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Can accounting standardization serve the public interest?

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Abstract

In line with his concerns to conceptualize the accounting principles and practices, the author develops the topic that falls under the above title, based on the premise that the facts and developments during the economic crisis show that accounting standards cannot be conceived solely by their internal consistency – often revealed a posteriori by their conceptual framework, but also by taking into account their economic and social impact, and their consequences. Hence, the standard setters claim that they work for the general interest.

Consequently, the author pursues to define the concept of general interest in the light of relevant literature and accounting law, and examines the procedural answers provided by standard setters to confirm the consideration of the general interest concept, and to finally find out whether a substantiated answer is possible. In his analysis, the author also outlines the issue of high relevance of stakeholders' representation in regulatory bodies and their intervention in the development of standards.

In his endeavour, the author also suggests a substantial approach to the general interest in terms of consequentialism, i.e. the teleological ethics according to which an action must be judged morally on the consequences it implies. Of course, the concept is applied to financial and non-financial information. An interesting conclusion is reached on the general interest that not only legitimizes the standard setters who claim it, but also the public authorities that also determine the content of the financial and non-financial statements of the companies. This intervention is due to the consequences of the standards and their impact on society. Therefore it can never be taken for granted the fact that international standard setters consider themselves as representatives of the general interest.

Keywords: Accounting standards, standard setters, regulatory bodies, general interest.

JEL Classification: M 41, M 48

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Introduction

The financial crisis that started in August 2007 has raised awareness: the accounting standards are not only used to produce an accurate and neutral image of the assets, results and financial situation of a legal entity (natural or legal person) or economic (group), but they create a reality. If a star or a chemical body is insensitive to the opinion that the observer may have on it or what is said of it, a human organization is not. For example, the rumour of the bankruptcy risk of a bank is enough to cause bankruptcy. In the economic domain, information is performative (Burlaud and Niculescu, 2015) and forecasts can be self-fulfilling.

More specifically, IFRS have been accused of having a pro-cyclical effect (Baert and Gaël Yanno, 2009). Well before the crisis of 2007/2008, but after the publication of the European Regulation no. 1606/2002 on the adoption of the IAS/IFRS, the President of the Republic, Jacques Chirac, in a letter dated July 4, 2003 and addressed to the President of the European Commission, Romano Prodi, warned against the risk of increased volatility of the financial markets as a result of the adoption of these standards, which are nevertheless applicable only to the consolidated accounts.

Let's go back to the financial crisis. Faced with the risk of chain failures of the financial institutions, the European Commission drew the attention of the International Accounting Standards Board (IASB) to the systemic risk implied by the method of evaluating the securities particularly held by banks. "Thus, it became aware of the harmful consequences of IAS 39 and, at the meeting of the ECOFIN Council on October 7, 2008, lobbied the IASB to allow the companies to reclassify their financial instruments in a category where they are no longer evaluated at their "fair value". This has been done since October 13, 2008, which allowed some banks to reduce their depreciation amounts and preserve (accounting) their results (Burlaud and Colasse, 2010). The reaction of the IASB was rapid according to the danger!

These reminders show that the accounting standards cannot be conceived by worrying only about their internal consistency often revealed a posteriori by their conceptual framework, but there must also be taken into account their economic and social impact, their consequences (Burlaud and Baker, 2015). Standard

setters therefore claim to work in the service of the general interest or the common good.

We will, hereinafter, (1) study and define the notion of general interest in the view of literature and accounting law, (2) present the procedural responses provided by the standard setters to affirm its consideration and (3) see if a substantial sound answer is possible.

1. Reflections on the concept of general interest

The concept of general interest was addressed more specifically in political science and law.

1.1. Political science and the concept of general interest

The whole standardization, of which accounting standards are only a special case, is an infringement of the individual freedom that must be justified, legitimized by a superior advantage generally called "general interest", "public interest" or "common good", (Lalande, 1983).

The concept of general interest appeared in the 18th century with two currents of thought:

- A utilitarian concept (we would say today "liberal" in the economic sense of the term) inspired by the works of Adam Smith and Bernard Mandeville;
- An interventionist and holistic concept inspired by the works of Jean-Jacques Rousseau.

The utilitarian current defines the general interest as the sum of particular interests. This is not a sum of all desires but only those which can express themselves in a relationship. The principle of the natural harmony of interests, thanks to the invisible hand of the market, rely on the two following postulates (Aroux, 1998):

- The decrease of interest in favor of the economic advantage and, consequently,
- The identification of the public good in favor of the economic prosperity.

Therefore, *homo oeconomicus* holds the center stage. According to this concept of the general interest, the scope of the standardization must be as limited as possible.

The interventionist current, on the other hand, states that the whole is not the sum of the parts. There is a superior

finality of individual interests, a peculiar interest of the community that overpasses that of its members. This is the concept expressed by Jean-Jacques Rousseau by the concept of “social contract”. More open to a limitation of individual rights, this current carries within it the germ of collectivism. But the utilitarian current carries within it another germ: that of growing inequalities and the obedience of the planet only to economic considerations.

The reality is obviously not reduced to a binary choice: pure utilitarianism versus pure interventionism. Both are associated in varying proportions. The English tradition is more utilitarian whereas the French tradition is more interventionist.

Utilitarianism has an important advantage: ensuring a better functioning of the market with minimal standardization is easier than trying to replace the market. The collapse of the USSR and, more generally, the planned economies have fully demonstrated this. But no collectivity would be able to function without rules and without the intervention of a public power form, it would be really necessary, to invoke the general interest to legitimize these actions. Therefore, there appears the incapacity to define the general interest which remains a vague and contingent concept, fluctuating with the case law of jurisprudence. However, it can be seen that the state’s incapacity to assume its regulatory and referee role usually leads to disasters. For example, the lack of financial regulations led to the 2008 crisis, exploited by some people in favor of a private interest: that of the speculator.

1.2. Law and the concept of general interest

The accounting law has many references to the general interest.

The regulations of the International Federation of Accountants (IFAC) state from the introduction that: “*The mission (...) is to serve the public interest (...)*”, (IFAC, 2014). Article 4.1 related to missions states that: “*IFAC acts in the public interest and has no profit-making purpose.*” If the regulations do not define what is meant by the public interest, they count the means of serving it. Thus, Article 4.2 ensures that: “*IFAC serves the public interest by: contributing to and supporting high-quality international standards, helping to build and encouraging strong professional accountancy organizations, accounting firms, and high-quality practices by professional accountants; and speaking out on public*

interest issues.” The IFAC Policy Position 5 provides the following definition of public interest, an expression we assume to be synonymous with the general interest: “*IFAC defines the public interest as the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy.*” More specifically, the benefits of the company include: “*the soundness of financial and non-financial reporting, the comparability of financial and non-financial information across borders, fiscal prudence in public expenditures, and the contribution that accountants make to corporate governance, efficient resource management, and organizational performance.*” The public includes the following stakeholders: “*investors, consumers, suppliers, citizens and taxpayers, as well as those seeking sustainable living standards and environmental quality, for themselves and future generations.*”, (IFAC, 2012).

The regulations of the IFRS Foundation (IFRS-F) also highlight the importance of its action in defending the public interest. Thus, Article 2 stipulates that: “*The objectives of the IFRS Foundation are: (a) to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world’s capital markets and other users of financial information make economic decisions.*” In addition, the Trustees, that is, the members of IFRS-F, and the members of the IASB commit themselves in writing to act for the public interest (Articles 6 & 17 of the regulations) and to be strictly independent. However, the public interest is not defined.

We can see that, in both cases, the reference to the general interest is found in the standards of the standard setter, which define the given objectives and not the standards themselves.

The European accounting law does not refer to the general interest in the Directive 2013/34 “regarding the annual financial statements, consolidated financial statements and the related reports” which defines the accounting standards applicable in the European Union, but it is mentioned in the Regulation 1606/2002 “on the application of the international accounting standards”, as we will see it in § 3 below.

The French accounting law does not mention the general interest at all. But does the law, voted by Parliament, need to refer to it? Is it not compliant with the pursuit of this objective simply because it comes from the national representation?

However, the invocation of the general interest is not a simple figure of speech. It generated procedural responses and sound responses as we will see hereinafter.

2. The procedural answers to the question of general interest

We have just seen that if the reference to the general interest is an essential element for the legitimization of the standard setter and the standards, we come up against the practical question of the definition of this general interest. The procedure may be a consensual manner of solving the issue. We call here "procedure" two different things:

- the manner of designating the people who produce the standard;
- the manner of consulting the stakeholders, the *due process*.

2.1. Stakeholders' representation within the standardization bodies

The practice of international standard setters, IFAC and IASB, inspired by the American practices, consists of entrusting the production of standards to professionals (*self-regulation*). But they do so under the control of a monitoring body meant to represent the interests of a wide range of stakeholders (*public oversight*). The purpose of the mechanism is to combine the technical expertise of professionals and the political perspective of this monitoring body.

The IFAC case. This organization standardizes, through its Standards Setting Boards (SSB), the International Public Sector Accounting Standards (IPSAS), the International Standards on Auditing (ISAs) and the Ethics (Code of Ethics for Professional Accountants). The architecture of the organization is very complex; we will therefore limit ourselves to the Public Interest Oversight Board (PIOB), (IFAC, 2015), which is one of the components of IFAC's external monitoring mechanism. It is a technical committee of the PIOB

Foundation, created in 2005 as the result of several "cases" including Enron in the United States, by three international organizations:

- The International Organization of Securities Commissions (IOSCO) which groups stock exchanges;
- The Bank for International Settlements (BIS), which regulates banks;
- The International Association of Insurance Supervisors (IAIS) which is the regulator of insurance companies.

The ten PIOB members are appointed by the Foundation. They come from the world of finance (banks, financial markets authorities), auditing or accounting standardization.

The PIOB has a triple mission:

- Control of the correct application of the *due process* of the SSB of IFAC;
- Monitoring the achievement of the SSB's objectives;
- Monitoring the appointment of SSB members.

This manner of organizing the PIOB leads to a double observation:

- In terms of its composition, it is a question of ensuring the proper functioning of the financial markets and not of representing "the general interest" which cannot be limited to finance;
- It does not interfere with the content of the standards but only with procedural matters. While these are obviously important, they are not everything.

The IASB case. The standard setter for financial accounting, the IFRS Foundation, has three components:

- The Monitoring Board, which represents the authorities of the financial markets and ensures the link with the public authorities;
- The Trustees who are responsible for the governance (Foundation regulations and *due process*) and ensures the monitoring of the IASB;
- The IASB itself which independently ensures the preparation of the standards and their interpretation proposed by the IFRS Interpretations Committee (IFRIC). It consists of independent experts from various geographical backgrounds, with experience

in standardization, accounting practice, auditing, financial analysis and training.

As precedent:

- The composition of the monitoring bodies essentially represents the interests of the financial markets and not a “general interest”;
- Complying with the procedure, the IASB is independent.

Europe and, as far as we are concerned, France, do not need to envisage monitoring bodies representing the general interest since the Parliament already plays this role. However, in both cases, the standard setter relies on the technical skills of the professional world: the European Financial Reporting Advisory Group (EFRAG) and the Accounting Standards Authority (ASA).

An organizational architecture can introduce, with the important reservations we have already emphasised, the possibility for some stakeholders to make their voices heard. But do they really use this possibility? Do they intervene in the production of standards? Are there stakeholders excluded from the monitoring bodies?

2.2. Intervention of stakeholders in the production of standards

Since the monitoring bodies are not validated by an electoral process and they represent only a limited number of stakeholders, mainly accounting and finance professionals, the production of standards must use a consultation procedure as wide as possible: the *due process*, consisting of publishing each draft standard accompanied by a call for comment. Anyone can thus supply the standard setter an opinion on this draft before its final adoption. The opinions and answers are made public in order to ensure at least formally the transparency of the procedure.

But again, the practice does not follow the intentions. Deciding on issues of great technical complexity requires resources in terms of skills and time and, for non-English speakers, language skills, since the comments should generally be written in English. As a result, many stakeholders are excluded from the process and most of the comments come from large international firms, the *Big Four* and a few others, corporate finance departments, finance ministers from some countries or their national standard setters and their professional organizations. It is therefore far from a balanced

representation of stakeholders. In particular, small enterprises, employee representatives and developing countries are not well perceived. The necessity of family capitalism based on a long-term patrimonial logic and not a logic of stock market nomadism concerned with shareholder value are not taken into account. The response provided by IFRS-SME is unsatisfactory.

Moreover, as Anne Le Manh has shown in her doctoral thesis about the IASB, even if the comments are subject to an answer, they are not taken into account. We can understand it; the standard setter is constrained by the need to guarantee the internal coherence of standards which is built up over the years and crystallizes a posteriori within a conceptual framework.

We saw in § 1.1 above that there were two concepts of the general interest: a liberal view and an interventionist view. The procedural answers considered in respect of the general interest are only the means to bring out the expression of different particular interests or at least of a certain number of particular interests in order to find a point of balance, the barycenter of the different positions. We find ourselves within the framework of a liberal view of the society: the general interest is the sum of classification interests. An interventionist vision, based on a superior project, implies taking into account the consequences of the adoption of standards and their impact on society.

3. A substantial approach to the general interest: the consequentialism

The consequentialism “is the teleological ethics according to which an action must be judged from a moral point of view, on the consequences it carries along. The good character of the consequences, in relation to which we determine what is right, what is good in an impersonal and neutral sense in respect to the agent, (Canto-Sperber, 1997). Consequentialism is opposed to the deontological ethics according to which the good results from the compliance with the rules.”, (Burlaud and Baker, op. cit).

The consequentialism can be applied to two different but interrelated areas: financial information and non-financial information.

3.1. A substantial approach to the general interest: the consequentialism applied to the financial information

When negotiating on the 4th Directive of 1978, an important part of the discussions focused on the concept of true and fair view. This is a superior principle (*overriding principle*). In fact, Article 4 of the Directive 2013/34 states:

- § 3: “The annual financial statements give a true and fair view of the company’s assets, financial position and results. Since the application of this Directive is not sufficient to give a true and fair view of the assets, financial situation and results of the company, the additional information to comply with this requirement is provided in the Annex.”
- § 4 states: “Since, in exceptional cases, the application of a provision of this Directive is incompatible with the obligation provided in paragraph 3, that provision shall not be applied in order to give a true and fair view of the assets, financial position and results of the enterprise. (...)”

In other words, all truth, the truth and nothing but the truth, must be said, possibly taking the liberty of standing away from the rule.

However, this attitude raises two questions:

- Is there one or more accurate images of the company’s assets, financial situation and results?
- Is the whole truth in accordance with the general interest?

The simple reference to the prudence principle (Article 6, §1c of the Directive) implies that the European legislator implicitly admits the existence of several accurate views of the same reality: one prudent and the other not, without counting the intermediate representations. If the choice of prudence is made, it is to avoid the damaging consequences of a lack of anticipation of risks. Prudence and general interest could therefore converge. If it can serve the interests of investors, it also serves those of creditors and employees, for example. From several possible accurate images, we choose the one that will have the most favourable consequences.

Can we say that it is “good” to tell the truth? Of course, concealing the reality there appears the risk

of undermining the stakeholders’ confidence and, thereby, threatening trade and investment, that is, the economic development. But things are not so simple: in our domain, there is interaction between the reality and the information about it. This is not the case of the physical world: the laws are independent of our knowledge and they are predictive. For example, the stars follow their path without worrying about astronomy and, once discovered and validated scientifically, these laws are universal and allow to predict the trajectory of a star. There is nothing like that in the liberal arts and social sciences where the financial information belongs to. The entities are affected by the information that concerns them. Thus, as we have seen in the introduction, spreading a rumour questioning the financial situation of a bank is the best way to really put it in trouble, which history has already shown several times. In theoretical terms, we will say that:

- The information is performative (Burlaud and Niculescu) and that
- The forecasts are self-fulfilling.

The financial information is based on ambiguity: the search for a true and fair view, but at the same time, taking into account the anticipated consequences of the dissemination of this information. This does not occur in Directive 2013/34 or the General Accounting Planning. On the other hand, Regulation 1606/2002, which adopted IAS / IFRS for consolidated accounts, introduced the reserve of the public interest. Thus, Article 3 §2 stipulates that: the international accounting standards may only be adopted (...) if they comply with the European public interest. But the latter one is not defined. Several working documents give a beginning of interpretation. This is about preserving financial stability, not hampering the economic development of the European Union, taking into account the impact of new standards on the competitiveness of the European companies, etc. Thus, consequentialism can be in conflict with the search for the accurate image, with a neutral and objective view on the financial information.

An interventionist view of the general interest leads quite naturally to expanding the field of information. For a few years, we have seen the development and standardization of the environmental, social and governance (ESG) reporting.

3.2. A substantial approach of the general interest: the consequentialism applied to the non-financial information

The interventionist view of the general interest, absent from the operating methods of international standard setters, appears in the European accounting law with the Directive 2014/95 concerning “the publication of non-financial information and information related to diversity” and in the French accounting law.

In respect of Europe, Article 1 §1 al. 1 of the Directive 2014/95 stipulates that: “Large companies which are public-interest entities (...) shall include in the management report a non-financial statement containing information, necessary for understanding the evolution of business, performance, enterprise situation and the impact of its activity, at least on environmental issues, on social and personnel issues, respect of human rights and the fight against corruption (...). But, to date (Capron and Quairel-Lanoizelee, 2007), no “guideline” has been published and this had to be done at the latest December 6, 2016 according to art. 2. This delay is probably due to the technical difficulty of the subject.

France has been a pioneer in the domain of non-financial communication. The law of 15 May 2001 regarding the new economic regulations (article 116) required the listed companies to include social, environmental and societal information in the annual reports of the board of directors or the executive board. The law of 12 July 2010 on the national engagement for the environment (known as Grenelle 2) extends this obligation to certain unlisted companies. Its implementing ordinance was voted on April 24, 2012. Today, article R225-105-1 of the Commercial Code presents a detailed list of headings classified into three large categories: social, environmental and societal. Article R225-105-2 deals with the control of this information in a manner close to the statutory audit. “The independent third-party body called upon to check (...) the information to be included (...) in the report submitted by the board of directors or the executive board of the company is appointed, as the case may be, by the managing director or the Chairman of the Management Board, for a period not exceeding six financial years, from the organizations accredited for this purpose by the French Accreditation Committee (COFRAC) or by any other accreditation body that has signed the multilateral recognition agreement established the European

coordination of accreditation bodies. (...) The verification of the information to be included (...) in the management report leads to a report from the independent third party (...)(Guivarc'h and Thauvron, 2016).

The corporate social responsibility (CSR), (Capron și Quairel-Lanoizelee, 2007) is an interventionist approach.

Conclusion

The general interest is a concept which, within the various texts that we have presented, is not clearly defined and which, therefore, leaves a wide freedom of appreciation to the various stakeholders and especially the public authorities in times of crisis.

The objective, which is to serve the public interest, is usually limited to what is in fact only a particular interest: the “good” functioning of the financial market. In fact, if the hypothesis of the market efficiency were verified, then they would ensure an economically optimal allocation of resources. But this hypothesis is questioned by an increasing number of economists analyzing the financial bubbles incompatible with financial theories or explaining the market's obstinacy in not reacting in compliance with the classical theory departing from the new paradigms such as those derived from the behavioural finance, (Guivarc'h and Thauvron, 2016).

But, because the operation of the markets is not without links with the stability and / or the economic growth, and therefore, with the employment, the consumption and the resources of the public communities, because the public suppliers are “accountants” of the macro-economic balances and they are often the insurers of the last recourse in a crisis (see the bailout of banks in 2008), the general interest not only legitimizes the standard setter who claims it but also the public authorities which also determine the content of the financial and non-financial statement of companies. This intervention is done on behalf of the norm consequences, of its impact on society. The fact that the international standard setters proclaim themselves representatives of the general interest cannot be taken for granted.

We noticed that taking into account the economic and social standard consequences, consequentialism can rise a problem of compatibility with the objective of the true and fair view based on the hypothesis of the standard neutrality.

As the Cardinal de Retz said cynically, "You only get out of the ambiguity at your expense." Therefore, there is not unambiguous policy and, consequently, no unambiguous accounting policy.

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