Originally published in French in *La Tribune*, 19 July 2007

For Whom Are Accounting Standards Set?

Nicolas Véron

The adoption by France and the rest of Europe of the International Financial Reporting Standards (IFRS) has fostered a debate on accounting that barely existed before. Four years ago, passionate arguments were made against fair value accounting and how it was going to tip our prudent and well-advised model of capitalism into short-termist abyss. But after two years of IFRS in action, Europeans can be proud of having shown the rest of the world the way. Most large developed economies have adopted IFRS, fully or with minor variations, or have undertaken to do so shortly.

The only major exceptions are Japan, committed to IFRS but so far with no deadline for adoption, and the US; but the latter is about to join the pack. On 2 July, the US Securities and Exchange Commission (SEC) proposed that foreign companies listed on Wall Street should be exempted from the requirement to 'reconcile' their accounts with the local US GAAP. The SEC is already envisaging the next step, which is to offer US companies the choice between IFRS and GAAP. These proposals are strongly supported in the US business community. If they come off, the world will have been conquered in a few years by a simple idea recently summed up by the US Financial Accounting Standards Board's chairman, Robert Herz: "global capital markets imply global standards".

But in reality, success cannot yet be taken for granted. As the IASB (the private body which sets the IFRS) increases in power and influence, its processes and priorities increasingly come in for scrutiny. To date, the IASB's decisions have been broadly sensible. But will this continue to be the case? Accounting standards must follow business developments and cannot remain a rigid corpus of rules. In the IASB's case, new standards should above all reflect the needs of the users of financial information, i.e. investors, creditors, and the analysts and rating agencies which help them. But the *de facto* power wielded by the IASB as a result of universal adoption of IFRS is giving rise to new and complex conflicts.

The IASB's difficult role is illustrated by the debate about the IFRS 8 standard on business segments, which governs the way in which companies publish the breakdown of their accounts according to their business lines and geographical areas of activity. This information is critical for investors and analysts in order to understand business models and risks. However, many users deem IFRS 8, adopted last year and aligned closely on the corresponding US standard, to be less demanding than the previously applicable rule, leaving companies excessive leeway to present themselves in the best possible light.

But users of financial information form a dispersed community, with few resources and often limited independence from large listed companies which themselves publish accounts under IFRS and as such have their own agenda. As a result, the users' voice often comes late, and with a low volume. Many users discovered IFRS 8 only after the end of the IASB's consultation phase in 2006, and even after the first stages of endorsement of the standard by the European Union. Concerned about the risk of a drop in the quality of financial information, the European Parliament at the end of April brandished its veto. All of a sudden, the IASB found itself in a tight spot. It could either repent and go back on IFRS 8, at the risk of irritating its US partners. Or take the risk of a clash with users of financial information, analysts and investors, even though these are supposed to be its key stakeholders.

It is to be hoped that a compromise solution can be found on IFRS 8, but this episode still sets alarm bells ringing for the IASB. The London-based body will only be capable of sustaining its authority if it remains credible in its claim to independence from Europe, the

US, big business, and the big accounting firms. The IASB is finding it difficult to play the institutional game and at the same time be listening permanently and actively to users of financial information, from whom its legitimacy derives. Despite appearances to the contrary, the long-term success of IFRS is by no means certain, and the most serious crises surrounding their adoption are probably still to come.

Nicolas Véron is a Research Fellow at Bruegel.