

# The IASB: From High Quality Accounting Information Towards Information to Foster Trust and Stability in Global Markets

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Since 2001, the International Accounting Standards Board (IASB) embarked on its mission to become the global accounting standard-setter. In the first decade, there was a lot of goodwill towards this goal and the number of countries adopting the International Financial Reporting Standards (IFRS) grew slowly. By the end of the 2000s, the economic landscape changed. First, in the aftermath of the financial crisis, doubts whether the IFRS contributed to market fluctuations during such a crisis came up. Second, the introduction of IFRS for small and medium-sized enterprises (SMEs), comprising companies not listed in the European Union, has not been successful, many large coun-

tries maintained generally accepted accounting principles (GAAP) of their own. Third, the wish of the U.S. authorities to allow domestic firms to use the IFRS for listing purposes on U.S. stock markets decreased dramatically. In order to adapt to a changing landscape and to keep its role as a vibrant global accounting standard-setter, the IASB carried out an agenda consultation. The IFRS Foundation reviewed its effectiveness and its structure. The IASB decoupled the review of the conceptual framework of financial reporting from the review by the Financial Accounting Standards Board (FASB) and recently the IASB has also adapted its Mission Statement.

## I THE FIRST DECADE: TOWARDS A SINGLE SET OF HIGH QUALITY ACCOUNTING STANDARDS

In the first decade of its existence, the IASB expressed its Mission Statement this way:

The objectives of the IASC [International Accounting Standards Committee] Foundation are:

(a) To develop, in the public interest, a single set of high quality, understandable and enforceable global standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions

(b) To promote the use and rigorous application of those standards

(c) In fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies

(d) To bring about convergence of national accounting standards and IAS and IFRS to high quality solutions.

The Mission Statement in the first decade underlines that the IASB will develop a “single set of high quality, understandable and enforceable global standards,” which produces “high quality, transparent and comparable

information in financial statements.” This high quality information is the core goal in the Mission Statement in the first decade. However, when the IASB describes high quality accounting standards and high quality accounting information in its publications, it never provides a concise definition of this concept. Its publications always provide a description of characteristics and other aspects concerning the consequences of high quality information. When academic researchers investigate whether accounting information quality has improved after the introduction of the IFRS, they also face the challenge of defining the concept *accounting quality*. Rather than providing a definition, academic scholars also describe the consequences of accounting quality. Nevertheless, they do so in a much more precise way that enables measuring the consequences of accounting quality in research models. Academic scholars define accounting quality in terms of avoiding low quality information. The latter occurs when preparers smooth income, manage earnings upward or downward, avoid timely loss recognition, and manage the balance sheet values, for instance, through off-balance sheet financing. Thus, accounting standards are regarded as having high quality when they do not provide preparers with discretion to smooth income, manage earnings upward or downward, defer recognition of losses, and manipulate balance sheet values. Low quality accounting standards allow preparers to show accounting numbers that reflect a firm's income and financial position different from the underlying economic situation.

However, does compliance with high quality accounting standards automatically lead to high quality reporting information? Do accounting numbers prepared through high quality accounting standards always represent the underlying economic reality of the company? Unfortunately, there is plenty of academic evidence showing that high quality accounting standards alone are not sufficient to guarantee high quality information (Pope & McLeay, 2011; Bruggeman, Hitz, & Sellhorn, 2013). High quality standards implemented in a defective manner will not result in high quality financial reports. Without proper enforcement, even high quality accounting standards will produce low quality accounting information. Pope and McLeay (2011) and Bruggeman et al. (2013) show that, in countries with low litigation risk and weak enforcement, preparers of financial statements will not be stimulated to report the financial situation in full compliance with the IFRS. Many academic studies (for an overview see Institute of Chartered Accountants in England and Wales, 2015) indicate that an increase in accounting quality after IFRS adoption significantly differs from country to country, depending on the characteristics of the institutional environment where a company operates. Differences in investor protection laws and in the quality of accounting standards enforcement

between countries lead to differences in accounting quality worldwide, despite the fact that all financial statements provide that they are prepared in compliance with the IFRS.

So, academic research shows that the ultimate goal of the IASB, namely, improving the financial information quality worldwide, is something which it is not able to pursue on its own. The IASB can provide a part of the building blocks needed (i.e. accounting standards) to create a global environment with high quality accounting information available to investors, creditors, and other stakeholders for economic decision-making, however the other building blocks required (i.e. institutional characteristics representing the quality of enforcement and investor protection) to stimulate high quality accounting information, depend on national regulators and supervisors. Hence, the core objective of the IASB's Mission Statement in the first decade can be grasped only if national authorities and surveillance authorities make the institutional changes needed as well.

Recently, the IASB adapted its Mission Statement; herein, we analyze whether the new Mission Statement also includes goals that can be grasped only when a country's institutional characteristics evolve with IFRS adoption, too.

## 2 THE SECOND DECADE: TOWARDS A SINGLE TRUSTED ACCOUNTING LANGUAGE THAT BRINGS TRANSPARENCY, ACCOUNTABILITY, AND EFFICIENCY IN THE GLOBAL ECONOMY

In mid-2015, the IASB adapted its Mission Statement. It states that:

Our Mission is to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy

- IFRS brings transparency by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions

- IFRS strengthens accountability by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. Our standards provide information that is needed to hold management to account. As a source of globally comparable information, IFRS is also of vital importance to regulators around the world

- IFRS contributes to economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation.

For businesses, the use of a single trusted accounting language lowers the cost of capital and reduces international reporting costs.

Comparing the two IASB's mission statements, we notice quite a number of differences. The IASB no longer claims to pursue developing a single set of high quality accounting standards that leads to high quality information. Now, the emphasis lies on providing transparency (which includes comparability), accountability, and efficiency to financial markets. May we conclude that the inclusion of the concept of accountability in the new Mission Statement means that the IASB will assign a dual role to financial reports from now on? The first role is related to the usefulness of accounting information for decision-making, which implies the possibility to estimate a company's future revenues and cash flows. This role was already embedded in the Mission Statement of the first decade. The second role is the usefulness of accounting information to evaluate management and a firm's past performance. This explicit introduction of the stewardship function of accounting information in the IASB's Mission Statement might not only be driven by the many reactions of stakeholders in comment letters sent in response to the review of the conceptual framework, but also by the fact that the IASB members in the second decade have a different attitude towards their role as board

members from that taken by the board members in the first decade. Peter Walton thought through these differences in a speech delivered at the European Accounting Congress in Glasgow, in April 2015, and in an article to be published in the journal of the European Accounting Association (EAA), *Accounting in Europe* (Walton, in press). According to Peter Walton, the 2015 board members differ quite a lot from the 2005 board members. The latter consisted of a pre-existing group of colleagues that went on a crusade against historic cost accounting and saw themselves on a mission to revolutionize financial reporting. The board members in the second decade are, according to Peter Walton, from rather diverse backgrounds and they are more pragmatic. The difference in their attitude may have triggered changes in the Mission Statement. Finally, the concerns from different countries, regions, and surveillance authorities that financial stability is needed for the economic welfare also inspired the IASB to rewrite its Mission Statement. Now, it takes into account the concerns voiced by these stakeholders.

In the new Mission Statement, a new concept, 'trust,' as well as a new characteristic, 'trusted accounting language,' have been introduced. First, by developing the IFRS, the IASB intends to cooperate to foster trust, transparency, and stability in the global economy. Second, the IFRS have to evolve into a single (i.e. global) trusted accounting language that reduces the cost of capital and reporting costs. Let us reflect on the concept of trust and how trust is gained. Academic evidence from the management and economics literature shows that people's trust in other individuals and institutions highly depends on the national influence. Although the definition of trust is more or less universal, academic evidence reveals that institutions help to sustain trust in a given society, but also that the level of trust in a society is conditioned to its institutions (Nunn & Wantchekon, 2011; Pierce & Snyder, 2012). So, what people trust largely depends on their national culture, their past history, and the local formal and informal institutions.

The founders of the International Accounting Standards Committee (IASC), predecessor of the IASB, and most of the current IASB members came from market economies where transactions take place based on formal contracts. In these countries, accounting numbers are a formal expression of the financial situation of a company and they may serve as a basis for contracting and decision-making. To make sure that accounting numbers are reliable, formal institutions in these market economies support their reliability by requiring external audit, the use of corporate governance mechanisms, strong enforcement of standards, and well-established laws designed to protect investors and property rights. In these market economies, where transactions take place based on formal contracts, investors, creditors, employees, suppliers, and other stakeholders rely on accounting numbers and they are trusted for contracting and business transactions, because there are strong formal institutions that make sure that accounting numbers may,

most of the time, be relied upon for decision-making and assessment. However, these formal institutions are not under the IASB's control.

Worldwide, we can distinguish between market-based economies, where formal contracting is the standard, and relationship-based economies, where transactions are embedded in long-term networks or informal relationships. Formal contracting and strong formal institutions are often absent in these relationship-based economies, which are characterized by weak protection to property rights and little transparency in the government and legal procedures. In these economies, informal institutions, such as relational ties driven by ethnic bonds, family connections, business groups, and government contacts, take over formal institutions (Jiang & Peng, 2011). According to North (1991), informal institutions are the 'actual rules that have been followed.' Informal institutions are usually unwritten entities and they are created and enforced outside the official channels. Helmke and Levitsky (2003) identify two types of interaction between formal and informal institutions. In the first type of interaction, informal institutions play a problem-solving role to assist social interaction, as well as coordinate and improve the performance of complex formal institutions. In this case, informal institutions reinforce failing formal institutions. In the second type of interaction, informal institutions play a problem-creating role, e.g. via corruption, clientelism, or clan-based politics that undermine markets, states, and democratic regimes. In this case, informal institutions undermine formal institutions. Often, economists also distinguish between extractive or inclusive institutions when analyzing country differences. Extractive institutions are those making it possible for a small minority to flourish at the expense of everyone else (Banerjee & Duflo, 2014). Inclusive institutions are the opposite.

Many papers have identified the importance of the national governance structure for growth, investment, and new firm entry (for an overview see Estrin & Prevezer, 2011), and we may assume that a country's governance structure also determines whether the IFRS can evolve towards a 'trusted' language in that country. In a country with extractive institutions or informal institutions that are conflicting with weak formal institutions, the environment is less munificent so that the IFRS becomes the trusted accounting language. In a country where informal institutions are conflicting with weak formal institutions, perhaps property rights are not observed, and regulation enforcement are lacking, thus there are low trust levels. When extractive institutions are operating, trust levels are not high as well. In these circumstances, it is hard to generate trust through accounting numbers. Therefore, it is extremely probable that national circumstances in a given country determine whether the IFRS accounting language will become a trusted language in its business environment. Again, the IASB seems to have introduced a goal in the IASB's Mission Statement that goes beyond the IASB's control.

These days, the IFRS have been adopted by an increasing number of countries. The reasons for their adoption may differ. IFRS adoption can take place as a part of a donor-aid package along with a global financial institution, such as the World Bank or the International Monetary Fund (IMF), or such adoption may be an initiative of a national government that wishes to increase the legitimacy of companies, since local formal institutions are weak and they do not provide companies with the legitimacy required to engage in international transactions. In both situations, the IFRS are quite often introduced in an institutional environment that is totally different from the environment the IASB's board members usually envisage when they set standards. Listed companies that have international trade relations or those intended to attract international invest-

tors have firm-level incentives to comply with the IFRS, a trusted language for this kind of listed companies may be easier to achieve. However, firm-level incentives to comply with the IFRS are weaker for listed firms that are mainly focused on the local economy or those pursuing business transactions with other economies also characterized by weak formal institutions and conflicting informal institutions. The challenge is even bigger for the IFRS concerning private firms. Private firms often have no or little international ambition. Full compliance with the IFRS among firms operating in their local economy or similar economies concerning institutional characteristics is not needed to increase legitimacy and engage in business transactions, since these firms manage along with informal institutions to make their businesses thrive.

### 3 FINAL REMARKS

The objective of the IASB members and the trustees of the IFRS Foundation by developing and contributing to a worldwide single trusted accounting language through the full IFRS and the IFRS for SMEs is understandable and laudable. Nevertheless, this mission faces the same kind of obstacle that the objective of devising a single set of high quality accounting standards aimed to contribute to high quality information. Both objectives depend on national

attitudes and traditions. They depend on how well formal institutions support and enforce compliance with accounting standards, in order to make sure that these numbers are reliable. It may be claimed that this new mission is even more challenging, since the objective not only requires changes in a country's formal institutions, but also changes in culture, traditions, and actual informal rules that involve transactions between business partners.

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