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One world, one standard - almost a reality?

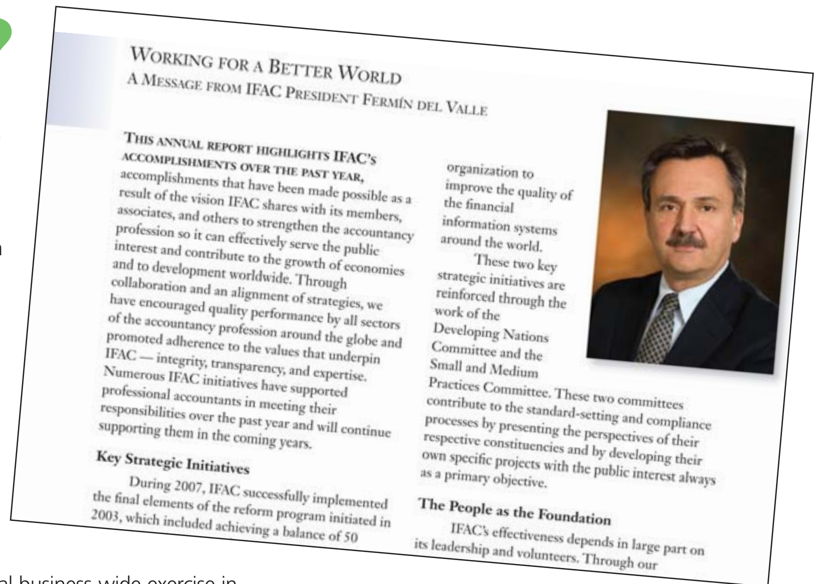
Over the last year or so there has been widespread debate about International Financial Reporting Standards (IFRS) replacing US Generally Accepted Accounting Principles (GAAP), but how close are we and what does it really mean? Are we really about to see a single worldwide accounting standard applied in every major market?

The chances are it will happen, but there are still issues to be resolved for regulators, businesses and for their professional advisers alike. Not only is the debate about US convergence and adoption of IFRS still ongoing but, assuming it does happen as expected, there will be major challenges for US businesses just as there were for European companies when IFRS came into force in 2005.

These issues include the transitional provisions contained in IFRS for converting to the new standards, elections available to first-time adopters and the general differences between IFRS and US GAAP financial statements, such as presentation and disclosure. US GAAP, for example, runs to some 25,000 pages whereas IFRS is more like 2,500.

The problem for the US is that it is used to more detailed rules. It is a more litigious society and these are less well-defined principles. The fear is that, at least in the short term, it could lead to more lawsuits.

Because the process and the implications of IFRS convergence can vary widely among companies based on a number of variables (such as level of experience, degree of centralisation of accounting processes and data collection, and the number of current accounting methods) IFRS conversion is much more than simply an accounting exercise – it is a vital business-wide exercise in change management.



WORKING FOR A BETTER WORLD
A MESSAGE FROM IFAC PRESIDENT FERMÍN DEL VALLE

THIS ANNUAL REPORT HIGHLIGHTS IFAC'S ACCOMPLISHMENTS OVER THE PAST YEAR, accomplishments that have been made possible as a result of the vision IFAC shares with its members, associates, and others to strengthen the accountancy profession so it can effectively serve the public interest and contribute to the growth of economies and to development worldwide. Through collaboration and an alignment of strategies, we have encouraged quality performance by all sectors of the accountancy profession around the globe and promoted adherence to the values that underpin IFAC — integrity, transparency, and expertise. Numerous IFAC initiatives have supported professional accountants in meeting their responsibilities over the past year and will continue supporting them in the coming years.

Key Strategic Initiatives

During 2007, IFAC successfully implemented the final elements of the reform program initiated in 2003, which included achieving a balance of 50

organization to improve the quality of the financial information systems around the world.

These two key strategic initiatives are reinforced through the work of the Developing Nations Committee and the Small and Medium Practices Committee. These two committees contribute to the standard-setting and compliance processes by presenting the perspectives of their respective constituencies and by developing their own specific projects with the public interest always as a primary objective.

The People as the Foundation

IFAC's effectiveness depends in large part on its leadership and volunteers. Through our

Conversion to IFRS will result in more standardised annual reports globally – here recognition of "convergence momentum" is heralded by the chairman of the International Federation of Accountants in its own 2007 annual report.

Background to change

Let's look at the background to this seismic change in financial reporting.

The International Accounting Standards Board (IASB) was set up in 2001, as part of the International Accounting Standards Committee (IASC), with the task of bringing some sense of order to international financial reporting standards. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. IFRSs are the means by which the IASB seeks to achieve this goal.

Almost immediately these ambitions were given a powerful kick-start when the European Commission decided in 2002 that all listed companies in Europe should follow IFRS from 2005 onwards. To IASB's great credit it achieved this goal despite the tight deadlines and the political minefield that it found itself operating in. And in 2005 IFRS did indeed become effective within Europe.

Commitment to IFRS

Seeing the European corporate world driving down the IFRS route, the rest of the world followed suit and now well over 100 countries have committed to introduce IFRS. China, Japan, India and others have announced deadlines by which they will join in. And regulators in the US are now formally en route to acceptance of IFRS.

US acceptance of IFRS is a major step change for the accounting world. It makes it almost a certainty that a single set of accounting standards will be followed around the world. Late in 2007, the US Securities and Exchange Commission (SEC) decided to allow foreign companies to file in IFRS without reconciling their accounts to US GAAP – a tacit acceptance of the quality of IFRS. Now there is every likelihood that IFRS will be accepted for US-listed businesses as well.

The US should benefit from the European experience and that of the many other countries that are using or adopting IFRS. Europe and other first-wave adopters learnt from the problems of being early-users. New rules were being issued by standard-setters right up to the last minute, making it tough for everyone to prepare for the new regime. The US will miss this painful start and can go directly to proven, workable standards. However, the issues for the US are now around training of accountants and auditors, and making companies and investors aware of the changes – and the real benefits these will offer.

Effects on mid-tier companies

But also of great relevance to UHY clients is the debate around how much IFRS should apply to mid-tier and smaller companies, an issue that is far from resolved. While superficially a simplified system should be universally accepted, proposals for an IFRS-related system for small and medium-size businesses have become a hotly debated issue. The debate is ongoing and fierce but the outcome is likely to be a new multi-tier system.

As John Wolfgang, UHY chairman, said at the time of his appointment: "The accounting world is going through a time of great change. Convergence of accounting standards is not just an issue for huge multinationals. It is also a serious concern for dynamic mid-tier businesses – the natural client constituency for UHY member firms. It is an issue for UHY as we investigate a consistent audit methodology across our global association."

Robert Bruce, the veteran accountancy commentator, writing in the UK's *Financial Times*, said: "The end result is likely to be a three-tier system in most countries around the world." He postulated that listed companies will produce figures under the full IFRS system. The remaining large companies will follow the SME standard, obtaining significant cost savings in the process. The smallest end of the business world will produce no accounts at all, or accounts under a further streamlining of the system, adequate to satisfy bankers, credit agencies and a small handful of investors.

Financial statements are prepared and presented for external users by many entities and, while these may appear to be similar in most countries, there are differences that have probably been caused by a variety of social, economic and legal circumstances. Different countries have also had the needs of different users of financial statements in mind when setting national requirements.

These differing circumstances have led to a variety of definitions of elements of financial statements, including assets, liabilities, equity, income and expenses. They have also resulted in the use of differing criteria for recognising items in the financial statements and in a preference for different bases of measurement. The scope of the financial statements, and the disclosures made in them, has also been affected.

Benefits to users and companies

The IASB, through IFRS, seeks to narrow these differences by harmonising regulations, accounting standards, and procedures relating to the preparation of financial statements.

In theory, and in time in practice, this means that users of financial statements will be able to compare companies in similar industries but different countries, e.g., a manufacturer in Europe with an Asian manufacturer. And companies will be able to promote their status to international investors more keenly as direct comparisons between competing offerings become more transparent.

It hasn't reached that stage yet, but the world is becoming smaller and more uniform, at least in accounting terms, and that ideal is now much closer. So who are these users for whom this standardisation is being delivered around the world?

Broadly, they are: present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public. They use the financial statements to satisfy their differing needs for information, but it is recognised that financial statements cannot satisfy the information needs of all these users.

As investors are providers of risk capital to the business, the provision of financial statements that meet their needs will also meet most of the needs of other users. And broad qualitative principles of understanding, relevance, reliability and comparability, that underpin the IFRS technical content, ensure that these wider needs are satisfied.

The challenge for businesses and their advisers now is to meet the demands of these users for consistent, transparent, high quality and comparable reporting. IFRS is the means to deliver this across the world.

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UHY

Nigeria: now for the better news

It's been described as the 'economic powerhouse' of West Africa, because of its vast oil reserves.

Indisputably, it has the potential to become one of the strongest economies in Africa. Petroleum and petroleum products account for 95% of exports. It is the largest oil producer in the continent after Angola and one of the largest oil producers in the world.

But, like some other African nations, Nigeria has had a bad press.

The country has been beset with lawlessness, endemic corruption and financial misappropriation – an estimated USD 40 billion worth of oil revenue is 'lost' or stolen each year; the government's economic reforms to promote growth have been undermined by militants striking at oil installations; and international headlines have all too often reported the kidnapping of expat oil workers and businessmen in the Niger Delta.

Moreover, the country, rightly or wrongly, has developed a world business reputation for being less than welcoming to outsiders.

But, there's better news – in fact, considerably better news for the investor prepared to look ahead and balance short-term risk with long-term return.

In 1999 – after years of military rule, when the country lurched from one coup to another – former general Olusegun Obasanjo took power, set about instilling civilian rule and declared his aim to reform the economy. He was admired for paying off all of the country's USD 35 billion foreign debt.

Current president Umaru Yar'Adua, who came to power in 2007, is continuing reforms. And, as a result of this first civilian-to-civilian transfer of power in the country's history, Nigeria is experiencing its longest period of civilian rule since independence from the UK in 1960.

Market-oriented reforms

In the more recent past the government has also begun showing the political will to implement the market-oriented reforms urged by the International Monetary Fund, such as modernising the banking system; curbing inflation by blocking excessive wage demands; and resolving regional disputes over the distribution of earnings from the oil industry.

The banking system in particular has been revolutionised. Reforms began in 2004, when Nigeria's central bank sharply increased the capital requirement for the country's banks by 1,150%. The spike brought about a rapid consolidation that slashed the number of Nigeria's banks from 89 to 25; the banking sector's asset base grew by 277% between 2003 and 2007; and by the end of February 2008, 11 banks had more than USD 1 billion in capital.

Other reforms quickly followed. The government increased capital requirements for insurance companies, many of which had been severely under-capitalised. The change also brought about a similar rapid consolidation in that sector. The country's under-funded pension infrastructure was reformed, streamlined and revamped to encourage more individual responsibility over contributions and savings.

These aggressive reforms have dramatically raised standards in the financial sector and placed it on a firmer foundation – so that political changes are far less likely to impact Nigeria's financial market institutions in the future than was the case in the past.

Strengthened by reforms, banks are exploring new opportunities, such as consumer and retail banking, pension administration, and mortgages. They are also expanding their reach beyond Nigeria into other parts of Africa, taking advantage of the region's under-served financial markets.

In line with reforms, the economy grew strongly in 2007, albeit based largely on increased oil exports and higher global crude prices, and continued its growth with a 6.49% year-on-year increase in the first quarter of 2008. The oil sector accounted for 21.5% of GDP. Nigeria's foreign exchange earnings in Q1 2008 were USD 29.02 billion, of which nearly 37% came from oil exports.

Investment channels

Meanwhile, the Nigeria Investment Promotion Commission (NIPC) has been opening channels for investors through its One Stop Investment

Centre – key government agencies have been brought to one location with the aim of offering a co-ordinated, prompt, efficient and transparent service to investors.

The NIPC provides registration of foreign investments; issuance of business permits; complaint management; links with NIPC departments and other Government agencies; and a country-wide liaison for investing in Nigeria's 36 states.
See: www.nipc-nigeria.org

The International Finance Corporation (IFC), which specialises in investment in under-developed countries, has been supporting Nigerian reform and directing still more of its financial support towards prospects for Nigerian growth. If the business environment continues to improve, it says, IFC will invest in new sectors, including agribusiness, infrastructure and manufacturing.

IFC executive vice-president Lars Thunell says Nigeria is among IFC's Top 10 countries for support globally and its largest market in Africa. "We had a record year for investments there last year and we expect to exceed that this year," he says. "We are collaborating with the World Bank to help improve investment opportunities for businesses, exploring work in new sectors, providing more products, and increasing our focus through improved support at the local level."

IFC's work in Nigeria has been growing sharply for several years. In 2006, IFC allocated USD 266 million to 10 projects in Nigeria, a jump of almost 30% from the year before. IFC's portfolio in Nigeria now comprises about one-third of its entire portfolio in Sub-Saharan Africa, up from only about 10% in 2001.

IFC says consistent and strong financial sector reforms in Nigeria in recent years have created a unique opportunity for it to strengthen institutions that promote the private sector. "IFC's participation brings global expertise to encourage the growth and expansion of institutions with local knowledge that can encourage new investment, provide access to finance to new market segments, like small and medium enterprises, and strengthen the foundation of the economy."

"The steady pace of regulatory reforms in Nigeria's financial markets has led to consolidation in the industry and created well-capitalised banks," says Solomon Adegbie-Quaynor, IFC's country manager for Nigeria. "IFC is committed to working with financial institutions and the government of Nigeria to sustain the pace of reforms, and we are looking to enter new segments of the market where we can further contribute to developing the country's financial sector."

Investor confidence

Investor confidence has also been triggered by moves to liberalise international trade, spurred on by the United States and European Union who want developing countries to open their economies to industrial goods and services.

Further signs of economic expansion include growth in the country's telecoms industry – the fastest-growing in the world over the past three years.

While infrastructure still remains an issue – such as erratic power supplies and poorly maintained roads – Nigeria is revamping its rail network: almost 8,000 kilometres of track, connecting 36 state capitals and major cities, are due to be built by concession holders.

And, in the last few months, looking ahead to greater stability and investment opportunities, UHY has selected its first member firm in Nigeria: UHY Maaji & Co, in Lagos, the largest city and most populous conurbation in Nigeria. The firm has additional offices in the capital Abuja, Port Harcourt, Benin City, Lokoja, Kaduna, Kano, Maiduguri, and Yola.

UHY Maaji & Co provides local knowledge of business culture and has contacts already in place to support UHY clients looking to take careful advantage of the opportunities as they present themselves.

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Tax treaties: A competitive advantage in the era of globalisation

The first years of the 21st century have seen renewed interest and developments of a trusted 19th century vehicle for tax planning – the double taxation treaty.

Whether it will be adaptable to confront business models such as web-based commerce is still an open question as taxpayers abandon bricks for clicks. But, meanwhile, tax treaties remain useful tools for reducing the overall tax bite as companies, and the employees who work for them, continue to cross borders both in real and virtual terms.

History

First developed in 19th century Europe to reduce double taxation of an *ad valorem* nature between the Habsburg and Prussian spheres of influence, they formed a useful basis for dealing with double taxation of income when income taxes took hold in the early part of the 20th century.

At that time, there were two camps – those who felt income should be taxed solely where an individual or a business enterprise was resident; and those who felt income should be taxed exclusively where it arose economically, even if the income recipient was not a resident.

This debate would likely still be raging were it not for the efforts of the League of Nations between the two World Wars, and eventual compromises which are still reflected in today's treaties.

The result is that:

- Some income items are taxed on residence, such as revenue from an enterprise's worldwide sales.
- Some are based on source, such as royalties from the use of intellectual property in a country other than the enterprise's country of residence.

How treaties work

Double taxation treaties are negotiated between countries and generally are based on one of three models:

- The first was created by the Organisation for Economic Co-operation and Development for use by its members. The model and commentaries are relied upon by many countries and updated regularly.
- Designed more with developing countries in mind, another model was created by the United Nations Commission on International Trade Law.
- Finally, there is the model developed by the US Treasury as the basis for negotiating treaties.

These models are the starting point for two countries to negotiate and arrive at a version that works for them. In the process, they agree that the treaty will take precedence over internal law, so that residents of contracting states enjoy lowered risk of double taxation when living, working, selling or transacting business in each others' states. Occasionally, new treaties replace old ones, or countries negotiate protocols amending certain articles of existing treaties.

While the model treaties have much in common, there are some striking distinctions, such as what constitutes a "permanent establishment", whether "tax sparing" is permitted, and whether citizens will be subject to tax even if they are not resident.

Here we focus on treaties applicable to business enterprises; a future *UHY International Business* article will address how treaties apply to individuals.

The broad areas covered by treaties are:

- **Residence -** who is entitled to apply the treaty
- **Taxable presence -** what types of activities give rise to a 'permanent establishment' where a resident of one country becomes taxable in another
- **Withholding on items of income -** when the person making a payment has the obligation to deduct tax and pay it on behalf of the recipient
- **Relief from double taxation -** how one country will help its taxpayer to avoid double taxation by providing a tax credit or an exemption
- **Limitation on benefits -** how countries, especially in the US, try to eliminate 'treaty shopping' or the reduction of withholding tax on persons that are not deemed sufficiently 'resident' in the other country.

Relationship to other international treaties

Bilateral tax treaties must also be interpreted in light of other international obligations. For example, the EU Parent-Subsidiary Directive would take precedence over a treaty so that dividends from certain subsidiaries are not subject to tax in either country.

The effect of this directive can be combined with holding company regimes in certain EU countries to reduce an international group's corporate tax to the lowest rate of tax in the dividend route from the profit-generating country to the holding company.

Using treaties in tax planning

Beyond these basics there are many differences from treaty to treaty, not only as to which contracting state has the right to tax, but what other benefits and limitations apply. Therefore, it is essential for tax planners to read any applicable treaty in its entirety and to check for recent protocols.

For example, a treaty may not provide an exemption from tax on the sale of shares in the article covering capital gains, but an exemption or credit with respect to just such a transaction may be embodied in the article covering relief from double taxation. Similarly, a limitation on benefits in the case of withholding tax on interest may not appear in an article covering interest, but rather in an article limiting benefits – that is also separate from an article defining residence, which had been traditionally the basis for determining who could claim treaty benefits.

Treaties between industrialised countries (other than the US) and emerging economies often involve 'tax sparing' to attract foreign investment. While the tax treaty provides for a reduced rate of withholding on payments such as royalties, the recipient in the industrialised country takes a tax credit as if the treaty were not in effect and higher tax was paid.

Future

The future of double taxation treaties appears bright as more and more are entered into, especially by countries whose economies are emerging and who are interested in attracting foreign investment. And while corporate tax rates have been dropping steadily in many countries over the last few years (with the notable exception of the US), this has not necessarily translated into lower withholding tax rates, so the attractiveness of treaties remains high for companies seeking to use foreign tax credits fully.

For more information on the use of treaties in international tax planning, contact Joseph Fay (jfay@uhy-fay.com) or Meril Markley (mmarkley@uhy-us.com).

Europe set to battle over mobile workers

Mobile workers tend to be younger, harder-working, more enterprising and, of course, more mobile than traditional workers. Like starting a new business, migrating is a risky enterprise, and hard work is needed to make it pay off. Migrants' efforts not only boost the productivity of the regional economy directly; they also encourage local workers to up their game.

So say business strategists analysing the effects of a sudden influx of mobile workers into one area of the UK. Nearly 120,000 migrants from Poland and other central and east European countries that joined the European Union in May 2004 have since registered to work in the sparsely populated Eastern region – more than in any other part of the country, including London. That's just those who have registered. Others, such as the self-employed, haven't needed to register, and have arrived uncounted.

This microcosm is just one of many influxes of economic migrants seeking a better life into popular parts of Europe in recent times that have changed demographics and established a new pan-European labour force.

In Eastern UK, migrants have included Lithuanians picking fruit, Slovakians processing food, Latvian builders and Polish care-workers, as well as highly skilled workers, such as doctors and IT specialists who congregate in the high-tech cluster around Cambridge known as Silicon Fen.

They provide much-needed labour and skills for local businesses, as well as vital public services.

Yet this new migrant working is often controversial – and the media debate is clouded by emotion, misconceptions and often patchy and flawed statistics. Community strains have arisen in some areas over providing for migrants' needs – such as translation services, help in learning English, and information about local norms and working

practices. Migrants have also been put in the spotlight over public sector weaknesses – areas whose economies benefit from an influx of workers often feel the pinch in terms of public services.

Businesses benefit – they often pay salaries below levels that they would have to pay nationals from their own countries, and often get jobs done efficiently which would otherwise remain unfilled because local labour does not want to do them.

That is, businesses benefit until the cheap labour supply dries up. Often, migrants are young people wanting to learn English, experience life abroad and send money home. They arrive, they work, they go home: the churn rate is high. They're not so much migrant workers (with the implication perhaps that they may settle permanently in a country) as mobile workers, who leave their families to work for a year or two where the economic conditions are best.

Of the million or so east Europeans who have gone to work in the UK since 2004, more than half have already left again. Three in five new arrivals intend to stay less than three months; only 8% more than two years.

And so it is that migrant mobility is causing business strategists around Europe to work out how they can attract mobile workers to sustain regional prosperity – and how they can compete for influxes of mobile workers who may well be attracted to other European states. For example, as an island, Britain, with its sometimes inclement weather, may not seem so attractive to migrants as working in sunnier climes in Portugal, which may also be perceived by them as just across a land border from home.

And from a purely economic perspective, some parts of Europe, the UK included, are already a less attractive proposition to mobile workers. The depreciating pound sterling – which at the end of May 2008 bought 16% fewer euros and 25% fewer Polish zloty than 10 months earlier – and Poland's economic boom are causing many mobile workers to seek more attractive opportunities elsewhere.

The decline in the number of migrant workers registering to work in the Eastern UK region alone has been particularly steep; nearly 30% fewer registered in the first three months of 2008 compared with the third quarter of 2007.

Rank (2007)	Country	1997	2002	2007
1	India	404,100	424,600	553,300
2	Poland	67,800	49,600	423,300
3	Ireland	534,600	490,500	410,400
4	Pakistan	222,400	281,600	357,900
5	Germany	227,900	266,700	255,300
6	Bangladesh	140,200	179,900	203,800
7	South Africa	93,400	140,900	194,500
8	China (and Hong Kong)	86,500	125,500	173,600
9	Jamaica	139,900	149,800	173,500
10	United States	126,800	141,900	170,600
	TOTAL foreign born	4,152,000	4,765,000	6,219,000

Countries of origin of migrants going to the UK in 2007 compared with 1997 and 2002.

Some argue that the economic impact of their departure will be minimal. A House of Lords (part of the UK Government) committee report into the economic impact of migration claimed that its benefits to the UK resident population were minimal.

But critics believe the report was based on flawed statistics – and the UK Government, in particular, has been heavily criticised for not keeping accurate records on the numbers of migrants entering the country.

What is known for sure, say business strategists, is that mobile workers help a regional economy adapt more readily to ever-changing economic conditions. In a single European market and globalising economy where goods, services and capital move more freely, company owners and workers increasingly need to move, too. Cheaper transport and communications make such mobility possible, and a region that does not take full advantage of this is at a competitive disadvantage.

Hard-working migrant workers have given the economy a new lease of life, say the business strategists. Because they are more willing to move to where the jobs are, and to change jobs as conditions change, they have made regional economies more adaptable, enabling them to grow faster for longer without running into inflationary bottlenecks – raising living standards and helping to keep interest rates down.

Just as the free movement of goods and services is generally accepted and documented as being a good thing, so too is the free movement of the people who produce them – the people who have created the new pan-European labour market.

Newcomers' different perspectives and experiences, and their drive to succeed, help stimulate new ideas on which the future prosperity of businesses depends. History and global experience show that the exceptional individuals who come up with brilliant new ideas often happen to be migrants (source: UK's Institute for Public Policy Research).

Instead of following the conventional wisdom, they tend to see things differently and, as outsiders, they can be more determined to succeed. Twenty-one of the UK's Nobel prizewinners arrived in the country as refugees.

If Europe's mobile workers leave a region because the economy is slowing and the demand for labour is less, it may not matter. But if mobile workers leave because plunging currency devalued their wages, or because other regions have become more attractive, the cost will be keenly felt.

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