DISCUSSION PAPER:

IMPACT OF INTERNATIONALIZATION ON BOARDS OF ACCOUNTANCY

NASBA INTERNATIONAL REGULATORS CONFERENCE COMMITTEE

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EXECUTIVE SUMMARY

- Assessment of Acceptable International Private-Sector Standard Setters - NASBA and boards of accounting may wish to independently perform their own assessment to conclude as to the acceptability of the IASB.
- Dual Reporting Systems for Both Public and Private Entities - While true internationalization may be a few years away, it is likely that IFRS will be required for public companies as early as 2013. Neither the FASB nor the AICPA can or should be allowed to make such a decision for non-public companies without appropriate guidance and input from boards of accountancy.
- Auditing Standards - IFAC's International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board are currently engaged in efforts to harmonize a variety of issues.
- Educational and Examination Update - NASBA and state boards need to think about changes to candidate educational and examination requirements so that appropriate planning and lead time will be available.
- Regulation of International Cross-Border Practice - As cross-border mobility increases, issues state boards will face in this new environment include:
  - determining which ethics standards to enforce;
  - ensuring and evaluating accounting firms' quality of work;
  - identifying the best standard of entry for the profession; and
  - providing a path for licensing and permitting of foreign firms and accountants.

FOREWORD[1]

In recent years there has been a steadily increasing dialogue regarding "internationalization" of accounting, auditing and ethics standards in response to the globalization of the capital markets.[2] Recent initiatives by the SEC and the FASB are rapidly accelerating this trend.[3]

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[1] This paper was authored by Chair of the Education Subcommittee John G.D. Carden, with editorial input from Subcommittee members Robert L. Gray, Gaylen R. Hansen, and Grace M. Lopez.

[2] E.g., *Global Capital Markets and the Global Economy: A Vision From the CEOs International Audit Networks* (Nov. 2006). http://www.iasplus.com/resource/0611visionpaper.pdf

[3] E.g., SEC *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (Corrected)(Release Nos. 33-8831; 34-56217; IC-27924; File No. S7-20-07; August 7, 2007), (stating that the SEC's proposal to rescind IFRS to U.S. GAAP reconciliations "*raises the question* of whether the [SEC] also should accept financial statements prepared

Up to this point, achieving a single set of standards has emphasized "convergence" projects of aligning country standards, particularly those of U.S. GAAP, with international accounting standards.[4] *Yet convergence means different things to different people and is very difficult to define.*[5] *More recently the discussion has evolved to a wholesale focus on "replacement" of U.S. standards by their international counterparts.*[6]

This paper considers convergence and/or replacement as having the same end game, "internationalization" of current U.S. standards and the related regulatory impact on boards of accountancy. While internationalization covers a broad swath that stretches across the accounting, auditing and ethics landscape, the prime focus of this paper is that of accounting standards, which is also the subject area which has been garnering the greatest attention and limelight.[7]

In response to efforts to internationalize standards NASBA organized, in the fall of 2007, an "International Regulators Conference Committee" to:

- *Identify international regulatory bodies and establish a dialogue, and*
- *Consider the feasibility of convening an "international regulators conference" to explore common regulatory issues and concerns.*

In some respects, the present sweeping internationalization trend appears inevitable. In that regard, this paper is not centered on the wisdom of internationalization per se, but rather the impact the trend will ultimately have on boards of accountancy. Indeed, despite controversial aspects, the Committee believes that many benefits of internationalization in the long run may outweigh the costs that will be encountered on the "globalization highway." However, it is the related issues and obstacles that must be appropriately handled by state boards, with the assistance of NASBA, in order to preserve their transcendent mission of protecting the public interest.

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in accordance with IFRS as published by the IASB from U.S. issuers") (emphasis added). http://www.sec.gov/rules/concept/2007/33-8831.pdf

[4] E.g., *International Standards – a Primer (Convergence: Who is Calling the Shots and Why Should State Boards Care?),* NASBA Regional Meetings – June 2007, Gaylen R. Hansen.

[5] E.g. *The SEC's Global Accounting Vision: A Realistic Appraisal of a Quixotic Quest*, Lawrence A. Cunningham, North Carolina Law Review Vol. 87 (2008), p. 15 *(*stating, "*How to define the meaning, progress and purpose of convergence is contestable... complete convergence remains a distant dream.")*

[6] Recent speeches by officials of the SEC and FASB indicate that convergence is a painfully slow and laborious process that will require decades to complete, if ever. The clear preference expressed by such officials is that of replacement and not convergence.

[7] Accounting standards tend to be continually evolving as humans constantly devise new ways of financing and transacting their economic circumstances. By contrast, while there are changes required to auditing and ethical theory, they are much more stable in terms of the needed changes… i.e. "ethics are ethics"

BACKGROUND

A strong need for cross-border comparability of financial statements is the linchpin for the worldwide move toward a single set of "high quality" international financial reporting standards. Other related pressures demanding internationalization include, but are not limited to, the desire of multinational companies to reduce the cost and complexity of compliance with a plethora of differing national standards; increasing globalization and speed of commerce; the European Union's 2005 mandate that listed companies adopt International Financial Reporting Standards (IFRS); the desire of the U.S. to retain its role as host of the world's premier capital market; and, the presumed appeal of accounting standards that are more principle-based than rule-based.

The SEC has emerged as perhaps the most influential supporter and enabler of internationalization. Without the influence of the SEC, internationalization would be at best a distant thought. In November 2007, the SEC voted to allow foreign private issuers to file their financial statements using IFRS without reconciliation to U.S. GAAP. NASBA, in its comment letter on the proposal, officially communicated its reluctance to unconditionally support the issuance of IFRS-based financial statements.[8] Nevertheless, U.S. securities laws vest the SEC with authority to define GAAP as it relates to public companies[9] and the proposal became effective March 4, 2008.[10]

For over forty years issues associated with multiple national financial reporting standards have been debated,[11] but of late the momentum for internationalization has approached warp speed. The initiative has been led by multinational corporations, private-sector standard setters such as the FASB, national regulators (e.g. the SEC, the U.K.'s Financial Services Authority – "FSA," and the International Organization of Securities Commissions – "IOSCO"), professional organizations (e.g. AICPA), and the major

[8] Letter dated November 13, 2007 signed by Chair Samuel K. Cotterell and CEO David A. Costello. (Stating, *"The FASB has demonstrated its relevancy and viability since its founding in 1973. NASBA urges the continued full support of the FASB's research and development of accounting standards and interaction with the IASB to harmonize future standards. The FASB must serve as the representative of the U.S. capital markets for accounting principles."*) http://www.nasba.org/862571B900737CED/PNL/Letter%20of%20Comment%20to%20SEC%20from%20NASBA%20111307/$file/Letter%20of%20Comment%20to%20SEC%20from%20NASBA%20111307.pdf

[9] *See e.g.*, section 7, 19(a) and Schedule A, items (25) and (26) of the Securities Act of 1933, 15 U.S.C. 77g, 77s(a), 77aa(25) and (26); sections 3(b), 12(b) and 13(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(b), 78l(b) and 78m(b); sections 8, 30(e), 31 and 38(a) of the Investment Company Act of 1940, 15 U.S.C. 80a-8, 80a-29(e), 80a-30 and 80a-37(a).

[10] SEC *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP* (Release Nos. 33-8818; 34-55998; IC 1302; File No. S7-13-07; July 2, 2007). http://www.sec.gov/rules/final/2007/33-8879.pdf

[11] E.g., SEC Release Nos. 8067 and 8068 (April 28, 1967 - wherein the Commission first addressed discrepancies in financial information provided under a foreign basis of accounting and U.S. GAAP).

accounting firms. Despite all of this dialogue, the drive towards internationalization has generally left unanswered the oversight role and responsibilities of local licensing regulators such as boards of accountancy.

Most noticeable has been the virtual absence of discussion as to how the states' regulatory authority correlates to the foregone internationalization decision.[12] This omission may be tolerable to state boards if internationalization occurs after its organizational and financial underpinnings are clearly established and the vast number of questions associated with independence, financing and legitimacy of the respective standard-setters are resolved.

State boards arguably have some level of "shared regulatory authority" with the SEC as it relates to audits of public companies but they have sole regulatory jurisdiction relative to services provided by independent accountants to non-public entities. The boards may adopt the standards of private-sector standard setters as they historically have done with the FASB, the GASB, the AICPA's Auditing Standards Board and its Code of Professional Conduct. However, such past reliance in no way obviates, limits or commits the states' ultimate jurisdictional authority and responsibility as far as future standard setting is concerned. That would include the drive towards internationalization.

IMPACT OF INTERNATIONALIZATION ON BOARDS OF ACCOUNTANCY

Some issues that NASBA and individual boards of accountancy need to consider in the current move towards internationalization are the following:

- Assessment of acceptable international private-sector standard setters;
- Dual reporting systems for both public and private entities;
- Educational and examination update to incorporate IFRS; and
- Regulation of international cross-border practice.

ASSESSMENT OF ACCEPTABLE INTERNATIONAL PRIVATE-SECTOR STANDARD SETTERS

CPAs are currently being asked whether they can issue audit reports on financial statements prepared in accordance with IFRS as promulgated by the International Accounting Standards Board (IASB). Rule 202 (*Compliance with Standards*) of the AICPA's Code of Professional Conduct (which is incorporated into the rules of many state boards) requires compliance with professional standards that are promulgated by

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[12] *See e.g.* Article X of the U.S. Constitution (stating in its entirety, "*The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.*") While recent SEC and FASB initiatives are couched tactfully as "proposals," speeches and commentary by their leadership has been more that of advocacy, leading one to conclude that the internationalization decision is past tense.

"bodies designated" by the AICPA. Rule 203 (*Accounting Principles*) of the Code prohibits CPAs from expressing an opinion or stating affirmatively that financial statements are presented in conformity with generally accepted accounting principles *unless* the financial statements have been prepared in accordance with accounting standards promulgated by such designated bodies.

The "bodies" currently designated by the AICPA to promulgate accounting standards include the FASB, Governmental Standards Accounting Board (GASB) and Federal Accounting Standards Advisory Board (FASAB). The AICPA's leadership currently supports and is expected to approve a Resolution in May 2008 to recognize the IASB as a "designated body" to establish professional standards with respect to international financial accounting and reporting principles.

The following criteria were developed by the AICPA for purposes of designating accounting standards-setting bodies under Rule 203.[13]

1. *Independence – The body should be independent from the undue influence of its constituency.*
2. *Due Process and Standards – The body should follow a due process that is documented and open to all relevant aspects of alternatives. The body's aim should be to produce standards that are timely and that provide for full, fair, and comparable disclosure.*
3. *Domain and Authority – The body should have a unique constituency not served by another existing Rule 203 standard-setting body. Its standards should be generally accepted by its constituencies.*
4. *Human and Financial Resources — The body should have sufficient funds to support its work. Its members and staff should be highly knowledgeable in all relevant areas.*
5. *Comprehensiveness and Consistency – The body should approach its processes comprehensively and follow concepts consistent with those of existing Rule 203 standard-setting bodies for analogous circumstances.*

As discussed below, an AICPA Task Force recently concluded that the IASB appeared to meet all criteria with the exception of *"Domain and Authority."* In addition, it identified potential issues with respect to IASB meeting the *"Human and Financial Resources"* criterion but believed there are mitigating factors to justify concluding that such criterion is met. Excerpts form the Task Force's comments are set forth below.

> *Domain and Authority.* The Task Force concluded that IASB did not currently meet the domain and authority criterion because the IASB's standards extend to the general-purpose financial statements of entities under the FASB "jurisdiction." However, the Task Force believed there was a basis for this criterion to be temporarily waived. Specifically, the Task Force recognized that the pace of events that are expected to eventually lead to the

[13] Such criteria were approved and used by AICPA Council to assess the FASAB as an accounting standards-setting body for federal government entities under Rule 203 (designated by Council in October 1999).

existence of a single set of global accounting standards—and to a single, global accounting standards setter—has been accelerating. Recognizing the significance of those events—in particular, the SEC's acceptance from foreign private issuers of their financial statements prepared in accordance with IFRS as issued by the IASB—the Task Force believed that it would be appropriate to temporarily waive the domain criterion and grant the IASB provisional Rule 202 and Rule 203 status for a period of at least three, but not more than five years. At the end of that period, the IASB would be re-assessed to determine whether continued recognition is appropriate. The temporary waiver would also give all parties involved, including the AICPA, the FASB, the SEC and the IASB time to set a more solid path toward the expected single set of global accounting standards.

In addition, it should be noted that AICPA members currently report on financial statements of foreign entities (e.g., U.S. subsidiaries of an international parent) using international accounting standards, including IFRSs promulgated by the IASB. For those entities, there is not a "domain and authority" conflict with FASB because U.S. accounting standards do not apply for international reporting.

Human and Financial Resources. Unlike the FASB, which is funded in large part by support fees provided by the Sarbanes-Oxley Act of 2002, the IASB is funded through financial commitments made by a diverse group of leading accounting firms, industrial corporations, financial institutions, central banks, and other international and governmental organizations. While the Task Force had some concerns that the IASB's budget may be inadequate for its proposed role in the U.S. financial reporting system, it was mindful that the Trustees of the International Accounting Standards Committee (IASC) Foundation, the oversight body of the IASB, recently initiated a number of reforms to improve confidence in the IASB standard-setting process, including amendments to the due process of the IASB, increased Trustee engagement with external parties, improved oversight responsibilities, and a program aimed at establishing a broader funding. Given the fact that the IASB's current structure and funding is not much different than that of the FASB when it was approved by Council as an accounting standard-setting body, and the fact that this criterion would be re-assessed after a three to five year period (which should be a sufficient time period to determine if the proposed funding program is adequate), the Task Force believed there was no basis to conclude that the criterion was not met.

NASBA and boards of accounting may wish to independently perform their own assessment of the criteria set forth above to conclude as to the acceptability of the IASB. Our regulatory considerations, in addition to the AICPA criteria and conclusions might incorporate:

- Acceptability of the multiple national versions of IFRS,
- Underlying political autonomy of the IASB, and
- Appropriate level of responsiveness of the IASB to national and local regulatory authorities, e.g. how is local regulatory sovereignty preserved?

In the event that NASBA and accountancy boards are able to get comfortable with the IASB, the next logical step would be consideration of updating the Uniform Accountancy Act and rulemaking to recognize the IASB.

DUAL REPORTING SYSTEMS FOR BOTH PUBLIC AND PRIVATE ENTITIES

While true internationalization may be a few years away, it is likely that IFRS will be required for public companies as early as 2013. While there may be some permutations of the following options, currently the two basic alternatives the SEC and FASB are considering for public companies are:

- Mandatory "drop-dead" adoption date for all public companies, or
- Phase-in period with voluntary early adoption. This option would obviously result in simultaneous differing standards.

It is unclear today as to whether IFRS would (or should) be the standard for non-public entities. While the SEC holds the key to the decision involving public companies, this is the turf of the boards of accountancy as it relates to non-public companies. For the private sector, neither the FASB nor the AICPA can or should be allowed to make such a fundamental decision in a vacuum without appropriate guidance and input from boards of accountancy.

FASB Chairman Robert Herz argues that conversion to IFRS should be easier and less costly for private entities because of all the planning and reconciliation done in conjunction with adoption by public companies.[14] Others argue that any transition will be painful and costly. It is not clear as to what FASB's long term role will be after the transition as well as what body will be responsible for providing financial support and technical expertise for non-public entities. As the debate continues, state boards should be prepared to consider the possibility (and desirability) of a long-term bifurcated reporting system.

AUDITING STANDARDS

IFAC's International Auditing and Assurance Standards Board (IAASB) and the AICPA's Auditing Standards Board are currently engaged in efforts to harmonize a variety of issues between their respective standards that directly impacts the audits of non-public entities. These activities leave open the question of whether state boards should continue to rely solely on the Auditing Standards Board and also accept guidance from IAASB with the potential of conflicting interpretations.

EDUCATIONAL AND EXAMINATION UPDATE

Clearly, a major updating of the Uniform CPA Examination will be necessary with internationalization. If the examination is to remain relevant it must test for current

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[14] E.g., *Change Agent: Interview with FASB Chairman Robert Herz,* Journal of Accountancy, February 2008, p. 31

concepts that are in actual practice. All of this will involve a massive retooling for college accounting programs, educators, curricula and text books.

NASBA and state boards need to think about changes to candidate educational and examination requirements so that appropriate planning and lead time will be available.

REGULATION OF INTERNATIONAL CROSS-BORDER PRACTICE

Internationalization will increase the cross-border mobility of practice required by businesses and their accounting firms. For a long period of time NASBA has worked to develop and enter into acceptable mutual recognition agreements with the appropriate authorities of other countries. Such efforts will likely need to be expanded in tandem with the overall expansion of the global economy. This will particularly be the case in developing countries that are attempting to bring their capital markets to the next level – countries such as Russia, the Balkans, India and China.

Issues state boards will face in this new environment include the following.

(1) Will state boards enforce international ethics standards? The International Ethics Standards Board for Accountants (IESBA) is an International Federation of Accountants (IFAC) standard setter that is responsible for its Code of Ethics for Professional Accountants. Currently the AICPA Professional Ethics Executive Committee (PEEC) is actively engaged in efforts to converge AICPA standards to those of the IESBA. In this context, questions are raised as to unique U.S. laws and business norms that rightfully influence American standards. Are such variations appropriate or are they subordinate to international standards? While it is expected that foreign accountants comply with our local regulations, would state boards hold those foreign accountants accountable to IESBA or PEEC standards of conduct in enforcement proceedings?

(2) To what extent will internationalization impact compliance assurance and quality reviews? Currently, some 235 non-U.S. firms are registered with PCAOB and are subject to PCAOB triennial reviews because of their material involvement in the audit of U.S. issuers or their audit of foreign private issuers of securities. In addition, many states have adopted as mandatory the quality review provisions of the AICPA. To date, IFAC has not issued a comparable quality review requirement as a condition of membership. The increasing role of foreign accounting firms within the U.S. raises a variety of questions as to how those firms can and should ensure the quality of their work.

(3) Can our standards for entry into the profession be reconciled to the wide range of entry found throughout the rest of the world? There are stark differences among countries as to standards for licensure or other credentials required to practice. In many countries the ability to practice is controlled by professional membership organizations, a regime that is not at all similar to our local regulatory scheme that requires governmental licensure and oversight. Experience levels required for

credentials also differ markedly. In the U.S. our licensing requirements emphasize education and then experience, in many other countries it is the reverse, with more of an apprenticeship approach. Can and should the Uniform CPA Examination remain the recognized gold standard globally? If so, what initiatives are required and when?

(4) What are the licensing and permitting options for foreign accountants and firms? Even without internationalization, accountancy boards are increasingly beginning to deal with the licensing and permitting of foreign firms and accountants. Will this process eventually emerge so that acceptably accredited foreign accountants and firms can access the same cross-border mobility that is currently emerging between states within the U.S.?

PARTING CONSIDERATIONS

Most of the past century and continuing to the present day our capital markets have been more dynamic and successful than those of any other country. Our financial reporting system has contributed greatly to that prosperity. We have a proven accounting and reporting system with methodologies developed and modified as the economy expanded and changed. U.S. GAAP has been a standard held in awe by the rest of the world. It has stood the test of time.

Our enforcement and regulatory system has also contributed greatly to the prosperity of our capital markets and the underlying intrinsic integrity of the information that drives it. Investors, creditors and other users of financial information can reasonably base their decisions upon that information.

At the same time there is always reason to deliberately and consciously question and improve upon what has gone before. As state boards of accountancy remain true to their fundamental mission of public protection, it will be important to anticipate the changing landscape and make those changes that continue to place the public interest above all other interests. State boards can and must be engaged in the internationalization of the global economy. If we insist that these issues are not ours, we will become irrelevant in our isolationism. If we are engaged in the process, we will have the ability to contribute to the solutions. In either event, the world is not going to wait for us to get on board.