A Flimsy Triumph for Global Accounting Standards

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On 27 August, the mighty US Securities and Exchange Commission (SEC) unanimously decided to consult the public on a plan for American adoption of International Financial Reporting Standards (IFRS). Subject to final decision in 2011, IFRS would become compulsory in 2014 for large listed US firms, in 2015 for the medium-sized, and in 2016 for the smallest ones.

Even if the decision is far from final, it marks a new stage in the remarkable story of IFRS, which mirrors the dynamics of globalisation in a fascinating way. International accounting standard-setting was born in 1973 under the innocent guise of a discussion of best practice among a few national accountancy bodies. As recently as ten years ago, it would have been a brave person who would have forecast that these standards might be adopted wholesale by major economies.

Then, in early-2000 stock-market euphoria, the European Union undertook to mandate the use of IFRS by Europe's listed companies. This bold move was cemented in 2002 and implemented as of 2005. Others then jumped on the bandwagon under various timetables and procedures, the US being among the last.

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The triumph of IFRS is breathtaking: after all, not many rules shape the business world as powerfully as accounting standards. It marks the victory of a unique governance model. The standards are decided by a 14-strong committee, the IASB (International Accounting Standards Board), formed within a US-registered foundation whose operations are located in London. The foundation is governed by 22 co-opted Trustees and receives voluntary funding from mainly private sources from all over the world, of which a big part comes from the main audit networks.

This private governance has proved to be a key success factor. The fact that it is, in principle, independent from political and economic interests which might be affected by changes in standards has allowed the IASB to adopt texts which, in general, meet the information needs of global capital market participants rather well, while at the same time remaining sufficiently flexible ('principles-based', as accountants say) to accommodate the huge diversity of situations throughout the world. IFRS have won out because they provided a better, ready-made response to market demand than any outcome of negotiations between nation-states. Europe, for example, thirty years ago had attempted accounting harmonisation under Community rules, and failed. But the global accounting experiment is too recent to conclude that it constitutes lasting success.

Two key questions remain open concerning the viability of IFRS. First, implementation. Good standards are not enough: they must also be applied properly. But in many countries public regulators remain tolerant of 'nostalgic accounting', when companies cling to practices inherited from former national standards at variance with IFRS orthodoxy.

Market participants favour principles-based standards in theory, but in practice they will increasingly call for specific implementing guidance or rules in order to ensure comparability and to reduce legal uncertainty. Even before the adoption of IFRS in Japan and the US, inconsistencies within Europe are becoming apparent. When Société Générale booked the 'Kerviel loss' in 2007 rather than 2008, French public authorities did not object even though the policy was deemed non-compliant with IFRS by many public and private observers in Europe. One solution would be to create a 'European chief accountant' with a comparable mandate to that of the SEC's chief accountant, who would work for the national authorities and would gradually thrash out a common implementation doctrine. But there is no consensus for this proposal in the fragmented universe of European financial regulation.

The second major open question is the ability of the IASB to maintain the quality of its standards over time. Responding to the European Commission's and Parliament's grumbling – these still have to come to terms with their ceding of sovereignty in 2000-2002 – and above all driven by desire to snatch a decision from the SEC before the end of the Bush era, the Trustees are preparing to submit themselves to the authority of a 'monitoring group' scheduled to start in a few months. The monitoring group, whose exact legal status remains fuzzy, is designed to control the appointments and reappointments of Trustees and thus, indirectly, the whole governance of IASB. It is to include the SEC, the European Commission and the Japanese financial services agency, as well as two other national regulators, the International Monetary Fund, and the World Bank.

The creation of the monitoring group was conceived in something of a rush at the end of 2007. It runs the risk of proving counterproductive, if it ends up reinforcing politicisation of standard-setting and reducing both its efficiency and its quality. The vivid debate this year on fair value and the role of IFRS in the financial crisis illustrate how vital the quality of standards is to the economy as a whole. The legitimacy of the IASB must be increased, but primarily vis-à-vis investors and other users of financial information, whose satisfaction should remain the IASB's overarching priority. In a nutshell, the Trustees must show more institutional creativity if they are to anchor the IASB with its various public and private stakeholders.

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In case of eventual failure, the recent decision of the SEC will have been a Pyrrhic victory, and perhaps herald a new era of fragmentation of the global financial sphere. Conversely, success could lead to a spread of the IASB's model beyond the accounting realm, and help create acceptable common norms for a globalisation which sorely needs them.

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