



“Does Accounting Matter?”

**Presentation of the book *Smoke & Mirrors, Inc.: Accounting for Capitalism*
(Cornell University Press, July 2006)**

Nicolas Véron

Discussant: Karel Van Hulle

19th September, 2006, 12:45 pm to 2:30 pm, at Bruegel

Nicolas Véron, research scholar at Bruegel, presented his book *Smoke & Mirrors, Inc.: Accounting for Capitalism* at Bruegel's lunchtalk on September 19. He highlighted the importance of accounting in influencing corporate behavior and the challenges that lie ahead for the regulatory and standard-setting institutions in this area.

First, Mr Véron outlined the main events in the accounting world over the past two decades. He pointed out that, although in the 1980's and early 1990's, there were some corporate scandals (like that of the Bank of Credit and Commerce International, BCCI), these were more about corporate governance than about accounting. Later in the decade, however, controversies about accounting standards started to arise – including the XEROX misstatements 1997-2000. At the turn of the 21st century, Enron's and WorldCom's defaults directed attention once again towards accounting and auditing standards and regulation.

Even before the Enron scandal, the EU had made the decision to adopt IFRS (International Financial Reporting Standards). The IFRS is considered a "principles-based" set of standards, in that they establish broad rules rather than dictating specific treatments. These standards are currently issued by the IASB (International Accounting Standards Board). Although the general framework of the IFRS was accepted with quasi-unanimity in the European Parliament, the approval of some of the individual standards has been controversial. Starting in 2005, all publicly traded EU companies are required to prepare their consolidated accounts using IFRS.

Véron followed his presentation with a discussion on some common misconceptions about accounting, mainly that accounting is unnecessarily complex and that it is about measuring the past. Similarly, he highlighted that accounting measurements are not neutral since they can have an important effect on corporate behavior like, for instance, stock options do.

The last part of the presentation focused on the new challenges faced by policy makers in terms of accounting standards. New challenges have arisen from the transformation of capitalism in the face of international economic integration and the emergence of new technologies. He noted that in today's world, there has been a shift in the balance of power from managers to investors and de facto regulatory competition at the global level among different standard setting institutions.

Mr Véron identified five main challenges. The first of these challenges is related to the implementations of the IFRSs in Europe and the non-US world. In particular, the presenter argued that it is not clear if the current framework includes the appropriate set of institutions and the needed consistency to be sustainable in the future. Secondly, Véron highlighted the need for the EU to try to get the SEC (United States Securities and Exchange Commission) to recognize the European companies that use IFRS at home – currently, the SEC requires all overseas companies listed in the US to prepare their results under US GAAP (Generally Accepted Accounting Principles) in addition to their local requirements and to reconcile the two results.

A related matter, discussed by Véron, is the need for the two main standard frameworks- IFRS and US GAAP – to converge. This poses important challenges in itself, if not only for sovereignty and autonomy issues, but also because the two set of standards are based on different philosophies (principles in IFRS vs. rules in GAAP). Finally, he emphasized the need for the IASB to accept its public role and, at the same time, foster public understanding –especially among businessmen and politicians – in terms of the relevance of accounting standards and their potential effect on behavior.

Before introducing the main discussant, Jean Pisani-Ferry noted that Véron's book *Smoke & Mirrors, Inc.* actually has three dimensions: an introduction to accounting, a reflection of how standards affect behavior and an analysis of current discussions. He added that the presentation, for time limitations, had focused on the third part of the book.

The discussant for this presentation was **Karel Van Hulle**, an active player in the setting of accounting standards in Europe, having represented the Commission within the International Accounting Standards Committee and chaired various related committees in the Commission. Mr. Van Hulle focused his presentation in an area he considered Véron's book had a gap: the role of the European Commission in developing accounting standards for European companies.

Van Hulle pointed out that with the rapid development of capital markets in the 1990's, there was a need for the Commission to help standardise the preparation of firms' financial statements. Already in 1995, the Commission recommended adopting international standards, which were made a requirement for firms ten years later. The discussant further emphasised that accountancy is full of politics, that financial reporting is about communicating and explaining the choices made by firms and, as such, reporting should be consistent and its rules stable.

In the open discussion, the first issue that came up was related to the role of public policy in the debate about accounting standards. There was disagreement in terms of the interest of policy makers on accounting issues. The presenter argued that, often times, businessmen and politicians do not understand the issues at hand so they prefer to refrain from the debate.

A different comment tackled issues related to the process of determining standards and the traditional separation between politicians/managers and accountants/auditors. It was pointed out that, in a modern economy, the two have to work together, even when in the past it could be afforded to have a breach between the two. Lack of sufficient funding for the regulations that are now required for firms and whether this funding problem is a national or a European issue were also addressed.

In terms of the extra-territorial issues involving international accounting and auditing, the presenter argued that there is always a tradeoff between legitimacy and efficiency when global governance institutions are designed. It was also recognised that a communication gap exists among the different parties and that the Commission needs to play an active role in closing it.

The discussion ended with an optimistic note that in accounting, like in other areas such as competition, there will be progress made and the different standards will converge even if rules do not become identical.