accounting requirements and practices in countries which are members of the technical committee. This has affected the list of core standards and the IASC's ability to adopt certain accounting treatments.

Take as an example the criterion that the IASC should eliminate free choices of alternative accounting treatments, something which IOSCO has always described as a necessary condition for its endorsement of IASs. IOSCO has supported the elimination of many free choices but it has objected to some, in particular the IASC's proposal to eliminate LIFO. Without warning and very late in the

process, IOSCO argued that a 'unitary approach' was unnecessary on the issue of the cost formula to be used for the valuation of inventories. The reason for this has never been explained but it probably reflects the use of LIFO in several countries which are represented on IOSCO's multinational securities offerings working party. Whatever the case, IOSCO's decision was influential in the IASC's decision to retain the choice between FIFO and LIFO.

More recently, IOSCO has compelled the IASC to reconsider its requirement that certain development costs should be capitalised. It has asked the IASC to reconsider both the capitalisation and the expensing of all research and development costs, again to reflect the different practices in IOSCO member countries. The IOSCO request came only months after the IASC had approved the revised IAS 9 *Research and Development Costs* with extensive IOSCO involvement. The IASC may have to re-introduce a free choice to win IOSCO's support but present indications are that the IASC will not do this and will stick with the approach in the revised IAS 9. This may lead to IOSCO's rejection of the standard and, as a result, to a further delay in the approval of the core standards.

In practical terms, to win IOSCO's endorsement of the core standards, the IASC has to do enough to satisfy Canada, Japan and the United States, the three countries which opposed the further endorsement of IASs in 1995. At the same time, the IASC has to avoid doing so much that it loses the support of those who favoured further endorsement or even endorsement of the process of setting IASs - Australia, Europe and Hong Kong.

Canada's objections were surprising as both the chairman and successive chief accountants of the Ontario Securities Commission have made public their support for the step by step endorsement of IASs. Historically, Canada has been a major supporter of the IASC with the Toronto Stock Exchange encouraging domestic companies to refer to compliance with IASs as well as Canadian GAAP. The Canadian Accounting Standards Board has used IASs as the basis of some of its own standards while making considerable efforts to remove any differences between Canadian GAAP and IASs. Canada and the IASC have also been working together for the past nine years to adopt common standards on financial instruments. The recent report of the Canadian task force on standard setting has reiterated Canada's backing for the work of the IASC and I expect Canada to support the endorsement of the core standards.

Japan's objections to the endorsement of IASs were more deep seated and many of the concerns about IASs which were raised by IOSCO in June 1994 originated in Japan. There are, however, three reasons why I believe that Japan will support the endorsement of the core standards. First, Japan will accept foreign GAAP financial statements from foreign issuers provided that it is satisfied with the quality of that foreign GAAP. The increasing convergence between IASs and the GAAP of many countries and the willingness of foreign regulators to allow the use of IAS financial statements should help persuade the Japanese Ministry of Finance about the quality of IASs. Second, Japanese regulators will accept foreign GAAP financial statements from companies in Hong Kong, Malaysia and Singapore all of which use IASs as, or as the basis for, their own standards. This should also help persuade Japan of the quality of IASs. Third, Japan's regulatory big bang includes a move towards domestic accounting requirements which are closer to international requirements. This should encourage the authorities to accept, as a first step in the reform process, IAS financial statements from foreign issuers.

The views of the American SEC will be the most critical because the SEC is the one regulator to impose additional accounting burdens on all foreign issuers and the United States is the favoured foreign country for many companies which wish to make cross border offerings or list their securities. Along with Japan, the SEC was the major source of IOSCO's concerns about IASs in June 1994. The SEC has identified three key elements to its ultimate acceptance of IASs:

- the standards must include a core set of accounting pronouncements that constitute a comprehensive, generally accepted basis of accounting;
- the standards must be of high quality - they must result in comparability and transparency, and they must provide for full disclosure; and
- the standards must be rigorously interpreted and applied.

The SEC should already be satisfied on the first element by virtue of the IASC's commitment to complete the core standards. However, it will be interesting to see the extent to which the SEC will require foreign issuers to comply with US GAAP in those areas not covered by the core standards.

It is the second element - the quality of the standards - which is now the real key to the SEC's acceptance of IASs. SEC chairman, Arthur Levitt, has emphasised that while the standards need not reproduce the words of US GAAP they must yield the same results in terms of the credibility and integrity of financial reporting. SEC chief accountant, Michael Sutton, has also argued that the process should enhance, not compromise, the strength of US capital markets and he has warned against diluting demanding but effective national standards.

How do IASs stand up to this test? Concerns were raised when the FASB published a study which showed 255 variations between IASs and US GAAP, a number which must be large enough for some to question the credibility and integrity of IAS financial statements. However, the SEC would have signed up to the IASC/IOSCO agreement if it had felt that the number of differences between IASs and US GAAP would ultimately block its acceptance of IASs. The SEC's staff had produced a similar study early in 1993 so the number of differences cannot have surprised the SEC. Furthermore, as Arthur Levitt has emphasised, the core standards need not be the same as US GAAP.

What may worry the SEC is the FASB's concern about conflicting or vague guidance in IASs and the IASC's practice of distinguishing black letter standards from background material and implementation guidance. The FASB believes that these weaknesses give rise to problems for practitioners applying the standards and it clearly thinks that all practitioners will not apply the standards in the same way, so reducing the comparability of the resulting financial statements. But again the problem is not new and SEC staff members have played an important part in the recent improvements to IASs which have, among other things, clarified the status of the guidance paragraphs in IASs and the distinction between standards and implementation guidance (in any event, IOSCO could decide to enforce all paragraphs in IASs equally without regard for the distinction between standards and guidance).

Another way in which the SEC can satisfy itself about the credibility and integrity of IAS financial statements is to compare them with what they might have shown had they had been prepared in accordance with US GAAP. In a recent study<sup>4</sup>, Professor Trevor Harris of the University of Columbia did just that. He looked at the reporting practices of eight multinational companies - Atlas Copco (Sweden); Bayer (Germany); BHP (Australia); Cap Gemini Sogeti and Valeo (France); Fletcher Challenge (New Zealand); Holderbank (Switzerland); and Olivetti (Italy).

Harris found that material differences between the accounting treatments used by the companies and those required by US GAAP were concentrated in five areas: acquisitions, business combinations and consolidations; foreign currency translation; post-employment benefits; property, plant and equipment; and taxation. In virtually all these areas, Harris suggests that the adoption of the revised IASs approved in 1993 would significantly reduce the differences with US GAAP. And in those areas where differences remain, Harris argues that the IASC treatments are every bit as good (and sometimes better) at meeting investors' needs as are those treatments required by US GAAP.

---

<sup>4</sup> Trevor S. Harris, *International Accounting Standards versus US GAAP Reporting: Empirical Evidence Based on Case Studies*, South Western College Publishing, Cincinnati, Ohio, 1995, ISBN 0-538-85693-9

Turning his attention to disclosure issues, Harris finds a greater number of differences between the financial statements and the requirements of US GAAP. The most notable differences were the lack of adequate disclosures about discontinued operations, related party transactions and business segments. Again, the use of the revised IASs would overcome many of the deficiencies and, as part of its core standards project, the IASC is currently revising the IASs on discontinued operations and segment information.

Even though the Harris study is based on a small sample, the SEC should be encouraged by its results. There is, however, one word of caution. Foreign companies which currently list their securities in the United States (including some in the Harris sample) know that they have to reconcile to US GAAP so they often minimise the number and size of reconciling items by choosing those options in their domestic requirements or IASs which are the same as US GAAP. They may also use US GAAP to deal with accounting issues which are not covered by domestic requirements (or IASs). Foreign issuers may no longer do either of these things if they are allowed to comply only with IASs; indeed some people in the United States are concerned that foreign issuers will interpret IASs as aggressively as US companies interpret US GAAP.

This leads to the SEC's third test for its ultimate acceptance of IASs - the rigorous interpretation and application of IASs. The need for rigorous interpretations should be satisfied by the IASC's decision to establish an interpretations committee to replace its old system of delegating interpretations of IASs to national accountancy bodies. But a far bigger problem is the consistent application or enforcement of IASs. My research reveals an extensive list of examples of non-compliance with IASs in financial statements which purport to conform with IASs (table 7) and which have been audited by major accounting firms. While some of these examples may be oversights which can easily be put right, others reflect a blatant disregard of the unambiguous requirements of IASs.

Juan Herrera, the president of IFAC, argued recently that companies and audit firms which allow non-compliance with IASs in IAS financial statements are misleading the users of financial statements and hurting enormously their own credibility. They are also hurting the IASC's chance of persuading IOSCO to endorse the core standards. It would be a great pity if all the hard work of the IASC and IOSCO over the last ten years was put in jeopardy by companies and their auditors failing to apply IASs properly. They must ensure that when financial statements state that they have been prepared in conformity with IASs this is truly the case.

Juan Herrera called for each accountancy body to establish a committee to enforce compliance with IASs and International Standards of Auditing. These bodies must not allow their members to think that IASs are a soft option and that companies can ignore those parts of IASs which they dislike. There is also a need for IFAC to take action against any of its member bodies which do not discipline those accountants and auditors who allow non-compliance with IASs in IAS financial statements.

Some have suggested that the IASC should set up an international equivalent of the UK's review panel. This may help but it would be difficult to make it work effectively in every jurisdiction in which companies issue IAS financial statements. One thing that the IASC can and should do is ensure that its officers and other representatives send out clear and unambiguous messages about the requirements of IASs and ignore their personal preferences about those requirements. This has not always been the case in the recent past.

I am confident that all these difficulties will be overcome and that the SEC is looking for ways to accept, rather than reject, IASs. I am also confident that the IASC/IOSCO agreement will be completed successfully within a reasonable period of its current deadline. If necessary, the IASC and IOSCO will find a further compromise to ensure that there is visible progress by the end of the century. That compromise will probably involve IOSCO's endorsement of those of the core standards which have been completed by 1998. It would also probably involve a second IASC/IOSCO agreement which recognises that for some of the more complex issues, such as the recognition and measurement of financial instruments, the IASC would be better off taking a little longer to get agreement with national standard setting bodies on common improvements in national and international standards.

**Table 7: Non-Compliance with IASs**

**Examples from 1995/96 IAS Financial Statements**

Non-disclosure of cost of sales (or operating costs applicable to revenues) (IAS 2)  
Inclusion of non-cash transactions in the cash flow statement (IAS 7)  
Classification of equity investments and short-term borrowings (which are not overdrafts) as cash equivalents (IAS 7)  
Deduction of expenses directly from shareholders interests (IAS 8)  
Failure to present pro-forma comparatives under the allowed alternative treatment for change in accounting policy (IAS 8)  
Failure to explain difference between effective tax rate and statutory tax rate (IAS 12)  
Non-disclosure of industry segment information by groups with wide variety of activities (IAS 14)  
non-depreciation of buildings (IAS 16)  
Non-disclosure of historical cost amounts for revalued assets (IAS 16)  
Out of date and/or selective revaluations of property, plant and equipment (IAS 16)  
Operating leases treated as sales so that the lessor recognises a lump sum receipt as revenue in the first year (IAS 17 & 18)  
Non-disclosure of retirement benefit costs (IAS 19)  
Absence of, or out date, actuarial valuations for defined benefit plans (IAS 19)  
Deferral of redundancy costs and amortisation of those costs over five years (IAS 19)  
Deferral of foreign exchange gains and losses (IAS 21)  
Inclusion of foreign exchange gains and losses arising on balance sheet monetary items in shareholders' interests (IAS 21)  
Addition/deduction of foreign exchange losses/gains arising on balance sheet monetary items to/from cost of long-term assets which are in use (IAS 21)  
Non-disclosure of foreign exchange gains and losses included in the income statement (IAS 21)  
Deduction of goodwill from shareholders' interests (IAS 22)  
Non-disclosure of the effect of acquisitions and disposals of subsidiaries (IAS 22 and 27)  
Capitalisation of borrowing costs after the asset is ready for its intended use (IAS 23)  
Non-disclosure of borrowing costs capitalised in period and capitalisation rate (IAS 23)  
Non-disclosures of the amounts of related party transactions (IAS 24)  
Failure to account for associates under the equity method (IAS 28)  
Failure to write down the carrying amount of associates to reflect a loss in value (IAS 28)  
Failure to amortise goodwill arising on acquisitions of associates  
Non-disclosure by a bank of the effect in the year of change from hidden reserves to full disclosure (IAS 8 and 30)

## **The Implications of the IASC/IOSCO Agreement for UK Companies**

The IASC/IOSCO agreement has four possible implications for UK companies:

- those UK companies that offer or list their securities in the United States will be able to satisfy SEC requirements by presenting a reconciliation to IASs instead of a reconciliation to US GAAP;
- the UK government may decide that some or all UK companies should be allowed to satisfy their UK accounting obligations with IAS financial statements;
- as the UK member of IOSCO, the Securities and Investments Board (SIB) will become an increasingly important player in determining UK accounting requirements; and
- the agreement will increase the pressure on the ASB to follow IASs which, in turn, may reduce the influence of UK companies on UK standards.

### ***Companies with US Listings***

When the IASC/IOSCO agreement is implemented, UK companies with US listings will have to decide whether to reconcile to US GAAP (as at present) or reconcile to IASs. The decision would be very easy if UK standards were identical in all material respects with IASs because companies would be able to use their UK statutory accounts as IAS financial statements and no further reconciliation would be necessary.

In practice the decision is unlikely to be that easy. Compliance with UK GAAP no longer achieves full compliance with IASs and it is unlikely that the ASB and the IASC will remove all the differences between UK GAAP and IASs by the time that the IASC/IOSCO agreement comes into effect. Therefore the decision is likely to be based on the nature, size and complexity of the adjustments to IASs when compared with those to US GAAP and the attitude of other capital market participants to IAS reconciliations.

Tables 8 and 9 summarise the UK GAAP/US GAAP reconciliations of net income and equity for 15 of the UK's largest companies. What would change in a UK GAAP/IAS reconciliation? The answer to this question will not be known until the core standards are finalised and will, of course, be affected by any revisions which the ASB makes to UK GAAP in the meantime. Nevertheless, it is possible to draw some initial conclusions.

Goodwill is currently the biggest item in most UK GAAP/US GAAP reconciliations and it would stay that way in a UK GAAP/IAS reconciliation if UK standards and IASs remain as they are now. UK GAAP currently allows an immediate write off to equity and this is the practice which is adopted by most UK companies. In contrast, both US GAAP and IASs requires the capitalisation and amortisation of goodwill with a 40 year cap on the amortisation period in US GAAP and a 20 year cap in IASs. If nothing changes, a switch from a UK GAAP/US GAAP reconciliation to a UK GAAP/IAS reconciliation will usually mean a slightly higher adjustment to net income for the amortisation of goodwill and a consequential reduction in the adjustment to equity.

But things are likely to change because the ASB, the IASC and the FASB are reconsidering their requirements for goodwill. The ASB has proposed that goodwill should be capitalised which will reduce significantly the adjustments needed to reconcile equity from UK GAAP to either US GAAP or IASs. Both the UK and IASC are also considering the possibility that goodwill could be amortised over an infinite useful life provided that the carrying amount is subject to an annual impairment test. If both the UK and the IASC allow such an approach, there would be no need for any adjustments for amortisation of goodwill in a UK GAAP/IAS reconciliation of net income or equity. There would continue to be adjustments in a UK GAAP/US GAAP reconciliation of net income and a compensating adjustment to equity for those UK companies which amortise goodwill over an infinite life or over a finite life in excess of that required by US GAAP.

<b>Table 8: Reconciliation of Net Income for UK GAAP to US GAAP</b>								
	<i>NET INCOME (UK GAAP)</i>	<i>Goodwill/ Intangibles</i>	<i>Borrowing costs</i>	<i>Deferred taxes</i>	<i>Pension costs</i>	<i>Restructuring costs etc</i>	<i>Other</i>	<i>NET INCOME (US GAAP)</i>
BP	2,552	-	-	(260)	-	-	46	2,338
BT	1,986	(36)	(22)	14	18	-	(154)	1,806
Cable and Wireless	607	(17)	2	( 24)	(7)	(21)	6	546
Cadbury Schweppes	340	(88)	-	-	(2)	(6)	3	247
Glaxo Wellcome	1,997	(1,028)	-	-	-	-	10	979
Grand Metropolitan	345	(155)	-	83	(8)	(89)	14	190
Hanson	1,419	(150)	-	103	43	-	(3,320)	(1,905)
National Power	608	-	23	(17)	-	-	(5)	609
Powergen	519	(1)	15	(93)	7	-	(10)	437
Reed Elsevier	604	(107)	-	(27)	18	-	5	493
Reuters	491	(49)	-	5	-	-	(7)	440
SmithKline	1,035	(187)	-	21	-	(104)	35	800
Unilever	1,610	(221)	6	50	(2)	(76)	-	1,367
Vodafone	310	(19)	-	4	-	-	(1)	294
Zeneca	643	(34)	(5)	(6)	(15)	(14)	15	584

<b>Table 9: Reconciliation of Equity from UK GAAP to US GAAP</b>										
	<i>EQUITY (UK GAAP)</i>	<i>Goodwill/ Intangibles</i>	<i>Borrowing costs</i>	<i>Deferred Taxes</i>	<i>Pensions etc.</i>	<i>Restruc- turing costs etc.</i>	<i>Reval- uations</i>	<i>Proposed dividends</i>	<i>Other</i>	<i>EQUITY (US GAAP)</i>
BP	12,795	-	-	(2,217)	71	-	-	-	1,014	11,663
BT	12,678	2,370	366	(1,802)	(1,308)	-	-	715	(9)	13,010
Cable and Wireless	3,259	962	202	(896)	(21)	5	-	154	150	3,815
Cadbury Schweppes	1,287	1,236	35	(98)	(43)	-	(76)	118	26	2,485
Glaxo Wellcome	1,225	6,209	-	(273)	-	-	-	673	319	8,153
Grand Metropolitan	3,211	3,420	-	(1,091)	(132)	22	(88)	211	(404)	5,149
Hanson	2,535	3,204	-	(732)	172	-	(165)	-	202	5,216
National Power	2,666	-	276	(772)	38	-	-	200	51	2,459
Powergen	2,252	16	51	(456)	5	-	-	106	30	2,004
Reed Elsevier	2,071	952	-	(191)	(9)	-	-	235	17	3,075
Reuters	1,260	216	-	(13)	-	-	-	145	(47)	1,561
SmithKline Beecham	1,369	3,363	-	(39)	(59)	79	(56)	160	(82)	4,735
Unilever	5,181	4,904	440	(707)	171	140	-	465	-	10,594
Vodafone	1,022	232	-	(79)	(2)	-	-	62	6	1,241
Zeneca	2,034	600	101	(45)	(151)	-	-	214	12	2,765

But will IOSCO accept an IAS which allows the infinite useful life/annual impairment test approach? The omens are not good. While the approach has some support in the US business community, the SEC's chief accountant has described it as a dangerous idea that imperils the credibility of financial reporting and the interests of investors. Most other countries which are members of the IOSCO technical committee put a fairly low cap on the amortisation period and would be sceptical about allowing a longer life. And, in any event, IOSCO has already told the IASC that it accepts the existing IAS on goodwill and the SEC allows foreign issuers to follow that IAS in place of US GAAP.

If the UK goes it alone with the infinite useful life/annual impairment test approach, UK companies will need to make adjustments for the amortisation of goodwill in their reconciliations to either IASs or US GAAP. The adjustments will continue to reduce net income by about the same amounts as at present and they will reduce the new UK GAAP amount of equity by the cumulative difference on amortisation.

Much the same comments can be made about the adjustments in respect of identifiable intangibles. However, the position is confused by a number of factors. Some UK companies currently recognise identifiable intangibles for US GAAP purposes but not for UK GAAP purposes (for example, Glaxo Wellcome, Grand Metropolitan and Unilever). Some also do not amortise intangibles (for example, BT, Grand Metropolitan and Reed Elsevier). It is also possible that some UK companies recognise more intangibles in their UK GAAP accounts than would be permitted under US GAAP or revalue intangible assets which is not permitted by US GAAP.

Both the ASB and the IASC are developing standards on intangible assets which could eliminate the need for any adjustments in UK GAAP/IAS reconciliations and may even lead to the same intangibles being recognised as under US GAAP. The same warnings apply to the amortisation of intangibles as apply to the amortisation of goodwill; the likelihood of IOSCO accepting an IAS which allows the infinite useful life/annual impairment test approach may be remote.

The IASC has already adopted the US GAAP approach on deferred taxes (with minor exceptions) and proposes to follow US GAAP on pension costs. Both these items currently give rise to large and complex adjustments from UK GAAP to US GAAP and it is likely that similar adjustments will be necessary in UK GAAP/IAS reconciliations.

No adjustments for restructuring costs and similar provisions should appear in UK GAAP/IAS reconciliations if the ASB and the IASC succeed in their efforts to adopt common standards on the recognition and measurement of provisions. This will avoid the problem which arises currently, that is differences between UK GAAP and US GAAP on the timing of the recognition of such provisions.

Many UK GAAP/US GAAP reconciliations include adjustments to eliminate the effects of upward revaluations of property, plant and equipment (not permitted in the United States) and to capitalise borrowing costs related to the acquisition of certain assets (required in the United States and allowed but rarely done in the UK). Both these adjustments should disappear in a UK GAAP/IAS reconciliation provided that IOSCO does not require a reconciliation to the IAS benchmark treatments. If IOSCO does require a reconciliation to benchmark treatments, UK companies would have to adjust for the revaluation of property, plant and equipment (historical cost in the IAS benchmark); this adjustment may be complex but companies have to know the information to satisfy UK Companies Act requirements. UK companies would not have to adjust for the capitalisation of borrowing costs (non-capitalisation is the IAS benchmark); this will save some complex calculations.

Many UK GAAP/US GAAP reconciliations include an adjustment for proposed dividends which are paid after the end of the financial period. Such dividends are recognised as a liability under UK GAAP but not under US GAAP. No adjustment will be required in a UK GAAP/IAS reconciliation as IASs allow both treatments. The IASC has no plans to reconsider this issue. In any event, the balance sheet adjustment is simple and there is no impact on the reconciliation of net income.

The changing nature of UK GAAP, IASs and US GAAP is well demonstrated by Hanson's adjustment in its UK GAAP/US GAAP reconciliation for the effect of its initial adoption of FAS 121 on the impairment of long-lived assets. Hanson recognised the same write-down of £3.2 billion for both UK GAAP and US GAAP purposes but it treated the write down as a prior year adjustment (a change in accounting policy) in its UK GAAP accounts whereas US GAAP requires the effect of such an accounting change to be included in the current period's profit and loss account. If the write down is a change in accounting policy, the IAS benchmark treatment is the same as the UK treatment and there would have been no adjustment in a UK GAAP/IAS reconciliation of net income.

However, the ASB has proposed in FRED 15 that write downs arising on the initial adoption of the proposed standard on impairment should be treated as changes in estimates and not as changes in accounting policy. Therefore, if a standard based on FRED 15 had been in force in 1996, Hanson would have had to recognise the £3.2 billion write down in the profit and loss account for UK GAAP purposes. The IASC may reach the same conclusion as the ASB which means that UK GAAP, IASs and US GAAP would all have shown a net loss for 1996 of £1.9 billion. In this case, therefore, it would have been a change in UK GAAP, rather than a switch to a UK GAAP/IAS reconciliation, which changed the reconciliation.

It is probable that UK companies will have to include some adjustments in a UK GAAP/IAS reconciliation which they do not currently include in their UK GAAP/US GAAP reconciliations. The most obvious examples relate to financial instruments. IAS 32 *Financial Instruments: Disclosure and Presentation* requires split accounting for compound instruments (for example, convertible debt) whereas current UK GAAP and US GAAP require the classification of compound instruments according to their predominant characteristics. The IAS treatment usually results in higher amounts of equity and net income. The IASC also intends to require that all financial assets and financial liabilities should be measured at fair value. This is probably further than either the ASB or the FASB is likely to go in the next few years so UK GAAP/IAS reconciliations are likely to include adjustments to equity and net income for changes in the fair value of long-term financial assets and long-term debt. The adjustments could be complex for some UK companies which may persuade them to stick with the simpler and less frequent US GAAP adjustments.

These examples do not include all the possible differences between UK GAAP and US GAAP or between UK GAAP and IASs. Furthermore, changes in any or all of UK GAAP, US GAAP and IASs in the next year or so could reduce or increase the adjustments in reconciliations, as the Hanson impairment example shows. UK companies with US listings should continue to monitor the changes in UK GAAP, IASs and US GAAP so that when the IASC/IOSCO agreement is implemented by the SEC they are ready to decide whether it is beneficial to switch from the current UK GAAP/US GAAP reconciliation to a UK GAAP/IAS reconciliation<sup>5</sup>.

### **Meeting UK Obligations with IAS Accounts**

The IASC/IOSCO agreement may persuade some regulators to allow companies to file IAS financial statements in satisfaction of domestic requirements even when IASs differ from those requirements. Two arguments have been put forward in favour of such an approach:

- the continental European argument, which is supported by the European Union in its new harmonisation strategy, which says that companies should not be required to publish two different sets of accounts and, therefore, those companies that are required by international markets to publish IAS or foreign GAAP consolidated financial statements should be able to use those financial statements to satisfy their domestic obligations; and

---

<sup>5</sup> An up to date comparison of IASs and UK GAAP as at the end of 2000 can be found in *The Convergence Handbook*, Cairns, D. and Nobes, C, Institute of Chartered Accountants in England and Wales, 2000.

- the American argument which says that domestic companies will be at a disadvantage if they have to report under domestic GAAP and foreign issuers are allowed to report under IASs.

The two arguments are, of course, related and they are influenced by the perception that IASs are superior to, or more onerous than, most national accounting requirements in continental Europe but IASs are inferior to, or less onerous than, US GAAP.

There are moves in both France and Germany to allow certain companies to use IAS financial statements to satisfy domestic legal requirements (there is also the possibility that the companies may be able to use US GAAP financial statements for the same purpose). Both countries, are likely to restrict any concession to certain companies (probably those with foreign listings) and will require that the IAS (or US GAAP) financial statements also comply with the EU 4th and 7th directives. Therefore, in practice, the concession will mean that French or German companies will be able to use accounting treatments in their consolidated financial statements which are not permitted under their national accounting laws but which are allowed by both the directives and IASs.

The UK government may consider the same concession (it may even be compelled to by the European Union). I do not expect the UK government to allow any concessions because the situation in the UK is different from that in France and Germany in two related respects.

First, the ASB's requirements are more detailed and prescriptive than French and German requirements and, to a lesser extent, IASs. The ASB has also made a number of improvements in UK GAAP which have not yet been reflected in IASs, for example the statement of total recognised gains and losses, the definition of cash and cash equivalents in the cash flow statement and the use of fair values in acquisition accounting. Allowing UK companies to use IAS financial statements to satisfy UK requirements would exempt them from these improvements and would result in the publication of financial statements which are inferior to those of other UK companies.

Second, French and German companies prefer to publish one set of consolidated financial statements which comply with both national requirements and either IASs or US GAAP. In contrast, UK companies prefer to publish UK GAAP consolidated financial statements with a reconciliation to US GAAP (or, in future, to IASs) even when the US GAAP (or IAS) treatments are permitted by UK GAAP.

The American argument in favour of IAS financial statements for domestic companies says such companies will be disadvantaged if they have to comply with US GAAP while foreign issuers are allowed to file IAS financial statements. It is difficult to support this argument in the UK which is well used to the fact that foreign companies listed on the London Stock Exchange do not have to follow UK GAAP. A similar situation exists in the rest of Europe and Japan where foreign issuers are often, but not always, allowed to report using home country GAAP and there is no evidence that European and Japanese companies are disadvantaged in their home markets by these arrangements.

The American argument fails to recognise that the whole thrust of the IASC/IOSCO initiative is to remove one of the impediments to cross border offerings and other foreign listings. It has never been about the accounting requirements which apply to domestic companies. The SEC has made clear that it does not intend to allow US companies to adopt IASs in place of US GAAP and I do not expect it to change its mind or the UK government to be persuaded by such an argument.

### ***The Role of the Securities and Investments Board***

The Securities and Investments Board is the UK member of IOSCO and is a member of IOSCO's technical committee, multinational securities offerings working party, and accounting sub-committee.

It is the SIB which has been negotiating on behalf of the UK with the SEC and other regulators to decide on whether IASs should be endorsed for use in cross border offerings and other foreign listings. It is also the SIB's responsibility to see that any IOSCO endorsement of IASs is implemented in the UK; in practice this is not difficult nor onerous as the London Stock Exchange has allowed foreign issuers to report under IASs rather than UK GAAP for many years.

In contrast to its extensive and important role in developing and approving IASs, the SIB does not take any part in the UK's accounting standard setting process. It is not represented on the Financial Reporting Council and it does not determine the accounting requirements which apply to foreign companies listed on the London Stock Exchange (although it does supervise the Exchange). Unlike, say, the SEC or the COB in France, the SIB has no role in regulating or reviewing the financial statements of domestic and foreign issuers. Therefore, the SIB lacks the detailed in-house knowledge on accounting matters of some of its IOSCO counterparts and has to rely on external consultants to advise it on the acceptability of IASs.

While the SIB has been supportive of the IASC and the use of IASs, it is unclear how its position on accounting issues is determined. Furthermore, while the ASB consults UK companies and involves them in its processes, the SIB's decision making process on the acceptability of IASs does not include the same level of consultation and involvement. Therefore, UK companies with foreign listings could lose some influence over the accounting requirements which apply to them. All UK companies could lose influence over UK accounting requirements if the ASB comes under further pressure to follow the standards which have been agreed by the IASC and endorsed by IOSCO.

Three things should happen without delay:

- the SIB should be appointed to the Financial Reporting Council and represented on that Council by an appropriate senior official who should report on how the SIB decides on its position on accounting matters in IOSCO and how it consults interested parties in the UK; and
- the Hundred Group of Finance Directors should ensure that the SIB involves UK companies in the process by which it determines its positions on the acceptability of IASs; and
- the ASB, the UK's accountancy bodies and the Hundred Group of Finance Directors should take the necessary steps to ensure that the SIB supports the recent improvements in the UK's financial reporting framework which have been introduced by the ASB and does not sacrifice those improvements as part of the negotiations in IOSCO.

### ***Increased Pressure on the ASB***

The ASB recognised from the outset the need for UK standards to be produced with due regard for international developments. It has supported the IASC in its aim to harmonise international financial reporting by adopting FRSs which conform with IASs, participating in various IASC activities and working with the IASC on such projects as provisions and the impairment of assets and in such groups as G4+1. The ASB has also been influential in co-ordinating the agendas of different standard setting bodies. How will the agreement between the IASC and IOSCO change things? Will the ASB come under increased pressure to adopt the standards approved by the IASC and endorsed by IOSCO.

Some have seen the IASC/IOSCO agreement as the beginning of the end for national standard setting bodies such as the ASB. The IASC chairman, Michael Sharpe, has argued that the existence of different national accounting standards is untenable and the work of national standard setting bodies is crazy. He has described the current situation of reporting in accordance with domestic standards as unacceptable and claimed that IASs are the answer to all the needs of international capital markets. He has also told national standard setting bodies to stop tinkering with IASs and adopt them in full without amendment.

These remarks have not gone down well with many national standard setters, particularly those who have co-operated with the IASC over the last few years. The remarks do, however, represent a widely held view which could have significant implications for UK companies which have become used to working with the ASB. If Michael Sharpe's ideas become a reality, the ASB will be the servant of the IASC and UK companies will lose both influence over national standard setting and the benefits which have flowed from those improvements in UK accounting which have not been accepted by the IASC.

A more realistic approach is to recognise that the IASC will not replace national standard setting bodies and that IASs will not replace national standards unless a country so decides. The IASC will, instead, revert to working directly with national standard setting bodies to achieve common improvements in accounting standards as well as greater compatibility between national requirements and IASs and among the national requirements of different countries. It will also continue to encourage individual standard setting bodies to work together on topics of mutual interest, emerging issues and other topics of international interest (whether or not they are on the IASC's work programme). These co-operative efforts should result in recommendations to the IASC that can be incorporated in new and revised IASs and in the adoption of common improvements by national standard setting bodies in their own requirements.

It is this approach, which has long been the official IASC policy, which should re-emerge from the IASC's current review of its strategy. If it does, the IASC/IOSCO agreement will lead to continuing co-operation between the ASB and the IASC with the ASB giving to the IASC rather more than it takes from the IASC. The ASB will be governed by domestic needs and the IASC will be governed by what is right and acceptable at the world level. However, the ASB will continue to recognise, as did the FASB several years ago, that 'international issues are so intertwined with domestic issues that there is no way to clearly separate the two'. As a result, the ASB will continue to work closely with other national standard setting bodies, particularly those in Australia, Canada, the United States and the European Union, as well as with the IASC.

The differences between UK GAAP and IASs will narrow as the ASB and the IASC learn from one another and from other national standard setting bodies. It is also desirable that standard setting bodies, including the ASB, sometimes accept compromises in the interests of international harmonisation but only when their solution to an accounting issue is no better than the international alternative. It is, however, wholly unrealistic to expect the ASB to adopt IASs, even those endorsed by IOSCO, without amendment. The ASB should continue to adopt new requirements or retain existing requirements which are different from IASs in three sets of circumstances:

- when the ASB has developed (perhaps in conjunction with other national standard setting bodies) a superior solution to that required or proposed by the IASC for an accounting issue - deferred taxes and pension costs are often quoted as examples;
- when the ASB has developed (perhaps, in conjunction with other national standard setting bodies) an even better solution to an accounting issue from that currently required by UK GAAP and IASs and wishes to improve existing UK GAAP by moving ahead of IASs - the recent changes to FRS 1 are a good example; and
- when the UK is not ready to accept, or is blocked by the law from accepting, a superior international solution and therefore must adopt or continue to use an inferior solution.

In order to avoid unnecessary differences between UK GAAP and IASs, it would be helpful if there was agreement on what is meant by 'superior' and 'inferior' standards so that everybody can understand why the ASB's solution in any particular case is superior (or inferior) and the international solution is both inferior (or superior) and different. The IASC's *Framework for the Preparation and Presentation of Financial Statements* and the ASB's proposed statement of principles will help in this respect even when people interpret their requirements differently.

The ASB also has an important role in helping Europe play its part in international harmonisation. As Georges Barthes, the former IASC chairman used to say, virtually all known accounting treatments exist alongside one another in Europe and international harmonisation is, therefore, only a little more difficult than European harmonisation. Removing differences within Europe will go a long way towards removing those same differences internationally and the ASB should work with other standard setting bodies in Europe and the European Commission to resolve such differences. Sometimes this may mean adopting a solution which is different from that preferred by the IASC. On the other hand, disagreements within Europe should not block or delay improvements in financial reporting which are accepted at the world level and which are supported by some Europeans.

If this sort of strategy governs the relationship between the ASB and the IASC, UK companies need not fear the impact of the IASC/IOSCO agreement on that relationship. UK companies should, therefore, make their views known both to the ASB and the IASC's strategy working party.

## **Beyond the IOSCO Agreement**

What happens after the IASC/IOSCO agreement is successfully completed and any company is allowed to use IAS financial statements as a passport to a listing of its securities of any foreign stock exchange? It is this question which is currently being addressed by the IASC's strategy working party. It is looking at three broad issues:

- the IASC's objectives and its work programme;
- the IASC's relationship with national standard setting bodies; and
- the further evolution of the IASC's structure.

The IASC's relationship with national standard setting bodies was dealt with in the previous section in the context of the increased pressure on the ASB to follow the IASC. But what of the two other issues?

The questions on the IASC's objectives and its work programme are quite simple to answer. The IASC will continue to work for the improvement and harmonisation of financial reporting by business enterprises primarily through the development and approval of IASs. The work will continue to focus on those issues which are important internationally in the financial statements of business enterprises. It must involve the further evolution of the core standards; they must not be cast in stone. It will mean less work on new standards but more work on the improvement of existing standards and the development of standards for some specialised industries (for example, banking, insurance and mining).

The future will also see a change in the relationship between the IASC and IOSCO. While the July 1995 agreement was heralded as a milestone, it is important to remember four facts:

- the list of core standards was determined by IOSCO and not by the IASC;
- the current process allows IOSCO to 'second guess' the IASC and, in so doing, reject IASs which have been developed through extensive due process;
- IOSCO's own process for deciding on the list of core standards and on the acceptability of IASs does not include any public consultation or other due process; and
- in 1992, IOSCO endorsed the use of International Standards of Auditing in financial statements used in cross border offerings and other foreign listings but that endorsement is no longer in effect because IOSCO was unhappy with the revisions to those standards.

In future, it is vital that the IASC determines its own work programme, that IASs are not 'second guessed' by IOSCO and that the IASC is free to improve IASs without the possibility that IOSCO

might withdraw its earlier endorsement or refuse to accept the revisions. Within the next year, I expect the IASC and IOSCO to find a way in which IOSCO's endorsement of IASs can, as Edward Waitzer suggested in 1994, be 'an endorsement of the processes by which those standards are developed rather than an endorsement of the individual technical positions taken'. A change in the IASC's structure, which is essential in its own right, may be necessary to get IOSCO's agreement to such an approach.

The most dramatic change to affect the IASC in the coming years will be a radical overhaul of its structure. The IASC has achieved a great deal with its current, albeit evolving, structure but it is time for a change which will go much further than the evolution envisaged by the foundation working party in 1994. In broad terms, the future structure of the IASC should involve:

- an International Accounting Standards Foundation (IASF) which is a partnership of the various members of the IASC's constituency, including the international accounting profession, companies and other business groups, financial analysts and other users of financial statements, regulators and stock exchanges, development agencies, and governmental and intergovernmental bodies;
- an IASF board of management which would have the present powers of the IASC advisory council plus the power to appoint the standard setting board;
- a standard setting board which has the power to issue IASs without the approval of any other body, and to establish direct links with any organisation or individual in any country;
- an international consultative group or groups to advise the standard setting board on technical issues and its work programme;
- a series of specialist or regional consultative groups to advise the standard setting board on individual projects (which would replace the current IASC project steering committees); and
- a strong and pro-active professional staff to support the work of the standard setting board.

The standard setting board should have about 10-12 members from a variety of geographical and business backgrounds. Some have suggested that they should be representatives of national standard setting bodies but such an approach is fraught with danger. The IASC board must have the freedom to take its own decisions which might differ from those taken by some national standard setting bodies. It must be free to lead (or follow) other standard setting bodies, to avoid political compromises which have been necessary in some national standards, and to make its own compromises when necessary. Therefore, the members of the IASC board should be chosen for their ability to address international financial reporting issues, their experience of (but not necessarily their current involvement in) national and international standard setting and their commitment to work closely with national standard setting bodies.

UK companies should support such changes. They would have direct links with the new standard setting board and would participate in its work. They might also have a representative on the board but that would depend solely on the relative abilities of potential candidates rather than their membership of particular accounting bodies. Whatever the case, UK companies will continue to contribute to and benefit from the efforts of both the ASB and the IASC to improve and harmonise financial reporting.