Held to Account

by

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Imagine an authoritarian regime insisting that regardless of history, culture and social needs, everyone has to use only one officially approved way of thinking and communicating. No experimentation would be permitted even though social and business needs would continue to change. There would be an uproar, critique and discontent. Yet this authoritarian world is with us in the guise of international financial reporting standards (IFRSs).

Organised corporate interests are very keen to promote international accounting standards by a single ‘private’ body as it helps to move regulation away from governments and public authorities to private interests. This gives them control of policymaking apparatuses to ensure that threatening issues can be marginalised, or organised off the agenda.

There is no theory to justify one set of standards for the whole world. All sorts of benefits are claimed for global accounting standards, but none are substantiated by any hard evidence. There is no evidence to show that the absence of IFRSs and the existence of diverse accounting practices had any adverse effect on global trade, foreign direct investment, or capital markets.

The key actor in globalisation of accounting is the International Accounting Standards Board (IASB). The IASB is controlled by the International Accounting Standards Committee Foundation (IASCF), an organisation registered in the US state of Delaware, a place well known for secrecy. The Big Four accounting firms provide about £3 million of its £10.4 million budget. The remainder comes from nearly 200 multinational corporations, many of whom are implicated in scandals. Unsurprisingly, corporate interests dominate the IASB structures and committees.

The IASB claims to be independent of its corporate backers, but the collapse of Enron brought some interesting information to light. The IASB had solicited a $500,000 donation from the disgraced American energy giant. Enron executives were considering the request because they thought it would give them influence over accounting policymaking. US Senator Carl Levin added that “Enron wanted to know whether its money would buy access and influence at the new accounting standards board, and its auditor didn't bat an eye at this inquiry[1]".

The accounting standards affect the distribution of income, wages, dividends, wealth, risks, taxes and social welfare of all citizens. Yet, the IASB is not accountable to democratically-elected parliaments. Its members are not elected by stakeholders or any representative organisations. Neither is their suitability scrutinised by parliamentary committees.

The victims of poor accounting cannot check the IASB because it does not owe a "duty of care" to any individual shareholder, creditor, pension scheme member or any other party affected by its pronouncements. The details of any Enron-type deals made with financial backers are not on public record. Despite being a de facto public policymaker, the IASB is not subject to "freedom of information" laws.

The IASB claims that its standards are based on ‘principles’ rather than detailed rules. Yet this myth is not supported by nearly 3,000 pages of accounting standards. The simple truth is that IFRSs are the outcome of politics and bargaining amongst corporate elites populating the IASB. The resulting residue is routinely described by the IASB as "neutral" and "objective". These are highly value-laden concepts and continue to disarm journalists and critics.

The European Union has adopted IASB standards for quoted companies, without agreeing any rights for the parties affected by them. The US is likely to follow and adopt a dominant role. The aim of the IASB is nothing less than global conquest and to make the world fit for major corporations. It expects all major businesses - whether based in America or Afghanistan, Britain or Bolivia - to follow its standards regardless of local needs and histories. The IASB accounting standards are imposed on developing countries as conditions of loans, grants, investments and donations by western governments, the World Bank and the International Monetary Fund. Such imposition makes developing countries dependent on the west and prevents them from developing appropriate local institutional structures. Ironically, the accounting standards forced upon developing countries have already failed, as evidenced by numerous western accounting scandals. They have little relevance to developing countries which do not have or need active capital markets and wish to develop alternative ways of corporate governance.

To secure its legitimacy, the IASB invites interested parties to comment on its draft standards. Such processes advantage corporate interests who have the resources to shape policies. Ordinary people suffering from dubious accounting and losing their jobs, savings, investments, pensions and homes are not in any position to shape IASB standards. There is no evidence to show that any note is taken of the views of non-corporate respondents.

Consider the recent episode relating to IFRS 8 “*Operating Segments”.* Some institutional investors are unhappy because IFRS 8 does not require companies to publish meaningful information about their geographical activities. They want this information to enable them to make assessments of the returns and risks that they face when investing in global companies operating in places as diverse as the UK, USA, Bangladesh and Nigeria. Increasingly, multinational companies face challenges from governments and Non-Governmental Organisations (NGOs) on environmental, human rights and tax avoidance issues. This could have serious consequences for timing of cash flows and quality of earnings.

Institutional investors and nearly 80 NGOs wrote to the IASB to object to the draft leading to IFRS 8. The NGOs advocated what has become known as the "country-by-country" approach. This would require multinational companies to publish a table a showing all the countries they operate from, together with turnover, profits, taxes, assets, liabilities, employees and carbon emissions in each.

The country-by-country approach would highlight some interesting situations. For example, NewsCorp has lots of economic activities (Sky TV, newspapers) in the UK but pays little corporation tax. Microsoft has relatively few employees in Ireland, but over $16bn of assets and $9bn of profits. How can that be? So the country-by-country approach would highlight anomalies and create possibilities for investors, citizens and the authorities to raise searching questions about corporate activities.

However, major companies oppose such disclosures. The IASB has sided with major corporations. IFRS 8 gives company management discretion on whatever they might choose to publish. It does not set any benchmarks for disclosures either.

The above episode shows that privately funded regulators cannot bite the hand that feeds them. The public rhetoric is that the IASB creates accounting standards for the benefit of investors, but that is not evident from the formulation of IFRS 8. The IASB also claims that its rules benefit society generally, but has totally ignored the concerns of NGOs. The "country-by-country" approach would highlight tax avoidance and carbon emissions and would benefit the whole society. But none of this persuaded the IASB to modify its draft 'segmental reporting' standard.

International financier George Soros stated that "international business is generally the main source of corruption[2]" and Transparency International adds that bribe "money often stems from multinationals based in the world's richest countries[3]". The global proceeds of corruption and bribery, including tax avoidance, are estimated to be around US$2 trillion each year. Yet the IASB has failed to develop any disclosure standards.

International accounting standards will become part of domestic strife and international conflict. In the aftermath of a scandal, governments will come under pressure to revise accounting rules. For them to abdicate their responsibility and claim that the undemocratic IASB would sometime in the future resolve the problems would risk domestic ridicule and electoral dissatisfaction. Any attempt to force the issues internationally would also lead to criticisms. The misadventures in global accounting would haunt us for years.

[1] Financial Times, 13 February 2002 (http://specials.ft.com/enron/FT35N1OMNXC.html).
[2] Financial Times, 8 December 1998.
[3] Transparency International, "Persistent corruption in low-income countries requires global action", Transparency International, Berlin, 2007.