

Editor's Note

As you can see our Institute has elected a new president, Mr. Igal Guzman, and a new Central Committee for the next three years.



We are all confident that they will do their best for the profession in general and our Institute in particular.

The profession under the leadership of IFAC should follow carefully the legislation forthcoming to strengthen

control over the banks and the financial institutions who led the way to the current economical crisis. We must contribute our share to the fulfillment of this goal.

I have participated recently in the FCM 8th Annual Conference in Bucharest – The Conference was very well organized and the subjects well selected and delivered. I take this opportunity to thank the Romanian Institute C.E.C.A.R. which hosted the Conference for the excellent hospitality extended to our delegation headed by our Past President, Mr. Reuven Shiff. ■

Morris Kanne

From the President

Since mid September 2009 I have the honor of leading the Institute of Certified Public Accountants in Israel, one of the most veteran, resplendent and important professional bodies in the country. I am sure that you will permit me to share with you a number of thoughts that accompany me as I enter into this role.

A survey was recently published in the Israeli financial press, which covered the level of satisfaction indicated by members of the free professions: accountants, lawyers, doctors, managers in industry, advertisers and so on. It arises from the survey that our accountants indicate the highest level of satisfaction from the work that they do, from their salaries and from their progress in their careers. Without doubt this is very good news for all of us, and this is especially so for the young people who have chosen to study accounting or those who are considering making that choice.

The Institute of Certified Public Accountants is the home of all of us. The Institute joins together accountants from small offices together with one's of the big firms, men and women, senior members of the profession together with the newly qualified. We have a common foundation, a common education.

The most important task I am facing is to deliver the sense of praud and belonging to every new accountant who enters the Institute.

There can be no doubt that our profession is facing considerable transformations in light of the challenges on our profession, our clients and the global economy.

We also have to cope with the continuing erosion in the fees that we receive on the one hand and with the growing professional and legal responsibilities being placed on the profession on the other hand. The question of the implementation of the IFRS standards in small and medium sized businesses will to a very large degree determine the face of the profession for many years to come. We need to expand the fields of responsibility for accountants, and also to ensure that we maintain the prestigiousness and the independence of the accounting profession. We can also be sure that more challenges will arise along the way.

I received the office as President of the Institute from Reuven Shiff, who did so much for the profession that we are engaged in. Reuven demonstrated leadership both at the time of the global financial crisis as well as in the day to day running of the Institute, he succeeded in raising the level of prestige attributed to the Institute and he strengthened its position. In the name of all of the members of the Institute, I would like to take this opportunity of once again thanking him earnestly for his activity over the past decades, and I am sure that we will carry on benefiting from his skills and his experience. ■



Igal Guzman



The Chairman of the State Control Committee Knesset member Yoel Hasson promotes a draft law to amend the internal audit law

The Chairman of the State Control Committee, Member of Knesset Yoel Hasson stated at the conference on “Quality Assurance for Internal Auditors”, which was held by the Institute of Certified Public Accountants, that he has prepared a draft law for the amendment of the Internal Audit Law – 1992, which aims to strengthen the status of internal auditors. Member of Knesset Hasson noted that the draft law accords, at this stage, with the conclusions reached by the Zeisler report*, however changes may very well be made to the draft. In his own words: “Since this is the draft of a law which has long-term implications, and it constitutes a significant change in the status of the auditors, a draft law such as this can only pass if there is broad support and agreement from within the government”.

Hasson also related to the work done by the State Control Committee and explained that at the present time we are dealing with a serious problem of matters falling by the wayside as the result of faulty enforcement of government decisions. “In many cases, the decisions

passed by the government are not carried out, the clerks in the civil service create bureaucratic problems and slow things down, and at the present time there are no sanctions that are taken against them. Where government decisions are not implemented and are no progress occurs with them, the result is that the ponderous bureaucratic system slows down or halts the processes. I see it as the role of the State Control Committee as being responsible for verifying execution. I intend to relate solely to the significant qualitative processes and not to all of them, and this will be the case until the process of correcting the weaknesses begins”.

As an example, Hasson brought up the subject of medical services for IDF soldiers- a subject that has still to be organized in a law, even though the government made a decision to do so five years ago. As he puts it, there was a breakdown of communications between the Ministry of Health and the Ministry of Defense, which was solved at one meeting of the State Control Committee, and which he now hopes will actually be



organized and a law and as a result the government's decision will be put into action.

Member of Knesset Hasson said that he intends to promote the new draft law, which he presented in partnership with Member of Knesset Ophir Pines, and whose objectives are to strengthen the standing of reports produced by the State Comptroller and to increase the level of supervision over the implementation of the reports. The draft law determines that the non-correction of weaknesses and a failure to take steps to correct weaknesses, without there being a justifiable reason, will be considered to be a disciplinary infraction. ■

* The Zeisler Checking Committee was appointed by the former Minister of Justice, Tzipi Livne in 2005 with a mandate to check the state of the internal audit function. The Committee determined that an internal auditor can be either a salaried employee or self-employed, they do not need to obtain an especial license, as is the custom across the globe and they cannot be forced to be members of a professional organization. Internal auditors are subject to the international standards, which have been set by the international organization of internal auditors – the IIA and which have also been adopted by the International Federation of Accountants – IFAC.



Minister Ne'eman calls for the placing of a general duty to report to the tax authorities

At the Institute's general meeting he stated: What unifies the Institute of Certified Public Accountants is the friendliness and the mutual consultation between its members. There has not been one major development in the tax field in which the Institute was not a partner.

The Minister of Justice, Ya'akov Ne'eman called for the placing of a general requirement for reporting to the tax authorities. In his speech to the Institute's general meeting, Ne'eman once again called for a transition from the enforcement of the tax laws where transgression is treated as a criminal act to the use of economic penalties to dissuade people from transgressing. He also stated that his ministry has already started to take action on this matter.

Ne'eman mentioned that back when he was the Director General of the Ministry of Finance he made a proposal that there should be a general duty to file reports, however this was never put into action. "In today's computer age, there is no reason whatsoever to avoid having every citizen file a report on their real income", he said. He expressed the hope that with the continuation of the reduction of the rates of both direct and indirect taxes, it will be possible to increase the level of enforcement.

With regards to the Institute, Ne'eman said that he felt very much at home, since he has participated in just about every conference that has taken place over



the course of the past forty years. "What unifies the Institute, and this is in contrast to many other professional organizations, is the attachment between the members: the friendliness, the mutual consultation, the love, the harmony, the peacefulness and the friendship between them, which warms the heart, and I would very much like to learn from you how you do it", he added.

At the general meeting, the Director of the Tax Authority, Yehuda Nasradishi

noted the very close connections that exist between the Authority and the Institute, which are typified by mutual co-operation and enrichment. "There has not been one major development in the tax field in which the Institute was not a partner", he added. Nasradishi awarded a present from the Authority to the outgoing President, Reuven Schieff: A silver pomegranate. "It is alright, this gift complies with all of the Civil Service Regulations, we are permitted to give it and Reuven is permitted to accept it", he said with a smile.

The Chief Rabbi of Israel, Rabbi Yona Meziger called for those present to learn the lesson from the blessing of hearing the sound of the Shofar: "We have to educate ourselves to be more patient, to listen to other people, even when we do not want to hear what they have to say".

The title of "Friend of the Institute" was awarded at the general meeting to four accountants who have been members of the Institute for more than 40 years: Arie Sinai (of blessed memory), Samir Abu-Nasser (the first Arab CPA in Israel and the founder to the Nazareth and the Valleys Branch), Solomon Ben Moshe and Nehemia Stern. ■



Annual Conference in Eilat

1,500 accountants and 4,000 members of their families participated in the annual conference of the Institute of Certified Public Accountants, which was held for the 28th time in Eilat, in two sessions, which took place in June and July this year. This is the biggest professional conference in Israel and it combined more than 20 professional sessions with leisure and entertainment activities for the accountants and for the members of their families.

The guests at this year's conference included the Minister of Justice, Professor Ya'acov Ne'eman; The Minister of Tourism, Stas Misezhnikov; The Chairman of the Securities Authority, Professor Zohar Goshen; The Director of the Tax Authority, Yehuda

Nasardishi; The Chairman of the Histradut Labor Federation, Ofer Eini and Retired Judge Bracha Ophir-Tom. The lecturers came from among the senior members of the accounting profession, who were joined by leading experts in the legal, business and technological fields.

An especial guest at the conference, which took place in June, was Ian Ball, the Chief Executive Officer of IFAC, who participated in a panel discussion on the future of the IFRS. Ball emphasized that IFAC is raising the banner for the "Audit is Audit", even though it recognizes that this principle has to be adapted for the size of the entities that are being audited and the size of the firms that are doing the

auditing. The subject of the IFRS was also discussed at the July conference, which took place more than one year after the implementation of the international standards in Israel.

Additional subjects that were discussed at the conference included: current tax matters, the managerial and accounting implications of the financial crisis, risks management, the internet as a business management tool, the reform in pensions in Israel and other subject that are matters of current interest. The two conferences both ended with enactments of tax trials, in which some of the central issues that are on the professional agenda today for those engaged in this field were discussed. ■



From Left to right: Ofer Minirav, Ian Ball, Reuven Shiff, Doron Kofman and Alex Hilman..



We are Called to the Flag

The financial crisis proves incontrovertibly, that it is vital for a revolution to take place in the ethical behavior of companies, whilst respecting the interests of all of the interested parties and the public at large. Only accountants can raise the banner for this revolution

Jacques Cory*

The current financial crisis is the zenith of a maelstrom of crises of growing severity. At the end of the eighties, it was the junk bonds and the crises in the stock markets and the serious crises in Asia and in Russia, in the nineties it was Barings Bank and LTCM, in the years 2000 – 2001 the dot com bubble burst accompanied by such scandals as Enron, WorldCom, Tycoon, Vivendi and so on.

When the Sarbanes-Oxley Act was legislated in the year 2002, the main responsibility for proper corporate governance was placed on the managements of the companies and on their auditors. However, the current crisis is evidence that at least the management side preferred not to invest money in the development in ethics, but rather in smarter ways of bypassing the legislation, in developing toxic financial instruments and in providing reports to the authorities which bordered on the unethical.

The people who raked off the billions from all of this were the controlling interests, the people who gained hundreds of millions were the CEOs, and the auditors were left behind to clean up the pieces for a few measly millions. The financial crisis only made the situation worse.

Most of the risk falls on the auditors, on the minority shareholders, on the pension funds

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and on the workers, who lose their source of income. The lawyers are not accountable because they are only advisors, whereas the CEOs and the controlling interests – as we have already mentioned – are the ones who, in any event, rake off huge profits.

And so the accountants are left at the crossroads, where they have the ability to insist forcefully on the upholding of ethical principles, the ethical codes, the spirit of the law, transparency, honesty and proper corporate governance. Lest we forget, this was always the declared objective of the auditing profession and so the proposal that it is the auditors who have to raise the flag of the ethical revolution, is merely to put things back in place, to reduce the risks and the impairment of the reputation, without harming income in any way.

There is a statutory status

It is patently obvious that the auditors cannot be the only ones to carry out this ethical revolution. It will have to be the result of combined action by all of the interested parties, who include:

- The minority shareholders, who are becoming increasingly active at general meetings in western countries.
- The banks, who suffered a mortifying blow in the latest crisis and who, we can only hope, will come to the ethical conclusions that are begging to be made.
- The employees, who are always the ones to pay the price, but who could, if they

were to insist on the maintenance of ethical standards, prevent management and the controlling interests from acting improperly.

- The State and the public at large, who are forced to cover trillions of Dollar's worth of damages.
- The community, which suffers from environmental damage.

The difference is that the auditors are the ones who have a statutory status, and if they were to be stubborn about not cooperating with all of the different "Enrons" – the unethical companies would not be able to bypass the legislations and to turn the global economy toxic.

The auditors must dictate uncompromisingly ethical behavior, just as it is expected of them. They are not employees, who receive their salaries from the management and who may be forced to waive their ethical principles; for indeed, independence is a fundamental principle of their profession.

Most of the financial statements issued by the large public companies in western countries are audited by the four large auditing networks. If they were to decide to act solely and exclusively in an ethical manner, then the companies would be left with no alternative other than to acquiesce. They do not need to purify of the vermin, in the same way as lawyers who protect the biggest criminals are required to, because that is their role. Auditors are expected to behave in a different way, they are expected to demonstrate uncompromisingly ethical behavior.



The ethical perspective on things has to start in the universities and in the accounting firms. There are very few academic institutions in which the accountants are required to pass courses in business ethics. Experience has proven that courses such as these – which are accompanied by practical examples, documentary and relevant films and books, are the best way of teaching what an ethical dilemma is and how to deal with it.

Regulation and legislation are of no help and self-discipline is also of no help as we have seen so irrefutably in the crises that have taken place over the course of the past two decades. It is only education that inculcates uncompromising ethical values in universities and in accounting firms that creates a foundation for honesty on the part of auditors. The cost is infinitesimal by comparison with the benefit that is derived from such an education.

The costs associated with a lack of trust had amounted, even before the present crisis, to tens of billions of Dollars a year. In such cases, the lawyers have a field day, since they prepare agreements that go on for ever, whereas it is the auditors who suffer the damage.

The current crisis has increased the damage caused by a lack of trust, the toxic assets and the difficulties experienced by the banks and the insurance companies into the trillions. If we remember that the entire global economy can be measured in tens of trillions of Dollars, then we can see that an even bigger crisis could collapse the global economy. There can be no doubt that such a crisis will occur, if a fundamental change does not take place in the ethical infrastructure of the global economy.

In the light of the collapse of trust in the rating companies, the need arises for the setting up of an institute of ethics, in cooperation with the auditing profession, which will give an ethical rating for all of the companies, the controlling interests and the senior managers, whilst recruiting staff having a record that is beyond reproach. In this way it will be possible to prevent a situation in which companies that have received an AAA rating collapse because they are ethically bankrupt.

The first sprouts can be discerned of activity taking place in these fields in Israel. A survey conducted by the Institute of Certified Public Accountants found that 80% of accountants believe that courts need to be set up that specialize in economic and tax affairs.

And indeed, one of the conditions that is of crucial importance for the enforcement of ethics is the existence of a judicial system that specializes in economic and tax affairs. The ingenuity of Lehman Brothers, Enron, Jerome Kerviel, Bernard Madoff, and similar affairs is on such a scale that only judges who have outstanding education and experience in business matters are capable of getting into the nitty-gritty of their activities. The judicial system in Israel is simply not capable of dealing with the workload placed upon it, nor with the ingenuity of people working in an unethical manner, and so judges who are experts in business, assisted by accountants, are an essential condition for the execution of the ethical revolution.

The companies too have to change their world views. They have to see profitability as being an essential requirement for their existence, but not their entire existence, since companies are also connected to their interested parties, who are entitled to their share of the cake. The companies will have to abandon the principle of maximizing profits, which of necessity is a factor in the maximization of risk and the maximization of the deprivation of the interested parties.

Companies will have to be stringent, with the assistance of the auditing profession, with regards to financial stability and maintaining a reasonable leverage of gearing, and they should not get to gearing ratios of 10 times capital as some of our tycoons have done or even to thirty times capital as was the case with Lehman Brothers and the hedging funds. Attention has also to be paid to the generation of positive cash flows, and above all, to the integrity of the financial managers, the auditors and the directors. Real and transparent financial statements have to be published, directors taking personal responsibility and everybody complying with the law and not trying to circumvent it.

These points have been made by brave businessmen, by journalists and academics

over the course of the past decade, but only a few individuals have dared to swim against the neo-liberal tide that was in control. However, today, the leadership of the business world, the economic leadership, politicians and the press are coming to the conclusion, that ethics are a vital precondition for the maintenance of a sustainable, profitable economy,

Israeli society too has to give a hand to this ethical revolution, which it can only benefit from. It must not give celebrity status to bankrupt individuals who have ripped off their creditors, to tax offenders who have deceived the authorities or to controlling interests who have deprived the minority shareholders, but rather, it should respect the “square” citizens, who pay their taxes and repay their debts. The white collar criminals should sit in prison for a good number of years, without plea bargaining and without mercy on the part of the judges for the lords of the land.

Israeli society has to reward people who blow the whistle on corruption, the deprivation of interested parties and ethical criminals. The public at large must take up the reins, it should only invest in ethically run companies, it should only buy ethically run companies, it should only work with ethically run companies. In this way we will only be left with those companies that make a contribution to the community.

In a situation like this, ethical standards, the ethical codes and talk about ethics will not be mere fig leaves, but rather they will be a vital precondition for the sustenance of a company. We must go back to the ethical sources, so that we will not do to others what we do not want them to do to us; so that we will operate in a balanced manner, which is moderate and not extreme, where the universal principle will work for all of us and each and every citizen in the state will be answerable to the same law and will be treated equally.

Salvation will not come from the politicians, who receive generous donations, or from government clerks, who then go on to work for the people who they were previously supervising; nor from lawyers who defend the ethical criminals. Salvation will come from the auditors, who will take up the cause of ethical behavior and will lead society on the straight and narrow road. ■



Accounting for Nonprofits The FASB #117 IASB #5 Approach

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(USA and Israel)**

Introduction

This article examines the approach of FASB #117 and IASB #5 for nonprofits organizations, such as government, healthcare, education, charity, religious, and research organizations.

Nonprofit accounting is typically part of advanced accounting in a three-part curriculum consisting of principles, intermediate, and advanced. It is a difficult subject for students to master. FASB and IASB accounting pronouncements force nonprofit entities to adopt the accounting model of profit enterprises. While this makes it easier for students to learn nonprofit accounting, I question how well this approach meets the needs of users of nonprofit accounting reports. The FASB and the IASB should try to make accounting as easy as possible for students to learn, but meeting the needs of users better—is more important.

Accountants are widely debating the merits of the FASB and IASB accounting rules on nonprofit accounting, stating their case in articles in accounting journals and in conferences about nonprofit accounting¹. The text I use for my course at Tel-Aviv University on nonprofit accounting states²:

“FASB Statement [of Accounting Standards] No. 117 [“Financial Statements of Not-for-Profit Organizations”] requires [non-profit organizations] to present financial statements showing an aggregate view of the entity. This revolutionary approach effectively moved not-for-profit financial reporting away from the disaggregated, traditional method of fund-based reporting and more toward the commercial for-profit model of financial reporting. Not all users welcomed this change

and the impacts of this controversial change will take several years to be assessed.”

It is important to understand that the sources of equity for nonprofits are not investments by outsiders who seek a return on their investment. Rather, the sources of equity for nonprofits are contributors and governmental and organizational units. Commercial for-profit organizations have the discipline of profits. The search for profits is the “unseen hand” in Adam Smith’s theory of free markets. Economic resources go to where the most profits can be expected. For Adam Smith’s theory to operate it is critical investors have financial statements with adequate disclosure and transparency. FASB 117 and IASB 5 required nonprofits provide a statement of financial position, a statement of activities, and a statement of cash flows.

Statement of Financial Position for Nonprofits

A student looking at the statement of financial position for a nonprofit entity is struck by several anomalies. The equity section in the nonprofit entity’s balance sheet is replaced by a section with a new name: “net assets.” This equity section with its new name is divided into three categories, also with new terminology: “unrestricted,” “temporarily restricted,” and “permanently restricted.”

I recommend the term “equity” instead of net assets. Students have enough trouble comprehending the equity section of a balance sheet and understanding equity transactions without radical new terminology. The term net assets suggests things of value. Things of value to an entity belong under assets—not in the equity section! Students are familiar with the fundamental accounting equation: assets = liabilities + equity. Equity in the sense of residual value still exists for nonprofits though there is no defined ownership interests that can be sold or transferred.

Instead of the terms unrestricted, temporarily restricted, and permanently restricted in the equity section of the balance sheet, I recommend, “general reserves,” “special-

purpose reserves,” and “perpetual-endowment reserves.” Students are familiar with the account name “reserves” as belonging to equity accounts.

Statement of Activities for Nonprofits

Instead of an income statement listing revenues and expenses and reporting net income—nonprofits are required to provide a statement of activities. This statement of activities reports details of the changes for the year in net assets with columns for unrestricted, temporarily restricted, and permanently restricted net assets. Remember net assets is the new terminology for owners’ equity.

Statement of Cash Flows for Nonprofits

Nonprofits are required a statement of cash flows that reports details of the change in its cash and cash equivalents for the year. In my view the cash from operations sub-total may well be the best “bottom line” to judge the financial management and viability of a nonprofit. It is generally a bad sign, as far as danger of bankruptcy, if a nonprofit is forced to use funds earmarked for capital expansion to meet current operating needs.

Conclusion

FASB 117 and IASB 5 require nonprofits to report on their financial statements how well they are adhering to the wishes of the contributors of their equity. I’ve argued elsewhere that modern management accounting techniques to improve management of commercial-for-profit organizations apply as well to nonprofits³. Our role as accountants is to assist commercial for-profit organizations as well as nonprofits, in preparing financial accounting statements, in evaluating internal controls, and in improving general management. ■

1 See Gerald Aranoff, Management Accounting Quarterly Spring 2003 15-23.

2 Earl R. Wilson, Susan C. Kattelus and Jacqueline L. Reck, Accounting for Governmental and Nonprofit Entities, 14th edition, Irwin, 2007, 575.

3 Gerald Aranoff, Cost Management, May/June 2009, 27-31.



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