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International Accounting Standards and Guidelines

January 1981
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Executive Summary

- The rapid growth in international activities by enterprises has led to a need and demand for international standards of financial accounting and reporting. A variety of private sector and governmental standard-setting organizations has developed to satisfy these needs and demands.

- Five major international standard-setting organizations have emerged as leaders in this endeavor; in our view, an understanding of their activities is important. The five organizations are as follows:

  - The International Accounting Standards Committee (IASC) is a private voluntary organization formed in 1973 by leading accounting professional bodies from various countries. IASC concentrates on issuing financial accounting standards on specific problems which are similar in format to those issued by the Financial Accounting Standards Board (FASB). To date, IASC has issued thirteen Statements of International Accounting Standards and has issued six other Exposure Drafts. The Statements cover topics such as inventories, consolidated financial statements, depreciation accounting, research and development and income taxes. The Exposure Drafts include accounting for foreign currency translation, segments, pensions, changing prices, property, plant and equipment, and leases. IASC has no authority, but must rely on its member organizations (such as the AICPA in the U.S.) who have pledged to use their best efforts to have the international standards adopted by the respective national authoritative standard setting bodies.

  - The International Federation of Accountants (IFAC) is a private voluntary organization comprised of 75 professional accounting organizations from 57 countries. IFAC concerns itself with auditing and other professional matters, such as ethics and education, that would lead to the development and enhancement of a coordinated worldwide accounting profession. IFAC has seven standing committees; the auditing practices committee has issued three International Audit Guidelines and four other Exposure Drafts. IFAC has no authority other than that which is self-imposed by the member organizations.

  - The European Economic Community (EEC), also known as the Common Market, is a supra-government organization. Its authority is governmental, but is restricted to the ten member countries: France, West Germany, Italy, the United Kingdom, Belgium, Denmark, Greece, Ireland, Luxembourg and the Netherlands. EEC directives are addressed to and are binding on the Member States who must bring the Directives into national laws within specified periods. Eight Directives impinging on accounting reports and related matters have been issued to date. The most important of these is the Fourth Directive which deals with corporate powers, mergers, stock exchanges and listing requirements, and protection of employees in the event of employer insololvency. Six proposed Directives have also been issued, the most important of which is the amended proposed Seventh Directive dealing with consolidated statements. Other proposed Directives deal with corporate management, auditor qualifications, interim statements and employee information and consultation.

  - The United Nations Commission on Transnational Corporations is an arm of the United Nations (UN). As such, it is a quasi-governmental organization with worldwide participation. The Commission reports to the UN Economic and Social Council; its accounting standard setting work is assigned to a “Working Group of Experts” which has 34 members from UN countries. The Working Group of Experts has broad objectives for (a) the development of a comprehensive information system designed to determine the effects of transnational corporations on home and host countries, to contribute to national
goals and worldwide economic growth, and to aid the negotiating capacity of host coun-
tries, and (b) development of a code of conduct for transnational corporations. Only two
reports have been issued by the UN pertaining to accounting and related matters. One es-
entially presented extended lists of minimum requirements for the disclosure of account-
ing and financial information, the other dealt with minimum information to be made
available by corporations designed to improve understanding of the structure, activities,
and policies of the corporation as a whole. Six background papers have also been pre-
pared. The work of the UN Commission is strongly influenced by a perceived desire (a) to
aid Member countries, especially those from the developing countries, in coping with
transnational corporations, (b) to help the Member countries in their economic develop-
ment, and (c) to assist and protect employees of transnational corporations.

- The Organization for Economic Cooperation and Development (OECD) is an intergov-
  ernmental organization of 24 countries formed in 1960; it includes most of Western
  Europe and the Commonwealth countries, Japan, and the United States. The OECD is an
  outgrowth of the Organization for European Economic Cooperation established in 1948
  under the Marshall Plan. In 1975, OECD formed a committee on International Investment
  and Multinational Enterprises; the Committee will offer Guidelines that establish stan-
  dards for the activities of multinational enterprises including Guidelines on disclosure of
  information, competition, financing, taxation, and employment and industrial relations.
  Guidelines are voluntary and not legally enforceable, but the governments of the Member
  countries have agreed to recommend the observance of the Guidelines. Like the UN, the
  objectives of OECD are broader than financial reporting; they include economic growth
  and social progress objectives, regulation of entry of foreign enterprises and furtherance
  of world trade.

This booklet provides a general reference to the five international organizations, their consti-
tuency, authority and procedures. Also, a synopsis is given of the more pertinent accounting
and related financial provisions of reports, standards and guidelines issued or proposed
to date.
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**Introduction**

The rapid growth in international activities by international and multinational enterprises has led to the inevitable need and demand for international standards of financial accounting and reporting. A variety of standard-setting organizations has developed; some organizations, which were narrowly composed of members from only a few countries, served to fill the breach temporarily during the development period and have subsequently ceased operations. Considerable confusion has arisen as to who the present organizations are, who sponsors them, what is the scope of their endeavors, and what is their authority. Five international standard-setting organizations have emerged as leaders, and these appear to have considerable staying power. In our view, an understanding of their activities is important.

This booklet provides a general reference to the activities of the five international organizations:

- *The International Accounting Standards Committee* (IASC)
- *The International Federation of Accountants* (IFAC)
- *The European Economic Community* (EEC)
- *The United Nations Commission on Transnational Corporations*
- *The Organization for Economic Cooperation and Development* (OECD)

These organizations are concerned with the development of harmonized international accounting and reporting standards and guidelines.

The first two organizations, IASC and IFAC, are voluntary private organizations whose membership is composed of professional accounting organizations from many countries in the world, including the United States and other developed countries as well as many of the developing countries. The latter three organizations are governmental-type agencies: the United Nations, the European Economic Community (the Common Market countries), and the OECD, the signatory countries to the Paris Convention of 1960 (which was an outgrowth of the Organization for European Economic Cooperation established under the Marshall Plan in 1948).

All five organizations have a common goal—standardization of international accounting standards as far as practicable, given differing legal, social, political, and other institutions in the various national environments. The voluntary private organizations have more flexibility but no authority. They must work through national standard-setting bodies and professional groups. The governmental agencies have the authority, but lack flexibility and are encumbered by governmental and political constraints. There has been a certain amount of overlapping—especially since the organizations are independent of each other; however, some patterns appear to be evolving that are promising. The private organizations are undertaking more detailed issues and proposing specific standards while the governmental organizations are developing broad principles or guidelines of minimum disclosures and reporting. One organization, IFAC, apparently is also endeavoring to act as a catalyst in cooperation among the five organizations. IFAC has concerned itself more with auditing and professional ethics standards while IASC has launched an effort to achieve working cooperation with the UN and OECD on accounting standards. (In 1980, a merger between IFAC and IASC was proposed and preliminary discussions were held.)

This booklet contains a brief description of the background and working procedures of the five organizations, and a synopsis of their more pertinent accounting and related financial provisions of reports, standards and guidelines issued or proposed to date. The booklet should be useful as a ready, general reference; however, the specific pronouncement or report should be consulted if a more thorough understanding is needed.
1. International Accounting Standards Committee (IASC)

BACKGROUND

The Accountants' International Study Group (AISG) was established by the leading professional bodies in three countries (Canada, the United Kingdom and the United States) in 1966 to publish comparative studies of the accounting problems in the three countries. In 1973, the members of the AISG set up an international committee to formulate international accounting standards. The leading accounting bodies in nine countries, including the AICPA in the United States, became founding members of the International Accounting Standards Committee (IASC). Additional members admitted thereafter were accorded associate memberships. In 1977, associate members became members of the IASC, and the operations of the committee were assumed by a board (the Board) consisting of a representative from each of the nine founding members and two representatives from among the other members.

The members of the IASC have agreed to use their best efforts to ensure (1) that the accounting standards in their respective countries are conformed to those of the IASC, (2) that independent auditors satisfy themselves that the financial statements comply with these standards or that the fact of noncompliance is disclosed in the financial statements, and (3) that in the event of nondisclosure, reference to noncompliance is made in the audit report.

The AICPA has agreed that if there are significant differences between U.S. generally accepted accounting principles and those promulgated by the IASC that it will urge the FASB to give early consideration to those areas. Statements of International Accounting Standards are not enforceable under the AICPA's Code of Professional Ethics.

WORKING PROCEDURES

The procedures followed by the IASC in developing International Accounting Standards are as follows:

- The Board selects an agenda of subjects to be studied.

- A Steering Committee, comprised of three members drawn from different countries, is appointed to develop an exposure draft on each subject.

- The exposure draft is submitted to the Board for approval.

- When approved by a two-thirds vote of the Board, the exposure draft is sent to professional accounting bodies and others for comment. The comment period, generally, is a minimum of four months.

- The Steering Committee reviews the comments and drafts a final Standard.

- A final Standard, when approved by at least three-quarters of the Board, is issued.

STATEMENTS OF INTERNATIONAL ACCOUNTING STANDARDS ISSUED

No. 1 — Disclosure of Accounting Policies (January 1975)

- Specifies that disclosure of significant accounting policies used should be an integral part of the financial statements.

- The policies should normally be disclosed in one place.

- Accounting policies encompass the principles, bases, conventions, rules and procedures adopted by management in preparing and presenting financial statements.
— If the fundamental accounting assumptions of going concern, consistency, and accrual are not followed, that fact should be disclosed together with the reasons why they are not followed.

— The selection of accounting principles should reflect due consideration for prudence, substance over form, and materiality.

— Disclosure does not rectify wrong or inappropriate treatment of items in the financial statements.

— Financial statements should show corresponding figures for the preceding period.

— A change in accounting policy and its effect on the financial statements, if material, should be disclosed.

— Effective for financial statements covering periods beginning on or after January 1, 1975.

No. 2 — Valuation and Presentation of Inventories in the Context of the Historical Cost System (October 1975)

— Deals with the valuation and presentation of inventories in financial statements in the context of historical cost accounting.
  
  • Does not deal with valuation based on replacement cost or other current values.
  
  • Does not deal with inventories accumulated under long-term construction contracts or with by-products.

— Inventories should be valued at the lower of historical cost and net realizable value.
  
  • Historical cost includes a systematic allocation of production overhead costs if related to inventories in their present location and condition.
    
    o If fixed production overhead has been entirely or substantially excluded from the inventory, that fact should be disclosed.
  
  • Exceptional amounts of wasted material, labor, or other expenses should not be included as part of inventory cost.

  • Cost should be based on the first-in, first-out (FIFO) method or on weighted average cost, with the exceptions noted below.
    
    o Specific identification may be used for noninterchangeable goods or for goods manufactured to specification.
    
    o Last in, first-out (LIFO) or base stock methods may be used if there is disclosure of the difference between the amount of the inventories as shown on the balance sheet and either:
      
      • The lower of FIFO or weighted average cost and net realizable value, or
      
      • The lower of current cost at the balance sheet date and net realizable value.
    
    o Standard costs or the retail method of valuing inventory may be used if they approximate the results that would be obtained by the lower of historical cost and net realizable value.

  • Net realizable value is estimated selling price of the inventory in the ordinary course of business, less costs to complete, if any, and less costs to be incurred in order to make the sale.
- The writedown to net realizable value may be made on an item by item basis, or by groups of similar items.
- The net realizable value of inventory held under firm sales contracts should be based on the contract price.
- Normal quantities of raw materials or goods-in-process inventory should not be written down below historical cost if the finished products in which they will be incorporated are expected to be realized at or above historical cost.
- Inventories should be segregated in balance sheets or in notes to the financial statements to show the amounts held in different categories (such as materials, work-in-process, and finished goods), and the accounting policies adopted for valuation, including the cost method used, should be disclosed.
- A change in inventory accounting policy and its effect, if material, should be disclosed.
- Effective for financial statements covering periods beginning on or after January 1, 1976.

**No. 3 – Consolidated Financial Statements (June 1976)**

- Requires that a parent company issue consolidated financial statements under rules which are generally the same as U.S. generally accepted accounting principles (GAAP).
  - A subsidiary should be excluded from consolidation when control is temporary or restrictions on transfers of funds impair control, and may be excluded if its activities are so dissimilar that consolidation would not produce meaningful financial statements.
  - A company may be treated as a subsidiary and consolidated when a group owns more than half of its equity capital but has less than half the voting power, or has the power to control the company by statute, agreement or other means. Disclosure of such facts is required.
  - Preferably, uniform accounting policies should be followed by each of the companies included in the consolidated statements.
    - If different accounting policies are followed by companies included in the consolidated statements, disclosure should be made of the proportion of assets and liabilities to which different accounting policies have been applied.
  - Minority interest in the equity of consolidated companies, and in the profits and losses of such companies, should be shown separately in the consolidated statements and should not be included in the shareholders’ equity or consolidated net income.
- Prescribes the equity method of accounting for investments included in consolidated financial statements when the investor may exercise significant influence over the investee (i.e., holds 20% or more of the voting stock), or the investee is a subsidiary not consolidated because its activities are so dissimilar from those of the parent as to make consolidated statements meaningless.
  - A change from the equity method of accounting to the cost method of accounting is required when:
    - A subsidiary ceases to be consolidated because of long-term restrictions on the transfer of funds.
    - An investee ceases to fall within the definition of a subsidiary and does not become an associated company (that is, one subject to the significant influence of the investor).
An associated company is no longer subject to the significant influence of the investor. In such cases, the carrying value of the investment under the equity method at the date of the change becomes “cost” for purposes of accounting under the cost method.

• A permanent decline in value below the carrying amount under the equity method should be recognized; any provision made should be on an individual investment basis.

• Investments carried under the equity method should be appropriately classified in the balance sheet, and the investor’s share of profits or losses should be disclosed as a separate item in the consolidated income statement.

• The investor’s share of unusual items included in the investee’s income should be disclosed separately in accordance with the accounting policies of the investor.

— Disclosures required include bases of accounting, description of significant subsidiaries, any differences in reporting dates, reasons for not consolidating subsidiaries, and any statutory restrictions on distributions.

• When a subsidiary is excluded from consolidation because it has significantly dissimilar operations from those of the group, its separate financial statements should be presented with the consolidated financial statements.

• Additional disclosures are required if a subsidiary is excluded from consolidation because of long-term restrictions on the transfer of funds.

— Effective for financial statements covering periods beginning on or after January 1, 1977.

No. 4  — Depreciation Accounting (October 1976)

— Deals with depreciation accounting and applies to all depreciable assets except natural resources, expenditures for research and development, and goodwill.

• A depreciable asset should be depreciated on a systematic basis, and its cost should be allocated to each accounting period during its useful life.

  o Estimates of useful life must consider expected physical wear and tear, obsolescence, and legal or other limits in the use of the asset.

  o When a depreciation method is changed, the effect should be quantified and disclosed and the reasons for the change given.

• The useful lives of major depreciable assets should be reviewed periodically, and, if expectations are significantly different from previous estimates, the depreciation rates should be adjusted for the current and future periods.

• Disclosures for each major class of depreciable assets should include the following:

  o The depreciation method

  o Useful lives or depreciation rates

  o Depreciation expense for the period

  o Gross depreciable assets and accumulated depreciation

— Effective for financial statements covering periods beginning on or after January 1, 1977.
No. 5 — *Information To Be Disclosed in Financial Statements* (October 1976)

- Deals with information to be included in a balance sheet, an income statement, and other statements, and notes and explanatory material identified as part of the financial statements.
- Certain minimum disclosures are set forth in this Standard.
- The Standard does not propose a particular format for presentation of financial statements.
- All material information should be disclosed that is necessary to make the financial statements clear and understandable.
- General disclosures about the enterprise should include the enterprise's country of incorporation, a brief description of the nature of the activities of the enterprise, the legal form of the enterprise, and the currency in which the financial statements are stated.
- Financial statements should show corresponding amounts for the preceding period.
- Significant items should not be included with, or offset against, other items without separate identification.
- Specific disclosures should include restrictions on the title to assets, methods of providing for pensions, contingent liabilities, and amounts committed for future capital expenditures; also, they should include such items as property, plant and equipment, other long-term assets, goodwill, deferred charges, current assets, liabilities, shareholders' interest, and income statement items.
- Effective for financial statements covering periods beginning on or after January 1, 1977.

No. 6 — *Accounting Responses to Changing Prices* (June 1977)

- Information that describes the procedures adopted to reflect the impact on the financial statements of specific price changes, or changes in the general level of prices, or both, should be disclosed in the financial statements.
- If no procedures have been adopted, that fact should be disclosed.
- Effective for financial statements covering periods beginning on or after January 1, 1978.

No. 7 — *Statement of Changes in Financial Position* (October 1977)

- Requires that a statement of changes in financial position be presented as a basic financial statement.
- The statement of changes should be presented for each period for which an income statement is presented.
- Funds provided from (used in) operations should be shown separately from other sources or uses of funds.
- Unusual items, defined as items which do not relate to the ordinary activities of an enterprise, should be separately disclosed.
- Certain transactions should be disclosed separately in the statement.
- Exchanges of one form of security for another (for example, the conversion of long-term debt into common stock) are equivalent to the issuance of one security and the redemption of the other.
• The investment and financing aspects of a transaction (for example, the acquisition of plant through the issuance of long-term debt or equity) should be treated separately.
  — No single format is prescribed.
  — Other topics discussed in relation to the statement of changes in financial position are consolidated statements, investments accounted for using the equity method, and acquisition or disposition of subsidiaries.
  — Effective for financial statements covering periods beginning on or after January 1, 1979.

No. 8 — Unusual and Prior Period Items and Changes in Accounting Policies (February 1978)

— Deals with the income statement treatment of unusual items, prior period items, and changes in accounting policies and estimates.
— Income from the ordinary activities of the enterprise should be disclosed in the income statement as part of net income.
  • Unusual items should be included in net income.
    ○ The nature and amount of each unusual item should be shown separately.
  — Prior period items and the amount of the adjustments resulting from changes in accounting policies, if any, should be reported by adjusting beginning retained earnings and restating prior years’ statements, or should be reported separately in current income.
  • In either case, the disclosure relating to these items should be adequate to facilitate comparisons for each period presented.
  • A change in accounting policy should be made only if required by statute or by an accounting standards setting body, or if the change would result in a more appropriate presentation of financial data.
    ○ The effect of a change in accounting policy and the reasons therefor should be disclosed.
  — A change in an accounting estimate should be accounted for as part of income from the ordinary activities of the enterprise in the current and future periods, as appropriate.
  • Revision of an estimate that relates to an item reported as an unusual item should itself be reported as unusual.
  • The effect of the change should be quantified and disclosed.
  — Effective for financial statements covering periods beginning on or after January 1, 1979.

No. 9 — Accounting for Research and Development Activities (July 1978)

— Deals with accounting for research and development activities.
  • Does not deal with research and development activities conducted for others under a contract, or with the activities of development stage companies.
  • Does not deal with accounting for exploration for oil, gas and mineral deposits.
  — Research and development costs should include salaries and wages of personnel engaged in research, cost of materials, depreciation of equipment, overhead costs and other costs related to research.
— Specifies that research and development costs should be charged to expense in the period in which the costs are incurred unless all of the following criteria are satisfied:

- The product or process is clearly defined, and the costs attributable thereto can be separately identified.
- Technical feasibility of the product or process has been demonstrated.
- Management has indicated its intention to produce and market, or use, the product or process.
- There is a clear indication of a future market or usefulness for the product or process.
- Adequate resources exist, or will be available, to complete the project and market or use the product or process.

— The deferral of research and development costs should be limited to an amount that reasonably can be expected to be recovered from related future revenues.

— If a policy of deferral is adopted, it should be applied to all development projects that meet the above criteria for deferral.

— Deferred costs should be amortized on a systematic basis. The amortization period should be based on the expected periods of sale or use of the product or process.

— Deferred development costs should be reviewed periodically and written off when the criteria justifying deferral no longer apply.

- Once written off, development costs should not be reinstated.

— Disclosure should include the total amount expensed, changes in deferred costs, and the basis of amortization.

— Effective for financial statements covering periods beginning on or after January 1, 1980.

No. 10 — Contingencies and Events Occurring After the Balance Sheet Date (October 1978)

— Deals with the treatment in financial statements of contingencies and events occurring after the balance sheet date.

- Does not deal with the following:

  - Liabilities of life insurance companies arising from policies issued
  - Obligations under retirement benefit plans
  - Commitments arising from long-term lease contracts
  - Income taxes

— A contingent loss should be included in income if it is probable that future events will confirm that an asset has been impaired or a liability incurred at the balance sheet date, and a reasonable estimate of the amount of the loss can be made.

- The amount of a loss accrued should be net of any related probable recovery.

— If the conditions for accrual are not met, the existence of a contingent loss should be disclosed, unless the possibility of loss is remote.

— Contingent gains should not be included in income. If it is probable that a gain will be realized, the contingent gain should be disclosed in the financial statements.
— If disclosure of contingencies is required, the following information should be provided:
  • The nature of the contingency
  • The factors that are uncertain
  • An estimate of the financial effect of the contingency or a statement that such an estimate cannot be made
— Events occurring after the balance sheet date are distinguished between those that provide additional evidence to assist with the estimation of amounts relating to conditions existing at the balance sheet date, and those that do not affect the condition of assets and liabilities at the balance sheet date.
  • Assets and liabilities should be adjusted for events of the former type, while only disclosure is required for events of the latter type, and then only if the financial statements would be misleading absent the disclosure.
— Assets and liabilities should be adjusted for events occurring after the balance sheet date that indicate the going concern assumption, in relation to the whole or part of the enterprise, is not appropriate.
— Dividends declared after the balance sheet date should be either adjusted for or disclosed.
— If disclosure of events is required, it should include the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.
— Effective for financial statements covering periods beginning on or after January 1, 1980.

No. 11 — Accounting for Construction Contracts (March 1979)
— Deals with accounting for long-term construction contracts, including the allocation of revenues and related costs to accounting periods.
— Types of contracts included are fixed-price contracts and cost-plus contracts.
— Accounting for long-term construction contracts should follow either the percentage-of-completion method or the completed-contract method.
  • All of the following conditions must be satisfied to use the percentage-of-completion method:
    o Fixed-price contracts:
      • Total contract revenues can be reliably estimated.
      • An adequate estimating process exists and both costs to complete and the percentage of contract performance completed at the reporting date can be reliably estimated.
      • The construction contract is clearly defined and the attributable costs clearly identified so that actual experience can be compared with prior estimates.
    o Cost-plus contracts:
      • The attributable costs can be clearly defined.
      • Costs other than those that will be specifically reimbursable can be reliably estimated.
— Costs accumulated for construction contracts include direct costs (such as on-site labor, materials, and depreciation of equipment used on the job), allocated costs (such as insurance, manufacturing and overhead), and costs to carry out enterprise activities (such as general and administrative expenses, selling costs, research and development costs, and finance costs), specifically attributable to a particular contract.

- Costs incurred before a contract is signed are usually treated as period expenses unless they can be directly associated with a specific future contract, and there is a reasonable basis to expect that the contract will be obtained.

— Foreseeable losses on contracts should be provided for the stage of completion reached, and for the future work on the contract.

— A uniform method of accounting should be applied to all contracts that meet similar criteria.

— Disclosure of a change in the method of accounting for construction contracts should include the reasons for and the effect of (quantified, if practicable) the change.

— Specific disclosures required include the following:
  - The amount of construction work-in-progress.
  - Cash received and receivable as progress payments and advances, and cash retentions on contracts-in-progress.
  - The amount receivable under cost-plus contracts not included in construction work-in-progress.
  - If both the percentage-of-completion and the completed-contract methods are simultaneously used, the amount of work-in-progress should be disclosed separately for each method.

— Effective for financial statements covering periods beginning on or after January 1, 1980.

No. 12 — Accounting for Taxes on Income (July 1979)

— Deals with accounting for income taxes and its presentation in the financial statements.
— Does not deal with methods of accounting for government grants or investment tax credits.

- The following are excluded from the scope of the Statement:
  - Taxes based on income which are refundable to the enterprise if the amount of income on which the tax is based is distributed in the form of dividends.
  - Taxes paid at the time a dividend is distributed which the enterprise may offset against taxes due on its income.

— The tax expense for the period should be included in the determination of net income of the enterprise.

— Taxes relating to an item that is charged or credited to a reserve, or to retained earnings, should be accounted for in a manner consistent with the related item, and should be separately disclosed.

— Tax expense for the period should be determined on the basis of tax-effect accounting, using either the deferral or the liability method.
• Tax-effect accounting should normally be applied under the comprehensive concept. Accordingly, tax effects of all timing differences arising and reversing in the period are accounted for as elements of tax expense for the period and of deferred tax balances at year end.

• Partial tax-effect accounting may be used only when there is reasonable evidence that timing differences will not reverse for some considerable period (at least three years) and there is no indication that after this period there will be a reversal.

• The method of tax-effect accounting used should be disclosed.
  o If partial tax-effect accounting is used, the amount of timing differences, both current and cumulative, not accounted for should be disclosed.

• Timing differences that would result in a debit balance or a debit to the deferred-tax balance should not be recorded unless there is a reasonable expectation of their reversal.

• Deferred-tax balances should not be included in shareholders’ equity.

• The Statement indicates no preference between the liability method or the deferral method of tax-effect accounting.

— Taxes recovered as a result of carrying back a tax loss should be included in income in the period of the loss.

— Potential tax savings resulting from a tax-loss carryforward should not be included in income until realized unless realization is assured beyond a reasonable doubt.

• If realization is not assured beyond a reasonable doubt, the potential tax benefit of the carryforward should be included in income in the period of the loss, but only to the extent that existing deferred-tax credits would reverse, or could be reversed, during the carryforward period.

• Disclosure is required of the following:
  o The amount of tax savings included in income in the period of the loss arising from unrealized-tax-loss carryforwards.
  o The amount of tax savings included in income as a result of realized-tax-loss carryforwards not accounted for in the year of loss.
  o The amount and future availability of tax losses for which the related tax effects have not been recognized in any period.

— Taxes payable by the parent company, or by subsidiaries, on distribution to the parent of undistributed profits of subsidiaries should be accrued unless it is reasonable to assume that these profits will never be distributed by way of dividend or otherwise.

• Taxes should be accrued on the investor’s share of the undistributed profits of associated companies when the profits are recorded by the investor if taxes would be payable by the investor on distribution of these profits, unless it is reasonable to assume that those profits will not be distributed or that a distribution will not give rise to a liability for taxes.

— Disclosure should be made separately of tax expense relating to the ordinary activities of the enterprise and of tax expense relating to unusual items, prior period items, and changes in accounting policies.
— Additional disclosures include:
  • The tax effects related to assets that have been revalued to replacement or current cost.
  • An explanation of the relationship between tax expense and accounting income which is not explained by existing tax rates.

— Transition provisions require that when tax-effect accounting is adopted for the first time, an enterprise should either adjust its accounts to record the accumulated deferred-tax balance or disclose the unrecorded amount.
  • Restatement or a catch-up adjustment is permitted (see IASC Statement No. 8).
  • The tax expense currently charged against income should be the same as that which would have resulted if tax-effect accounting had been in effect.
  • The adjustment to account for the reversal of timing differences not accounted for when they arose should be either charged (credited) to retained earnings or treated in the income statement as an unusual item.

— Effective for financial statements covering periods beginning on or after January 1, 1981.

**No. 13 — Presentation of Current Assets and Current Liabilities (November 1979)**

— Deals with the meaning and presentation of current assets and current liabilities in financial statements.
— Does not deal with the basis of valuation for current assets and current liabilities.
— Each enterprise should determine whether or not to present current assets and current liabilities as separate classifications.
  • When the current/noncurrent distinction is not made, no subtotals should be given that would imply that such a distinction is made.

— Current assets include cash and bank balances available for current operations, marketable securities held as short-term investments, trade receivables, inventories, and prepaid expenses expected to be used up within one year of the balance sheet date.
  • The amount of receivables not expected to be realized in one year should be disclosed.

— Current liabilities include obligations payable on demand and other liabilities due within one year of the balance sheet date.
  • The current portion of long-term debt should be excluded from current liabilities if there is intention to refinance and if there is reasonable assurance of ability to refinance the obligation on a long-term basis. This ability may be indicated by:
    o The issuance of capital stock or a long-term obligation after the balance sheet date.
    o A noncancellable financing agreement with a financially capable lender which does not expire within one year of the balance sheet date.
    o Disclosure should be made of the amount of the liability and terms of financing.
— No offsets between current assets and current liabilities should be made unless a legal right of offset exists, and that offset also represents the expected settlement.
• Progress payments and advances may be deducted from construction work-in-progress, provided disclosure is made in accordance with IASC Statement No. 11, *Accounting for Construction Contracts*.

— Effective for financial statements covering periods beginning on or after January 1, 1981.

**EXPOSURE DRAFTS ISSUED**

**E 14 — Accounting for Foreign Transactions and Translation of Foreign Financial Statements**

(December 1977)

— Deals with financial accounting for, and reporting of, transactions in foreign currencies in the financial statements of a reporting enterprise.

— Also deals with accounting and reporting for the translation of the financial statements of foreign-based operations, for the presentation of combined or consolidated financial statements, or for accounting under the equity method.

— Does not deal with the translation of the financial statements of an enterprise from its reporting currency into another currency solely for the convenience of readers.

— Transactions in foreign currencies should be recorded in the reporting (domestic) currency using the foreign exchange rates existing at the time of the transactions.

• The forward exchange rate specified in a foreign exchange contract may be used.

• At each balance sheet date, receivables or payables in foreign currencies should be reported at the closing rates except when the foreign monetary item is covered by a forward exchange contract.

• Foreign exchange gains and losses will result when there is a change in the exchange rate between the transaction date and the settlement date for a monetary item.

— Translation of foreign financial statements should be based on either the temporal method or the closing-rate method.

— Disclosure should include the accounting policies adopted for the translation of foreign financial statements and for the treatment of foreign exchange gains and losses.

• Separate disclosure is required of the following items:
  
  o Aggregate gain or loss originating in the current period, indicating the amount included in income, stockholders’ equity, or deferred.
  
  o The aggregate gain or loss included in income for the period.
  
  o The amount of change in stockholders’ equity or in deferred gain or loss arising from the translation of monetary or nonmonetary items.
  
  o The amount of any deferred gain or loss existing at the balance sheet date.
  
  o The method of accounting for any accumulated deferred gains or losses on translation.

— Comment period ended April 28, 1978.

(Note: A revised exposure draft is expected to be issued in 1981.)
E 15 — Reporting Financial Information by Segment (March 1980)

— Requires reporting financial information by different industry segments and by the different geographic areas in which the enterprise operates.

• Applies to enterprises whose securities are publicly traded and to other economically significant entities.

• Segment financial information need not be presented for a parent company when both parent company and consolidated financial statements are presented.

• Industry segments are the distinguishable components of an enterprise in which it is engaged in providing a different product or service, or a different group of related products or services, primarily to customers outside the enterprise.

• Geographical segments are the distinguishable components of an enterprise in which it has operations in individual countries or groups of countries.

• Such segments need not be considered as independent businesses; comparisons between similarly labeled segments of different enterprises are not necessarily valid.

— The activities of each reported industry segment and the composition of each reported geographical area should be disclosed.

• Management must exercise its judgment in identifying segments.

  o In making such decisions, management should take into account such factors as profitability, risk, and growth of an enterprise’s activities and the relative impact of these factors on the enterprise as a whole.

— Financial information for each reported industry and geographical segment should be disclosed as follows:

• Sales or other operating revenues; state separately revenue derived from outside customers and revenue derived from other segments.

• Operating profit attributable to a segment; include direct segment revenues and expenses and those that have been allocated.

  o Segment operating profit does not include interest income and expense, taxes on income, minority interest, and unusual items. Also, in many enterprises, head office expenses are not allocated to segments.

• Identifiable assets employed; express in terms of carrying amount or percentage of total assets.

• Basis on which intersegment revenue has been determined.

— A reconciliation of the sum of the financial information given for individual segments and in the financial statements should be provided.

— Changes in segments and changes in accounting practices used in reporting segment information are changes in accounting policies and should be disclosed.

— Comparative figures need not be presented in the first period in which this Standard is introduced if such information is not readily available.

— Comment period ended September 30, 1980.
E 16 — Accounting for Retirement Benefits in the Financial Statements of Employers
(April 1980)

— Deals with accounting for retirement benefits in the financial statements of employers.

• This Statement does not deal with:
  o Employment termination indemnities.
  o Deferred compensation arrangements.
  o Long-service leave benefits.
  o Bonus plans.

• The Statement applies to both funded and unfunded pension plans.
  o The Statement does not deal with accounting by such plans.

— Definitions are provided for accrued benefit valuation method, projected benefit valuation method, defined benefit plan, deferred contribution plan, and other terms.

— Accounting methods are specified for defined benefit plans.

• Current service cost of retirement benefits determined by using an accrued benefit or a projected benefit method should be charged to income consistently over the working lives of covered employees.

• Pay-as-you-go and terminal funding methods should not be used in accounting for the cost of retirement benefits.

• Past service costs related to present employees and experience adjustments should be charged or credited to income as they arise or allocated over the remaining working lives of the participating employees.

• The effect of changes in actuarial assumptions on future costs should be allocated over the remaining working lives of the participants.

• An actuarial evaluation should be made at least every three years, and also in intervening years if significant changes in circumstances have occurred or if events indicate that the assumptions need modification.

— Accounting methods are specified for defined contribution plans.

• The contribution applicable to a particular accounting period should be charged against income in that period.

• Past service cost should be accounted for in a manner similar to that specified for defined benefit plans.

— The termination or probable termination of a plan requires the immediate accrual and charge to income of any unrecorded liability unless the whole liability is transferred to another plan.

— Disclosures required include the following:

• Accounting policies, including a description of the valuation method or methods used.

• Significant matters affecting comparability with prior periods.

• The liability or deferred charge resulting from differences between amounts funded since the inception of the plan and the amounts charged to income over the same period.
• The funding policy.
• For defined benefit plans, the amount of the excess, if any, of the actuarially determined value of vested benefits over the total of:
  o Fund net assets (not including the actuarially computed obligation), and
  o The liability or deferred charge (if any) described above.
• For defined benefit plans, the date of the latest actuarial valuation.
  — On adoption of the provisions of this Statement, an enterprise that has previously used the pay-as-you-go or terminal funding method should either:
    • Adjust its financial statements in accordance with IASC Standard No. 8, Unusual and Prior Period Items and Changes in Accounting Policies, to record a liability for the cumulative effect of the change, or
    • Accrue the amount as a liability over the remaining working lives of participating employees. The resulting amount should either be charged to retained earnings or charged in the income statement as an unusual item.
      o The amount of any unrecorded liability should be disclosed.
      o The cost of retirement benefits charged to income in subsequent years should be the same as that which would have resulted as if accrual accounting had been in effect from the beginning.
  — Comment period ended December 31, 1980.

E 17 — Information Reflecting the Effects of Changing Prices (August 1980)

— Deals with information reflecting the effect of changing prices upon measurements used in the determination of an enterprise’s results of operations.
• Does not affect the primary financial statements prepared on an historical cost basis.
• Applies to large publicly traded enterprises and other entities that are economically significant.
  o Entities that are not required to and do not present information reflecting the effects of changing prices are required to disclose that fact in conformity with IASC Statement No. 6, Accounting Responses to Changing Prices.
  o The information required by this Statement need not be presented for a parent company, an investee, or other enterprise in any financial report that includes the required information on a consolidated basis.
— Current cost concepts and general purchasing power concepts are defined.
— The IASC believes that further experimentation is necessary before consideration can be given to requiring enterprises to prepare primary financial statements using a comprehensive and uniform system for recognizing changing prices.
— Required minimum disclosures include the following:
  • The amount of the adjustment to or the adjusted cost of sales and the amount of depreciation of property, plant and equipment.
• Financing adjustments, if such adjustments are generally part of the method adopted for reporting information on changing prices.
  o The enterprise’s results recomputed to reflect the effects of any of the following financing adjustments:
    • Effects of changing prices on net monetary items.
    • Adjustment for the effects of changing prices on the financing required to maintain the monetary working capital.
    • A gearing adjustment. (Reduces the total of the adjustment for depreciation, cost of sales, and monetary working capital in the proportion that financing by borrowing bears to financing by total borrowing and equity capital.)
    • Application of a general price index to the amount of shareholders’ interests.
  — The information called for should be provided on a supplementary basis unless it is incorporated in the primary financial statements.
  — The procedures adopted to compute the information called for should be disclosed, including the nature of any indices used.
  — Comment period ends January 31, 1981.

E 18 — Accounting for Property, Plant and Equipment in the Context of the Historical Cost System (August 1980)

— Deals with the accounting for property, plant and equipment, and defines property, plant and equipment, fair value and historical cost.
— Systems of accounting based on replacement costs or other current values are beyond the scope of this Statement.
— Does not cover the following items:
  • Forest and similar regenerative natural resources.
  • Expenditures on mineral rights, the exploration for the extraction of minerals, oil, natural gas and similar non-regenerative resources.
  • Expenditures on real estate development.
  • Assets acquired in a business combination.
  • Capitalization of interest costs.
  • Government grants.
  • Assets acquired under financing leases.
  • Allocation of the depreciable amount of property, plant and equipment to future periods.
— The gross carrying amount of an asset included in property, plant and equipment should be its historical cost, which may be adjusted for revaluations.
  • The cost of an asset comprises its purchase price and any directly attributable costs necessary to bring the asset to its present location and working condition for its intended use.
A self-constructed asset’s cost should comprise those costs that relate directly to the specific asset and those that are attributable to the construction activity in general and can be allocated to the specific asset.

- Cost inefficiencies should be excluded.
- The carrying amount of that asset should not exceed the amount that would be payable for an outside purchase of a similar asset.

An asset acquired in exchange for shares or similar securities should be recorded at fair value.

An asset acquired in exchange for other assets should be recorded either at fair value or at the carrying amount of the assets given up adjusted for any receipt of cash.

- Subsequent expenditures should be added to the carrying amount only if the expenditures increase the future benefits from the existing asset beyond the original standard of performance.
- If recoverable amounts are significantly lower than the carrying amount, the carrying amount should be reduced to the recoverable amount by a charge to income.
- In modified historical cost financial statements, the following revaluation rules apply:
  - If an item of property, plant and equipment is to be revalued, the entire class of assets to which such an item belongs should normally be revalued, or reasons for not doing so should be disclosed.
  - Revaluation should not result in the carrying amount of a class of assets greater than the aggregate amount which is expected to be recovered from continued use, or, where applicable, from disposal of the assets within that class.
  - When revaluing a class of depreciable assets, any accumulated depreciation on that class of assets at the date of revaluation should not be credited to income.
  - A gain arising from revaluation should be credited directly to shareholders’ equity, except that, to the extent it is directly related to a loss previously recorded in income, it should be credited to income.
  - A loss on revaluation should be charged directly to income except that, to the extent that such a loss is directly related to a gain previously recorded as a credit to shareholders’ equity and has not been subsequently reversed or utilized, it should be charged to shareholders’ equity.

Property, plant and equipment retired from use or otherwise disposed of should be written off.

- Gains or losses arising from retirements or disposals of fixed assets carried at cost should be recognized in the income statement.
  - Where the composite rate method is used, gains or losses arising from normal retirements may be credited or charged to accumulated depreciation.
- In modified historical cost financial statements, gains or losses on disposal should be entered in income except to the extent that any losses or gains have been previously charged or credited directly to shareholders’ equity and have not been subsequently reversed or otherwise utilized.
— In addition to disclosures required by IASC Statement No. 5, *Information to Be Disclosed in Financial Statements*, the following disclosures should be made:

- The valuation bases used for determining the carrying amounts of fixed assets.
  - Where more than one basis is used, the carrying amount for each basis should be given.
- The method used to compute the amounts of revaluations, and the frequency of such revaluations.

— Comment period ended January 31, 1981.

**E 19 — Accounting for Leases** (October 1980)

— Deals with accounting for leases by lessees and lessors, and defines such terms as finance lease, operating lease, lease term, minimum lease payments, contingent rental, inception of the lease, and the like.

— Does not cover the following items:

- Leases to use natural resources, such as oil, gas, timber, metals and other mineral rights.
- Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents, and copyrights.

— A lease is a finance lease if it transfers substantially all the risks and rewards incident to ownership, and the lease is normally non-cancellable and secures for the lessor the recovery of his capital plus a profit.

- Classification as a finance lease would be expected if any one of the following conditions were met:
  - The lease transfers ownership of the asset to the lessee by the end of the lease term.
  - The lessee has the option to purchase the asset at a price which is expected to be a bargain price at the date the option becomes exercisable.
  - The lease term is for the major part (normally 75 percent or more) of the economic life of the asset.
  - The present value at the inception of the lease of the minimum lease payments is greater than or equal to substantially all (normally 90 percent or more) of the fair value of the leased asset net of grants and tax credits to the lessor at the inception of the lease.

— Accounting by the lessee:

- A finance lease should be reflected in the balance sheet by recording an asset and a liability at amounts equal, at the inception of the lease, to the present value of the minimum lease payments or, if lower, at the fair value of the leased property net of grants and tax credits.
  - The discount factor is the interest rate implicit in the lease if it is practicable to determine; if not, the lessee's incremental borrowing rate is to be used.
  - Rentals are apportioned between a finance charge and the reduction of the outstanding liability so as to produce a constant periodic rate of interest on the remaining balance of the liability during each accounting period.
Depreciation policy for the leased asset should be consistent with that for depreciable assets which are owned.

- If there is no reasonable certainty that the lessee will obtain ownership, the asset should be fully depreciated over the lease term.

- Accounting by the lessor:
  - An asset held under a financing lease should be recorded on the balance sheet not as property, plant and equipment but as a receivable, at an amount equal to the net investment in the lease.
  - Lease rentals are treated as repayments of principal and finance income.
    - Finance income is usually allocated on a pattern reflecting a constant periodic return on the lessor's net investment.
    - The pattern of income recognition may need to be modified where there are uncertainties relating to the collectibility of lease rentals or future changes in tax rates and where appropriate, interest rates.
  - Manufacturer or dealer lessors should include selling profit or loss in income.
    - The sales revenue is the present value of the minimum lease payments computed at the interest rate implicit in the lease.
    - The cost of sales must be reduced by the present value of the estimated unguaranteed residual value accruing to the lessor.
    - Where the implicit rate is artificially low, a commercial rate of interest should be used in discounting the minimum lease payments.
  - Initial direct costs of finance leases are usually expensed at the inception of the lease by manufacturers or dealers, whereas others may allocate the initial direct costs over the term of the lease.

- Disclosure by lessees includes:
  - The amount of assets that are the subject of finance leases.
  - Liabilities under finance leases, current and noncurrent.
  - The amount of operating lease rentals charged to income.
  - Commitments for minimum lease payments under finance leases and under non-cancellable operating leases with terms of more than one year, showing in summary form the amounts and periods in which payments will become due.
  - Financing restrictions, purchase options, contingent rentals, and the like.

- Disclosure by lessors includes:
  - Gross investment in finance leases and related unearned finance income and unguaranteed residual values of leased assets.
  - The basis used for allocating income.
  - The amount of assets that are the subject of operating leases.
  - Aggregate minimum lease payments less finance income due under finance lease contracts written during the year.
— Special provisions deal with such matters as:

- Leases of land and buildings.
- Sale and leaseback transactions.

— Effective date would be subject to the following transition rules:

- For a period of three years from the effective date, lessors and lessees need not apply the full provisions of this Standard provided the following information is disclosed.
  - Lessees: The amount of the assets and liabilities that would have been included in the balance sheet had the finance leases been accounted for in accordance with the Standard, and the effect on net income.
  - Lessors: The method used to recognize income under finance leases.

— Comment period ends April 30, 1981.

**SUBJECTS UNDER STUDY BY STEERING COMMITTEES**

- Disclosures in Financial Statements of Banks
- Business Combinations
- Revenue Recognition
- Accounting for Government Grants
- Accounting for the Capitalization of Finance Costs
- Related Party Transactions
2. International Federation of Accountants (IFAC)

BACKGROUND

The International Federation of Accountants (IFAC) was formed in October 1977 at the XI International Congress of Accountants. It is governed by a 15-member Council drawn from 15 different countries including the United States. The broad objectives of IFAC are the development and enhancement of a coordinated worldwide accounting profession with harmonized standards. Its members include 75 professional organizations of accountants from 57 countries. The members from the United States are the American Institute of Certified Public Accountants (AICPA) and the National Association of State Boards of Accountancy.

STANDING COMMITTEES

Seven standing committees have been appointed to carry out the mandate of IFAC. The committees and their objectives are as follows:

- **International Auditing Practices Committee**
  - To develop guidelines on auditing and reporting practices and seek to promote, with the support of the Council of IFAC, the voluntary acceptance of such guidelines by members.

- **Education Committee**
  - To prepare a survey setting forth for each member organization a summary of the entry and practical experience requirements, and to develop guidelines on prequalification, training, and education.
  - To monitor developments and develop guidelines with respect to continuing professional education.

- **Ethics Committee**
  - To develop a suggested minimum code of professional ethics; would cover such matters as independence, objectivity, integrity, competence, and technical matters.
  - To promote understanding and voluntary acceptance of such a code.

- **International Congress Committee**
  - To have oversight of the plans and arrangements for the 1982 International Congress.
  - Committee plans and arrangements are subject to approval of the Council.

- **Management Accounting Committee**
  - To encourage the development of management accounting.
  - To increase the level of competence of management accountants.
  - To interact with other committees and provide the management accounting perspective on the issues.

- **Planning Committee**
  - To maintain the relevance of IFAC's continuing objectives by reviewing strategy, plans, and the like.

- **Regional Organizations Committee**
  - To encourage and promote the development of regional organizations and to encourage their participation in IFAC activities.
INTERNATIONAL AUDITING PRACTICES COMMITTEE (IAPC)

— Membership

• IAPC consists of 11 members nominated by the member bodies in the countries selected by the Council of IFAC to serve on IAPC.

• Members are appointed for a five-year period. A representative of the AICPA is a member.

— Authority

• International auditing guidelines issued by IAPC do not override the local regulations governing the audit of financial information in a particular country.

• In the event that local regulations differ from, or are in conflict with, International Auditing Guidelines on a particular subject, member bodies should work towards the implementation of the Guidelines issued by IAPC.

— Scope of Guidelines

• International Auditing Guidelines apply whenever an independent audit is carried out, and are applicable to all entities irrespective of form, size, profit or not-for-profit.

— Working Procedures

• IAPC selects subjects for study by a subcommittee established for that purpose.

• The subcommittee prepares an exposure draft for consideration by IAPC.

• If approved by three-quarters of the members of IAPC, the exposure draft is published.

• Comments are reviewed by IAPC and a revised draft is prepared.

• If the final draft is approved by at least three-quarters of the committee, the draft is issued as a Guideline.

— International Audit Guidelines Issued

• Preface to International Auditing Guidelines of the International Federation of Accountants (July 1979)

• No. 1 - Objective and Scope of the Audit of Financial Statements (January 1980)

• No. 2 - Audit Engagement Letters (June 1980)

• No. 3 - Basic Principles Governing an Audit (September 1980)

— Exposure Drafts Issued

• No. 4 - Planning (February 1980)

• No. 5 - Using the Work of an Other Auditor (June 1980)

• No. 6 - Study and Evaluation of the Accounting System and Internal Control in Connection with an Audit (June 1980)

• No. 7 - Control of the Quality of Audit Work (October 1980)

• Proposed Standard Inter-Bank Confirmation Request (Issued jointly by IAPC and the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Major Industrialized Countries and Switzerland.)

— Other Projects Selected for Study

• Audit Evidence
• EDP Auditing
• Documentation
• Fraud and Error
• Internal Audit
• Reporting
• Reviewing Financial Information

ACTIVITIES OF OTHER COMMITTEES

— Education Committee
  • The following drafts are being prepared:
    o Prequalification, Education and Training for an Accountant.
    o Guidelines on Continuing Education.

— Ethics Committee
  • Guidelines issued:
    o Professional Ethics for the Accounting Profession (July 1980).
  • Exposure drafts issued:
    o No. E 1 - Guidance on Advertising, Publicity and Solicitation (May 1980)
    o No. E 2 - Professional Competence (May 1980)
  • Projects under study:
    o Integrity, Objectivity and Independence.
    o Confidentiality.

— Management Committee
  • Exposure drafts issued:
    o Definition of Management Accounting, Responsibilities of Management Accountants,
      Interface with External Auditors (May 1980)
3. The European Economic Community (The Common Market)

BACKGROUND

The European Economic Community (EEC), also known as the Common Market, was established by the Treaty of Rome on March 25, 1957. On July 1, 1967, three existing communities, EEC, European Coal and Steel Community, and the European Atomic Energy Community were merged in terms of governance. A single Commission and a single Council of Ministers (Council) now exercise the powers and responsibilities incorporated in the separate treaties.

The Council represents the governments of the ten Member States. The Council is the decision-making body and acts on proposals that emanate from the Commission. A majority vote by the Council is generally required for approval of proposals.

The Commission initiates proposals for Council action, ensures that Council decisions are implemented by the Member States, and administers community funds. The Commission consists of 14 members appointed by their respective governments for a 4-year term. The major Member States—France, West Germany, Italy and the United Kingdom—appoint two commissioners each; the other six commissioners are appointed by Belgium, Denmark, Greece, Ireland, Luxembourg, and the Netherlands. Commission members act on behalf of the EEC and not their respective governments.

COUNCIL DIRECTIVES

Directives are among the various orders that may be issued by the Council for harmonizing company law and establishing uniformity in accounting. However, all efforts to establish uniformity in accounting have been made through Directives. Directives are addressed to and are binding on the ten Member States although national authorities are given some latitude on matters of implementation.

The Council has issued six Directives. In addition, there are six proposals for Directives which have been published by the Commission. Directive Four and proposed Directive Seven deal with accounting principles. The other Directives and proposed Directives generally deal with corporate matters and auditor qualifications.

PROCEDURES

The procedures followed by the EEC in developing Directives are as follows:

- The Commission consults with officials of the Member States and their specialists on specific suggestions for harmonizing company law or accounting.
- The staff of the Commission prepares a working paper for purposes of discussion by the Commission and national experts.
- A formal draft directive is prepared and approved by the Commission, submitted to the Council and published.
- The Council submits the formal draft directive to the Economic and Social Committee and to the European Parliament for comments.
- After receipt of comments, the proposal is deliberated by the Council and negotiated with delegates of the Member States, as needed.
- The directive is approved by Council and issued to the Member States.
• The Member States are then required to bring into their respective national law, within specified time periods, the regulations and administrative provisions needed to comply with the Directive.

• The effective time period for compliance has varied from six months to as much as five years for certain provisions.

DIRECTIVES ISSUED BY THE COUNCIL

First Directive—Corporate Powers and Disclosures (March 9, 1968)
— The only significant reference to accounting in this Directive is a requirement that certain specified types of companies, generally corporations, disclose annual balance sheets and income statements.

• Compulsory application of this provision, however, is postponed until the implementation of a Directive (the Fourth Directive) concerning coordination of the contents of the balance sheet and the income statement, and concerning a size exemption.

— The general provisions, exclusive of the accounting provision, must be put into force by Member States within eighteen months following the issue date.

Second Directive—Incorporation of Public Companies and Transactions in Capital Shares (December 13, 1976)
— Deals essentially with matters of incorporation and transactions in the capital shares of a corporation such as subscriptions, issuance, repurchase, and dividends for purposes of establishing uniform standards for the protection of shareholders and creditors.

— Most provisions must be put into force by Member States within two years following the issue date.

Third Directive—Mergers of Public Companies (October 9, 1978)
— Deals with the legal and certain procedural aspects of mergers of public limited liability companies.

— Specifies, in Article 11, certain documents that shareholders shall be entitled to inspect, including:

  • The draft terms of the merger.
  • Annual financial reports of the merging companies for the preceding three fiscal years.
  • An interim balance sheet if the last annual balance sheet is dated.

— Most provisions must be put in force within three years following the issue date.

— Provides a framework for a common standard of accounting disclosure for companies subject to the jurisdiction of Member States.

— The purposes of the Fourth Directive are:

  • Coordination of national laws relating to the publication, presentation and content of annual financial statements of limited liability companies and the accounting principles used in their preparation.
• Establishment of minimum disclosure of financial information to the public by companies which are in competition with one another.

• Establishment of the principle that annual financial reports should give a true and fair view of a company's assets and liabilities and of its financial position and profit or loss.

• Provision of the fullest possible information about limited companies to shareholders and third parties.

— The Fourth Directive applies to companies that are similar to U. S. corporations, both public and private.

• The Directive need not be applied to banks, insurance companies and other financial institutions.

• The Directive does not require consolidated statements to be prepared. Consolidated statements will be dealt with in the proposed Seventh Directive.

• Until the Seventh Directive comes into force, under certain circumstances, the Member States need not apply the provisions of the Fourth Directive.

— The Fourth Directive provides that the annual financial reports shall comprise the balance sheet, the income statement and the notes to the statements.

• The Directive purports to set out only minimum requirements for the financial reports; Member States may require additional information.

— Although the financial statements that are prepared in accordance with the Fourth Directive are normally expected to result in a true and fair view, in exceptional cases a requirement of the Directive may lead to the opposite result. In such circumstances, companies must disregard that requirement, and give an explanation of the reasons for and the effect of any departure.

— The Fourth Directive deals with the following topics:

• Format of financial statements:
  o The objective of specifying a format is to make the financial statements of different companies in different Member States more comparable and to facilitate the collection of national statistics. Matters discussed under format include:
    • A requirement of comparative financial statements.
    • A prohibition against set-off (right of offset) between asset and liability items, or between expenditure and income items.
    • The classification of costs in the income statement; costs may be classified according to their nature or by function.

• Specific disclosure requirements deal essentially with matters of classification and presentation of items in the financial statements.

• Valuation rules (accounting principles), which include the following:
  o Assets and liabilities must be valued on the presumption that the company is a going concern as long as the facts support the presumption.
  o Valuation must be made on a prudent basis, and in particular:
    • Profits should be recorded only when realized.
    • All foreseeable liabilities and potential losses should be provided for.
The accrual concept is to be used.
Consistency is to be followed.
The opening balance for each year must correspond to the closing balance for the preceding year.
Departures from the valuation rules, when justified, must be disclosed and quantified.
Either the cost or equity method for valuing holdings in affiliated companies is permitted.
Inventories may be valued on a weighted average, FIFO, LIFO, or other similar basis.
If historical cost is significantly different than year-end cost, the amount of the difference must be disclosed.
Alternative accounting bases may be permitted by Member States.
Such bases must be specified in detail by the respective national legislature.
A note on the items affected and the methods used must be included in the statements.
The Directive authorizes the following alternatives:
Replacement value accounting may be used for tangible fixed assets and for stocks (inventory).
Valuation of all items in the accounts by any other method “designed to take account of inflation.”
Revaluation of tangible fixed assets and long-term investments.
Where such alternatives are used, any resulting surplus must be shown under liabilities as a revaluation reserve, and any tax effects must be explained.
No part of the reserve may be distributed unless it represents realized gains.
Value adjustments to fixed assets or current assets that are made for tax reasons only must be identified and explained in the notes.
Research and development costs may be capitalized to the extent allowed by the laws of the respective Member States, and in general such costs must be written off over a maximum period of five years.
Goodwill is to be amortized over a maximum period of five years. Member States may allow companies to amortize goodwill over a specified period exceeding five years, provided this period does not exceed the useful life of the asset.
Notes to the financial statements should cover such matters as:
Accounting policies
Significant shareholdings
Taxation
Sales by products and activities and by geographic areas.
Average number of employees and payroll costs.
A fair review of the development of the company’s business and its position should be given, including:
Any important post-balance sheet events.
o A company's likely future development.
  o Research and development activities.
  o Purchase of treasury shares.
  • The financial statements must be audited by persons who are authorized by the laws of
    the respective Member States to audit accounts.

— Special provisions are made for small and medium-sized companies.

• To qualify as a small company, a company must meet two of the three following conditions:
  o Gross assets must not exceed 1,000,000 European units of account. (The European
    unit of account (EU) is a standard unit for which there are fixed translation rates into
    the currencies of the Member States; in December 1980 EU 1 equaled approximately
    $1.40.)
  o Sales must not exceed EU 2,000,000.
  o The average number of employees during the year must not exceed 50.

• Small companies may publish abridged balance sheets.

• Member States may exempt small companies from the audit requirements of the
  Directive.

• To qualify as a medium-sized company, a company must meet two of the three following
  conditions:
  o Gross assets must not exceed EU 4,000,000.
  o Sales must not exceed EU 8,000,000.
  o The average number of employees during the year must not exceed 250.

• Medium-sized companies may publish abridged versions of the income statement and
  the balance sheet.

— Member States must introduce legislation to implement the Directive generally within two
  years following the issue date (i.e., by July 1980) although implementation of certain mat­
  ters may be delayed eighteen months to five years.

Directive—Coordinating the Conditions for the Admission of Securities to Official Stock Ex­
change Listing (March 5, 1979)

— Establishes minimum conditions for listing shares and debt securities.

— References to the publication of information include:

  • The company must make available to the public, as soon as possible, its most recent
    financial statements in comparative form.

  • Consolidated as well as parent company only statements are to be issued unless one or
    the other does not contain any significant additional information.

  • If the financial statements do not comply with the provisions of Council Directives con­
    cerning company accounts and if they do not give a true and fair view of the company's
    assets and liabilities, financial position and profit or loss, more detailed and/or additional
    information must be provided.
• The company must inform the public as soon as possible of any major developments in its sphere of activity which are not public knowledge and which may, by virtue of their effect on the company’s assets and liabilities or on the general course of its business, lead to substantial movements in its share prices.

— Member States shall take measures to comply with this Directive within two years following the issue date.

**Directive Formerly Titled the “Sixth Draft Directive”—Publication Requirements for Listing Securities** (March 17, 1980)

— Harmonizes the contents, scrutinizing, and publication of listing particulars to be published when securities are admitted to an official stock exchange listing.

• This Directive is designed to eliminate obstacles to the listing of securities on stock exchanges in different Member States and to facilitate access to these different stock exchanges.

• The objective is to contribute to the establishment of a European capital market.

— References to accounting in the Directive include the following:

• Listing particulars shall include information which is necessary to enable investors and their investment advisors to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer.

• Annual financial statements shall comprise the balance sheet, the income statement and the notes to the financial statements.

• Where the issuer prepares both its own (parent company) and consolidated statements, both sets of statements must accompany the listing particulars.

  o The omission of one of the sets of statements may be allowed provided the set furnishes no material additional information.

— Member States shall take measures to comply with this Directive within thirty months following the issue date.

**Directive—Protection of Employees in the Event of Insolvency of the Employer** (October 22, 1980)

— Provides that Member States must set up institutions to take over unpaid claims of employees for wages and retirement benefits that arose before insolvency.

• A national foundation or body would be funded by contribution from employers, employees, and the Member State.

• Amounts that would have been payable by the bankrupt employer are taken over by the national foundation with some limits on the amounts and periods for which they would be paid.

— Member States must conform their laws to the Directive within thirty-six months following the issue date.
PROPOSALS FOR DIRECTIVES ISSUED BY THE COMMISSION

Proposal for a Fifth Directive—Corporate Management Structure and Employee Participation
(Submitted by the Commission to the Council on October 9, 1972.)

— The essential references to accounting in the proposed Directive cover:
  • Presentation of annual financial statements adopted by management or shareholders.
  • Audits of financial statements by qualified independent auditors.
  • Specification of certain matters to be discussed in the auditor’s report.

— The critical aspect of the Directive is a proposal to include employee participation in corporate management and decision making, as, for example, on boards of directors.

Proposal for a Directive—Scissions of Public Limited Companies
(Submitted by the Commission to the Council in September 1978.)

— Relates to transfers by a company of all of its assets and liabilities to more than one company in exchange for shares in the acquiring companies. The payment may include cash.

— Specifies that the terms must be published.

— Provides for the protection of creditors.

Amended Proposal for a Seventh Directive—Consolidated Statements
(Submitted by the Commission to the Council on December 14, 1978.)

— The Fourth Directive states that until the Seventh Directive is effective, under specified conditions, Member States need not apply the provisions of the Fourth Directive to group-controlled companies.

— The proposed Seventh Directive recognizes the need for consolidated statements for affiliated companies.

  • The proposed Directive is divided into six major sections: definitions, scope, preparing group accounts, group annual report, auditing requirements, and publication.

— Definitions

  • An associated enterprise is one over which another enterprise exercises, directly or indirectly, a significant influence.
    ○ An enterprise is presumed to be associated with another where the latter holds, directly or indirectly, 20 percent or more of the capital of the former or of the votes attaching to shares issued by that enterprise.

  • A dependent enterprise means an enterprise over which another enterprise, referred to as the dominant enterprise, is able, directly or indirectly, to exercise a dominant influence.
    ○ Dominance is presumed to exist where an enterprise has:
      • Ownership of a major part of subscribed capital.
      • Control over a majority of the votes attaching to shares issued.
      • Ability to appoint more than half of the members of an administrative, managerial or supervisory body.
— A dominant enterprise and one or more enterprises dependent on it shall constitute a group if the dominant enterprise exercises its dominant influence to the effect that the enterprises are managed on a unified basis.

— If the dominant enterprise is established essentially as a public or a private corporation and the dominant enterprise has its registered office within a Member State, it shall prepare annual consolidated financial statements.

• All enterprises of the group shall be consolidated regardless of where their registered offices are located.

• Sub-group annual consolidated financial statements may be required under certain circumstances.

• Pending subsequent provisions, Member States need not apply certain provisions to enterprises within a group that are banks, insurance companies, or other financial institutions.

— The consolidated statements shall comprise a consolidated balance sheet, a consolidated income statement and notes to the statements.

— Procedures for consolidation of financial statements are specified.

— Investments in associated enterprises by a consolidated entity shall be shown in the consolidated balance sheet as a separate item.

• Essentially, the equity method of accounting is prescribed for accounting for associated enterprises.

— Provision is made for accounting for jointly held companies on a pro rata consolidation basis.

— Notes to the financial statements, among other things, should include:

• Sales broken down by activity and geographic markets; a distinction should be made between internal and external sales.

• Details about numbers of employees and payroll.

— The consolidated annual report shall contain a detailed review of the developments of the group’s business, including:

• Important post-balance sheet events.

• The group’s likely future development.

• Research and development activities.

• Purchase of treasury shares.

— The consolidated financial statements must be audited.

(This proposed Directive is currently being reviewed by the Council of Ministers and significant changes are under consideration.)

Amended Proposal for an Eighth Directive—Auditor's Qualifications (Submitted by the Commission to the Council on November 30, 1979.)

— This proposed Directive deals entirely with qualifications of independent auditors.

— The objective of this proposal is to harmonize the qualifications of auditors of limited liability companies within the EEC.
Proposal for a Directive—Procedures for Informing and Consulting Employees of Companies with Complex Structures, Transnational Firms (Submitted by the Commission to the Council on October 2, 1980.)

— Requires that workers employed in a Member State be informed and consulted on certain matters where:

• The decision-center of the company is located in another Member State or in a non-member country.
• The company has several establishments or one or more subsidiaries in a single Member State and its decision-making center is also located therein.

— The required information must be furnished quarterly or semi-annually and must give a clear picture of the activities of the dominant company and its subsidiaries taken as a whole. The required information should include:

• Structure of the enterprise.
• Economic and financial situation.
• Business developments including matters relating to production and sales.
• Employment situation.
• Production and investment programs.
• New work methods, and other plans likely to have an effect on workers.

— Management must consult with employees with the objective of reaching agreement on plans such as:

• Closing or transferring an establishment.
• Restrictions, extensions, or substantial modifications to activities.
• Major modifications with regard to organization.

Amended Proposal for a Directive—Interim Financial Data to be Published by Listed Companies (Submitted by the Commission to the Council on June 25, 1980.)

— Directive applies to companies whose shares are admitted to listing on a stock exchange situated or operating within the territory of a Member State.

• Does not apply to investment companies other than the closed-end type.

— Requires that Member States shall ensure that companies publish an interim report semi-annually in comparative form.

• The report shall disclose:
  • Net turnover (sales).
  • Other operating income.
  • Operating charges.
  • Gross operating results.
  • Interim dividends paid or proposed.
• The report shall also include an explanatory statement on the above data which may enable investors to make an informed assessment of the development of the company's business. Additional data required, if significant, include:
  ○ Number of persons employed.
  ○ Investments carried out and firm commitments made concerning principal future investments (exclusive of acquisitions of other companies).
  ○ Back orders.
  ○ Status of inventories.
  ○ Degree of capacity utilization.
  ○ Additions to product lines.
  ○ Prospects for current financial year.

• If the company prepares both unconsolidated and consolidated statements, the interim report shall be drawn up in both forms, unless one or the other is not significant.

• The interim report shall be published in one or more national newspapers in the Member State, or be made available to the public in announced places.

• The interim report shall state whether or not it has been audited.
  ○ If audited, any qualification or refusal of a report by the auditor requires that the refusal or qualification be reproduced in full and the reasons for such be given.

BACKGROUND

In 1973, in response to a resolution of the United Nations Economic and Social Council (the Council), the Secretary General appointed a group to study the impact of multinational corporations on development and international relations. In its report, issued in 1974, the group noted a serious lack of both financial and non-financial information in usable form about the activities of transnational corporations, as well as the limited comparability of corporate reports. The report recommended that a group of experts be convened under the auspices of the Commission on Transnational Corporations (the Commission), an intergovernmental subsidiary body of the Council, to consider the formation of an international system of standardized accounting and reporting. The recommendation was endorsed by the Commission and the Council and, in 1976, the Secretary General appointed a Group of Experts in International Standards of Accounting and Reporting (the Group of Experts).

The Group of Experts consisted of fourteen members from diverse backgrounds and geographic areas. In 1977, the Group issued a four-part report, *International Standards of Accounting and Reporting for Transnational Corporations* (the Report), which was submitted to the Secretary General. The Report and the recommendations of the Secretary General were presented at the fourth session of the Commission held in May 1978.

The Commission at that time recommended the formation of an Ad Hoc Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (the Ad Hoc Group) to continue work on development of international accounting standards. In 1979, the Ad Hoc Group composed of thirty-four members was formally established by the Council.

The Ad Hoc Group is mandated to report to the Commission on further steps taken in the field of international standards of accounting and reporting. The Centre on Transnational Corporations (the Centre) is an autonomous body within the United Nations Secretariat to transnational corporations; it acts as secretariat to the Commission and serves as the research arm of the Ad Hoc Group.

OBJECTIVES

The work of the Ad Hoc Group falls within the framework of objectives established by the Commission for the entire work program of the Centre. These objectives are:

- The development of a comprehensive information system for:
  - Furthering the understanding of the nature and the political, legal, economic and social effects of the activities of transnational corporations in home and host countries, and in international relations particularly between developed and developing countries.
  - Securing effective international arrangements for the operation of transnational corporations designed to promote their contribution to national developmental goals and world economic growth while controlling and eliminating their negative effects.
  - Strengthening the negotiating capacity of host countries, in particular the developing countries, in their dealings with transnational corporations.

- The development of a code of conduct regarding the behavior of transnational corporations and the treatment of transnational corporations by home and host governments.
  - Disclosure of information to the public in the countries in which a transnational corporation operates is an important component of the code of conduct.
• The information should be designed to improve an understanding of the structure, activities, and policies of the transnational corporation as a whole.

• An Ad Hoc Intergovernmental Working Group on a Code of Conduct (the Ad Hoc Code of Conduct Group) was formed to develop the code of conduct; it will seek the expert opinion of the Ad Hoc Group to the extent that the disclosures called for include financial data.

The specific objective of the Ad Hoc Group is to establish an international system of standardized accounting and reporting for transnational corporations.

WORKING PROCEDURES

The proceedings of the Ad Hoc Group are governed by the rules of procedure of the Council. A Council resolution specifies that the Ad Hoc Group should:

• Consult appropriate international accounting bodies on matters pertaining to the development of standards.

• Elicit the views of other interested parties.

• Utilize the services of the Centre for research and other analyses.

• Concentrate on formulating priorities taking into account the needs of host and home countries and in particular the needs of developing countries.

• Report to the Commission.

Recommendations submitted by the Ad Hoc Group are reviewed by the Commission and, if approved, are transmitted to the Council. Upon approval by the Council, the recommendations are transmitted to the General Assembly of the United Nations for final vote to achieve international agreement.

To date no recommendations have been made by the Ad Hoc Group to the Commission; however, the Ad Hoc Group met twice in 1980.

REPORTS ISSUED


• The Group of Experts was requested to:

  o Review existing practices of reporting by transnational corporations and reporting requirements in different countries.

  o Identify gaps in information in existing corporate reporting and examine the feasibility of various proposals for improved reporting.

  o Recommend a list of minimum items, together with their definitions, that should be included in reports by transnational corporations and their affiliates.

• The Group of Experts directed its main efforts towards the formulation of lists of minimum requirements for the disclosure of financial and nonfinancial information.

  o General recommendations:
    • All countries should require transnational corporations to issue parent company statements in addition to consolidated statements.
 Companies whose assets are less than $10 million and whose sales are less than $20 million should be exempt from the standards of disclosure.

 Consolidated reports by country should also be issued.

 Detailed rules for segmentation, on geographical or line of business bases, should not be prescribed.

 The basis of accounting for intragroup transactions should be disclosed.

 The Group of Experts should not promulgate rules and principles with regard to the valuation of assets and liabilities.

 Recommendations are limited to questions of disclosure.

 The Report notes that the International Accounting Standards Committee (IASC) is engaged in promulgating principles of accounting for assets and liabilities.

 The Report, which deals with minimum items for general purpose reporting, is divided into the following major sections:

 - General introduction including objectives, applicability, basic reporting standards, and materiality.
 - Definitions of certain general terms.
 - Financial information including fundamental assumptions and a list of the following minimum items for reporting by the enterprise as a whole and each individual company, including the parent company:
   - Main items to be included in the financial statements.
   - Disclosure of accounting policies.
   - Information concerning members of a group and associated companies.
   - Segment information by geographical area and by line of business.

 - Nonfinancial information for the enterprise as a whole and for each individual company.
   - A general recommendation is made that nonfinancial items should be made an integral part of the general purpose reports.
   - Minimum disclosures include the following five areas:
     - Labor and employment
     - Production
     - Investment programs
     - Organizational structure
     - Environmental measures

 The report also deals with certain aspects of special purpose reporting to governments, trade unions, and other public interest groups.

 The Report recommends that the Centre should monitor corporate reporting practices to determine the extent to which they conform to the recommendations.

The Ad Hoc Group, in response to a request by the Ad Hoc Code of Conduct Group to comment on the practical and technical aspects of a proposed code of conduct, recommended the following:

- A transnational corporation should make available to the public in the countries in which it operates clear, full, and comprehensible information designed to improve understanding of the structure, activities, and policies of the corporation as a whole.
  - Financial and nonfinancial information should be made available annually.
  - Interim information should be made available semiannually.
  - Where appropriate the information should be on a consolidated basis.
  - The information should include at least a balance sheet, income statement, and a statement of attribution of profits (which indicates how earnings are distributed to dividends, bonuses, reserves, etc.), together with notes.
- The information should also include:
  - The structure of the transnational corporation.
  - The main activities of its subsidiary entities.
  - Operating results and sales.
  - Significant new investment.
  - Sources and uses of funds.
  - Employment information.
  - Research and development expenditures.
  - Transfer pricing policies.
  - Accounting policies.
- In providing information, transnationals should consider the significance of their operations to the countries concerned, irrespective of the relative importance of such operations to the transnational corporation as a whole.
- Insofar as practicable, the information should be reported by segments as follows:
  - Geographic areas of countries indicating sales, operating results and new investment.
  - Major lines of business indicating sales and new investment.
- In addition, some delegations proposed that transnational corporations should state on an annual basis:
  - That they had not, directly or indirectly, engaged in any illegal act in the countries in which they operate.
  - That they abide by the International Code of Conduct.
  - The extent of their activity in transfers of technology to the developing countries.
- Some delegations were also of the opinion that certain of the provisions should be applicable only to larger enterprises.
BACKGROUND PAPERS (prepared by the Centre for the Ad Hoc Group)


• Reviews the events leading to the establishment of the Ad Hoc Group.
• Discusses the relationship of the work of the Ad Hoc Group with other activities of the Commission.

— *International Standards of Accounting and Reporting: A Comparative Study* (December 1979)

• Presents a comparative study of the lists of minimum items for general purpose reporting proposed by the Group of Experts with pronouncements of:
  ○ The International Accounting Standards Committee (IASC).
  ○ The Organization for Economic Cooperation and Development (OECD).
  ○ United States disclosure requirements of the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC).
• The study presents a detailed tabulation of the results of the comparison of reporting standards.

— *International Standards of Accounting and Reporting: Regional and International Organizations Promoting Accounting and Reporting Standards* (December 1979)

• Describes some regional and international organizations involved in the pursuit of harmonizing accounting standards, including OECD, EEC, IASC, and IFAC.

— *Ongoing Efforts of Harmonization* (September 1980)

• An update of activities of various bodies to achieve harmonization in the area of corporate accounting and reporting, including:
  ○ Intergovernmental organizations such as the UN, EEC, OECD, and the African Accounting Council (AAC).
  ○ Professional accountancy bodies such as IASC, IFAC, and the Union Europeen des Experts Comptables Economique et Financiers (UEC).
  ○ International trade union organizations such as the World Confederation of Labor (WCL).
• The study includes a comparative analysis of the membership by State of the different groups.

— *Information Disclosure: Numbers of Employees* (September 1980)

• A study of the extent to which information in terms of number of employees is disclosed in publicly available reports issued by corporate entities.
  ○ The criteria prescribed by several organizations, such as the UN, OECD, EEC, and WCL, serve as a background against which actual information disclosure is examined.

— *Information on Gross Operating Profit and Depreciation* (September 1980)

• Presents the results of a 40-country questionnaire study of accounting and reporting of gross operating profit and depreciation.
5. Organization for Economic Cooperation and Development (OECD)

BACKGROUND

The Organization for Economic Cooperation and Development (OECD) was established under a Convention signed in Paris in December 1960. It is currently comprised of twenty-four countries: Austria, Australia, Belgium, Canada, Denmark, Finland, France, West Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The OECD itself is an outgrowth of the Organization for European Economic Cooperation (OEEC) established under the Marshall Plan in 1948.

The Council is the governing body of the OECD and is composed of permanent voting representatives of all twenty-four Member countries. It is within the Council that governments meet to take action on matters of substance; the Council meets frequently for ongoing operations and also meets at least annually at a ministerial level.

- The Secretariat of the Council serves as a data bank and makes forecasts of the main economic variables for each of the Member countries. Also, studies are prepared which serve as inputs to problem and policy oriented analyses.

- International agreements and understandings comprise decisions of the Council which are binding on governments, Council recommendations which are voluntary actions and not legally binding, and declarations by ministers which are merely expressions of political will on the part of the respective governments.

In January 1975, the Council established a Committee on International Investment and Multinational Enterprises (CIIME).

In June 1976, the OECD issued a Declaration on Investment and Multinational Enterprises. The key points in the Declaration are that the governments of Member countries agree to:

- Jointly recommend to multinational enterprises operating in their territories the observance of the Guidelines set forth in the Declaration.

- Accord to enterprises operating in their territories and owned or controlled directly or indirectly by nationals of another Member country (Foreign-Controlled Enterprises) treatment under their laws consistent with international law and no less favorable than that accorded in like situations to domestic enterprises (referred to as “National Treatment”).

- Retain the right to regulate the entry of foreign investment or the conditions of establishment of foreign enterprises.

- Consult each other on the above matters in conformity with the decisions of the Council relating to Inter-Governmental Consultation Procedures on the Guidelines for Multinational Enterprises, on National Treatment and on International Investment Incentives and Disincentives.

OBJECTIVES

The Convention under which the OECD was established provides that it shall establish policies designed to:

- Achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries while maintaining financial stability and, thus, to contribute to the development of the world economy.
• Contribute to sound economic expansion in Member as well as non-member countries in the process of economic development.
• Contribute to the expansion of world trade on a multilateral non-discriminating basis in accordance with international obligations.

The objectives of the CIIME are to:
• Improve the international investment climate through joint undertakings by the governments of Member countries.
• Strengthen confidence between multinational enterprises and Member countries.
• Encourage the positive contributions of multinational enterprises to economic and social progress.
• Establish internationally agreed guidelines, intergovernmental consultations, and review mechanisms.

WORKING PROCEDURES

The Council adopted the following procedures for the CIIME:
• The CIIME shall periodically or at the request of a Member country hold an exchange of views on matters related to the Guidelines.
• The CIIME shall periodically invite other committees of the OECD to express their views on matters related to the Guidelines.
• On the proposal of a Member country, the CIIME may decide whether individual enterprises should be given an opportunity to express their views on the Guidelines.
  ○ The CIIME shall not reach conclusions on the conduct of individual enterprises.
• Member countries may request that consultations be held by the CIIME on problems arising from the fact that multinational enterprises are made subject to conflicting requirements.
• The CIIME shall periodically review the application of “National Treatment” and act as a forum for consultations thereon.
• The CIIME reports to the Council; Council decisions must be put into effect by each government in accordance with appropriate national procedures.

GUIDELINES FOR MULTINATIONAL ENTERPRISES

— The Guidelines for Multinational Enterprises (the Guidelines) were annexed to the Declaration on International Investment and Multinational Enterprises published in June 1976.
— The Guidelines state that the common aim of the Member countries is to encourage the positive contribution which multinational enterprises can make to economic and social progress and to minimize and resolve the difficulties to which their various operations may give rise.
— The Guidelines are recommendations jointly addressed by Member countries to multinational enterprises operating in their territories.
  • The Guidelines establish standards for the activities of multinational enterprises.
  • Observance of the Guidelines is voluntary and not legally enforceable.
• Every Member country has the right to prescribe the conditions under which multinational enterprises operate within its jurisdiction, subject to international law.

• The Guidelines are not aimed at introducing differences of treatment between multinational and domestic enterprises.

— The Guidelines are set forth under the following major headings:
  • General policies.
  • Disclosure of information.
  • Competition.
  • Financing.
  • Taxation.
  • Employment and industrial relations.
  • Science and technology.

— Enterprises should publish, at least annually, financial statements and other pertinent information relating to the enterprise as a whole; they should disclose:
  • The structure of the enterprise, the parent company, and main affiliates.
  • The geographical areas of operations and principal activities in which the enterprise is engaged in each area.
    o Operating results and sales by geographical area, and sales by major lines of business for the enterprise as a whole.
    o Significant new capital investment by geographical area and, as far as practicable, by major lines of business for the enterprise as a whole.
    o Average number of employees by geographical area.
  • A statement of sources and uses of funds for the enterprise as a whole.
  • The research and development expenditures for the enterprise as a whole.
  • The intra-group pricing policies.
  • The accounting policies, including those on consolidation.

ACCOUNTING STANDARDS FOR INTERNATIONAL ENTERPRISES

— The effectiveness of the Guidelines on disclosure of information would be greatly enhanced if the information disclosed were comparable from one country to another; CIIME organized a Working Group on Accounting Standards (the Working Group) which met for the first time in April 1980.

• The tasks of the Working Group are to:
  o Assist the CIIME by clarifying the accounting terms contained in the Guidelines on the disclosure of information.
  o Encourage exchanges of views between governments and professional accounting bodies.

• The Working Group will not set uniform standards itself, but will consider ways of generating efforts by Member countries and professional bodies to do so.
Provide technical advice relating to accounting and disclosure standards.

Consider ways to make a constructive contribution to solving the problems related to the international harmonization of accounting standards.

STUDIES ISSUED


- The study was prepared on a questionnaire basis to assess the diversity of actual practices and the scope of harmonization. Twenty-one delegations responded to the questionnaire.

- The survey is in two parts:
  - Questions of a general nature covering conceptual aspects of financial reporting and the way standards are established and implemented.
  - Specific points relating to the disclosure of information of the Guidelines.

- The analysis does not provide an exhaustive treatment of accounting practices in Member countries. It does show some salient features and common approaches or significant differences that would need to be taken into account in any efforts toward harmonization.