Global accounting rules – an unfeasible aim

By Stella Fearnley and Shyam Sunder

The introduction of the euro and the adoption of International Financial Reporting Standards (IFRS) in the EU and other countries were promoted by aspirational rhetoric about gains from uniformity. Applying uniform process or rule in diverse societies does not yield uniform outcomes. Effective oversight and control of the process and rule-making can become impossible and unbalanced with so many players involved. Failure to recognise and manage the risks associated with uniformity has driven the European Monetary Union to a critical precipice. Similar risks apply to the efforts of the International Accounting Standards Board (IASB), the accountancy profession and some international regulators to bring about adoption of IFRS for global use.

The IASB and US Financial Accounting Standards Board have committed significant resources since 2002 trying to agree on common accounting standards. Despite their efforts, IFRS have not been approved by the Securities and Exchange Commission for US adoption. The SEC may never risk the political backlash from ceding control of its accounting to a non-US body. We can learn from the euro debacle and assess not only if the vision of one set of global accounting standards is achievable but also if it is desirable.

Accounting standards interact with law, commercial codes, and social norms in different countries in many ways. The IASB has pushed its agenda ahead taking no responsibility for recurrent unintended consequences. The disaster of some banks depleting their capital by paying bonuses and dividends out of false profits, generated under IFRS’s defective mark-to-market and loan-loss provision standards, is a good example.

Abandonment of judgmental true-and-fair standards in favour of written rules make accounting vulnerable to mis-statements through complexity beyond the grasp of users and directors.

China, Japan, and India have yet to be persuaded to adopt IFRS and watch from the sidelines. Within Europe, some countries view IFRS as an Anglo-American invention, and remain sceptical of its suitability for their own needs.
Complexity and interactivity of social systems and markets make it all but impossible for a group of experts to divine the “best” accounting solution that will serve divergent economies. Even if it were feasible, it can only be developed through bottom-up evolution of accounting and not through top-down imposition of a single method selected by a board of “experts” with limited accountability.

The IASB’s persistent denial that the procyclical and complex accounting model played a part in the banking crisis by inflating profits undermines trust in its competence and intent.

The euro debacle points to prudent wariness of Icarus-like overreaching ambition that is not underpinned in theory or experience. Common standards, such as common currency, may appear a good idea, particularly for international companies, regulators and audit firms. But what did we get? A Board that issues standards that can induce false profits in reports and drown users in complexity; that has not accepted responsibility for the dysfunctional consequences of its standards; and has no effective mechanisms for timely correction of defects.

Although the big players get economies of scale from applying IFRS across their international activities, shareholders and other stakeholders, particularly in the banking sector, have not been well served by the outcomes of IFRS standards.

We therefore urge the SEC not to proceed with IFRS in the US. Directors and auditors in the EU and other countries applying IFRS could lead by insisting on a true-and-fair override to cut complexity in IFRS based accounts.

We suggest the G20 drop its support for global accounting standards. Instead, they could recommend that accounting reports reflect the economic substance of businesses based on professional judgments and sound, prudent principles, and recognise that Anglo-American based accounting standards are not necessarily appropriate for the whole world.

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