Institute of Advanced Legal Studies
School of Advanced Study
University of London

Maureen Nabukeera

Impact of International Accounting Standards in implementation of national securities regulation

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Author Name and Student ID: R6705 ICGFREL

Tutor/Supervisor: Professor Mahmood Bagheri

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1 **Abstract**

In a financial/securities regulating world, accounting reporting provides useful information to both the decision makers and financial regulators. As a result, as the business environment changes, so do the accounting standards that govern the disclosure/reporting of financial information. In a globalised economy, international accounting standards[1] are certainly central to such concept. International accounting standards were first developed in the 1960s. That said, the evidence suggests that, international accounting standards did not reach their zenith of importance until today. Indeed, it has taken nearly 20 years for the international accounting standards to reach their zenith in the financial/securities markets.

[1] International accounting standards/International Financial Reporting Standards (IFRSs) may be defined as Standards and Interpretations adopted by the International Accounting Standards Board (IASB). Warren McGregor, 'Draft Memorandum of Understanding on the role of Accounting Standard-Setters and their relationships with the IASB' (2005) available at http://www.iasplus.com/resource/0503draftmou.pdf.

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To be precise, it has only been in the last seven years that international accounting standards reached prominence and that some countries decided to adopt them in place of their national accounting standards.

2 **Methodology**

This paper aims to examine the issues surrounding international accounting standards in securities markets. To do so, it will start in the first chapter, by examining the meaning and place of information in securities transactions, information disclosure under securities regulation and the role of accounting standards in verifying disclosure requirements in securities regulation. Chapter one will further examine the reasons why SOX Act 2002 was adopted and consider whether congress aimed at regulating the accounting practice when they adopted the SOX Act. As such, chapter one will look at the issue whether the accounting practice and standards would need to be regulated for securities regulation to be implemented.

Chapter two will focus on internationalization of securities markets and will consider the question as whether there is a need for harmonization of accounting standards. The challenges that may be faced in introducing and incorporating International Accounting Standards will also be looked at in chapter two. Chapter two will further examine the role of international accounting standards in combating corruption. This paper will then conclude with an overall evaluation of the role of international accounting standards and a few recommendations that may help to overcome the challenges associated with the implementation of international accounting standards.

3 **Introduction:**

Accounting Standards are one of the facilitative mechanisms used in the implementation of securities regulation. In a globalised market and following the recent reforms in response to the current financial crisis, it is important to examine the role and function of Accounting Standards on a global scale. Following a recent global transformation, the world's financial markets have increasingly become more interlinked. As John Donne's saying goes, "no man is an island", in today's markets, no investor is now just a national investor.[2] It seems trading or investing in international financial/securities markets has become a common practice. Companies/corporations looking to raise or borrow capital are now willing to look beyond their country's boundaries.

[2] See Blazey, Patricia, Connors & Benedict 'Emissions Trading – Traps for New Players' (2008), MqJIBLaw 13; (2008) 5 Macquarie Journal of Business Law 291 available at http://www.austlii.edu.au/au/journals/MqJlBLaw/2008/13.html

Similarly, investors are increasingly becoming more interested in investing in foreign and intercontinental businesses. As a result, securities regulators around the world face the challenge of meeting the needs of all market participants, maintenance of investor protection and promotion of market integrity.[3] In order to promote investor protection and ensure market confidence, securities regulators do promote the principle of full disclosure. For the purpose of achieving full disclosure and indeed, as a way of acknowledging the change in the business environment, it seems the government and policy makers have come to accept/appreciate the importance of international accounting standards in the regulation of securities markets.

This was demonstrated when the European Council of Ministers passed a resolution requiring all EU companies listed on a regulated market to prepare accounts in accordance with International Accounting Standards for accounting periods beginning on or after 1 January 2005. Having said that however, while the International Accounting Standards Board welcomed the resolution and was pleased that the EU was among the first major "nation-states" to take the initiative to embrace international accounting standards, this change on the other hand was met with great furor in the accounting profession and in the corporate

[3] For instance, some of the main aims and objectives of the FSA as a financial regulator is to promote market integrity, promotion of the principle of transparency/disclosure, promotion of market confidence and ensuring of investor protection.

boardrooms. The EU appreciated the many benefits of requiring the implementation of international accounting and auditing standards.

However, although the US at first was not so keen to abandon their standards in place, for international accounting standards, their Securities Exchange Commission (SEC) recently also changed and decided to vote requiring U.S public companies to start using International Financial Reporting Standards by 2014. In their statement, while declaring its involvement and support to develop a globally accepted high quality financial reporting framework, the SEC declared that, the benefits of international accounting standards can be financial, economic and political. They further conveyed that preliminary evidence suggested that companies, lenders, and investors would prefer a convergence of domestic accounting standards with international accounting standards to create a quality financial reporting framework.[4]

Having said that, while recognizing the significant benefits to implementing international accounting standards, it is nevertheless important to appreciate the many challenges involved in the implementation of international accounting

[4] See US SEC Concept Release: 'International Accounting Standards', SECURITIES AND EXCHANGE COMMISSION 17 CFR PARTS 230 and 240 [RELEASE NOS. 33-7801, 34-42430; INTERNATIONAL SERIES NO. 1215] (2008) available at http://www.sec.gov/rules/concept/34-42430.htm.

standards. In order to understand these challenges it is of great importance to look at factors such as social/cultural values, political/legal systems, the business culture, economic conditions, standard setting processes, capital markets and forms of ownership, and the cooperative efforts by nations that often influence the development of accounting regulations. Thus, as international accounting standards are important today and most certainly will become more important for the future as they continue to develop further, it would be best appreciated if the differences in how standards developed in various countries, the history behind the development of International Standards, the benefits of international standards and the challenges of implementing international standards were understood.

For instance, although securities markets have grown more global, they are nationally regulated.[5] Indeed, at the moment companies (issuers) wishing to raise capital or have access to securities markets in different jurisdictions must comply with the varying regulatory requirements of each jurisdiction. With the aim of reducing the differences and inefficiencies that may arise, securities regulators around the world are working together in encouraging the use and development

[5] See John Fontecchio, "The General Agreement on Trade in Services: Is it the answer to creating a harmonised global securities system?" (1994) *North Carolina Journal of* International *Law and Commercial* Regulation 115 at 119-120. Also, Rhys Bollen, 'The international financial system and future global regulation', Journal of International Banking and Regulation (2008), 23(9), 458-473 available at Westlaw UK

of accounting standards in transnational dealings. Demonstrating this point for example, the US Securities and Exchange Commission (SEC), while focusing on the work of the International Accounting Standards Committee, have been advocating that securities/capital markets can operate efficiently only when investors have access to good and high quality financial information.[6]

This poses a question as to what is high quality and whether high quality information can exist in an international market with various disclosure standards. In an investor's point of view, high quality information would be reliable /consistent financial information indicating a company's financial performance. Therefore, in a market with varying standards, it is fair to say that it may be challenging to achieve consistence. Thus, as a regulatory, facilitative mechanism, perhaps the economic world should consider establishing International Accounting Standards that could be incorporated into national standards which could facilitate the implementation of securities regulation by creating uniform standards across the market.

[6] See Ian P. Dewing and Peter O. Russell, 'Regulation of statutory audit in the European Union: New developments' Journal of Financial Regulation and Compliance, Emerald Publishing (2006) 10(1)

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Chapter I

4 <u>What is the meaning of accounting information in securities transactions and where would information be found?</u>

In verifying disclosure requirements the major issue for accounting standards would be the quality of accounting information.[7] However, before looking into the role of accounting standards in more detail, at this stage, it would be important to know the meaning of accounting information. Accounting information could be defined as a facilitative instrument used by companies to convey the achievements of their business operations. What this means is that business enterprises have many operational activities but may not have an easy way of articulating these operational achievements. This is because such articulation would require quantification of the operational activities. Hence, due to the accountants' knowledge and expertise, companies tend to employ the accountants to help in the quantifying of business activities which results into accounting information.

Why would companies be interested in accounting information? Does it matter whether they express their operation achievements? With regards to securities regulation, it could be said that accounting information is important for the

[7] Accounting standards as issued by the Accounting Standards Board (ASB) can be defined as financial accounting/reporting principles which set the criteria for which accuracy and reliability of accounting information can be judged. As an economic measurement, the aim of accounting standards is to meet the needs of market participants by providing information that would facilitate the making of investment and regulatory decisions.

purpose of providing systemic stability and safety of financial/securities markets. Similarly, accounting information is so important to companies simply because they act as economic cells of the society in that, all enterprises and market participants base their decisions on accounting information. For instance, investors when making investment decisions will often rely on accounting information. Likewise, when making operational, investment and other policy decisions the enterprise management will consult with the accounting information. Equally, banks will also rely on accounting information to make their decisions for loans approval. In addition, regulators may rely on accounting information to investigate issues of financial crimes, tax problems and any financial error that may have been overlooked by the management. This implies that, almost, if not the entire economy/business world relies heavily on accounting information to do business.[8] Thus, in essence this means that, the more accurate and reliable accounting information is, the more market participants will have trust and confidence in the market.

While it is important to grasp the meaning of the concept and learn how useful accounting information is, at this point it is also, worthy to consider where such information can be found. Generally, companies issuing securities to the public

8 See Dr. Francis W. K. SIU's work on 'Accounting System and Information Disclosure' available at http://www.cipe.org/regional/asia/china/p3_accsys.htm.

are required to file registration reports and financial statements with a regulatory authority.[9] This implies a requirement that, before a company can make its initial public offering to the market, it must file a registration statement which includes a prospectus[10] and the supplemental information detailing the financial position of the company. The purpose of filing these reports and statements is to disclose the company's accounting information to prospective investors and regulatory bodies to enable them make an informed decision about the company's operations. This means that, as one of the sources, accounting information can be found in annual reports and financial statements filed with a securities regulatory authority.

5 <u>What is the role of accounting standards in verifying disclosure requirements in securities regulation?</u>

Earlier, I mentioned that accounting information needs to be accurate for market participants to trust and be confident in the market. In being accurate, this means that the accounting information disclosed in the company financial statements ought to reflect the exact operational and financial achievements of the company and all major incidences that could have an impact on the investors' decisions to invest in the company need to be fully disclosed. This implies that there would

[9] In the UK for instance, companies have to file their statements with the Financial Services Authority (the FSA) or the Securities Exchange Commission (the SEC) in the USA
[10] This is also known as an offering document and would be distributed to all prospective investors/buyers.

need to be a criteria or measure to assess/determine whether the disclosed accounting information is accurate, transparent, reliable and complete.

Thus in this case, the accounting standards provide the criteria for which accounting information can be verified to be either true or false. According to disclosure requirements, accounting information must be accurate, transparent and reliable. This means that by being accurate, the accounting information as well as being prepared according to the acceptable accounting standards, it would reflect the exact operational and financial position of the company. In other wards, companies would need to ensure that their financial statements are comprehensively prepared disclosing all necessary accounting information.

From the above, it could be said that in general, accounting profession play an important facilitative role of interpreting uncertain market signals and influencing the behaviour of both market participants and regulators.[11] They do this by setting, monitoring the financial status of companies and implementing market regulatory objectives such as disclosure requirements. By monitoring companies' financial performance, accounting standards play an important role of providing reliable and transparent information upon which investors base their decisions to

[11] See Professor Mahmood Bagheri's work on 'Informational intermediaries and the emergence of the new financial regulation paradigm, Company Lawyer (2003) 24(11), 344-345 available at Westlaw UK

invest in various securities. Indeed, following the recent financial crisis resulting partially from regulatory failures, it could be argued that this crisis highlights a regulatory gap which could only be filled by the accounting and auditing profession.[12] This is because accountants and auditors alike hold strategic positions in enterprises which allow them to access privileged information on a daily basis.

6 Why was Sarbanes-Oxley Act (SOX) adopted? The reasons behind the adoption of the SOX Act 2002

As an enforcement mechanism, securities regulations have been in place to deal with market failures such as the agency problem and asymmetric of information in markets. However, following the Enron, WorldCom and Tyco scandals (of 1994-2000), it was concluded that for the regulations to succeed, regulators needed to receive accounting information from the experts who can analyze such information.[13] As accountants prepare company financial statements and auditors verify them, securities regulators came to a conclusion that it was the accounting profession or accountants and auditors who holds the key to accounting information.

[12] See Professor Mahmood Bagheri ‘Informational intermediaries and the emergence of the new financial regulation paradigm, Company Lawyer (2003) 24(11), 344-345 available at Westlaw UK

[13] According to Doreen, SOX was a result of corporate scandals such as the Enron bankruptcy. See Doreen McBarnet After Enron will "whiter than white collar crime" still wash? British Journal of Criminology (2006)

Thus, as a way of ensuring accuracy and reliability of accounting information, it was thought that it would be a good idea for regulators to focus on regulating the accounting practice. As a result, the SOX Act was adopted.[14] Thus, one of the aims of the SOX is to oversee and regulate the accounting and auditing profession.[15]

In 2000, it was discovered that Enron, WorldCom and Tyco had all in one way or the other misled the market with distorted accounting information. For instance, while Enron through the practice of off balance sheet financing failed to disclose important financial information regarding some of their transactions, WorldCom on the other hand confessed to having caused investors lose lots of money by overstating in its income statements resulting in investors losing confidence in the securities markets. Consequently, this prompted Senator Sarbanes and Oxley's proposal for the SOX, as a measure of reestablishing market confidence. Named after its main Congressional sponsors, Senator Paul Sarbanes and Representative Michael Oxley, the Sarbanes-Oxley Act was introduced to

[14] The SOX also known as Sarbox may be defined as US legislation which deals with corporate governance and financial disclosure. Introduced in response to corporate and accounting related scandals including those affecting Enron, WorldCom and Arthur Andersen, the SOX was sponsored by US senator Paul Sarbanes and US representative Michael Oxley.
[15] See P. N. Saksena, 'The Sarbanes-Oxley Act and occupational fraud: does the law tackle the real problem?' International Company and Commercial Law Review (2009) 20(2), 37-43 available at Westlaw UK

congress in 2002 following immediate discovery of the problems at WorldCom.[16] With the aim of improving transparency the SOX introduced new financial practices and reporting requirements such as the executive certifications of financial reports,[17] thus restructuring the accounting industry and impacting corporate governance and the enhanced punishment of white collar crimes for US publicly traded corporations.[18]

To enforce the provisions, the SOX consequently created the Public Accounting Oversight Board (PAOB) which could be said to have been designed to include the accounting professional in the regulatory structure and act as a regulatory mechanism which would regulate, supervise, oversee, inspect and discipline the accounting/auditing practice at the same time.[19] This was demonstrated by Senator Sarbanes' words when he stated that one of the reasons that led to the adoption of the SOX Act was the problem of inadequate oversight of accountants. Hence, by requiring all financial reports to include an internal

[16] See Donald Nordberg 'Waste makes haste: Sarbanes-Oxley, competitiveness and the subprime crisis', Journal of Financial Regulation and Compliance (2008) 16(4), 365-383 available at Westlaw UK

[17] To be precise, under section 302 SOX Act 2002, company chief executive and chief financial officers, under criminal prosecution threat are required to attest to the accuracy of their financial statements.

[18] See P. N. Saksena, 'The Sarbanes-Oxley Act and occupational fraud: does the law tackle the real problem?' International Company and Commercial Law Review (2009) 20(2), 37-43 available at Westlaw UK

[19] PAOB is a private-sector, not-for-profit Corporation which regulates and oversees public accounting firms.

control report which would ensure both the accuracy and the company's confidence in their financial data, it could be said that the SOX Act was adopted to regulate financial reporting.[20] Thus, as one of the many goals of the SOX Act, regulating of the accounting profession meant that accounting firms conducting audits of financial statements would have to certify the accuracy of the company's financial/accounting reports and substantiate the effectiveness of the firm's internal control system.[21]

One thing in common about the Enron, WorldCom and Tyco scandals was the lack of financial transparency.[22] Since SOX was a response to these scandals, it could be fair to argue that the essence of SOX was to enforce financial transparency which would ensure that investors, shareholders and other stakeholders could confidently review a company's financial statements and see

[20] Also see The SEC chairman, William H Donaldson's testimony concerning 'Implementation of the Sarbanes-Oxley Act of 2002'

[21] See Donald Nordberg 'Waste makes haste: Sarbanes-Oxley, competitiveness and the subprime crisis', Journal of Financial Regulation and Compliance (2008) 16(4), 365-383 available at Westlaw UK. Also, see section 404 SOX Act 2002. Section 404 mandates that all US publicly traded corporations must establish internal controls and procedures for financial reporting. In addition, the Act requires that companies document, test and maintain those controls and procedures to ensure their effectiveness.

[22] What is financial transparency? Financial transparency may be defined as a reasonable investor, shareholder and /or other stakeholders being able to review a company's financial statement and understand exactly how the business is performing. (American Management Association, 'Yes, You Do Need to Know about Sarbanes-Oxley' http://www.amanet.org/training/articles/Yes-You-Do-Need-to-Know-about-Sarbanes-Oxley.aspx)

the exact company financial position.[23] Having said that therefore, can it be argued that through SOX accounting regulation, the quality of accounting/auditing standards was improved? Or could it be said that the SOX's intended aim of protecting investors and employees was achieved and therefore corporations would no longer be able to use accounting and financial maneuvers to hype their share prices?

Following studies such as Sarbox "quack" governance by Roberto Romano, it is not clear if one can confidently claim that regulation of the accounting profession by the SOX Act would indeed improve the quality of accounting/auditing practices and standards.[24] This can however, be achieved if the regulator's knowledge and skills in the accounting and financial standards demonstrate to be superior to those of the accounting and auditing professionals. Short of that and indeed, by involving the accounting profession in the regulatory chain, it could be argued that adoption of SOX Act gave the accounting profession more power over financial reporting and as a result the regulators subordinated themselves to the accounting professional. Hence by involving accountants and auditors in the regulatory chain, the regulators need to ensure that, they do possess the knowledge and skills either superior or, of the same level to that of the

[23] American Management Association, 'Yes, You Do Need to Know about Sarbanes-Oxley' http://www.amanet.org/training/articles/Yes-You-Do-Need-to-Know-about-Sarbanes-Oxley.aspx.
[24] Roberto Romano, "The Sarbanes-Oxley Act and the making of quack corporate Governance" Yale Journal (2005)

accounting and auditing professional, otherwise they would be making it clear that, short of that they would be putting themselves in the situation seen as lucking the expertise needed to analyze accounting information and therefore, making them dependant or rely on the accounting professionals. Thus, it begs a question as to who is superior of the other, is it the regulators with no expertise or the accountants and auditors who do possess the necessary knowledge and expertise of analyzing/interpreting the accounting and financial information? In essence, it is only logical for any one to determine the wrong, if they do know the right.

However, by looking at the wide wording of the Act, does this mean that the SOX Act goes beyond US territorial regulatory boundaries? The answer to this question can be conveniently said to be a yes. The SOX Act mandated that the rules under the Act would apply to all securities issuers in the US capital markets regardless of whether they domiciled in the United States.[25] As a result, audit firms based outside the US if they worked on the accounts of any companies with securities listed in the US would have to register with the PCAOB.[26]

[25] This means that, the SOX Act bears international implications. Therefore, this implies that not only the SOX Act applies to US public companies but its wide wording meant that all companies US or non US wishing to trade in the US securities market would have to comply with the SOX Act 2002.
[26] See Donald Nordberg 'Waste makes haste: Sarbanes-Oxley, competitiveness and the subprime crisis', Journal of Financial Regulation and Compliance (2008) 16(4), 365-383 available at Westlaw UK. 'International reaction'

7 Do we need to regulate the accounting practice and standards to get securities regulation implemented?

Following the collapse of Enron and WorldCom resulting from accounting failures and as securities regulators rely on accounting disclosure (to be precise, accounting practices possess all the information required by the regulators) to ensure market transparency, in order to implement effective regulation and ensure consistent accounting reporting, implementing securities regulation may be easier if accounting practices are regulated. This is because it is only the accountants who are able to prepare and understand financial/accounting statements. Hence, due to their knowledge and strategic positions in the enterprises which allow them to access privileged information, it would be fair to say that accountants hold the key to succeeding in implementing securities disclosure requirements. Thus, to ensure accuracy and reliability of accounting information, it would be a wise move to focus on regulating the accounting profession more than the companies themselves.

Having said that, it is not clear how this may work because today in formulating and setting the regulatory criteria, regulators feel the need to rely heavily on the knowledge and expertise of the accounting profession.[27]

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[27] See Professor Mahmood Bagheri's work on 'Informational intermediaries and the emergence of the new financial regulation paradigm' Company Lawyer (2003) 24(11), 344-345 available at Westlaw UK

This was demonstrated by the recent crisis, which suggests that regulatory failures came as a result of regulators leaving the implementation of the regulatory standards in the mercy of the accounting profession who were believed to possess the necessary knowledge and expertise of analyzing accounting information. Thus, as noted above, unless regulators are able to gain the necessary expertise superior or, of the same level to that of the accounting and auditing professionals to enable them analyze such information of complex understanding, regulating accounting practices may be challenging.

Chapter II

8 Internationalization of securities markets and the need for harmonization of accounting standards: In a global economy, can national securities regulations be implemented without harmonizing accounting standards?

To some extent harmonization of accounting standards has become a major issue surrounding financial disclosure debates. Does that mean that national securities regulation can not be effectively implemented without harmonizing accounting standards? It seems that, as long as the needs and interests of all those who rely on financial statements to make decisions are not entirely met, call for harmonization of accounting standards will continue to be advocated for by market participants such as scholars, regulators and possibly accounting bodies and the governments. Indeed, due to the globalization of businesses and the growing increase in cross-border investments, economists, academicians, regulators and the governments have long recognized the need to harmonize accounting standards.[28]

Economists and academicians alike believe that harmonization of accounting standards ensures uniformity in financial reporting, reliability, comparability among published companies' financial information and high quality financial reporting and disclosure.[29] Indeed, harmonization of accounting standards would provide a level playing field where no country would be advantaged or disadvantaged by its local accounting standards.[30] This as a result would make comparison of the performance of a company against its domestic and international competitors easier and more meaningful.[31]

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[28] Different authors have defined harmonization of accounting standards in different ways. No one seem to define it explicitly. Therefore, could this mean that harmonization of accounting standards is such a complex term to define? For the purpose of this study, harmonization of accounting standards refers to the process of increasing compatibility of accounting standards by setting bounds for the degree of variations (Nobes, 1992). Thus, harmonization of accounting standards may be defined as the aligning of national accounting standards with international accounting standards.

[29] See for instance Samir S Mogul's work on 'Harmonization of Accounting Standards.', Accounting (2003), available at http://icai.org/resource_file/11430p681-684.pdf

[30] Weber Cameron M, 'Harmonization of international accounting standards' (1992) available at http://www.allbusiness.com/accounting/methods-standards/339832-1.html.

[31] Thus quoting Arthur Levitt, former chairman of the Securities & Exchange Commission (SEC) statement, 'financial reporting standards that cross national borders are not merely an ideal for a better global marketplace –they are fundamental to its very existence.'

Thus, as securities markets are already internationalized and possibly out of control, one may be compelled to argue that unless an agreement is reached on international accounting standards, it may the challenging to implement national regulation. Following Enron and WorldCom bankruptcy scandals which took place around middle 1990s-2001, it is clear that the accounting and auditing profession as well as holding very important positions in corporations, they possess the knowledge and expertise of analyzing accounting information.[32]

This implies that if securities regulators were to rely on the accounting profession as the right channel of receiving and analyzing information, in a global market, they will need a uniform standard of accounting practice to ensure reliability. Equally, as more corporations are becoming more global, investors may find it easy to understand harmonized/international accounting standards than the varying domestic standards. Thus, in order to help investors make informed decisions and to be able to enjoy the gains of the increasingly global market, it could be argued that harmonization of accounting standards would be the key to providing investors with uniform and consistent information.[33]

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[32] See Frank Harding 'Corruption; Rising to the Challenge', IFAC (1999)

[33] See Nikhil Chandra Shil, Dr. Bhagaban Das & Alok Kumar Pramanik 'Harmonization of Accounting Standards through Internationalization' International Business Research (2009) 2(2) available at http://www.ccsenet.org/journal/index.php/ibr/article/viewFile/1149/1145.

The market is such an important user of financial information as almost everyone relies on accounting information to make informed decisions. As such, it could be argued that an effective assessment of a company's financial state can not be done if there is no adequate disclosure. Having said that however, one may not help but wonder how financial information can be comparable and clear when languages and meanings differ from one country to another? It is fair to say that translation if added to other problems may hinder transparency, consistence and fairness in accounting information, especially when they are not prepared using a particular reporting standard. Thus, by harmonizing international accounting standards and promoting a common accounting language which aims to facilitate an understanding of accounting information, it would mean that when evaluating companies' performances, regulators, the auditors and the market in general would stand a chance of receiving the same information, enabling them to compare like with like.[34] Just as regulators and investors would be able to receive the same information, when raising capital, companies would also be able to compete on the same level.[35]

[34] Weber Cameron M, 'Harmonization of international accounting standards' (1992) available at http://www.allbusiness.com/accounting/methods-standards/339832-1.html.
[35] See Robert W. McGee 'The Role of International Accounting Standards in Foreign Direct Investment: A case Study of Russia' Presented at the Thirteenth International Conference of the International Trade & Finance Association, Vaasa, Finland (2003) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=409020.

Equally, as well as facilitating implementation of national regulations, it could be argued that if accounting standards are harmonized, a country's aspirations for a globally integrated capital market would also be fulfilled through this uniform financial reporting code. But can complete harmonization be achieved? At this point, one may not help it but wonder whether total harmonization can actually be achieved. Although certain studies have shown that for countries with low quality financial reporting, authorizing international accounting standards might be the way forward for bringing the accounting practices of such countries on par with international best practices. Thus, due to the varying nature of business/services, economic and financial considerations prevalent in each country, it is important to accept that the process of harmonizing accounting standards is not an easy task but indeed a complex and dynamic activity which can not be underestimated. However, hard as it may seem, in an increasingly global market, harmonization of accounting standards is the way forward if regulators are to succeed in implementing national regulations.

9 <u>International accounting standards could help improve transparency in securities markets but what impact would international accounting standards impose on the implementation of national securities regulation?</u>

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While it is arguably true that international accounting standards are not problems free, it is also evidently true that, if implemented and properly applied would help to improve transparency and thus eliminate barriers in transnational securities trading.[36] For instance, from the accounting world's point of view, efficient disclosure of accounting information in an accurate, timely and reliable manner helps influence an accurate assessment of a company's financial performances. Evidence demonstrates that securities regulators around the world use accounting standards as a facilitative regulatory mechanism which provides a framework for transparent, reliable and consistent financial reporting.

However, one can not help but raise the question as to how financial information can be clear when languages and meanings differ from one country to another? Due to the varying laws and cultures, different accounting standards have been developed around the world. For instance, while in the US accounting standards are designed to meet the needs of capital markets participants and ensuring that the information provided to the markets is of the quality that can help investors make informed investment decision, while in other countries, accounting

[36] As the internal market commissioner for the European commission Frits Bolkestein (2000) put it, adequate disclosure serves to improve the transparency of financial information published by banks and other financial institutions.

standards have been developed to meet the needs of tax authorities and private creditors.[37]

As a result, one may be persuaded to argue that in a global market, with varying standards, developing and incorporating neutral international accounting standards into implementation of national regulations would be the best mechanism to ensure that high quality financial information is provided to the capital for investors to access. Thus, it could be argued that, the establishment of a set of neutral international accounting standards that seeks to deliver high quality financial reporting standards and encourages transparency would help prevent the challenges and difficulties that may be faced by issuers preparing financial statements using more than one set of accounting standards. In return, this could help improve transnational listings and as a result, capital allocation and market efficiency may be increased.

Furthermore, while acceptance of international accounting standards worldwide not only would it improve transparency and thus, limit confusion to investors, it would also reduce costs associated with preparation of financial statements by issuers seeking to raise funds from various markets. Having said that, at this point it would be worthy noting that transparency may be successfully improved

[37] www.sec.gov/rules/concept/34-42430.htm

only if international accounting standards receive full support of the accounting and auditing profession. Evidence suggests that some accountants and auditors all over the world are reluctant to comply with the rules of international accounting standards.[38] Thus, unless the entire accounting and auditing profession accept international accounting standards as the rules under which they prepare and audit financial statements, securities regulators may struggle to improve the reliability and transparency of financial statements.[39]

10 Agreeing to incorporate international accounting standards is one thing and implementing them is another. Could it be said that signing up for international accounting standards would be in the national interest of a country? What challenges may be faced in introducing and incorporating International Accounting Standards?

An honest answer to the first question here would be that, the interests to be gained would depend on a particular country. This is because every country has different interests.[40] While it is clear that countries' national interests vary, it is arguable that international accounting standards are attaining worldwide

[38] This was demonstrated in Cairns D's survey. 'International Accounting Standards survey 2000' David Cairns, Oxford, p. 2.

[39] This was identified in a discussion paper entitled, 'Discussion paper on a financial reporting strategy within Europe', FEE, Brussels (1999).

[40] See Rhys Bollen, 'The international financial system and future global regulation', Journal of International Banking and Regulation (2008), 23(9), 458-473 available at Westlaw UK

recognition. This is demonstrated by the EU directive which requires all publically traded companies to adopt the international accounting standards and incorporate them in their business operations.

Similarly, many other countries are either planning to adopt international accounting standards or they have in fact already adopted them.[41] That said, implementing international accounting standards can not be easy.[42] As different countries have different languages, it may prove challenging to implement international accounting standards as not all international accounting standards have been translated into the various languages. Thus, as many regulators and accountants may not be sufficiently familiar with both the language in which international accounting standards are drafted, they may not be able to incorporate them while implementing national accounting standards.

In addition, it may be challenging to resolve any conflicts in situations where some countries' national accounting standards conflict with the international accounting standards in important ways. For instance, it could be challenging to implement the International accounting standards No. 32 and 39 in the EU. This

[41] For instance, in 2002 the Russian Prime Minister announced that by 01st Jan 2004 it would be a legal requirement for all Russian companies and banks in preparation of their financial statements to adopt the international accounting standards.
[42] See McGee, Robert W., The problem of implementing international accounting standards. A case study of Armenia.

is because, while these international accounting standards promote the use of fair value in measuring and reporting all financial instruments, the EU Company Directive on the other hand does not allow full fair valuation of all liabilities. Similarly, due to the still existing thin market, it may also be challenging if not difficult to implement and incorporate the fair value approach as advocated by the international accounting standard No. 39 in developing countries such as Uganda which have low or no accounting standards. This is because not all financial instruments may have easily measurable value. Thus, the notion that a uniform standard may be applied to all financial reporting may seem too ambitious and may be naïve simply because the accounting standards such as fair value accounting may ignore the inherent political and economic influences of financial reporting.

Furthermore, it is a common belief among economists that for any reforms to be introduced these changes must be an improvement on the status quo, and they must stand a chance of being implemented. Therefore, unless international accounting standards aim to improve on the status quo, it will be challenging to incorporate them in national laws. This is because, in addition to the internal dysfunctions of national law, there may be a lack of international co-operation. As companies trade and raise capital from various jurisdictions, lack of international co-operation may thus stand in the way of increasing international investment/transactions.

11 <u>Corruption is one of the greatest issues hindering the development of securities markets. What role would international accounting standards play in the fight against corruption in securities markets?</u>

Corruption is one of the major problems hindering the development of healthy global securities markets. In fact due to its occurrence and its detrimental effects on the overall development of economies, corruption could be said to be the greatest challenges the financial world has faced so far.[43] Indeed, corruption by no means deters investors from investing freely and reduces the flow of capital thus, making raising of capital a very costly exercise. In addition to that, not only would corruption damage investors' confidence, but it would also undermine the government and regulators' creditability. However, what is corruption? Corruption may be defined as an act of dishonestness in which company personnel such as a company director, manager; employee or contractor acts contrary to the interests the of company and abuses his position of trust with the aim of achieving a personal gain for himself or another person or company other than

[43] See Arvanitiduo Virginia, Konstantiniduo Eleni, Papadopuolos Dimitrios & Xanthi Chrysoula, 'The role of financial accounting information in strengthening corporate control mechanisms to alleviate corporate corruption' available at http://pdfcast.org/pdf/the-role-of-financial-accounting-information-in-strengthening-corporate-control-mechanisms-to-alleviate-corporate-corruption.

his company.[44] If that is the case, so how can international accounting standards be of any help?

As they are responsible for preparing a company financial/accounting statements, it could easily be said that accountants and auditors are the first set of gatekeepers who ensures that transactions are recorded according to the established disclosure standards.[45] This implies that accountants and auditors while preparing accounting statements and enhancing corporate governance are more likely to discover any acts of accounting manipulation. Hence, since it has been identified that, corporate governance is the key catalyst to corruption, perhaps as a solution in a global context it could be argued that, since accounting standards act as corporate governance control mechanism and a source of transparent information, then international accounting standards, as a source of reliable and transparent financial information would be an effective instrument to fight corporate corruption.[46] This is because accountants and

[44] See definition under the Australian Standard on Fraud and Corruption Control (AS8001: 2003)
[45] Lal Balkaran 'The role of Accountants and Auditors in Fighting Corruption (2002) available at http://www.guyanajournal.com/Corrupt.html
[46] Also, see Arvanitiduo Virginia, Konstantiniduo Eleni, Papadopuolos Dimitrios & Xanthi Chrysoula, 'The role of financial accounting information in strengthening corporate control mechanisms to alleviate corporate corruption' available at http://pdfcast.org/pdf/the-role-of-financial-accounting-information-in-strengthening-corporate-control-mechanisms-to-alleviate-corporate-corruption.

auditors often have access to the companies' financial information due to the positions they hold in a company.[47]

Also, since accountants and auditors would have an understanding of the business operations, when managers try to conceal the company's underperformance they often rely on the geniusness of the accounting personnel to manipulate financial reports. Thus, as the eyes and ears of the companies, and since securities markets in their operation seek to rely on reliable and consistent financial information which would be obtained from transparent financial statements,[48] in a global context, it could be argued that, international accounting standards if supported by the accounting and auditing profession would be an effective instrument for detecting and combating corruption through promoting fairness, openness and transparency in the securities markets.[49] That said however, it may be challenging to convince accountants and the auditing professionals.

[47] See Lal Balkaran 'The role of Accountants and Auditors in Fighting Corruption (2002) available at http://www.guyanajournal.com/Corrupt.html Also, see Frank Harding 'Corruption; Rising to the Challenge', IFAC (1999)

[48] See Arvanitiduo Virginia, Konstantiniduo Eleni, Papadopuolos Dimitrios & Xanthi Chrysoula, 'The role of financial accounting information in strengthening corporate control mechanisms to alleviate corporate corruption' available at http://pdfcast.org/pdf/the-role-of-financial-accounting-information-in-strengthening-corporate-control-mechanisms-to-alleviate-corporate-corruption.

[49] See Musa Kayrak 'Evolving challenges for supreme audit institutions in struggling with corruption' Journal of Financial Crime (2008) Also, see Lal Balkaran 'The role of Accountants and Auditors in Fighting Corruption (2002) available at http://www.guyanajournal.com/Corrupt.html

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Author Name and Student ID: R6705 ICGFREL

Tutor/Supervisor: Professor Mahmood Bagheri

12 Conclusion:

In a global market with varying standards and due to the varying economic sizes, it would be of great benefit to investors and companies wishing to raise capital for their local markets to incorporate international accounting standards in national standards.[50] Accessing multiple capital markets where each jurisdiction has its reporting requirements can be very expensive. As a result, those seeking to raise funds from major capital markets may be discouraged from doing business in other markets other than their local markets simply because they would be required to comply with another jurisdiction's standards which they may not be familiar with.

In addition, in order to achieve reliable and effective global capital markets, investors need to feel confident about the financial information. However, in a global economy with varying standards, I am compiled to argue that foreign investors may find international accounting standards to be more reliable and consistent standards which would provide them with useful companies' financial performance comparisons than the various national standards. Thus, to achieve reliable and effective financial reporting, governments need to give issuers the

[50] See Jen Shek Voon's views in his work on the importance of international accounting standards in promoting Regional Business Growth. Jen a partner at Earnest & Young Singapore in his work argues that in the interest of increasing transparency worldwide and thus encourage foreign investment, securities markets regulators should consider converging local accounting standards with international accounting standards.
http://www.cipe.org/pdf/publications/fs/article6258.pdf

choice to choose whether to prepare their financial statements in accordance with either international accounting standards or national standards or both.

As regards to corruption, everyone has a moral duty to fight corruption. Having said that, ultimate responsibility for discouraging and preventing corruption, whether within the business world or in the public sector, rests with the management. However, because of the strategic position accountants hold in the business enterprise, it means that accountants would have to access highly confidential financial information on a daily basis and therefore, they have a key role in society's efforts to reduce corruption. Thus, in a global economy, as a corporate governance instrument, if supported by the accounting and auditing profession, international accounting standards would be an effective instrument to combat corruption as they aim at promoting fairness and greater transparency in the securities markets.

12.4 Thus, International accounting standards are brilliant, facilitative regulatory provisions which would create consistence in global financial reporting. That said however, unless securities regulators work together with the accounting and auditing professional who have the knowledge and often have access to companies' financial information, international accounting standards may not be efficiently implemented. Hence, although it would make regulators more dependent on the accounting profession, it seems the only way they will be able to implement international accounting standards in national securities will be through working together with the accounting profession. Having said, it may not be easy to get all accountants to accept international accounting standards. This is because, while the International Accounting Standards Board welcomed the resolution and was pleased that the EU was among the first major "nation-states" to take the initiative to embrace international accounting standards, this change on the other hand was met with great furor in the accounting profession and in the corporate boardrooms.

This implies that transparent global capital/securities markets can only be truly achieved if both securities regulators and the accounting/auditing profession around the world speak the same financial reporting language.[51] Therefore, to ensure high quality financial reporting or accounting/auditing standards which could result into greater transparency and efficient application, international accounting standards would require support of the accounting and auditing profession who are responsible for the preparation and auditing of financial statements.

[51] See Ian Ball's speech on the role of financial reporting in creating vibrate emerging markets. Ian is the Chief Executive Officer for the International Federation of Accountants. 5th Islamic Financial Services Board Summit "Financial Globalization and Islamic Financial Services"

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Tutor/Supervisor: Professor Mahmood Bagheri

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