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**REPORT OF THE TECHNICAL COMMITTEE**

**INTERNATIONAL ACCOUNTING AND AUDITING STANDARDS**

REPORT TO THE 15th ANNUAL CONFERENCE  
OF IOSCO, NOVEMBER 1990

INTERNATIONAL HARMONIZATION OF ACCOUNTING  
AND AUDITING STANDARDS

IOSCO Technical Committee Working Party No. 2

The mandate of Working Party No. 2 is to assist the International Accounting Standards Committee (IASC) and the International Auditing Practices Committee (IAPC) in their efforts to develop accounting standards and auditing standards sufficient such that IOSCO member organizations will consider acceptance of such standards in connection with multinational offerings and filings.

Improved international accounting and auditing standards will require the development of new standards, the elimination of various alternative standards and the clarification and expansion of certain existing standards. Substantial progress has been made to date but significant work remains to be completed before the final goal can be realized. IOSCO members are strongly encouraged to support the activities of the IASC and the IAPC towards global harmonization of accounting and auditing standards.

This report describes the activities of Working Party No. 2 in carrying out its mandate.

ACCOUNTING STANDARDS

Comparability of Financial Statements

During the year, the IASC reconsidered the proposals contained in an exposure draft on Comparability of Financial Statements (E32) dated January 1, 1989. Approximately 160 comment letters were received on the E32 proposals. E32 deals with twenty-nine accounting issues where the choice of alternative accounting treatments permitted by International Accounting Standards (IAS) may have a significant effect on the definition, recognition, measurement and display of net income, assets, liabilities and equity as reported in the financial statements of an enterprise. E32 recognizes that the alternative accounting treatments permitted by International Accounting Standards may represent free choices for like transactions and events or different treatments that should be applied in different circumstances.



The objectives of the E32 proposal were to:

- a) eliminate all but one accounting treatment where the alternative treatments represent a free choice for like transactions and events; and
- b) ensure the appropriate treatment is used where alternatives represent different treatments which should be applied in different circumstances.

In some cases however, E32 proposed the retention of two accounting treatments for like transactions and events particularly when the application of different criteria supports the use of different treatments. In these circumstances E32 identified one treatment as the preferred treatment and allows the other as an alternative. E32 proposed that an enterprise that presents financial statements incorporating alternative accounting treatments which purport to conform with International Accounting Standards should reconcile reported net income and shareholders' interests to those amounts determined using the preferred treatment.

The members of Working Party No. 2 have been heavily involved in the discussions on E32. These discussions have led to the finalization of E32 and its publication as an approved Statement of Intent on Comparability of Financial Statements dated July 1990 (the "Statement of Intent"). Briefly summarized the main points in the Statement of Intent are that:

1. twenty-one of the twenty-nine proposals in E32 should be incorporated in revised International Accounting Standards without substantive change. This project will be the primary responsibility of the Improvements Committee and its work is discussed later in this report;
2. three of the proposals in E32 require substantive change and hence should be re-exposed for public comment. The three are as follows:
  - the LIFO inventory method will be eliminated whereas E32 would have permitted it as an allowed alternative;
  - the capitalization of development costs will be required when specified criteria are met;
  - the capitalization of borrowing costs will be required when specified criteria are met; and



3. reconsideration of five remaining proposals are being deferred pending further work by the IASC. These proposals dealt mainly with issues arising in IAS 25, Accounting for Investments.

A substantial number of comment letters indicated disagreement with the proposed reconciliation requirement in E32 for those enterprises that present financial statements which incorporate alternative treatments and which purport to conform with International Accounting Standards. The IASC Board has been convinced by the commentators' arguments and does not intend to require reconciliation. However, the IASC Board recognizes IOSCO is interested in mutually acceptable accounting standards for use in multinational securities offerings and other foreign issues of equity and debt securities. Therefore, the IASC Board will encourage enterprises to publish such a reconciliation as part of their financial statements. The IASC Board intends to work with IOSCO to encourage individual securities regulators to consider the use of IASC standards in multinational offerings by requiring or allowing foreign issuers to present a reconciliation in their financial statements prepared in conformity with their domestic requirements to the benchmark treatments in International Accounting Standards.

The IASC has also decided to change the terminology from "preferred" to "benchmark" in those few cases where it continues to allow a choice of accounting treatment for like transactions and events. The term "benchmark" more closely reflects the Board's intention of identifying a point of reference when making its choice between alternatives.

The IASC has acted very quickly to finalize E32 and it is to be commended for its actions. Attached as Appendix A is a list of the accounting issues and alternatives considered in E32 and the conclusions reached. The IASC has set up an Improvements Committee to deal with the decisions in the Statement of Intent and this will be the next major project for Working Party No. 2.

#### Improvements Committee

The Statement of Intent is a public declaration of the decisions taken with respect to E32. It describes how the decisions will be implemented and the further efforts of the IASC in seeking the improvement and harmonization of accounting standards and other requirements relating to the presentation of financial statements. The Statement of Intent does not alter the status of existing International Accounting Standards. The announced changes will not take effect until the IASC has issued exposure drafts and received



and considered comments on each individual standard. Just as E32 was exposed for comment as a package, so the revised standards will be implemented as a package.

As indicated previously, twenty-one of the twenty-nine proposals in E32 are to be incorporated into revised International Accounting Standards without substantive changes to the proposals. A further three proposals call for substantive changes and these proposals will be re-exposed for specific comments on the changes. For these twenty-four items, the Improvements Steering Committee terms of reference are:

- (a) to implement the changes agreed in the Statement of Intent in revised International Accounting Standards; and
- (b) to revise existing International Accounting Standards to ensure they are sufficiently detailed and complete and contain adequate disclosure requirements to meet the needs of capital markets and the international business community.

Drafts of the revised standards will be exposed for comment. However the IASC does not intend to reconsider any of the accounting issues identified during the discussion of E32 for the twenty-one proposals that were adopted without change. Of course, comments will be sought for the three proposed standards with substantive changes. This is an enormous task and the plan is that it be completed by January 1, 1993. However, there is no particular magic to this date and progress will have to be monitored and any changes to the completion date will be publicized.

The IASC has set up an Improvements Steering Committee. The Improvements Steering Committee is made up of members from Canada, Japan, Jordan, the Netherlands, and the United Kingdom with both the European Commission and IOSCO as participating observers. However, in the interest of efficiency it has been agreed that, although IOSCO retains full control over the membership of the representatives of the Working Party, the Working Party may be represented by not more than four IOSCO individuals at any meeting. Normally, those four individuals will be the members of Working Party No. 2 although technical advisors may occasionally attend if a member is unable to attend.

Two meetings of the Improvements Committee have been held and significant progress has been made. A strategy for the implementation of the improvements project has been developed and this plan will be presented to the IASC Board for its approval in November 1990. In general terms, the scope and proposed work program will have many of the following elements.



The first task is to make the changes agreed to in the Statement of Intent. Priority will be given to those standards where alternative treatments have been eliminated and where benchmark treatments have been identified. Work has begun on making these changes and on making the consequential amendments to the related explanatory material.

The next task, on which there is a variety of views, is to agree in principle on the general format and style of the new standards. For example, at present the standards are written such that the background discussion and the principles of the standard are two complete and separate parts of each standard. It may be preferable to interweave the background discussion and the principles of the standard throughout each standard, being careful of course to distinguish the two. It has been suggested that this approach would eliminate duplicate wording and should produce a more tightly written and cohesive document. Consideration is also being given to adding a statement of the objective of each standard as an introductory item separate from the text of the standard. Of course, every attempt is being made to conform terminology and language throughout all standards to obtain greater consistency and have more uniformity of understanding of the standards.

The challenge in making such changes is that the mandate is not to substantively change any existing measurement principles or to introduce new measurement principles. In the unusual event that the Improvements Steering Committee felt such a change should be introduced, it must specifically draw that item to the attention of the IASC Board for its consideration. Once the general format and style of the new standards has been agreed upon, that approach will be applied to the revisions to each standard so they all will be prepared on a consistent basis.

This is an enormous task. To cope with it, a small number of standards will be worked on at one time. This will allow the Improvements Steering Committee and the IASC to develop revised standards, expose them for comment and make any necessary revisions. Unlike the current process, a Statement of Principles stage is not expected to be needed and it is hoped that for those standards where significant changes are not contemplated, a shorter comment period might be possible (ordinarily a six month comment period is provided). This process will be repeated until all standards have been considered. Only after all the standards have been subjected to this process will the package of standards be approved for implementation.

Significant human resources must be committed. In addition to the IASC Secretariat resources and the IASC and IOSCO volunteers, the IASC Secretariat has obtained the assistance of several UK academics who have agreed to assist in redrafting the standards after the general format and style have been agreed. For the next several years, a hectic pace must be maintained.



It is important to receive input on the revised standards from as wide a cross-section as possible. There are often differing views on the issues being examined and it is extremely important these views be debated fully before final standards are established. The input of IOSCO is critical to the IASC process since the Comparability project is an important first step in obtaining a set of mutually acceptable accounting standards for use in multinational securities offerings. Members of IOSCO are strongly encouraged to review IASC exposure drafts when they are published for comment and to provide those comments to the IASC for its consideration.

#### Other IASC Initiatives

The IASC has continued to actively pursue the development of additional standards to achieve a sufficiently complete set of standards (e.g. cash flow statements, financial instruments, disclosure by banks, joint ventures, intangibles and earnings per share). Additional standards are needed in other accounting areas and consideration should be given to the need for accounting guidance for specialized industries.

#### AUDITING STANDARDS

##### Assessment of International Auditing Guidelines

The Working Party was asked to consider whether uniform auditing standards could be identified and recommended for acceptance by IOSCO member bodies for purposes of multinational offerings. In this report, the term "auditing standards" refers to those audit tests and procedures that are essential for the conduct of an effective audit examination. The Working Party recognizes that in addition to the harmonization of auditing standards it is also necessary to consider the competence and independence of the auditors who perform those tests and procedures.

The Working Party concluded that it is desirable to rely to the maximum extent possible on standards that have been developed by the auditing profession and that have the profession's support. The International Federation of Accountants ("IFAC") has attempted to develop such standards. The broad objectives of IFAC are the development and enhancement of a coordinated world-wide accountancy profession with harmonized standards. The International Auditing Practices Committee (IAPC) is a standing committee of IFAC which has been given the specific responsibility and authority to issue, on behalf of IFAC, guidelines on auditing and related services. To date, the IAPC has issued some twenty-nine International Auditing Guidelines (IAGs). The IAGs apply whenever an independent audit is carried out on any entity, irrespective of its size or legal form.



The Working Party agreed to assess the IAGs to determine whether acceptance of audits conducted in accordance with the IAGs could be recommended to members of IOSCO.

A joint IFAC/IOSCO review was conducted. The results of this analysis indicate that the IAGs compare favourably, in many respects, with the generally accepted auditing standards of the major audit jurisdictions throughout the world. Nonetheless there were some potentially significant deficiencies and a list of them has been prepared. This list identified those audit issues considered highly relevant for IOSCO's purposes which were not dealt with to our satisfaction in the IAGs. For each "highly relevant" item a course of action has been undertaken by the IFAC which has the potential to resolve the matter satisfactorily within a reasonable time. Likewise joint agreement was reached on approaches to resolving those "moderately relevant" items where the Working Party believes that improvements to the IAGs are desirable in the medium to longer term.

Eleven highly relevant and eight moderately relevant issues have been identified. For three of the highly relevant issues and one of the moderately relevant issues, revisions have already been made to IAGs. By the end of 1990, several more issues are scheduled for resolution.

#### Ethical and Independence Issues

A major review has been undertaken by the Working Party relating to ethical and independence standards. The previous standards were jointly reviewed and in May, 1990, a revised IFAC Guideline on Ethics for Professional Accountants was approved for issuance. IFAC made several changes to those guidelines prior to their issuance in response to IOSCO concerns. At present, the major unresolved matters concern auditor independence issues. A list of these unresolved issues has been prepared and has been forwarded to the IFAC Ethics Committee to assist them in preparing a project proposal to develop an incremental set of minimum independence requirements for the auditors of multi-national issuers. Among the specific independence issues, there continues to be disagreement as to the nature and extent of non-audit services that an auditor may provide to an audit client and other business relationships that auditors may have with their clients. Concurrent with this project, SEC staff is reviewing the relevance and efficacy of the current SEC independence rules. Among the issues being considered by the SEC staff are the independence requirements in other countries. The Working Party will take into consideration the results of the SEC staff review when it is completed.



### Reporting Practices

Reporting practices around the world differ in terms of the specific wording of the standard auditor's report when the auditor is satisfied that the financial statements are fairly stated (a "clean opinion"). Reporting practices also differ as to the circumstances in which an auditor is unable to express a clean opinion and the wording of the appropriate reservation of opinion, if any. Those differences relate principally to situations involving the consistency of application of accounting principles and a company's ability to continue as a going concern. The Working Party is of the view that the objective of international harmonization requires that agreement be reached on the essential minimum audit procedures that are necessary in order to express an opinion without making reference to a limitation on the scope of the audit. Auditors of multi-national offerors must be cognizant of the domestic reporting standards of each relevant jurisdiction. Although this may result in audit reports that differ somewhat from jurisdiction to jurisdiction, auditors who have performed at least the minimum essential auditing procedures, should be in a position to issue a report which conforms to the host country requirements. Accordingly, the Working Party does not believe that it is necessary at this time to reach agreement on uniform international reporting standards. It may be desirable, however, to include a statement that the auditor has complied with the IAGs.

The Working Party has tabled with the Technical Committee a list of the major issues relating to the form and content of the auditors' communications. However, in light of the Working Party's conclusions, no further action in this area is proposed at this time.

### Other Matters

On an ongoing basis, the Working Party will continue to review all exposure drafts issued by IFAC and provide comments to IFAC. These reviews are necessary to ensure that future standards issued by IFAC continue to be acceptable.

Submitted on behalf of IOSCO Working Party No. 2 by

Michael B. Meagher  
Chairman  
October 16, 1990.

**Table 1 - Issues on which the Board has agreed to incorporate the proposals in E32, Comparability of Financial Statements, in revised International Accounting Standards without substantive change**

ISSUES	Required or Benchmark Treatment	Allowed Alternative Treatment	Treatment Eliminated
Correction of fundamental errors and omissions, and adjustments resulting from accounting policy changes	Adjust opening retained earnings (subject to certain exceptions)	Include in income of the current period	
	Amend comparative information	Present amended pro forma comparative information	
Recognition of revenue and net income on construction contracts	Percentage of completion method  When the conditions for profit recognition are not met, recognise revenue to the extent of costs incurred that are recoverable		Completed contract method
Measurement of property, plant and equipment	Measure at cost	Measure at revalued amounts	
Measurement of property, plant and equipment acquired in exchange for another asset	Fair value for dissimilar assets acquired  Net carrying amount of asset given up for similar assets acquired		Net carrying amount of asset given up for dissimilar assets acquired Fair value for similar assets acquired
Recognition of a revaluation increase relating to a revaluation decrease previously charged to income	Recognise in income of the current period		Recognise in shareholders' interests
Recognition of revenue on transactions involving the rendering of services	Percentage of completion method  When the outcome of the contract cannot be reliably estimated, recognise revenue to the extent of costs incurred that are recoverable		Completed contract method
Determining the cost of retirement benefits	Accrued benefit valuation methods	Projected benefit valuation methods	
Use of projected salaries in determining the cost of retirement benefits	Incorporate an assumption about projected salaries		Do not incorporate an assumption about projected salaries
Recognition of past service costs, experience adjustments and the effects of changes in actuarial assumptions	Recognise systematically over a period approximating the average of the expected remaining working lives of participating employees (subject to certain exceptions)		Recognise in income of the current period as they arise
Recognition of foreign exchange gains and losses on long-term monetary items	Recognise in income of the current period unless hedged		Defer and recognise in income of current and future periods
Recognition of foreign exchange losses on the acquisition of an asset that result from a severe devaluation against which there is no practical means of hedging	Recognise in income of the current period	Recognise as part of the cost of the asset	
Exchange rate for use in translating income statement items of foreign entities	Exchange rates at the dates of the transactions (or average rate)		Closing exchange rates
Treatment of differences on income statement items translated at other than the closing rate	Recognise in shareholders' interests		Recognise in income of the current period
Subsidiaries operating in hyperinflationary economies	Restate financial statements in accordance with IAS 29 Financial Reporting in Hyperinflationary Economies, before translation		Translate financial statements without prior restatement
Exchange differences on foreign operations integral to those of the parent	Recognise in income of the period unless hedged	Recognise as part of the cost of an asset when they result from a severe devaluation against which there is no practical means of hedging	Defer and recognise in income of current and future periods



**Table 1 (continued)**

ISSUES	Required or Benchmark Treatment	Allowed Alternative Treatment	Treatment Eliminated
Accounting for business combinations	Purchase method for acquisitions		Pooling of interests method for acquisitions
	Pooling of interests method for uniting of interests		Purchase method for uniting of interests
Positive goodwill	Recognise as an asset and amortise to income on a systematic basis over its useful life. The amortisation period should not exceed 5 years unless a longer period can be justified which should not, in any case, exceed 20 years		Adjust immediately to shareholders' interests
Negative goodwill	Allocate over individual non-monetary assets. After such an allocation, if negative goodwill remains, treat as deferred income and recognise in income on a systematic basis as for positive goodwill	Treat as deferred income and recognise in income on a systematic basis as for positive goodwill	Adjust immediately to shareholders' interests
Measurement of minority interest arising on a business combination	Measure at pre-acquisition carrying amounts	Measure at post-acquisition fair values	
Measurement of investment properties	Measure at cost with depreciation	Measure at revalued amounts	Measure at cost without depreciation
Recognition of a realised gain previously recognised in revaluation surplus	Transfer to retained earnings		Recognise in income of the current period

**Table 2 - Issues on which the Board has agreed to make substantive changes to the proposals in E32, Comparability of Financial Statements; these issues will be reexposed and reconsidered in the light of comments received**

ISSUES	Required or Benchmark Treatment	Allowed Alternative Treatment	Treatment Eliminated
Assignment of cost to inventories	FIFO and Weighted Average Cost formulas		LIFO and Base Stock formulas
Development costs	Recognise as assets when they meet specified criteria and as expenses when they do not meet criteria		Recognise development costs that meet specified criteria as expenses
Borrowing costs	Recognise as part of the cost of an asset if it takes a substantial period of time to get it ready for its intended use or sale; recognise as expense in other circumstances		Recognise borrowing costs that meet criteria for capitalisation as expenses

**Table 3 - Issues on which the Board has deferred consideration pending further work**

Recognition of finance income on finance leases

Measurement of long-term investments

Measurement of marketable equity securities held as long-term investments

Measurement of current investments

Recognition of increases and decreases in market values of current investments