MANAGING THE GLOBAL ECONOMY AND ACCOUNTING IN THE CARIBBEAN

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Introduction

Corporate governance refers to the systems and processes by which companies are controlled, directed and made accountable to shareholders, creditors and other stakeholders (Demirag 1998). One of the primary mechanisms used to facilitate these objectives is the preparation and publication of general-purpose financial statements – income statement, balance sheet and statement of cash flows. These statements, which are prepared at least annually, provide users with information about the financial position and performance of an entity, and enable them to compare alternative opportunities for resource allocation.

The effectiveness with which these statements facilitate resource allocation has recently been challenged by the development of a global market. In this global market, firms and individuals have increasingly gone beyond national boundaries in search of the most productive opportunities for their resources. As a result, shareholders and creditors have increasingly had to rely on general-purpose financial statements prepared in different financial reporting jurisdictions to guide their decisions. However, the fact that these statements are prepared in different countries using a wide variety of financial accounting and reporting policies complicates the decision making process. Users tend to have more difficulty analyzing, interpreting and comparing published financial accounting information (Chio 1998, Nobes & Parker 1991). Globalization, therefore, added a new dimension to the attributes desired of high quality financial accounting information. In addition to being timely, understandable, relevant, reliable and intra-nationally comparable, such information must now also be internationally comparable.

After examining this situation, several multilateral institutions including the United Nations (UN), the World Bank, and the International Monetary Fund (IMF), concluded that the existing independently developed network of national financial accounting and reporting infrastructure was incapable of dealing with the information needed for corporate governance in the global economy (Whittington 1993). As a result, strategies were initiated to harmonize international financial accounting and reporting standards, with a view to improving corporate governance and promoting greater transparency in public and private sector activity.

For instance, the Organization for Economic Cooperation and Development (OECD) developed “Guidelines for Multinational Enterprises” in the early 1970’s to promote international harmonization of
accounting and reporting practices of multinational companies (Nobes and Parker 1991). At about the same time, the UN established an “Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting” (ISAR) to publish standards for multinational companies and improve the availability and comparability of information disclosed by multinational corporations. More recently, spurred on by the economic crises in Asia, Latin America and Russia, other initiatives have been started by multilateral financing agencies such as the IMF and the World Bank (Demirag 1998).

To date, however, the most important institution in the movement to harmonize international accounting and reporting practices, both in terms of the range of issues addressed and the number of states and firms affected, is the International Accounting Standards Committee (IASC) (Nobes 1991). The IASC was established in 1973 by the professional accounting bodies of nine countries – Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, The United Kingdom and Ireland (jointly), and the United States.

The accounting standards issued by this body have generally found favor with the other institutions pursuing harmonization (e.g., the European Commission and the United Nations) (Harding 1999). Countries as diverse as Austria, France, Trinidad and Tobago, and Zimbabwe now sanction the use of IASC standards for the preparation of financial statements. Additionally, firms whose securities are traded on most of the world’s major stock exchanges (Australia, France, Germany, Hong Kong, Japan, Singapore and the United Kingdom) may currently use IASC standards for financial reporting purposes.

The paper is divided into four sections. Section one describes and critiques the structure of the IASC. Section two describes and critiques the process used by the IASC to develop accounting standards. Section three assesses the strategies used by CARICOM states to adopt IASC standards as national accounting policy. The final section of the paper offers suggestions for reforming the accounting policy-making process used by CARICOM states and the international accounting standard-setting machinery to better serve the various stakeholders.

Structure and Functioning of the IASC

Currently, all professional accountancy bodies that are members of the International Federation of Accountants (IFAC) are members of the IASC. The objectives of the IASC are to (i) formulate and publish in the public interest, accounting standards to be observed in the presentation of financial statements, and to promote their worldwide acceptance and observance, and (ii) work generally for the improvement and harmonization of regulations, accounting standards and procedures, relating to the presentation of financial statements.

Structure of the IASC

The IASC comprises the following units: a Board of Trustees, the IASC standard setting Board, the Standing Interpretations Committee (SIC), and a Standards Advisory Council (SAC). The nineteen-member Board of Trustees comprises six representatives from North America, six from Europe, four from Asia Pacific, and the remaining three from any region. The Board of Trustees has the power to appoint the new IASC Board, the SIC and
the SAC. Additionally, the Board of Trustees raises funds, approves the IASC's budget, and promotes public awareness of the IASC and its work. It also establishes and amends operating procedures for the IASC Board, the SIC and the SAC, and approves amendments to the constitution of the IASC (IASC 2000).

The IASC Board has sole responsibility for setting international accounting standards. It comprises twelve full-time and two part-time members, all individuals with technical expertise. Selection is not based on geographic representation. Five board members must have a background as practicing auditors, at least three must have a background in financial statement preparation; another three must have backgrounds as users of financial statements, and at least one member must have an academic background.

The SAC of the IASC provides a forum for organizations and individuals with an interest in international financial reporting to participate in the standard setting process. It comprises about thirty individual members from the accountancy profession, national standard setting bodies, preparers, auditors and users of accounting information, international groups and academia (Cairns 2000). Members are appointed for three-year, renewable terms. The SAC gives advice to the IASC Board on which topics should be included in its agenda and the prioritization of its work. It also provides a forum for the debate of technical and other issues with the IASC Board.

The SIC comprises 12 voting members, most of whom are accountants in public practice. Members are appointed for three-year terms and are eligible for re-appointment. The SIC considers thorny accounting issues that have not been resolved by the IASC Board, and prepares draft interpretations of current IASs consistent with the IASC's conceptual framework, for approval by the IASC Board.

This structure, which became effective on April 1st 2001, is intended to provide a balanced approach to legitimacy based upon representativeness among members of the Trustees, the SIC, and the SAC, and technical competence and independence among IASC Board members (IASC 1999). This (legitimacy) is vital given the IASC's inability to use legal mechanisms to enforce adoption of, or compliance with, its pronouncements.²

Critique of IASC Structure

The diverse geographic and functional backgrounds required of the members of the new IASC Board of Trustees is clearly intended to address concerns expressed in various quarters about the negative effects of the old IASC structure. That structure was dominated by a small clique of developed states and was widely believed to have an adverse effect on the quality and legitimacy of the standards issued by the IASC. The fact that geographic diversity is being instituted at the highest level of the organization, and in the form of oversight of the composition and operations of the IASC's Board is commendable. It will, in theory, reduce the amount of politics involved in the technical work of the IASC.

A close examination of the geographic composition of the Board of Trustees suggests that it may not be sufficiently diverse. The board is primarily drawn from North America and Europe, these regions accounting for at least 12 of its 19 members, while the Caribbean is not guaranteed a single
representative. Why? Is this a reflection of the international distribution of accounting/finance expertise? Is it that the CARICOM region lacks individuals with the required qualifications, or is it that CARICOM states have been deemed (are) politically and/or economically insignificant? Either way it is unlikely that the needs, concerns and priorities of CARICOM states will be favorably voiced or heard in such a body. That being the case, it is inevitable that questions will again be asked about the legitimacy and appropriateness of the standards issued by the IASC.

Similarly, the new IASC standard setting Board with full-time (paid) experts from diverse, technically relevant functional backgrounds seems poised to enhance the expert-based legitimacy of IASC standards. However, the realization of this benefit will depend on whether or not the expertise that is brought to bear on the process includes an understanding of the full range of systems that will be impacted by the decisions of the IASC. This, in turn, will depend on the weight assigned to such expertise by the IASC’s Board of Trustees when appointing individuals to the IASC standard setting Board. If one is to judge from the geographical distribution of the membership of the Board of Trustees it seems that not much weight has been assigned to such ‘environmental’ expertise.

The implication of this is that CARICOM states can look forward to the continued use of economic “persuasion” by their creditors, trading partners and multilateral lending agencies to adopt IASs regardless of their appropriateness to the needs of the region and/or individual states.

Procedures for the Development of an IAS

Usually, an international accounting standard is developed in a seven-step process. First, a paper identifying an issue must be submitted to the IASC Board for inclusion in its agenda. The Board currently considers papers from any organization. Second, once a topic has been adopted by the IASC Board, a Steering Committee is set up. The Steering Committee generally has 6 to 8 members, four from Board Member countries. Additionally, the IASC Board usually makes every endeavor to include a representative from a developing or newly industrialized country in each Steering Committee. A representative from a Board Member country chairs each Steering Committee.

Third, the Steering Committee identifies and reviews the accounting issues associated with the topic at hand in the light of the IASC’s conceptual framework, national and regional accounting requirements and practices, and other relevant material. The committee then submits a Point Outline of its deliberations to the full IASC board for comments.

Next, the Board’s comments on the Point Outline are incorporated into a Draft Statement of Principles (DSOP) or other discussion documents. Traditionally, Steering Committees have relied heavily on generally accepted accounting principles (GAAP) in member countries, especially the US and the UK, when developing the DSOP for a new international accounting standard (IAS) (Wallace 1991). The DSOP sets out the underlying accounting principles that will form the basis for the preparation of the Exposure Draft of a proposed IAS. It also
describes the alternative solutions considered and the reasons for recommending their acceptance or rejection. The DSOP is available to interested parties on request, and the Board invites comments from all interested parties during an exposure period, usually three months.

In step five, the Steering Committee reviews comments on the DSOP and normally agrees on a final Statement of Principles for submission to the Board. The final Statement of Principles is available to the public on request, but is not formally published.

In step six, the Steering Committee prepares an Exposure Draft for approval by the IASC Board. After revisions, and with the approval of at least two-thirds of the IASC Board, the Exposure Draft is published. Interested parties are invited to comment on the Exposure Draft during an exposure period of one to three months. The IASC does not include dissenting comments in the published text of Exposure Drafts or IASs (IASC 2000).

The process culminates with the Steering Committee reviewing the public comments and preparing a draft International Accounting Standard for review by the IASC Board. After revisions, and with the approval of at least three-quarters of the IASC's Board, the new standard is published. The above due process takes, on average, two to three years. For minor issues the Board may forgo the appointment of a Steering Committee. In such cases, the full Board considers the issue.

Critique of the IASC Standard Setting Process

The detailed procedures of the IASC Steering Committee for setting standards are comprehensive and allow a broad range of stakeholders “voice” if not “influence” in the standard setting process. However, the process is not flawless.

As was noted above, Steering Committees dealing with accounting issues have tended to focus almost exclusively on the accounting practices and standards of a few developed nations in their search for alternative models capable of dealing with problems. To the extent that this practice was adopted because only developed nations had addressed the issues in question, it would be understandable. Conversely, if other nations had devised solutions to issues being considered by the IASC, then this practice may be based on the assumption that the solutions devised by developed nations are “more appropriate,” a priori, than those of other nations. Either way the practice may have led to the IASC settling for sub-optimal solutions to accounting problems.

The standard setting process is also compromised by the highly political nature of the deliberations that determine the final content of IASs. Board members have tended to lobby for the inclusion of the accounting practices sanctioned by their respective countries/organizations in IASs. This has resulted in the Board routinely making imperfect compromises to get IASs passed. As a consequence, IASs have tended to sanction a number of (often) technically inconsistent alternative treatments for a particular transaction or event, reducing their expert-based legitimacy. This situation is compounded by the almost routine omission of alternative treatments used by less powerful states from the final text of IASs.

This practice is clearly inconsistent with the principles of representational legitimacy.
which call for the widest possible participation by stakeholders in the decision making process and influence on the outcomes of decision making processes. It may also make compliance with IASs more costly for CARICOM-based firms and thereby reduce their ability to compete internationally.

The process also seems deficient in terms of transparency. First, there continues to be secrecy about the criteria used to evaluate proposals submitted to the board of the IASC for inclusion in its agenda. Secondly, the Final Statement of Principles, which guides the preparation of Exposure Drafts for proposed IASs, is not formally published, and the IASC continues to omit dissenting comments from the published text of Exposure Drafts and IASs without any explanation. Additionally, information about the voting pattern of board members is not currently disclosed by the IASC. These practices break the audit trail and compromise the otherwise high quality of the due process used to develop IASs.

**What Happens After an IAS is Issued by the IASC**

Once an IAS is issued, the IASC relies on the “best endeavors” of its members to get their national standards into compliance with the IAS. Professional accountancy bodies in CARICOM states that are IASC members – Barbados, the Bahamas, Jamaica and Trinidad & Tobago, have achieved this requirement fairly easily. The government of each of these countries has given the local accountancy bodies legal authority to set national accounting standards.

The professional accounting bodies in CARICOM states have taken one of two broad approaches to achieve compliance with IASs; (i) wholesale adoption of IASs as national standards and (ii) using IASs as the basis for the development of national standards. The Bahamas, Trinidad & Tobago and Barbados follow the first approach. Under this approach, IASs are adopted in two stages. First, the standards committee of the respective professional accountancy body reviews IASC Exposure Drafts of new IASs and makes formal comments to the IASC. Secondly, when a standard is issued by the IASC it is adopted for use in the respective territory with just a change of name, and with minimal involvement from local stakeholders.

This policy was reportedly influenced by the IASC’s access to considerably more financial, physical and intellectual resources than the local accountancy profession, and the presumption by local accountancy bodies that the standards issued by the IASC are of a very high quality (Soo Ping Chow 2000). The decision to adopt IASs as the national standards by these countries may also have been influenced by their need to implement appropriate financial infrastructure to access the facilities of multilateral lending agencies in the 1980s.

Jamaica currently relies on the second approach; using IASs as the basis for the development of national standards (ICAJ 2000). The standards developed by the Institute of Chartered Accountants of Jamaica (ICAJ) are based on IASs, standards used in other jurisdictions, and local economic conditions. These factors are considered in a due process that involves the business community and other professionals. The process often results in the elimination of some of the alternative treatments contained in IASs, and the provision of additional disclosure and guidance.
The primary reason offered by ICAJ for this policy is that IASs may not be fully relevant to the country’s stage of development, and its political, economic and business conditions. Nonetheless, ICAJ is currently considering a proposal that would lead to the wholesale adoption of IASs supposedly to enhance the country’s attractiveness to potential investors (ICAJ 2000).

Critique of Policy Guiding Adoption of IASs

The strategy adopted by Jamaica, of using IASs as the basis for the development of national accounting standards, seems well considered. It allows the country to realize the benefits associated with the use of IASs, including conserving on resources, while simultaneously having an opportunity to customize the IASs to the local environment by, for example, removing politically motivated alternative treatments or changing their scope.

Conversely, the strategy chosen by the Bahamas, Barbados and Trinidad & Tobago, of adopting IASs, wholesale, as national accounting standards seems misinformed from a number of perspectives. The professional accountancy bodies in these countries have asserted that the decision was based, in part, on the relative lack of local resources to dedicate to the development of national standards.

However, this “resource scarcity” argument is not compelling. If a lack of resources was a major consideration in deciding on the strategy to be followed in the implementation of IASs, one would expect poorer countries to choose wholesale adoption, while their richer counterparts would choose to adapt IASs to meet their respective local conditions. This is not the case though. Jamaica, the least well-off of the four CARICOM states that have implemented IASs, has chosen to customize the standards, while its better-off counterparts, the Bahamas, Barbados and Trinidad & Tobago, have adopted IASs wholesale. Additionally, Trinidad & Tobago, the only CARICOM state that has changed its policy for adopting IASs, went from using the more expensive customization strategy during the 1980’s and early 1990’s while its economy was struggling, to the less expensive wholesale adoption policy after 1998 when its economy was booming.

There are at least three alternative explanations for the wholesale adoption policy. The first explanation is based on the assumption that the objective of the countries (the Bahamas, Barbados, and Trinidad & Tobago) in selecting among alternative policies was to minimize total out-of-pocket costs without regard for associated benefits. Such an approach is clearly short sighted and will not be discussed further.

The second explanation is that the policy represents the conscious or unconscious continuation of a historical dependency psyche by CARICOM states (the accountancy profession). Professional accountancy bodies in the region may have gotten used to having the accounting practices of developed states imposed on them. As a result, they may be unable or unwilling to act independently or proactively even though the more direct/overt political and economic shackles have been removed (Chaderton and Taylor 1993).

The third explanation for the wholesale adoption strategy is that it may be due to the flexibility afforded to CPA firms and their
clients under the guise of international comparability. This argument is supported by the indifference shown by CARICOM businesses to IASs. If the standards had imposed additional costs or otherwise required them to change their financial reporting systems, one would expect firms to object to their adoption. No such objections were made.

Even if one assumes that there is a sound rationale for the wholesale adoption strategy, its use is still troublesome. Under this strategy, international comparability may be achieved at the expense of local (intra-national) comparability. This follows from the fact that the IASC does not sanction a myriad of alternative treatments used globally, while professional accountancy bodies in CARICOM states have retained even the politically motivated alternative treatments included in published IASs.

This latter practice impairs the ability of investors and other users to assess the stewardship of management and the performance of firms. For instance, local investors wishing to compare the financial position and performance of two domestic firms that comply with IASs may still need to adjust for the use of different accounting techniques before doing so. This is not true to the same extent in the major industrialized countries each of which generally permits only one of the alternatives accounting treatments allowed in most IASs for domestic reporting.

This situation begs the following question. What is/should be the primary purpose of national accounting standards? The following are three possible answers: to cater primarily to the needs of (a) local stakeholders, (b) international investors, or (c) both groups equally or adequately. If we assume that the objective is to serve primarily local stakeholders or both local stakeholders and international investors, adequately, the above situation suggests that the wholesale adoption policy is not equal to the task. Conversely, if we assume that the objective is to serve primarily the interests of international investors, even at the expense of domestic stakeholders, the above situation is understandable. However, a second question arises concerning the current scope of IASs adopted by CARICOM states.

If national accounting standards in CARICOM states are primarily geared to meet the needs of international investors, why are they (the IASs) mandatory for private companies, companies traded only on the local stock exchange with only local investors, as well as for companies with international investors? Here again the current policy of adopting IASs without modification seems misguided. By imposing the detailed disclosure requirements and complex measurement procedures of IASs on both domestic and international companies, CARICOM states may be imposing unnecessary costs on domestic firms and hampering their competitiveness and ability to contribute to national development.

Another troublesome aspect of the wholesale adoption strategy, as used by Trinidad & Tobago, is the minimal opportunities afforded to local stakeholders (political, social, economic, legal) to review and comment on proposed national accounting standards (Staking and Shulz 1999). This compromises the representational legitimacy of the final standards and raises questions about their appropriateness to the local environment, especially given the tendency of regional professional accountancy bodies not to become actively involved in the
IASC’s standard setting process. The uncritical attitude of the regional professional accountancy bodies to the proceedings of the IASC have, therefore, exacerbated the problems inherent in the IASC’s structure and decision making processes.

Additionally, the position taken by CARICOM governments on accounting policy making is curious. The government, of Barbados, Jamaica, and Trinidad & Tobago have each delegated the responsibility for setting accounting standards to the respective local professional accountancy bodies without providing any guidance about the goals and objectives to be achieved. They have also failed to establish any formal, programmed mechanisms to monitor the performance of these bodies. Therefore, it would not be inappropriate to conclude that CARICOM states have abdicated responsibility for accounting policy making.

**Recommendation**

First, the regional professional accountancy bodies that are charged with setting national accounting standards need to be true to themselves and their respective countries. If they lack the resources necessary to do the job properly, professional accountancy bodies should seek support from the governments that initially delegated the task to them, and the multilateral agencies that currently champion international harmonization. If the resources are not forthcoming from either source, the professional accountancy body in each CARICOM State may need to politely relinquish its standard setting responsibilities. While such a move would lower the status of the profession in the short-term, it may place accounting standards onto the national agenda and facilitate a solution in the best interest of the respective countries.

If the professional accountancy bodies continue to function as standard setters, they must not allow the prominence given to the IASC’s conceptual framework of accounting in the standard setting process to obscure the fact that accounting policy making is an inherently political process, and therefore involves value judgments (Solomon 1978). Stakeholders in CARICOM countries should at least have an opportunity to decide whether they want the values of the Western powers that are embodied in the IASC’s conceptual framework to be imposed upon them. This may be facilitated by the following initiatives.

First, standard setters must subject IASC Exposure Drafts of proposed standards to a broad-based review process or public exposure before they are adopted. Ideally, the business community, employees’ representatives, and regulatory agencies would participate in such a forum. The comments and concerns expressed may form the basis of an explanatory foreword to each standard and inform standard setters’ response to the IASC.

Secondly, professional accountancy bodies in CARICOM states may lobby for a permanent regional representative on the IASC’s Board of Trustees and/or standard setting body. This will ensure that CARICOM states have an active voice in the deliberations of the IASC. Consideration could be given to having the Institute of Chartered Accountants of the Caribbean fill this role.

Additionally, CARICOM governments and regulatory agencies need to recognize that the adoption of high-quality international
accounting standards without improving the related compliance monitoring and enforcement mechanisms is potentially more dangerous than the situation it is intended to fix. In such an environment, users may be misled into believing that financial information is comparable across firms and jurisdictions when indeed it is not. This could have disastrous consequences for investors.

On a more micro level, regional standards setters should give serious consideration to (i) reducing the number of allowed alternatives in the IASs that have already been accepted as national accounting standards; (ii) clarifying the objectives of national accounting standards, and (iii) revising the policies that guide the adoption of international accounting standards to allow for a more critical review of their appropriateness in the light of national and regional needs and priorities.

Finally, it may also be beneficial to reduce the scope of IASs. This may involve the imposition of different disclosure requirements for firms of different size, and or restricting the use of IASs to firms that are either listed on a stock exchange or otherwise raise public funds.
Endnotes

1 Part of the OECD's aim in this initiative was to protect developed nations from any extreme proposals that might have come from the United Nations (Nobes and Parker 1991).

2 While the IASC has no legal authority to mandate compliance with its standards, the fact that its pronouncements are endorsed by the IMF and development banks means that developing states are frequently 'persuaded' to adopt and use IASs to access programmes administered by these bodies (IASC 1999).

3 The same is true of Africa and Latin America.

4 This process is likely to change with the recent restructuring of the IASC.

5 None of the other CARICOM members of the IASC (Guyana and Haiti) have officially adopted IASs for financial reporting in their respective jurisdictions.

6 Honduras, Peru and Panama also use this approach.

7 The economic classification of these countries is based on their 1995 and 1998 GNP (atlas method, current US$). For each country the 1995 GNP is the first figure. Jamaica ($1,660; $2,200); the Bahamas ($11,830; $12,500); Barbados ($6,600; $8,000); Trinidad & Tobago ($3,860; $4,230); Guyana ($630; $780) (World Bank 2000).
References


Soo Ping Chow, C. 2000. “Interview with Colin Soo Ping Chow.” President of The Institute of Chartered Accountants of Trinidad & Tobago.

