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The Group of Twenty (G-20)
c/o Mr François Baroin

By e-mail: sp-eco@cabinets.finances.gouv.fr

Recommendations for the G-20 Nations – Meeting of November 3-4, 2011

Monsieur le Ministre,

Dear Minister,

The International Federation of Accountants (IFAC) is pleased to provide a series of recommendations for consideration by the G-20 at its meeting on November 3-4, 2011 in Cannes, France.

Through its membership, currently 164 professional accountancy organizations in 125 countries, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education. As the global organization for the accountancy profession, IFAC is committed to contributing to the highest quality professional services by the accountancy profession around the world. IFAC, through the independent standard-setting boards that it supports, and in conjunction with the international regulatory community, sets international auditing and assurance, ethics, education, and public sector accounting standards. IFAC also issues guidance to encourage high-quality performance by professional accountants in business.

This submission follows up previous submissions to the G-20 in 2009 and 2010. The recommendations are in line with IFAC's mission to contribute to the development, adoption and implementation of high-quality international standards; and by doing so, contributing to the development of strong international economies. We encourage the G-20 to continue its essential work on addressing important issues arising from the global financial crisis and to meet the commitments made in its communiqués of 2008–2010 and in the reports of its working groups. To achieve these aims the G-20 must strive for reporting of high-quality, internationally consistent, relevant, and reliable financial and non-financial information by all sectors.

It is important for the G-20 to consider the means by which it can promote economic and financial stability, and at the same time encourage greater transparency and accountability in reporting and decision-making, especially in the public sector. For the last ten years IFAC has consistently promoted the need for enhanced transparency and accountability in the public sector, noting in particular the risk that a lack of transparency presents to the efficiency of capital markets and global financial stability. It is with some concern that IFAC notes that even with a serious sovereign debt crisis, transparency, accountability, and the need of institutional reform in the public sector are not elements of the current debate.

IFAC recommends that the G-20 consider the following three objectives: 1) urgent and fundamental work to consider the nature of institutional change in public sector financial management, transparency, and accountability; 2) global regulatory convergence; and 3) development of integrated reporting.

1. Urgent and fundamental work to consider the nature of institutional change in public sector financial management, transparency, and accountability

IFAC recommends that the G-20 facilitate urgent and fundamental work, to be conducted or commissioned by the Financial Stability Board (FSB), to consider the nature of institutional changes that are needed in public sector financial management to protect the public and investors in government bonds.

The sovereign debt crisis engulfing the European Union and related government debt issues affecting the United States, and potentially other countries around the world, are cause for major concern for the G-20. The failure of fiscal management in the public sector is widespread and has an economic impact that will far exceed the impact of losses incurred by corporate failures, such as Enron, WorldCom, Parmalat, and Lehman Brothers.

The sovereign debt crisis and related government debt issues demonstrate that the policies chosen to address the global financial crisis may inadvertently have changed the nature of the problem, moving it from the corporate to the government sector. In the context of Europe, the sovereign debt crisis highlights the need for convergence beyond regulatory convergence; that is, a form of fiscal convergence, something intended but not achieved (because of weak objectives and weak enforcement) by the Maastricht Treaty.

The problems highlighted by the sovereign debt crisis include, but go much deeper than, the transparency and accountability of governments, and poor public finance management and public sector financial reporting. The institutions for fiscal management are clearly deficient in many countries, creating neither the constraints nor the incentives for governments to manage their finances in a manner that protects the public interest and also protects investors. Within most existing systems, it is assumed that poor fiscal management will lead to a change of government–this may occur, but incoming governments face the same incentives and constraints, which, not surprisingly, is likely to lead to similar behavior.

IFAC is of the view that what is needed is some urgent and fundamental work to consider the nature of the institutional changes that are needed to protect the public and to protect investors in government bonds. It strongly encourages the G-20 to initiate such work through the FSB. The G-20 should look to the institutional arrangements for public finances in jurisdictions in which fiscal positions have been well managed, and should recognize that the problems that need to be addressed are ones in which governments are self-interested parties.

Arrangements that might be considered as part of this study include:

- High-quality and timely accrual-based financial reporting (refer Section 1.1 below for more detailed discussion pertaining to the need for high-quality accrual-based financial reporting in the public sector);

- Audited financial statements released within six months of year end;

- Budgeting, appropriations, and reporting on the same accrual basis;

- Full transparency in fiscal positions ahead of general elections, ensuring that voting is fully informed;

- Independent, audited, projections of fiscal position to accompany budgets; and

- Limitations on deficit spending, or at least full transparency around the reasons for deficit spending and explanations of how, over an economic cycle, fiscal balance will be restored.

1.1 *In relation to the need for high-quality and timely accrual-based financial reporting, IFAC recommends that the G-20 actively encourages and facilitates the adoption of accrual-based accounting by governments and public sector institutions.*

Accrual-based accounting for the public sector:

a) **Promotes greater transparency and accountability in public sector finances;**

b) **Allows for monitoring of government debt and liabilities for their true economic implications; and**

c) **Can be achieved through the adoption and implementation of International Public Sector Accounting Standards (IPSASs).**

A key issue for public sector financial reporting is that most governments still adhere to the cash basis of accounting, and therefore provide minimal disclosures relative to what the public, banks, investors, and credit providers generally expect of the private sector.

Greater Transparency and Accountability in Public Sector Finances

In a time when sovereign debt issues are prominent, and the veracity of government reporting and transparency are being questioned, it is critical that governments work to establish greater trust between themselves and their constituents. It should be one of the highest priorities for national leaders and public officials. To establish such trust, it is important that governments provide accurate and complete information on expenditures and transactions, in order to demonstrate accountability and stewardship, and to reinforce their own credibility.

Governments are urged to provide clear and comprehensive information regarding the financial consequences of economic, political, and social decisions. This information must also focus on the longer term impact of decision making; something which cannot be achieved through the reporting and disclosure only of cash flows. Furthermore, given the prominence of banks and private sector investors in holding government debt, it is of no surprise that there is a growing demand for the same level of financial transparency and accountability from the public sector as is expected from the private sector.

The type of information required can only be provided through a high-quality, robust, and effective accrual-based financial reporting system.

Monitoring of Government Debt and Liabilities for their True Economic Implications

The sovereign debt crisis, and the consequences that are being felt around the globe, illustrate the implications of government balance sheet management failures and the inability of organizations such as global financial institutions, investors in government debt, and credit rating agencies to adequately monitor the financial positions of governments.

Reducing economic uncertainties and the significant threats that unmanageable debt poses should be seen a major priority for all governments. However, it should be recognized that government debt alone does not provide a comprehensive picture of fiscal soundness. The full disclosure of all assets, liabilities, and contingent liabilities is vital for assessing the true economic implications of public sector financial management. Furthermore, the disclosure of all liabilities, including the long-term obligations of government (e.g., pension obligations), may encourage government leaders to make decisions that are driven by matters other than short-term political incentives.

Only through a high-quality, robust, and effective accrual-based financial reporting system can all government assets and liabilities (including debt) be appropriately recorded, reported, and disclosed, and hence effectively monitored.

Adoption and Implementation of International Public Sector Accounting Standards (IPSASs)

IPSASs are issued by the International Public Sector Accounting Standards Board (IPSASB). The adoption of IPSASs by governments worldwide will improve the quality of financial information reported by public entities, which is critical for investors, taxpayers, and the general public to understand the full impact of decisions made by governments with respect to their financial performance, financial position, and cash flows. Global adoption of these standards will facilitate the comparability of such information on a global basis and assist in internal management decisions in resource allocation (planning and budgeting), monitoring, and accountability. Furthermore, as a universal set of public sector accounting standards, IPSASs would also provide better information regarding systemic risks associated with government liabilities.

The adoption of IPSASs would represent a significant step forward in achieving the financial transparency of national governments worldwide. IPSASs are designed to apply to the general purpose financial statements of all public sector entities, and are developed primarily for an accruals-based accounting context. While application of IPSASs would not solve the problem of government debt, the appropriate use of the financial information rendered from such standards would assist public officials and other groups in assessing the implications of fiscal decisions proposed or made by government.

2. Global Regulatory Convergence

IFAC encourages the G-20 to continue its momentum and ambition for regulatory reform and convergence that has been developed during the global financial crisis.

a) Adoption and implementation of common globally accepted standards for financial reporting, auditing, and auditor independence

IFAC recommends the adoption and implementation of International Financial Reporting Standards (IFRS), International Standards on Auditing (ISAs), and the auditor independence requirements set out in the *Code of Ethics for Professional Accountants* across all jurisdictions. Consistent financial information around the world assists in facilitating cross-border activity and promoting economic and financial stability. Global adoption and implementation of high-quality standards promotes the G-20's goal of strengthening transparency and accountability in the context of financial and capital markets and creating a level playing field in the interpretation and exchange of financial information.

IFAC notes that IFRSs and ISAs are two sets of standards across 12 policy areas that have been identified by the FSB as key for sound financial systems and deserving of timely implementation.

b) Recommendations of the Private Sector Taskforce of Regulated Professions and Industries

IFAC's views in respect to regulatory convergence in the financial sector are reflected in the reports of the Private Sector Taskforce of Regulated Professions and Industries. This taskforce, established at the request of the Presidency of the G-20 in May 2011, comprises representatives from private sector organizations of professions and industries that are subject to regulation and operate within the financial sector. IFAC was responsible for coordinating its establishment and provides it with administrative and secretariat support.

While recognizing that there may be instances in the financial sector where complete convergence of regulatory requirements might not be the best outcome in the short-term, the taskforce conveyed several key messages in its reports, including the importance of the G-20:

- supporting the adoption of globally accepted, high-quality international standards and requirements across all key aspects of the financial sector, in a manner appropriate for each regulated profession or industry.

- promoting consistent adoption, implementation, and enforcement of standards across jurisdictions, to the greatest extent possible, as well as consistency in the interpretation and application of regulation of the financial sector.

- continuing to enhance macro-prudential oversight measures, including close coordination and cooperation between G-20 nations.

- working to support strengthened resourcing and governance arrangements of international regulatory organizations (including standard-setters) that have clearly defined expectations and responsibilities.

- addressing the need to establish a credible, globally coordinated resolution regime for the financial services industry.

- working with all parties to develop arrangements that achieve goals of avoiding undue reliance on external ratings while also permitting achievement of internationally workable and consistent standards and supervision of credit ratings agencies.

- continuing to strengthen, in a timely and globally consistent manner, the oversight and regulation of the shadow banking system.

c) Internationally consistent, robust regulation of Credit Ratings Agencies

Many people consider credit rating agencies to have played a key role in the global financial crisis, arguing that ratings are pro-cyclical. Credit rating agencies are again in the spotlight as a consequence of the recent questions about ratings for sovereign debt.

Ratings are integral to the work of issuers, buy-side firms (such as pension funds and insurance companies), and sell-side firms (broker-dealers); and play a key role in private contracts. Furthermore, they have an important use in regulatory, supervisory, and oversight arrangements in the banking and securities sectors; for example, in terms of determining capital requirements, classifying assets and determining disclosure requirements. EU and US regulations differ in respect to the use of ratings for Basel II/III capital requirements for banks, creating uncertainty and problems of consistency for the implementation of Basel requirements.

Recognizing the fundamental importance to the operations of the financial sector, a common criticism aimed at credit rating agencies relates to the manner of supervision and oversight of their operations. It is a system that, prior to and during the height of the financial crisis, was considered to be one largely of self-regulation; it was seen as being far less stringent than the regulation, supervision, and/or oversight of other financial sector participants.

IFAC recognizes that legislators have taken action aimed at addressing several of the perceived shortcomings in the regulation and oversight of agencies' operations–for example, in respect of potential conflicts of interest, and the lack of information disclosure about ratings decisions. The EC issued Credit Rating Agencies Regulation in 2009, and as recently as September this year has issued (through the European Securities and Markets Authority (ESMA)), for consultation, a series of standards of conduct rules for credit rating agencies (aimed at various matters, such as information disclosure, compliance with earlier established requirements on rating methodologies, and registration and certification requirements). Similarly, the Securities and

Exchange Commission (SEC) in the US issued a series of measures in 2009 aimed at strengthening the oversight of credit rating agencies. These measures were supplemented by further new rules and amendments outlined in May this year, focusing on the need for credit rating agencies to: report on internal controls; protect against conflicts of interest; establish professional standards for credit analysts; and enhance public disclosure.

While IFAC welcomes these initiatives, it is not clear that such action is being undertaken in a timely, effective, and globally consistent manner. Inconsistent regulation – both in the regulation itself and the timing of reforms–across jurisdictions encourages regulatory arbitrage, promotes uncertainty, and potentially heightens economic and financial instability and systemic risks.

3. Development of Integrated Reporting

IFAC encourages the G-20 to support the development and use of integrated reporting, and in particular, the work of the International Integrated Reporting Committee (IIRC) in creating a globally accepted integrated reporting framework.

The financial crisis has revealed the need for governments and private sector corporations to better understand how their financial and operating decisions impact all areas of society. Furthermore, it has highlighted the importance of understanding the longer-term considerations of decision making, especially in the capital markets. Such understanding can be achieved through the use of integrated reporting, which "demonstrates the linkages between an organization's strategy, governance and financial performance, and the social, environmental and economic context within which it operates." Arguably, "by reinforcing these connections, integrated reporting can help business to take more sustainable decisions and enable investors and other stakeholders to understand how an organization is really performing."

A common criticism of current financial reporting regimes is that they often fail to appropriately recognize the social, environmental, and long-term economic context within which businesses–whether they are in the public sector or private sector–operate. Consequently, as evidenced in the global financial crisis, a focus on short-term risks and rewards can encourage behaviors that lead to inappropriate and disastrous outcomes. Furthermore, while the incidence of sustainability reporting has being growing in recent years, it is not clear that this reporting always appropriately links the risks and opportunities of a business to the strategy and models employed.

The IIRC was established with a mission is to create a globally accepted integrated reporting framework which brings together financial, environmental, social, and governance information in a clear, concise, consistent, and comparable format. It aims to develop this framework in a manner that assists organizations in providing relevant historical and forward-looking information, which it hopes will meet the needs of a more sustainable, global economy. A strength of the IIRC is that it represents a collaboration of representatives from a cross-section of leaders from the corporate, investment, accounting, securities, regulatory, academic, and standard-setting sectors, as well as civil society. IFAC recommends that the G-20 formally signals its support for the work being undertaken by the IIRC in respect to developing a framework for integrated reporting.

Please contact us should you require further information on any of the recommendations included in this letter. IFAC would welcome the opportunity to participate in, or contribute to, activities aimed at progressing these recommendations and which assists the G-20 in achieving its objectives.

Sincerely,

Ian Ball
Chief Executive Officer