



The World Bank
Reports on the Observance of Standards and Codes (ROSC)

Overview of the
ROSC Accounting and Auditing Program

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OVERVIEW OF THE ROSC ACCOUNTING AND AUDITING PROGRAM

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OVERVIEW OF THE ROSC ACCOUNTING AND AUDITING PROGRAM

I. INTRODUCTION

1. In the wake of the international financial crisis of the 1990s, initiatives worldwide were set in place to strengthen the international financial architecture in crisis prevention, mitigation, and resolution. The agenda focuses on weaknesses in the international financial systems that potentially contribute to the propensity for and magnitude of global financial instability, hence requiring collective action at the international level. In this regard, the international community emphasized the role of minimum standards and codes in strengthening the international financial architecture.

2. There is widespread recognition that global financial stability rests on robust national systems and, hence, requires enhanced measures at the country level. In a world of integrated capital markets, financial crises in individual countries can imperil international financial stability. This provides a basic “public goods” rationale for minimum standards, which benefit international and individual national systems.

3. This overview of the Reports on Observance of Standards and Codes (ROSC) looks at the *objectives* and *applied methodology* of the ROSC Accounting and Auditing (ROSC A&A) program, and in particular at its *role* in the broader context of the international financial architecture exercise.

II. ROLE OF ROSC IN THE INTERNATIONAL FINANCIAL ARCHITECTURE

4. At the international level, standards enhance transparency. They identify weaknesses that may contribute to economic and financial vulnerability. They foster market efficiency and discipline. At the national level, standards provide benchmarks to identify vulnerabilities and guide policy reform. To best serve these two objectives, the scope and application of such standards need to be assessed in the context of a country’s overall development strategy and tailored to individual country circumstances.

5. In this context, the World Bank and the International Monetary Fund (IMF) have initiated the joint ROSC initiative, which covers a set of twelve internationally recognized core standards and codes relevant to economic stability and private and financial sector development.² Following the process, each of the twelve core standards is assessed and reported on in an individual module. Under this modular approach, the IMF takes the lead in preparing assessments in the areas of data dissemination and fiscal transparency. Modules for the financial sector (transparency in monetary

¹ The G7 comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. The G20 comprises the G7 plus Argentina, Australia, Brazil, China, India, Indonesia, Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, and the European Union. The International Monetary Fund and the World Bank participate in the discussions. The G22 comprises the G7 plus Argentina, Australia, Brazil, China, Hong Kong SAR, India, Indonesia, Korea, Malaysia, Mexico, Poland, Russia, Singapore, South Africa, and Thailand.

² The twelve standards are data dissemination, fiscal transparency, transparency in monetary and financial policies, banking supervision, securities market regulation, insurance supervision, payments and settlements, anti-money laundering, corporate governance, accounting, auditing, and insolvency and creditor rights.

and financial policies, banking supervision, securities market regulation, insurance supervision, payments and settlements) are mostly derived from the Financial Sector Assessment Program (FSAP).³ The World Bank takes the lead in anti-money laundering, corporate governance, accounting and auditing, and insolvency regimes and creditor rights.

6. The ROSC and the FSAP programs are tools to assess financial sector vulnerability and development needs. They provide input to IMF for its surveillance activities and are useful instruments to support the policy dialogue of international financial institutions, policymakers, and the private sector. They can contribute to the design of loans, assist in the preparation of key policy documents, and provide benchmarks for the design and monitoring of technical assistance and capacity-building programs. To remain useful, assessments of progress in implementing standards must be updated periodically.

7. The IMF and the World Bank have set up a website to disseminate the final ROSC assessments into the public arena.⁴ The FSAPs retain some confidentiality shared only with IMF, World Bank, and the assessed country. In contrast, ROSC assessments are meant to be public documents.

III. OBJECTIVES OF THE ROSC A&A MODULE

8. The World Bank is responsible for assessing the accounting and auditing module of the ROSC, known as the Review of Accounting and Auditing Standards and Practices. The review objectives are twofold:

- Assess the *comparability* of national accounting and auditing standards with International Accounting Standards (IAS) and International Standards on Auditing (ISA),⁵ respectively; and the degree to which corporate entities comply with established accounting and auditing standards in the country.
- Assist the country in developing and implementing a *country action plan* for improving the institutional framework, which underpins corporate financial reporting regime in the country.⁶

9. The ROSC A&A module addresses financial reporting by *public interest entities*. Public interest entities are defined as entities which are of significant public interest because of their business, their size, their number of employees or because their corporate status is such that they have a wide range of stakeholders. Examples of such entities might include credit institutions, insurance companies, investment firms, pension firms and listed companies. Therefore, the ROSC A&A does not specifically address financial reporting by small- and medium-size entities.

³ The FSAP, a joint IMF and World Bank effort introduced in May 1999, aims to increase the effectiveness of efforts to promote the soundness of financial systems in member countries. See www.imf.org/external/np/fsap/fsap.asp.

⁴ The ROSC website including details of the twelve core standards and country modules is available at <http://www.worldbank.org/ifa/rosc.html>.

⁵ Within this document, IAS refers to all standards and related interpretations issued by the former International Accounting Standards Committee (IASC), and the International Financial Reporting Standards (IFRS) and related interpretations issued by IASC's successor body, International Accounting Standards Board (IASB). The ISA are promulgated by the International Federation of Accountants (IFAC).

⁶ Within this document, the term "accounting" refers both to accounting and financial reporting.

III.1 Comparability of National and International Standards and Compliance

10. The ROSC A&A review entails an evaluation exercise that (a) assesses the strengths and weaknesses of existing *institutional frameworks* that underpin financial accounting and auditing practices; (b) determines the *comparability* of national accounting and auditing standards with internationally recognized standards (IAS and ISA); and (c) examines the degree of *compliance* with national accounting and auditing standards and evaluates the effectiveness of enforcement mechanisms for ensuring compliance with existing national standards, rules, and regulations.

III.1.1 Institutional Framework

11. The institutional framework should promote high-quality accounting and auditing practices. The institutional framework as examined by the ROSC A&A in each country includes (a) legislative laws and regulations, (b) the history and current state of the accounting and auditing profession, (c) the strengths and weaknesses of accounting education and training, (d) the accounting and auditing standard-setting process, and (e) arrangements for ensuring compliance with accounting and auditing requirements. The ROSC A&A module focuses on the current state of the institutional framework and provides policy recommendations for strengthening the framework.

12. While IAS and ISA are the two benchmarks that the ROSC A&A review uses to assess accounting and auditing standards and practices in any given country, there are no international regulatory standards for accounting and auditing. Efforts to address current gaps that have come to the fore in light of recent corporate governance and accounting scandals are still underway. In the absence of standards, World Bank staff draw on their own experience and international best practices in assessing the institutional framework mentioned earlier.

III.1.2 Comparability of National and International Standards

13. The benchmarks used in developing the methodology for this assessment are IAS and ISA. Achieving conformity of the country accounting and auditing standards with IAS and ISA promotes sound financial reporting in an economy. For various reasons, the standards and regulations of different countries have reached various levels of conformity with comparable international standards. The ROSC A&A module helps identify these gaps.

III.1.3 Compliance with National Standards

14. Corporate stakeholders depend on access to high-quality financial information. While setting accounting and auditing standards is an important step in developing a sound financial reporting environment, enforcement of these standards is even more important. The lack of an effective and efficient mechanism to ensure compliance with established accounting and auditing standards contributes to the weakness of a financial reporting environment.

III.2 Bolstering Corporate Financial Reporting Regime

15. With regard to the second objective for assisting the country in bolstering corporate financial reporting regime, the ROSC A&A module also identifies areas for improvement that help policymakers and other country stakeholders develop an action plan for enhancing accounting and auditing standards and practices in the country.

IV. ROSC A&A METHODOLOGY

16. The ROSC A&A module evolves from a participatory approach with a strong involvement of policymakers and other country stakeholders. The World Bank has developed a diagnostic tool that captures a comprehensive review of accounting and auditing standards and practices in a country.⁷ The World Bank also supplements the information from the diagnostic tool with a due diligence exercise in capturing primary experiences of practitioners and other facts on professional accounting and auditing practices in the country. All collected information is compiled in a report of factual findings and policy recommendations by World Bank staff. Country stakeholders and World Bank staff co-develop a country action plan based on findings, and ultimately the country action plan is implemented.

IV.1 Involvement of Policymakers and Country Stakeholders

17. At the inception of a ROSC A&A review in a given country, the country authorities (policymakers) identify the country stakeholders who have an interest in accounting and auditing matters. These stakeholders may include representatives from the Ministry of Finance, securities market regulator, banking regulator, insurance companies and other nonbanking financial institutions regulator, higher education institutions, professional accounting and auditing bodies, auditing firms, and institutional investors. These representatives are typically grouped in a National Steering Committee (NSC) established for the purpose of the ROSC A&A.⁸ Past experience has demonstrated that the chairmanship of the NSC is critical for the success of the program. A government official of high rank, such as from the Ministry of Finance or the Ministry responsible for capital market development/supervision, typically chairs the NSC.

18. The National Steering Committee provides inputs on key factors during the ROSC A&A process, including the strengths and weaknesses of the existing institutional framework that underpins accounting and auditing practices, the extent of compliance of national accounting and auditing standards in practice, and the effectiveness of enforcement mechanisms. The NSC also assists in identifying areas for improvements in the accounting and auditing standards and practices. The NSC acts as counterpart to the World Bank in the preparation of the ROSC A&A report and country action plan. The NSC acts as an intermediary with the Government in getting approval for publication of the final report. Finally, it oversees the implementation of the country action plan.

19. The degree and manner of involvement of the National Steering Committee in the assessment phase may vary from country to country. One option may be for the NSC to assist through regular meetings while the World Bank staff member and/or a consultant hired by the World Bank complete the four questionnaires within the diagnostic tool. Another option is for the NSC to fill in the questionnaires themselves. The procedures for conducting the assessment are defined at the outset of the review in the NSC terms of reference. The diagnostic tool is supplemented by a due diligence review as detailed below.

⁷ The diagnostic tool is available at www.worldbank.org/ifa/rosc_aa.html.

⁸ The involvement of country stakeholders may be organized in different ways. For example, some countries may prefer to use an existing structure rather than establishing an NSC.

IV.2 The Diagnostic Tool

20. Once the participatory structure is in place, the diagnostic tool is used to conduct the assessment. The diagnostic tool is comprised of four parts:

- **Part 1, Assessment of the accounting and auditing environment.** Data regarding the accounting and auditing environment is collected. This provides an overview of the institutional framework in the country. The input of relevant members of the National Steering Committee is instrumental for the identification of the strengths and weaknesses of the accounting and auditing environment.
- **Part 2, Comparison of national accounting standards and IAS/IFRS.** This part of the review exercise leverages available information on the gaps existing between national accounting standards and IAS/IFRS. The preparers also interview national experts, such as individuals who work in organizations with jurisdiction for setting national accounting standards.
- **Part 3, Assessment of actual accounting practices.** A sample of publicly available financial statements of public interest entities is reviewed. The review assesses the compliance with existing national accounting standards. This part of the diagnostic requires the involvement of independent reviewers with appropriate technical knowledge.
- **Part 4, Assessment of auditing standards and practices.** National auditing standards and their implementation are assessed. The ten largest auditing firms in the country are asked to complete the questionnaire within this part. The input of relevant members of the National Steering Committee (which might include the securities market regulator, any statutory body responsible for regulating the auditing profession, and academic researchers) is instrumental for the assessment of the robustness of national auditing standards and practices.

IV.3 Due Diligence Review and Final Report

21. Upon completion of the assessment, the ROSC A&A team⁹ conducts a due diligence review on the basis of the data collected by the World Bank staff, the consultant, or the National Steering Committee, as the case may be. The due diligence involves a detailed review of the findings arising from the diagnostic tool, an inception and closing meeting with the National Steering Committee, meetings with representatives of the Ministry of Finance, the securities market regulator, the banking regulator, the insurance companies and other nonbanking financial institutions regulator, higher educational institutions, professional accounting bodies, listed companies, financial institutions, other public interest entities, and institutional investors. In addition, the due diligence involves a roundtable with the major auditing firms in the country to discuss the issues faced in the conduct of audit engagements.

22. Upon completion of the due diligence, the ROSC A&A team prepares a report presenting the factual findings arising from the review and makes policy recommendations to help the country enhance its accounting and auditing standards and practices.

⁹ ROSC A&A team members are comprised of World Bank financial management specialists with specific country/regional expertise and other experienced Bank staff who have conducted ROSC A&A reviews in several countries.

23. The National Steering Committee reviews the draft report prepared by the ROSC A&A team. The ROSC A&A team may also organize a workshop where various national stakeholders, including members of the National Steering Committee would discuss findings of the review and policy recommendations. The deliberations in the workshop should lead to improved policy recommendations.

24. The final draft report is prepared taking into account comments received from the National Steering Committee and submitted to the country authorities for comments, approval, and permission to publish. Once agreed, these reports are published on the Web site of the World Bank.¹⁰

IV.4 Development of a Country Action Plan

25. After approval of the final report by the country authorities, the National Steering Committee meets and prepares a country action plan. If requested by the country authorities, the World Bank would assist in developing the country action plan. The country action plan should address the most significant areas for improvement. With a focus on specific, realistic, and achievable objectives, the action plan derives success from country ownership. The NSC may oversee its implementation.

IV.5 Implementation of the Country Action Plan

26. The ROSC A&A report and country action plan can contribute to the design of loans, assist in the preparation of key policy documents, and provide benchmarks for the design and monitoring of technical assistance and capacity-building programs. If requested by the authorities, the World Bank would assist the country in gathering resources for implementation of the action plan. It is worth mentioning here that **long-term developmental programs are necessary** for achieving results from accountancy reform initiatives. An appropriate **lending instrument of the World Bank** can be helpful in creating development impact. During the interim period between completion of the ROSC A&A and launching of a long-term developmental program, implementation of some elements of the country action plan may commence with financial assistance from one of the following two facilities:

- *Institutional Development Fund (IDF)*—a World Bank grant facility designed to finance quick, discrete, action-oriented, generally innovative, upstream capacity-building activities that are identified during (and closely linked to) the World Bank’s policy dialogue and economic and sector work; and
- *Financial Sector Reform and Strengthening (FIRST) Initiative*—a new multidonor program, supporting capacity building and policy development through technical assistance grants for short- and medium-term projects in the areas of financial sector regulation, supervision, and development.¹¹

¹⁰ See http://www.worldbank.org/ifa/rosc_aa.html.

¹¹ See <http://www.firstinitiative.org/>