

Convergence of Accounting Standards: A Closer Look from the Perspective of SEC

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1. Thank you for inviting me to share some thoughts with you on the issue of international convergence of accounting standards. I have to confess that I might not be in the best position to address you in the capacity of an accountant. It was such a long time ago when I qualified as a chartered accountant in England.
2. I still remember the very first training in the audit firm that I joined. I was one of the few graduates who entered the profession without any accounting background during my first degree. All my studies were in economics.
3. You can imagine my surprise when I was first told that, in double entry accounting, one had to do every entry twice, once as a credit and one more time as a debit. As an economist, this immediately struck me as an inefficient use of resources.
4. I still recall our instructor telling us to remember that the debit side was by the window of the training room, the credit side by the door. Or was it the other way round?
5. My views to you today therefore do not carry any deep insight of an accounting profession practitioner. They only reflect my experience as a regulator, my 26 years at the Bank of Thailand and the 10 months that followed in my new capacity as the Secretary-General of the Securities and Exchange Commission.
6. In the next 10 minutes or so, I shall explore the necessity of international convergence - - why is it necessary, what difficulties or points of concern exist about its implementation, and what emerging markets, particularly Asian countries, can do to address this problem?
7. But first, I have to tell you what improvements I have done in Thailand, in the area of accounting, since I took office at the SEC in late December last year.
8. The first thing that I tackled was the auditors' opinion page. I had noticed that some auditors were weak in their dealing with clients. They allowed some clients to present financial statements that circumvented accounting standards. Often the clients refused to make adequate provisions against doubtful debts, or against bad investments.
9. The auditors would give unqualified opinions. Obviously they knew it was not correct. They therefore protected themselves by adding a paragraph of their own remarks. These remarks would raise mild doubts about the circumstances regarding those items. They would make it appear that the doubts raised were not strong enough to prevent them from giving a clean opinion. The remarks were only designed to protect the auditors against lawsuits.

10. Unfortunately, shareholders would construe these remarks to be technical points. They would mistakenly believe that perhaps the auditors really did not have any serious worry about those remarks.

11. This caused two problems. Not only were the financial statements misleading, but the proliferation of unnecessary remarks in auditors' opinion page also made it next to impossible to separate the important remarks from the clutter.

12. Here therefore, the interest of the shareholders was thrown out the window, the debit side of my first training room.

13. We therefore called a stop to this practice. We announced that thenceforth we would not accept filing of financial statements with such remarks.

14. The auditors either had to express their opinions as clean, or if they have doubts that the financial statements may not comply with proper standards, they must express qualified opinions. They can no longer sit on the fence. They must commit themselves one way or another.

15. I hasten to point out that in Thailand the vast majority of the auditors of public companies adhere strictly to principles. It is the very small minority that we had to enforce discipline as described.

16. The second thing I did was to tighten up the process of financial statement monitoring. The SEC has long had a process to analyze financial statements in order to identify improper disclosures.

17. Last year, we ordered 11 companies to amend their statements, and a further 16 companies this year.

18. What I have added to this monitoring process is also to **detect for frauds**, or misappropriation of funds, or transactions that are related to major shareholders. We aim to prevent the siphoning of money out of public companies.

19. The result has been very successful. In the 10 months of this year, we have been able to identify improper transactions at 11 companies totaling more than US \$ 100 million.

20. When we found these items, we immediately raised our objections to those companies. Following our objections, all of these transactions had been reversed or subsequently amended to our satisfaction.

21. We are now able to prevent top management or majority shareholders from taking unfair advantage of the companies better than ever before.

22. The monitoring process has yielded another important result. We had found that some public companies did try **take advantage** of the fact that some accounting issues were not clear-cut.

23. Since accounting standards generally state only the basic principles, some public companies did interpret them the way to suit their window dressing of the financial statements. We went to work without delay with the Institute of Certified Accountants and Auditors of Thailand. Our two organizations cooperated to issue circular letters that spell out clearly the interpretations of some of the accounting principles that were most open to misinterpretation.

24. We have so far issued 6 circular letters, with a few more in the pipeline. These letters have served to better guide the profession and the public companies to proper understanding of the principles.

25. They are the important tools to ensure that accounting principle compliance in Thailand occurs **not just in form - - but in substance, and in reality.**

26. Let me now move beyond Thailand and talk about international convergence. The trend towards international convergence is clear. We are going to see capital movement of the portfolio type growing much more in Asia.

27. Even a capital deficit country may be able to allow outflow for certain group of investors, via collective investment schemes, for example. Capital exchanges can therefore occur even between capital deficit countries, although the exchanges will occur step by step in small amounts.

28. Exchanging capital between Asian countries can provide concrete benefits. It allows investors to diversify risks. This is why the Thai government has been trying to promote Asian bonds.

29. People who invest overseas naturally want to be able to keep track of financial health of the securities issuers. Convergence of accounting standards is the only means to achieve this. Only by talking the same language can one understand each other across borders.

30. A recent survey by the big four international accounting firms of 59 emerging market and advanced countries found that 3 per cent had already adopted the international standard, and a further 92 per cent has plan to do so in future.

31. It does seem that convergence is something inevitable. However, if you look closely, you will find that the one common language spoken over the world is not Latin, despite its long roots, or Esperanto, despite its perfection. It is broken English.

32. There can be no one language if it aims for **too much** perfection. This is also true of international accounting convergence. There may be local conditions that make it impractical, or even wrong, to adopt international standards in every little aspect. There may be times that international standards should not apply.

33. Take the example of IAS 39 regarding debt restructuring. The standard requires for valuation of the restructured cash flows to be discounted **by the original contract interest rate.**

34. However, in the case of Thailand, the financial landscape before and after the Asian crisis in 1997 simply could **not** be compared. There was a very big paradigm shift.

35. Before the crisis, typical lending rates were in the high teens, 16 per cent per year would not be abnormal, for example. Plus all contracts also had clauses that set penalty rates in case of delayed payments at the maximum, often 20 – 24 per cent per year. Those very high rates were set as deterrents, to scare debtors against default.

36. Unfortunately, during the crisis, almost half of all bank loans became non-performing. The penalty clauses had kicked in. Of course, no debtor could afford to pay those exceptionally high rates. They all had to be restructured to the rates prevailing after the crisis, mostly less than 10 per cent per year. Would it make sense to discount the restructured loans at the 20 – 24 per cent rate? Or even the 15 – 16 per cent normal rate pre crisis? I think not. The financial paradigm has shifted so much that it does not make sense to follow IAS 39.

37. What can we do under such a circumstance? In Thailand, we issued our local standard that required restructured loans to be discounted at the prevailing market rate. We ignored the original contract rate. But by doing so, we have to live with the label that Thailand does not comply with international convergence.

38. This is just **one** example occurring in Thailand. I am sure that local conditions may also present similar problems in other countries. Emerging markets are particularly disadvantaged, because financial and commercial conditions can swing dramatically due to crises and excessive speculation.

39. Imbalances and distortions that came up are all against our will. They are sometimes caused by domestic factors. But often they are caused by outside influences, particularly operators of hedged funds.

40. Emerging markets can only work to speed up their reform processes to avoid imbalances from building up into an economic storm. But development and reform does take time. Emerging markets will not become fully developed overnight.

41. In the meantime, I wish to call on the international bodies in charge of setting accounting standards to open their doors to adequate representation from emerging markets.

42. All emerging market regional groups should have better access to these bodies, both at the board level and at the technical committee level. ASEAN accountants and securities regulators should strive to ensure this.

43. I conclude therefore that international accounting convergence cannot ignore emerging markets. This is the only way international convergence can produce any real lasting benefit.