Report on the Observance of Standards & Codes (ROSC) Accounting & Auditing (A&A)

REVISION OF THE DIAGNOSTIC TOOL – SUMMARY NOTE

WORLD BANK GROUP
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1. INTRODUCTION

The Reports on the Observance of Standards and Codes (ROSC) Accounting and Auditing (A&A) program is a part of the joint World Bank-International Monetary Fund (IMF) initiative on assisting member countries to strengthen their financial system by improving their capacity to comply with important internationally recognized standards and codes.

The Standards and Codes initiative was developed in the wake of the financial crises of the late 1990s as part of a series of measures to strengthen the international financial architecture. The international financial community selected a set of twelve standards and codes that, if properly adopted and implemented, provide a framework to strengthen domestic institutions, identify potential vulnerabilities, and improve transparency.

There is widespread recognition that implementation of robust standards not only helps financial stability but also contributes to the economic functioning and efficiency of a country’s institutions that underpin the market economic system. Ultimately, such standards enhance countries’ resilience to shocks and support better risk assessment and investment decisions.

The A&A module covers the two corresponding, globally accepted standards which have been officially endorsed as the international standards for financial reporting and auditing in the ROSC initiative: International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA).

As of August 2016, 155 ROSC A&A reports had been prepared, with the following regional break-down:

<table>
<thead>
<tr>
<th>Region</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFR</td>
<td>48</td>
</tr>
<tr>
<td>EAP</td>
<td>14</td>
</tr>
<tr>
<td>ECA</td>
<td>47</td>
</tr>
<tr>
<td>LCR</td>
<td>28</td>
</tr>
<tr>
<td>MNA</td>
<td>9</td>
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<tr>
<td>SAR</td>
<td>9</td>
</tr>
</tbody>
</table>

Of these 155 reports, 141 have been published and are available on the Bank’s external website (http://www.worldbank.org/en/programs/rosc#2), or through Imagebank.

The ROSC A&A continues to be relevant to the Bank’s dual goals of eliminating extreme poverty and boosting shared prosperity. Indeed, in most partner countries, the private sector remains the primary engine of growth and needs capital and credit to fund productive investment and job creation. In turn, long-term investments and credit from financial institutions require investors’ and lenders’ trust in the financial situation of companies, and therefore, transparent, high-quality and comparable financial reporting.

From that standpoint, the issue of the quality of A&A practices is relevant to the new Sustainable Development Goals (SDGs), in particular Goal 8 (Promote inclusive and sustainable economic growth, employment and decent work for all) and Goal 9 (Build resilient infrastructure, promote sustainable industrialization and foster innovation). In a growing number of countries, companies have started reporting on their commitment to the SDGs, and they rely partly on their financial reporting systems for that purpose.

The ROSC A&A Diagnostic Tool was first developed in 2001. Whilst a number of relatively limited amendments and updates have been introduced over the years, this recent project is the first detailed revision of the Tool. The purpose of this note is to provide an overview of the key changes to the Diagnostic Tool.
In revising the Diagnostic Tool, the Bank pursued two main objectives:

i. **Update and improve the existing four-part diagnostic tool** to allow task teams to assess corporate sector accounting and auditing practices in a manner that is consistent and comprehensive; and,

ii. **Develop a set of guidelines** to help teams in planning and conducting ROSC A&A assessments using the revised diagnostic tool.

Upon completion of the revision exercise, the project team envisages the development of a suite of performance indicators to complement the diagnostic tool. These indicators would seek to succinctly communicate a country’s position on key aspects of a sound corporate financial reporting system to both technical and non-technical specialists, and to provide an objective means of measuring and tracking progress over time.

**2. CONTEXT AND RATIONALE FOR THE REVISION**

The revision of the diagnostic tool was motivated by the following considerations:

**Changing funding model for ROSC A&A assessments.** Funding for the ROSC A&A will no longer come from the global engagement budget, but instead from the country engagement budget. This change has not only affected the resources available for the ROSC A&A assessments, but has also heightened the need to raise the value proposition of the assessments vis-à-vis country management units and country stakeholders. Likewise, the new funding model has reinforced the need to align the ROSC A&A assessment and output to the needs of the countries being assessed, and the respective work programs i.e., lending and other ASA.

*Priori*, in practice, the change in funding model does not represent a major change in engagement dynamics within the World Bank Group. Regional teams are still responsible for identifying countries that would benefit from a ROSC A&A assessment. Likewise, the responsibility for meeting client demand for ROSC A&A assessments and thus ownership of the process, remains with regional teams.

**Enhancing completeness and consistency of the ROSC A&A assessments.** The existing diagnostic tool was developed at a time when several important features of modern corporate financial reporting had not yet been introduced (e.g., quality assurance and public oversight of the work of auditors, differentiated reporting for small and medium-sized enterprises (SMEs), including the issuance of the IFRS for SMEs). The tool was therefore missing important elements to allow teams to assess these new aspects effectively and in a consistent manner.

**Drawing lessons from the application of the diagnostic tool since 2001.** Experience from carrying out ROSC A&A assessments has shown that some of the sections in the existing diagnostic tool represented a very significant effort without corresponding benefits in terms of relevance and precision of the assessment. The diagnostic tool had already been undergoing changes and carve-outs in practice, on an *ad hoc* basis.

For example, in some countries, a simplified version of the former Part I questionnaire was produced to align with country circumstances. Parts II, III, and IV in the former tool (respectively, on the gaps between national accounting standards and IFRS; on actual compliance with IFRS; and on auditing standards as designed and as practiced) had become outdated and thus had not been used for several years. Other tweaks and enhancements to the diagnostic tool had also been carried out e.g., dedicated questionnaires for accountancy education and perceptions on the demand for financial reporting had been developed and used in some country assessments.
Strategic priority for the Bank. Given the importance of corporate financial reporting and A&A frameworks to governance, private sector development and financial stability, and the continued relevance of the WB-IMF joint initiative on Standards & Codes, the ROSC A&A program still represents a strategic priority for the Bank. Accordingly, it is critical to ensure that Bank teams conducting ROSC A&A assessments are equipped with relevant and up-to-date tools to prepare high-quality reports. In its 2010 report on Lessons Learned from the ROSC A&A Program, the Bank’s Operations Policy and Country Services (OPCS) department recommended a revision of the diagnostic tool and guidelines as a key priority to ensure the continued relevance of the tool.

Giving the assessment tool a stronger development focus. The experience of the last 10 years has shown that the issue of the quality of A&A practices is relevant not only to upper middle-income countries with developed capital markets, but also for countries who seek to improve their business environment to attract foreign direct investment and mobilize savings and finance to support productive and job-creating activities. Therefore, the diagnostic tool needed to be adapted to support assessments in countries that are still at an early stage of development of the A&A framework.

3. APPROACH

Revision of the diagnostic tool

• The project team updated the questionnaires from the previous diagnostic tool, taking into consideration current international standards and good practices in financial reporting and auditing, namely: IFRS, ISA, the International Federation of Accountants’ (IFAC) Statements of Membership Obligations (SMOs), International Education Standards issued by the International Accounting Education Standards Board, and other relevant benchmarks relating to supervision.¹

• Each revised questionnaire was then reviewed by two or three colleagues with experience in conducting ROSC A&A assessments and technical expertise on the subject matter. Their comments were taken into consideration by the project team, and a revised draft was then made available to a wider group of colleagues for further suggestions.

• The project team submitted the updated drafts of the questionnaires for peer review and endorsement by management and other stakeholders. The peer reviewers include internal as well as external specialists with expertise in financial reporting, auditing, and the ROSC A&A specifically.

• Elements of the draft diagnostic tool was tested in recent ROSC A&A assessments performed in Pakistan and Myanmar including the full suite of questionnaires under Module B. Feedback received from the task teams were incorporated into the DT.

Guidelines

• The guidelines were developed to accompany the revised diagnostic tool, to provide task teams with a roadmap to the key activities and considerations in conducting a ROSC A&A assessment, and to support the consistency and comparability of ROSC A&A reports.

• The guidelines are principles-based, and draw on the cumulative good practices and lessons learned from fifteen years of practical experience and the 155 completed ROSC A&A assessments. Helpful tips and templates to assist task teams have been provided. The Bank’s ASA directive (July 2016) and Accountability and Decision-Making (ADM) framework are also reflected in the guidelines.

¹ e.g., the Basel Committee’s Core Principles for Effective Banking Supervision or the International Forum of Independent Audit Regulator’s (IFIAR) Core Principles for Independent Audit Regulators.
The guidelines focus on the three main phases and corresponding activities once the decision has been taken to conduct a ROSC A&A in a jurisdiction namely: (i) initiation phase, (ii) implementation (assessment) phase and (iii) completion phase.

The draft guidelines were circulated for review by colleagues with experience in conducting ROSC A&A assessments ahead of submission for peer review and endorsement. A strong feedback mechanism will be put in place during the first two years of implementation of the revised ROSC A&A diagnostic tool in order to make adjustments if necessary.

4. OVERVIEW OF THE REVISED DIAGNOSTIC TOOL

The revised Diagnostic Tool comprises the following three modules:

<table>
<thead>
<tr>
<th>MODULE A. A&amp;A STANDARDS</th>
<th>MODULE B. INSTITUTIONAL FRAMEWORK FOR CORPORATE FINANCIAL REPORTING</th>
</tr>
</thead>
<tbody>
<tr>
<td>MODULE C. OBSERVED REPORTING PRACTICES AND PERCEPTIONS</td>
<td></td>
</tr>
</tbody>
</table>

An overview of each new module and corresponding sections is provided hereafter.

Module A: Accounting and Auditing Standards
Module A, which replaces the former Parts III (accounting) and IV (auditing) relating to “standards as designed”, is designed to help teams to compare (i) national financial reporting standards with IFRS and (ii) national auditing standards with ISA. Specifically, the tool seeks to capture significant differences, if any, in order to give readers of the ROSC A&A report a clear sense of where key areas of divergence lie, and to provide country counterparts with concrete suggestions for improving national standards and aligning them to the extent possible with IFRS/ISA.

The module comprises the following sections:

A.1 Financial reporting standards analysis
A.2 Auditing standards analysis

A.1 and A.2 provide a suite of checklists to help ROSC A&A teams in their assessment of key areas of divergence between national financial reporting standards (or “national GAAP”) and IFRS and national auditing standards and ISA, respectively. Decision trees are included in the guidance to A.1 and A.2 to assist teams in determining when and how to use the checklists.
In Section A.1 the areas selected for comparing national GAAP to IFRS are those deemed most relevant for assessing the quality of financial reporting standards for PIEs as part of a ROSC A&A and correspond to transactions that are inherently more complex from an accounting standpoint as well as to recently issued or revised IFRS. A specific checklist was developed for each of the following transactions/key areas to assist ROSC A&A teams in assessing key differences between national GAAP with the corresponding IFRS:

A. Presentation of financial statements (IAS 1)
B. Accounting policies, estimates and errors (IAS 8)
C. Revenue recognition (IFRS 15)
D. Impairment of assets (IAS 36)
E. Leases (IFRS 16)
F. Provisions and contingent liabilities (IAS 37)
G. Employee benefits (IAS 19)
H. Financial instruments (IFRS 9)
I. Business combinations (IFRS 3)
J. Consolidation and joint arrangements (IFRSs 10-12 and IAS 28)
K. Operating segments (IFRS 8)
L. Other topics: Fair value (IFRS 13); Income taxes (IAS 12); and Foreign exchange (IAS 21)

Although the effective date of IFRS 9 and IFRS 15 is January 1, 2018 and that of IFRS 16 is January 1, 2019, these new standards were deemed appropriate benchmarks as they reflect current thought-leadership vis-à-vis best practice reporting of financial instruments, revenue, and leases respectively.

Similarly, for Section A.2, the six key areas (one general, five specific) selected for comparing national auditing standards to ISA are based on recently issued/revised ISAs which are effective from December 15, 2016. Fewer checklists were provided given the wide adoption of Clarified ISA (i.e., ISA re-issued in 2009 following the revision project conducted by the International Auditing and Assurance Standards Board).1

The six key areas / ISA are:

A. Overview of national auditing standards
B. Communication with those charged with governance (ISA 260)
C. Forming an opinion and reporting on financial statements (ISA 700)
D. Communicating key audit matters in the independent auditor’s report (ISA 701)
E. Modification to the opinion in the independent auditor’s report (ISA 705)
F. Emphasis of matter paragraphs and other matter paragraphs (ISA 706)

Introductory questions to gauge the extent to which key concepts relating to audit strategy, planning and documentation are addressed in national auditing standards are also included.

1 Where the effective date of a standard is in the future, teams are encouraged to inquire with counterparts from the standard-setting body if the intention is to adopt the full and current IFRS.

1 According to the IAASB, as of November 2015, Clarified ISAs have been adopted in over 110 countries.
Module B: Institutional Framework for Corporate Financial Reporting

Module B (formerly Diagnostic Tool Part I) comprises nine questionnaires which aim to assess key areas of the corporate financial reporting and audit framework of the country, using internationally-recognized standards or principles and other examples of good practice as benchmarks.

The nine questionnaires are as follows:

B.1 Commercial enterprises (including SMEs)
B.2 Listed companies
B.3 Banks
B.4 Insurance
B.5 Accountancy profession
B.6 Accountancy education
B.7 Audit regulation, quality assurance and public oversight
B.8 Accounting standard-setting
B.9 Auditing standard-setting

Module C: Observed Reporting Practices and Perceptions

The objectives of Module C are twofold: (i) to corroborate the findings from the assessments of A&A standards (Module A) and the institutional framework for corporate financial reporting (Module B) with reference to financial statements issued and reports from the regulators in the jurisdiction; and (ii) to gather perceptions on the demand for and quality of financial information from users of financial statements e.g., credit risk analysts within financial institutions, investment managers, and financial analysts.

Module C assesses the quality of financial reporting and audit practices, through three exercises:

C.1 Financial statements review
C.2 Review of regulatory findings
C.3 Perceptions survey

Who should complete the modules?

- Modules A and C are typically completed by the task team, subject to validation with the counterparts.
- The perceptions survey is circulated to users of financial statements for completion.
- Module B is typically completed by counterparts, subject to thorough review by the task team.
The following table shows the specific topics/areas covered in the different sections (Part/ Module) of the Previous (2001) and Revised (2016) versions of the diagnostic tool:

<table>
<thead>
<tr>
<th>REVISED</th>
<th>PREVIOUS</th>
<th>PART I</th>
<th>PART II</th>
<th>PART III</th>
<th>PART IV</th>
<th>NEW*</th>
</tr>
</thead>
<tbody>
<tr>
<td>MODULE A</td>
<td>A1</td>
<td></td>
<td></td>
<td>Accounting standards</td>
<td>Auditing standards</td>
<td></td>
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<td></td>
<td>A2</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>MODULE B</td>
<td></td>
<td></td>
<td></td>
<td>Institutional framework for A&amp;A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MODULE C</td>
<td>C1</td>
<td></td>
<td>Financial statements review</td>
<td>Auditing practices</td>
<td>Regulatory findings</td>
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<td></td>
<td>C2</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>C3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Perceptions</td>
</tr>
</tbody>
</table>

* Activities not explicitly/formally incorporated into the previous diagnostic tool.

5. KEY CHANGES TO THE ROSC A&A DIAGNOSTIC TOOL

In order to achieve the objectives of the project, a number of changes were made to the previous diagnostic tool, as summarized below:

Module A: Accounting and Auditing Standards

1. The revised diagnostic tool incorporates checklists to facilitate the assessment of key areas of divergence between national standards and IFRS/ISA. Instead of the previous approach involving a detailed review of all national financial reporting standards or auditing standards with IFRS/ISA, teams are encouraged to focus on key standards/ areas where departures are most likely. The areas of focus and the rationale for selecting these areas are described in the preceding section.

Module B: Institutional Framework for Corporate Financial Reporting

2. The structure of the questionnaires on the institutional framework has been changed to allow a greater degree of flexibility in performing ROSC A&A assessments. The former Part I questionnaire has been significantly revised and now comprises nine thematically-linked questionnaires as outlined in the preceding section. This approach will give teams a greater degree of flexibility in determining which questionnaires are most appropriate to the country context; for example, the questionnaire on listed companies (B.2) may not need to be completed if there is no active securities market in a jurisdiction.
The modular approach is also useful because the thematic format of the questionnaires facilitates ease of completion and collection of information from counterparts. Furthermore, in cases of a ROSC update, it will allow the task team to focus on those areas in which there have been changes since the previous assessment.

**Box on ROSC A&A Updates**

It may be necessary or useful to carry out “targeted” assessments of A&A practices. (i.e., partial, focused on aspects deemed most relevant to the particular circumstances). In a country where a ROSC A&A has never been published, a full assessment would normally be expected. Likewise, in countries with large securities markets where a previous ROSC A&A was conducted more than five years ago, a full update report would be appropriate. Conversely, if an FSAP mission is being planned in a country where a ROSC A&A was carried out relatively recently (e.g., 2-3 years), it would be more appropriate to conduct a partial assessment with a particular focus on banks and large corporate borrowers.

In any event, when a team conducts a targeted assessment of A&A practices in the country, the output (e.g., technical note) should not contain “ROSC” in its title and it should state clearly that the assessment only focused on specific areas and did not cover all aspects of a full-fledged ROSC A&A.

3. Questions on monitoring and enforcement of A&A practices have been updated to align with current applicable international principles of supervision and complementary assessment tools. The methodology has been revised to reflect current international principles of supervision (e.g., the Core Principles for Effective Banking Supervision and the Core Principles for Independent Audit Regulators). For example, there are now questions on key aspects of audit regulation such as quality assurance of external auditors and independent oversight; as well as questions on the A&A reporting requirements for small and medium-sized enterprises, primarily to determine whether these are simplified and not overly burdensome.

The project team also reviewed complementary assessment tools such as the Bank’s Financial Sector Assessment Program (FSAP) and IFAC’s dashboard report, to ensure that the questionnaires were consistent.

**Module C: Observed Reporting Practices and Perceptions**

4. The revised DT now includes a new section to review the findings of financial sector regulators and the audit regulators (C.2), and the perceptions survey (C.3) has been incorporated. The assessment of actual A&A practices in the DT previously comprised only the financial statements review (C.1). Regulatory reviews were not a common practice and audit regulation was at an incipient stage when the ROSC A&A was initially developed in 2001.

The DT now includes an exercise to review regulatory reports and findings (C.2). In circumstances where the regulators in a country have robust supervisory processes in place for A&A practices and publish reports of monitoring and enforcement activity performed, teams are encouraged to draw on this information, as such reports can provide useful insights. Where appropriate, task teams may include a summary of the findings in the ROSC A&A report. Further, the survey of the perceptions of users of financial statements, which was not formally part of the diagnostic tool, has now been incorporated (C.3).
The list of questions from the previous tool no longer included in the revised DT is provided in the Annex. The project team conducted a thorough review of the questions in the previous tool, including comparing the questions to a sample of published ROSC A&A reports to check whether the corresponding information was actually featured in reports. Questions which rarely formed part of the report, were duplicative, or no longer relevant are not included in the revised methodology. Refer to the annex for the list of such questions.

Given the evolving nature of corporate financial reporting and emerging standards and practices, further revisions will be made in the future, in the form of additional modules to address specific areas such as Other Forms of Corporate Reporting, Financial Reporting for Islamic Finance and other type of assurance engagement auditors provide.