

Complacency vs Reform:

ACCA Position Paper on the G20 Summit September

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ACCA's role

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We have 131,500 members and 362,000 students across the world, including 206,000 members and students in G20¹ countries such as the UK, the Republic of China, Russia, Australia, Canada, the US, Mexico and South Africa. We support our members and students throughout their careers, providing services through a network of 80 offices and centres around the world.

We use our expertise and experience in areas such as tax and finance to work with governments, donor agencies and professional bodies to develop the global accountancy profession and to advance the public interest. By promoting our global standards, and supporting our members wherever they work, we aim to meet the current and future needs of international business.

Our staff around the world have been working with members and others in the financial services sector to develop the network necessary to understand the financial crisis from the perspectives of governance, remuneration, regulatory and accounting stances. ACCA has played an active role in influencing the G20 discussions, including the production of our position paper: *The G20 summit*, April 2009², a paper which included analysis and recommendations to leaders and policy makers in advance of the meeting.

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1. Included in the G20 are Argentina, Australia, Brazil, Britain, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey and the United States. The 27-nation European Union bloc is also a member of the grouping.

2. http://www.accaglobal.com/pubs/publicinterest/pressandpolicy/unit/global_briefings/g20.pdf

Executive summary

In spite of the embryonic signs of recovery, there will be many challenges facing G20 leaders when they meet in Pittsburgh in September. The first will be to ensure that they are not too optimistic. The IMF and World Bank are still predicting declining growth and contracting output around the world, and the outlook according other indicators such as unemployment will remain gloomy. Although the steps taken so far may be beginning to yield results, much more work is still needed to ensure the recovery.

Any optimism may actually go further than stopping the recovery in its tracks – it could reignite the financial crisis. Leaders and economic policy makers will need to ensure that they balance their approach: large government deficits could generate inflation and make it more expensive to borrow on international markets. But implementing a shift toward policy restraint too early will impact with considerable force on the fragile recovery.

A further challenge facing world leaders will be the waning momentum for change. As some indicators begin to pick up, public and political pressure to push through reforms is decreasing and there is a danger now that the impetus for radical and necessary change will be lost. The result of this would be that, except for a few cosmetic changes, the global economy will emerge from this recession looking much as it did before, only smaller and with more people alienated, unemployed and angry.

Reform, for example, of the Bretton Woods institutions is something that is not only important – it is something that has to be implemented more quickly. The Western powers need to face up to political reality and offer a reform of governance that properly reflects the distribution of power in the new global economy. Without these reforms, developing economies, particularly countries such as China and Brazil, may begin to reject the institutions on the basis that they are not representative enough to efficiently pursue their primary objectives, ie stability of the international financial system and the fight against poverty.

The scale of the current crisis has been associated with inadequate regulation and supervision of banks and financial markets. But ACCA believes that rushing through new financial regulation in a purely reactive response to the financial crisis would be a mistake. The priority should be to ensure that existing regulation is enforced thoroughly, and ACCA sets out later in this paper a number of principles which we believe should be reflected in the future design and administration of regulatory systems in the financial and business sectors.

There have also been many political criticisms relating to fair value accounting rules, alleging that they caused some of the market volatility and may have been a factor in the financial crisis. ACCA does not believe that fair value caused the financial crisis, and sets this out later in more detail. ACCA firmly believes that at this critical time, the G20 must show leadership and commitment to the principle of an accountable, transparent and sound system of international regulatory cooperation, maintaining full support for the move towards a single set of high quality international accounting standards. The globalisation of business means that one set of reporting standards, the principles-based IFRS, is essential. ACCA is also concerned that political interference in the standard process is more prevalent, and warns against anything that impacts on the integrity of the standard-setting process

In addition to bigger businesses, SMEs are vital to driving economic recovery through the role they play in creating jobs, innovation, and macroeconomic growth. It is crucial that G20 Government leaders recognise the importance of SMEs and find more ways to collaborate and partner with business, civil society and governments in encouraging institutional changes to help improve the operating environment for SMEs.

Finally, ACCA has been concerned at the lack of concrete proposals to invest in a low-carbon economy that have come out of the two previous G20 Summits, and, without pre-empting the COP 15 summit in December, this is something that leaders should address in Pittsburgh. While politicians struggle to retain votes and work economies out of recession, it is crucial that they acknowledge the climate crisis as well. Acting early, as key policy documents, economic forecasts and project proposals are urging, will raise our chances of diverting catastrophe at a reduced financial and environmental cost, while building a strong green economy.

Context

The meeting of the G20 in September 2009 will be the third meeting of world leaders at this level to discuss how to resolve the financial crisis.

The London Summit, in April 2009, saw a number of agreements reached as part of a plan for reviving growth and stabilising the financial system. The agreements were summarised in a nine page communiqué, which stated:

'Our message today is clear and certain: We believe that global problems require global solutions.'

The agreements reached at the G20 summit in April 2009 included: the regulation of hedge funds, credit ratings agencies, tax havens and a review of accounting rules. The highlight of the deal reached at the summit, is an injection of £1.1 trillion (€810bn) of resources for the International Monetary Fund (IMF) and other international institutions – the biggest increase in their history.

These agreements represented a strong start in dealing with the financial crisis in a coordinated way, and in preventing a future crisis, although there are areas where more detail or commitment would have been useful. It is also crucial that reforms to the way the financial services sector is regulated forestall future crises, rather than simply focussing on past failings in the system.

Following on from this, the overarching aims of the September Summit will be:

- to review progress on the financial and other commitments reached at the November 2008 and April 2009 summits
- to ensure that efforts to make 2010 a year of sound and sustainable recovery from the severe global economic crisis are on track or whether further measures are needed.

Assessing the current situation

Many of the decisions taken by the G20 leaders at the London summit are in the process of being implemented, and it is likely that there will be some signs of recovery. However, leaders should ensure that they are not too optimistic. The IMF has projected a contraction of 1.3% in world output this year¹ and the World Bank has predicted that GDP will decline by 3% in OECD countries and by 2% in other high-income economies². Much more work is still needed to ensure the recovery.

FISCAL STIMULUS

Most of the countries in the G20 have announced fiscal stimulus measures, with policymakers in G20 economies acting on the joint announcement in November 2008 to use fiscal stimulus in a coordinated manner to boost economic activity.

The total fiscal stimulus in the G20 amounts to approximately \$692 billion for 2009, (equivalent to c.1.4% of their combined GDP and a little over 1.1% of global GDP).³ Although this is a significant amount, it may fall short of what is needed to effectively tackle a crisis of the size we are currently in. The IMF, for instance, has called for stimulus equal to 2% of global GDP.⁴ Some, including Barack Obama, have pushed for a greater stimulus, and this is something that may be reconsidered at the Pittsburgh Summit.

However, although fiscal stimulus can play an important role in stabilizing the world economy, questions remain about its effectiveness, especially in economies where the financial system has broken down and where monetary policy can no longer play much of a supporting role. Moreover, excessive government borrowing to finance large budget deficits could itself generate instability and there are serious concerns about the medium-term sustainability of fiscal positions in economies that are building up public debt at a rapid pace.

Given the economic situation and the lack of other tools, G20 leaders will need to assess the current position and carefully consider the need for further any global fiscal stimulus.

REDUCING PUBLIC DEBT

World financial leaders are starting to consider how to unwind their emergency spending packages and bank rescues once the financial crisis bottoms out. Indeed, economic policy makers are facing a serious challenge. Large government deficits could generate inflation and make it more expensive to borrow on international markets. But implementing a frugal approach too early could damage any recovery. What is certain is that it is too early to shift toward policy restraint. Government cutbacks would impact with considerable force on the fragile economy. Cuts in government spending, especially in Europe and the US, will arrest recovery.

The IMF warned in a report in June 2009 that:

*'The sombre fiscal outlook raises issues of fiscal solvency, and could eventually trigger adverse market reactions. This must be avoided: market confidence in governments' solvency is a key source of stability and a precondition for economic recovery. Therefore, there is an urgent need for governments to clarify their exit strategy to ensure that solvency is not at risk.'*⁵

In response to this, finance ministers from the G8⁶ countries asked the IMF on June 13 to research strategies to reduce budget deficits and government presence in the financial sector, focusing on methods that would not reignite the crisis. ACCA fully supports this strategic approach.

1. <http://www.imf.org/external/pubs/ft/survey/so/2009/RES042209A.htm>

2. <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/0,,contentMDK:22122200~pagePK:64165401~piPK:64165026~theSitePK:469372,00.html>

3. http://www.brookings.edu/articles/2009/03_g20_stimulus_prasad.aspx

4. <http://www.imf.org/external/pubs/ft/survey/so/2008/INT122908A.htm>

5. <http://www.imf.org/external/pubs/ft/spn/2009/spn0913.pdf>

6. The Group of Eight governments of eight nations of the northern hemisphere: Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States; in addition, the European Union is represented within the G8, but cannot host or chair.

COMPLACENCY VS REFORM

The global economy is beginning to show signs of emerging from the financial crisis. However, the real economy is still hurting and will be for some time longer. The economic definition of recession is, of course, a contraction in national output. But as GDP starts growing again in both Britain, the rest of the EU, and the US, there are many other indicators, especially unemployment, that will not turn around quickly – and the GDP growth that does appear will be weak at best. Even though the recession will technically be over, the problems that came with it will not end for the mass of people affected by the downturn.

However, with the decreasing urgency and the waning of public interest in carrying out reform, political pressure for radical reform will ease, and there is a danger now that the impetus for it will be lost. The result of this would be, that with a few cosmetic changes, the global economy will come out of this recession looking much as it did before, only smaller and with more people unemployed and angry. Has the moment for real reform passed? There has to be a push for change for change to happen and the tide is already going out on the issue of corporate governance, for example. At risk of seeing a repeat of the events that led to the current financial crisis, we cannot allow the response to be complacent.

Leaders around the world said it often: a return to the status quo is not an option. Barack Obama, for example, called for:

'...a 21st century regulatory framework to ensure that a crisis like this can never happen again'⁷

saying that financial regulatory reform will be one of the top legislative priorities of his Administration.

The financial sector is acting overconfidently to show the government that it can make money again, and to prove that it should not have its hands tied by regulation. The fact remains, however, that government intervention saved the day and kick-started any recovery. Taking too complacent an approach at this stage may see a repeat of the current situation in the future.

7. Announcing the nomination of Mary Schapiro as chair of the SEC and Gary Gensler as chair of the Commodity Futures Trading Commission, 18 December 2008.

The regulatory response

In ACCA's view, the immediate focus should be getting finance flowing through the global economy again, rather than on regulation. However, regulation is, of course, high on the political agenda and ACCA has published a paper, *The Future of Financial Regulation*,⁸ which incorporates comments provided by many senior figures from the finance industry and accountancy profession in major capital markets around the world. The paper sets out in the first instance to explain the nature of the financial crisis and in the second, sets out a number of principles which ACCA believes should be reflected in the future design and administration of regulatory systems in the financial and business sectors. These include:

1. THE PURPOSE OF REGULATION

There needs to be a clear understanding of the purpose of regulation. This should be to facilitate legitimate business activity while providing essential safeguards for the interests of stakeholders and ensuring fair competition in the market. In order for regulation to be credible and effective, authorities need to have a thorough understanding of the businesses and markets they are supervising.

2. COMPETITION

Governments and national and regional authorities should regard the promotion of healthy competition in the market place as being crucial to the enhancement of the potential effectiveness of their regulatory systems. The international response to the global banking crisis must address the issue of whether governments and regulatory systems may have contributed to the scale of the crisis by allowing entities to become ever larger and more powerful. This process has led to questions as to whether those entities have become too big to regulate, and too big for governments to allow to fail. It is clear that the concentration of market power in the hands of a few very large entities has presented very significant challenges to regulators and will continue to threaten the effectiveness of regulation unless steps are taken at the policy level to address this trend. One means of addressing this issue would be to consider separating wholesale and retail banking activities.

3. STANDARDS OF BUSINESS CONDUCT

Companies should be expected to carry out their activities in accordance with high standards of business conduct, in line with the following conclusion of the G20 meeting of April 2009:

'Strengthened regulation and supervision must promote propriety, integrity and transparency.'

The adoption of a firm commitment to an ethical corporate culture would not only help to protect the interests of shareholders and external stakeholders but would help to achieve internal and external transparency and help companies tackle the various threats to commercial operations, such as fraud and bribery.

4. CORPORATE GOVERNANCE

Boards, shareholders and, where appropriate, other stakeholders should have a common understanding of the purpose and scope of corporate governance. In other words, they should all appreciate the ultimate aim of securing long-term prosperity for the company concerned; to this end, each should play his own part in the process while recognising the special interest and rights of the others. The financial crisis has suggested that there are problems with regard to, for example, the way that companies engage with their shareholders and stakeholders and the extent to which shareholder groups monitor the actions and plans of their directors. In particular, though, serious questions have been posed about the ability of non-executive directors to fulfil their main function of exerting effective supervisory control over the executive.

8. http://www.accaglobal.com/general/activities/library/financial_reporting/other

5. ACCOUNTABILITY

Companies should be expected to account for their activities transparently, thoroughly and with due regard for, as appropriate, the demands, rights and information needs of their stakeholders.

There are legitimate concerns about some aspects of financial reporting. The accounts of banks in particular have become so detailed, complex and lengthy that their capacity to meet the information needs of most investors is being questioned. Some commentators have also criticised the role of accounting standards (and in particular the concept of 'fair value') in the banking crisis – something which this paper addresses in more detail later. A related issue which has been raised at government level is whether accounting standards should in future be framed so as to meet the information needs of regulators, rather than investors. ACCA considers that, whatever their perceived faults, the current rationale of accounting standards is the correct one. If regulators need other, specific information they should seek it via separate, prudential requirements.

The process of external audit remains the principal means whereby shareholders and the markets receive independent, external assurance about the way that boards manage their companies; regulators and the auditing profession should be prepared to explore the potential that external audit has for adding new value to the regulatory process, whether through changes in the nature of an audit or extensions to its scope.

6. INCENTIVES

Remuneration schemes for directors and employees should be integrated into a company's strategic plans and should be careful not to distort behaviour which could be detrimental to the long-term interests of the company; in particular, incentive schemes should be linked, primarily, to the achievement of longer-term shareholder value by the company as a whole. The regulatory authorities should keep under review the extent to which their own rules influence short-termist pressures on remuneration. They should further consider the pressures which fund managers and market analysts may exert on companies in relation to the time-scales linked to incentive awards, and whether such pressures are detrimental to the achievement of regulatory objectives.

7. FUNDING

Companies in the financial sector should be required to have capital structures and levels of liquidity which correspond to the scale and the level of risk inherent in their activities and which make reasonable provision for changes in economic circumstances. International regulatory authorities should pursue a co-ordinated approach to the definition of optimal capital levels for the major retail banks. As an integral part of any new regime on capital requirements, the system of regulation needs to build in safeguards which will help protect against future repetition of boom and bust cycles.

Reform and modernisation of the IMF and the World Bank

ACCA firmly agrees with UNCTAD and World Bank that the developing countries must be given a safety net in any revised global system of regulation. The emerging economies in Africa, Asia, Latin America and Central and Eastern Europe have a huge role to play in terms of boosting the world economy. It is essential that their interests are fully recognised.

One concrete way of doing this is by undertaking a thorough review of the international bodies such as the IMF and the World Bank, two of the three legs of the 'Bretton Woods stool'. Just as the G7 has become the G20, all global bodies need to take on board modern realities. Indeed, G20 leaders have already agreed in the communiqué following the April 2009 Summit that:

*'We will reform their mandates, scope and governance to reflect changes in the world economy and the new challenges of globalisation, and that emerging and developing economies, including the poorest, must have greater voice and representation.'*⁹

The US and Europe have agreed to bring forward a review of IMF voting weights to 2011, but the last review, after two years of negotiations, only succeeded in raising China's quota to 3.6% – which is just larger than Italy's.

The IMF, has, due to the financial crisis, been given greater resource and more power to help countries around the world, seeing a trebling of the size of its resources. But China and the other so-called BRIC countries (China, India, Brazil and Russia) are unwilling to finance an organisation over which it has little or no influence, and are demanding governance reform now.

It is reasonable for countries like Brazil and China to prevaricate in handing over cash to the IMF until the governance structure is opened up. The decision-making structure of these institutions is undemocratic. For example, if we consider the World Bank, the US effectively has a veto on some constitutional decisions as it owns just over 16% of the shares in the bank and decisions can only be passed with votes from countries whose shares total more than 85% of the bank's shares.

Similarly, the IMF also stands accused of being for the most part controlled by the major Western powers, with voting rights on the Executive Board based on a quota calculated according to the relative size of a country in the global economy. The US has 17%, in effect giving it veto power, preventing other countries from reaching the 85% of the votes needed to pass significant policy changes. The combined voting shares of China, India, Brazil and Mexico are a little over 10%.

Reform is something that needs to move faster. Ultimately, the Western powers need to face up to political reality and offer a reform of governance that properly reflects the distribution of power in the new global economy. Without these reforms, developing economies, particularly those in Asia and South America, may begin to reject the institutions on the basis that they cannot efficiently pursue their primary objectives, ie the stability of the international financial system and the fight against poverty, without being more representative.

9. G20 communiqué <http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409>

Accounting standards – Fair Value, IFRS vs GAAP

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

There have been political criticisms that fair value accounting rules caused some of the of the market volatility. Indeed, fair value has come in for more scrutiny and criticism recently than any accounting issue since inflation accounting in the 1970's, after banks and financial institutions placed some of the blame for the current crisis on so-called 'mark-to-market' valuation methods. As a consequence of this scrutiny, the EU has persuaded the IASB to revise its rules on fair value accounting. Some countries now want the EU to go further to seek exemptions from the international standards. However, this would be a serious step backwards.

In the interest of establishing a valid internationally accepted standard rather than continuing with or reverting to disparate sets of regional rules, the focus should be on ensuring that IFRS continues to be a high quality, largely principles-based accounting language. An essential requirement for this is that the governance and process arrangements for the IASB (as the standard setting body), and its parent foundation, the IASCF, are in proportion to the global reach of their standards.

ACCA believes that globalisation of business means that one set of reporting standards is essential. We favour the principles-based IFRS and support the principle of an independent, but widely consultative, standard-setting body. The G20 has already expressed support for the creation of a single set of global accounting standards:

'...work intensively toward the objective of creating a single high-quality global standard'.¹⁰

However, there is growing unease within the accountancy profession regarding the differences emerging between the FASB and IASB and Mary Shapiro's recent statements on US financial regulation. Shapiro has recently expressed concerns about the direction of IFRS and has reportedly written a letter saying she is not prepared to delegate standard setting outside the US.¹¹

IFRS sets out to provide a single set of high quality and internationally accepted accounting standards, developed after due process and consultation by an international standard setter that seeks to reflect the changing distribution of world economic activity. IFRS is helping to make financial information more transparent and comparable across countries, industry sectors and companies. In doing so, it improves investor information, comparability and investment choice.

There are of course many challenges in moving towards a single set of agreed global accounting standards and concerns about the alleged complexity and procyclicality of IFRS must be addressed. But a fragmented system of financial reporting will not address such concerns and will simply hamper comparability and limit the transparency which is essential to investors in financial markets. More importantly, to step back from the goal of a single set of global accounting standards would signal a move away from the very principles which the G20 wants to underpin the long-term international response to the problems highlighted by the financial crisis. This would seriously undermine the credibility of the G20 governments as architects of a coordinated global financial infrastructure.

As IFRS is adopted internationally, there is a growing risk of local variations being introduced thereby undermining the objective of comparable, high quality financial reporting throughout the world.

With the future of the US IFRS roadmap uncertain and the global development of IFRS in question, G20 leadership is essential for maintaining commitment to a global solution and in seeking to avoid national or regional versions of IASB-issued IFRS.

10. Declaration of the Summit on Financial Markets and the World Economy, Office of the Press Secretary, the Whitehouse, 15 November 2008

11. <http://www.accountancyage.com/accountancyage/comment/2236761/schapiro-stance-threat-recovery>

FAIR VALUE

ACCA's paper *Fair Value*¹² points out that the scale of political disquiet may suggest that fair value affects more businesses than is actually the case in practice.

The fact that fair value is the only realistic method of accounting for derivatives and getting them on the balance sheet is evidence enough of its worth. The crisis has shown the urgent need for clarification of what accounts can and cannot do so that realistic expectations of different stakeholders can be met. But the IASB should never again be put in the position of having to abandon due process under political pressure.

The paper states the global financial crisis poses many questions for standard-setters, but any watering down of fair value risks spelling the demise of the roadmap towards convergence between IFRS and US accounting standards. Global standards, which allow easier comparability of markets for investors will be of even more importance as the world economy recovers.

- Fair value accounting has significant advantages, but current illiquid markets have highlighted problems of attributing reliable values to financial instruments and derivatives.
- Therefore IFRS should continue to employ a mixture of cost and current value measurement bases - overall ACCA see no case for the extension of the use of fair values in accounting standards at present, particularly in areas where markets are non-existent.
- Historical cost could also be disclosed in the accounts if fair value is being used so that users can make up their own mind on the stated values of assets. Accounts are intended to inform shareholders on the affairs of the company, not to provide a financial stability tool for regulators.

12. <http://www.accaglobal.com/allnews/global/2009/NEWSQ1/News/3190155>

POLITICAL INTERFERENCE IN INTERNATIONAL STANDARD SETTING

The accountancy profession's international standards setters are under pressure from national interests, and ACCA is becoming increasingly concerned at political interference in the standard-setting process.

The IASB for example, has come under pressure from the European Commission, as well as the French and German governments, to relax the IAS 39 standards on asset impairment, while FASB has been pressured by Congress to loosen FAS 157 standards on fair value and mark-to-market accounting.

The IASB and FASB last year set up an international body, the Financial Crisis Advisory Group (FCAG), to advise them on the standard-setting implications of the global financial crisis and potential changes to the global regulatory environment. Members of the FCAG warned at a meeting in London¹³ that political pressure on accounting standard-setters posed a threat to:

'...the very existence of international accounting standards'.

Giving in to political pressure on some crucial rules risks damaging the credibility of not only the standard-setters, but also the integrity of the accounting standards, which should be set by experts who justify their decisions appropriately, in the way that central banks set interest rates independently of politicians.

The reliability and predictability of accounting standards are key prerequisites for a sustainable and well functioning capital market, and robust accounting standards are essential for a speedy recovery from the financial crisis. It is important that the integrity of standards is maintained in a transparent way or we may be setting the scene for future financial crises. Indeed, the desire of governments to gloss over risks in the financial system as they increased during the boom years led indirectly to the subsequent bust.

While politicians have a responsibility to ensure there is an effective system for setting accounting standards, decisions relating to accounting methodologies should not be made on political grounds, but should be left to those who have the necessary expertise. Within this context, however, ACCA also acknowledges that standard setters themselves should ensure they consult widely and develop standards appropriate both to business and the wider environment in which business operates.

13. On 26 May 2009.

ACCA believes that the role of fair value should be carefully examined in the context of a wider review of the role of accounts and financial statements. 'Knee jerk' reactions in terms of watering down its impact, are the wrong response. We should not be shooting the messenger. Any attempt to reduce transparency of accounting should be resisted: rather, the opposite should apply. Transparent accounting is in the interests of all stakeholders in business, including the wider public.

THE ROLE OF AUDIT

It is right that the accountancy profession comes under scrutiny, and that account preparers, standard-setters and auditors should all learn from the events of the last year. The accountancy profession has to consider what it can improve to ensure the current circumstances are not repeated in the future. It is no use the global profession signing a clean bill of health for itself at this time without acknowledging that there is also scope to consider what it can improve.

ACCA believes that, as famously stated in *Re Kingston Cotton Mills* case in 1896, by L.J. Lopes of the Appeal Court: the auditor is:

'a watchdog but not a bloodhound'.

However, there is scope for the profession to look at wider areas of assurance. A review of the business model and risk profile of the organisation would be one area to consider.

Above all, the profession has to acknowledge the expectations gap which exists and consider ways of improving education among those who rely on the audit as to what it can or cannot achieve.

Audit instils discipline, financial rigour, better corporate governance and can deter fraud. It is part of the operating fabric of the economy, and the success of capital markets is dependent on there being a competitive and stable audit market. However, there is much evidence showing that the public around the world and other users of financial statements do not understand what the role of audit is. Indeed, many believe that the role of an auditor is to detect fraud and error in financial statements.

How to resolve this issue has been the subject of much debate. Possible ways forward include:

- broadening the role and responsibility of auditors in the areas of fraud detection
- further strengthening the independence of auditors and improving financial disclosure
- providing wider education to the public and users of financial statements on the limitations of an audit.

The financial industry and all involved in it need to learn the hard lessons from the past year and be bold enough to make the changes needed to climb out of the financial crisis – and make sure the mistakes made are not repeated.

Climate change

Recent projections from the Intergovernmental Panel on Climate Change (IPCC) warn that unless action is taken to cut greenhouse gas emissions, global warming will exceed the danger level of a 2°C increase. According to the IPCC's worst-case scenario, climate change could reach dangerous levels as early as 2050. Current assessments show that this is likely to happen. Unprecedented action is required nationally, regionally, and internationally to address this.

In the light of this, the 'green' lobby and others were disappointed with conclusions of the April G20 Summit, pointing especially to the weak language and lack of concrete commitment to environmental measures including low-carbon recovery projects. WWF, for example, stated in their response that:

*'Today's meeting was a huge missed opportunity for the G20 leaders. They failed to position sustainability at the core of their efforts to restructure the world's economy.'*¹⁴

Indeed, none of the \$1.1 trillion stimulus package was allocated for environmental investment, and no other environmental agreements were made. We recognise that leaders will not have wanted to preempt COP 15 in Copenhagen. This will aim to bring in a follow up to the 1997 Kyoto Protocol, which promotes the use of market based solutions to climate change, such as the EU's Emissions Trading Scheme. In spite of this, ACCA is concerned at the lack of concrete proposals to invest in a low-carbon economy coming out of the G20 summit.

While politicians struggle to retain votes and work economies out of recession, it is crucial that they acknowledge the climate crisis as well. Acting early, as key policy documents, economic forecasts and project proposals are urging, will raise our chances of diverting catastrophe at a reduced financial and environmental cost, while building a strong green economy.

For pessimists, the current economic downturn has substantially delayed green economy plans, with governments now pre-occupied with the recession and focusing on fiscal stimulus measures. There is an increased reluctance by countries to commit resources to climate change policies and taking measures which (in the short-term) will harm the competitiveness of domestic industries. The phenomenal financial bailout has prevented any large scale investment in climate change mitigation and the green energy sector. The economic downturn will lead to a decline in direct investments and reduce the rigour of future climate change legislation and environmental taxes to protect the competitiveness of industry in the dire financial climate.

For optimists, the twin crunches of climate and finance have led to a unique opportunity to re-build the global markets with systems sympathetic to climate change, that value societal and environmental costs, and that are sustainable in the truest sense. The trillion dollar banking sector bailout is proof that governments can work together, quickly, to help resolve global catastrophes.

ACCA believes that the fight against climate change must remain a priority even in difficult economic times, which could actually provide a golden opportunity to encourage investment in a low-carbon economy, specifically in energy-efficient technologies and renewable energy and in creating lower-carbon growth and green jobs. But developing a global framework to address climate change needs to be a collaborative effort between government, business, scientists and society, to promote a common understanding across all stakeholder groups of the issues at hand and how they should be addressed.

- Countries need to act individually of course, but also need to take coordinated global steps.
- We need to secure a new global agreement that includes China and the US.
- We need to create laws and regulations that protect the environment without damaging trade and economies. Good laws create market opportunity – we need incentives for positive action.
- We need to design markets which promote technological and behavioural responses.

The global nature of climate change calls for global action.

14. http://www.wwf.org.uk/what_we_do/press_centre/?2926/WWF-Response-to-G20-Communique

SMEs

Small and medium sized enterprises (SMEs) are an important part of developed and developing economies. They play an important role in creating jobs, innovation, supporting stability, macroeconomic growth and also act as a growth engine. In OECD countries, SMEs represent 95% of all enterprises, accounting for two thirds of employment and representing the main source of new job creation.¹⁵ As such, SMEs in many countries around the world are the major source of economic recovery and assist the return to sustainable growth. SMEs need special attention in the current financial crisis.

SMEs are particularly badly affected in times of financial crisis, due to the reduced demand for products and services, sudden rises in the prices of raw materials, energy and food, liquidity and credit related problems, variations in exchange rates, inflation, and still are subject to a relatively high cost of capital. Access to finance continues to be one of the most significant challenges for the creation, survival and growth of SMEs, especially those that are innovative. Start-ups in particular are most vulnerable, often lacking the resources to survive the downturn.

In addition the uneven application of regulatory and legal frameworks which have primarily been designed for large listed companies leads to market failure and requires governments to intervene to support these important contributors to the economic well being of countries. SMEs will require effective short-term measures to address these financial and other aspects that are apart of their business environment. It is critical in these circumstances that regulators think small first.

SMEs need more urgency on measures to help restore confidence, on issues such as late payments, access to finance and employment support measures. These will need, however, to be linked to structural improvements in the SME financial environment over the longer term in order to be successful and to restore growth

The current economic context is a unique opportunity for G20 Government leaders to find more far-reaching ways to collaborate and partner with business, civil society as well as between governments, to pool efforts to build infrastructure, build social capital and encourage institutional changes and help improve the operating environment for business.

Governments need to ensure that the SME interests are adequately represented within government. Separate agencies, with strong influence and links within government, that deal with small business policy and manage government intervention relating to business

support may be needed in order to ensure a focused policy and a clear point of contact. Ensuring that small businesses have a strong voice within government is crucial to ensuring a small business friendly environment. Regulation, for example, is a key area for creating the right environment both for entrepreneurship and for business to prosper. World Bank research has found that countries with burdensome regulation have larger informal sectors, higher unemployment, and slower economic growth.¹⁶

Working collaboratively, G20 Governments can do more to support host governments in developing and emerging markets with the development of enabling frameworks that encourage responsible private sector investment. For example, by supporting efforts to put in place effective regulatory and voluntary standards; legal frameworks; funding and investment vehicles; policy consultation mechanisms; accountability structures; and civil society networks.

G20 Governments can also support the creation and strengthening of local business associations, chambers of commerce – which are often weak or non-existent – as well as essential ‘institutional infrastructure’ (linkage programmes, skills/training programmes) for SME development.

Although, much of the emphasis is on Governments to act ‘locally’ to the problems confronted by SMEs during this crisis there are important issues that have a global dimension and need to be addressed to ensure the sustainability and growth of the SME community. For example, the level of SME cross border activity is increasing year on year through the development of technology and communication. It is important that SMEs are protected against external events that are out of their control such as fluctuations in exchange rates.

15. *SME and Entrepreneurship Outlook*, OECD, 2005.

16. *Doing Business*, The World Bank, 2008.

Conclusion

The third meeting of G20 world leaders at the September 2009 Summit will arguably face an even more difficult task than the previous two meetings. It has to continue efforts to end the global recession against the background of waning public and political interest and to reform financial regulation with dwindling support from financial institutions around the world. But if the G20 Summit in Pittsburgh makes progress on only three things, ACCA recommends that they be making better regulation, accounting standards and climate change.

Leaders at the April 2009 Summit committed themselves to achieving higher levels of co-operation between authorities in their different countries and consistency in regulatory practices. ACCA believes that the regulation of the financial sector will be enhanced if coordination in matters of controls and standards can be achieved in practice. Learning from best practice is one way to achieve this. Another is more regular formal and informal forums where national regulators could discuss issues of common interest, particularly at regional level where there may be common cultural understandings.

At its April Summit, the G20 identified accounting standards as one of several priorities to strengthen financial regulation. ACCA welcomes the G20's endorsement of a single set of high-quality global accounting standards. We recommend implementation of the principles-based IFRS as the global accounting language for all finance professionals, because they bring transparency, comparability and clarity to reporting. We also believe that IFRS are a practical example of implementing a global solution to a global challenge.

Accounting standards are likely to remain at the heart of the debate on reforming financial regulation, and ACCA has two key recommendations to policy makers on this area. With the future of the US IFRS roadmap uncertain and the global development of IFRS in question, ACCA believes that G20 leadership is essential for maintaining commitment to a global solution and in seeking to avoid national or regional versions of IASB-issued IFRS. We encourage leaders to take a stand on this issue, but also warn against political interference in standard setting.

Finally, on climate change and sustainability, the pursuit of economic growth at the cost of everything else cannot continue, and ACCA recommends that governments respond to the recession by implementing measures that will encourage environmental investment and ultimately, a more sustainable approach.

ACCA will continue to engage with and lend our expertise to forums such as the G20, in order to assist in finding a way out of the global financial crisis. As an accountancy body operating across the G20 countries, ACCA will seek to address the challenges posed for the global economy, not least the need to ensure appropriate regulation which favours fair competition, capital investment and economic growth.

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