



**Second  
Symposium  
on accounting  
Research**

*Proceedings*



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# Introduction to the conference



## Jérôme Haas

*Chairman of the Autorité des normes comptables*

Good morning to all of you, Ladies and Gentlemen, dear friends. Thank you for coming this morning.

This time last year, the first symposium on accounting research was launched, a project dear to the newly created French Autorité des normes comptables. We were really touched by the particularly warm and resounding feedback we received on that first symposium. It has been a driver for our work throughout the year.

And here we are at the start of this second symposium on accounting research, exactly as we promised at the end of that first symposium on 16 December 2010.

The coming year will be a crucial one for accounting standard-setting. Accounting standards are or are becoming a common subject for discussion. Many decisions have been made and will need to be made, and strategic thinking is underway as the crisis persists and continues to raise questions to which we need to find answers. Accounting standards are undoubtedly a part of the issues of this crisis, whether we view it strictly as a financial crisis or as a regulatory crisis or even, to some extent, as a civilisation crisis. There are a number of possible exit scenarios in our field. We will be discussing these alternatives throughout the day and preparing ourselves intellectually to tackle this decisive year.

So how will we proceed? Let me give you a brief outline of today's work schedule. You will find the programme in your folder. I will just give you a quick rundown.

- First, we will talk again about the need for accounting research that was the starting point for our discussions last year, when we showed that there was a real demand for accounting research and that the ANC was working to match supply to this demand.

- We will then present our work over the past year. This is obviously not intended to be an assessment, performance report, since it represents just one year of work. The idea is more to gather your reactions and friendly advice so that we can improve on our actions. We will show you some of our results and present the laureates of the first calls for proposals we launched in 2011.

These will form a good point from which to kick off our discussions. So there it is for this morning's work, reflection and exchanges of ideas and tips on French accounting research.

- We will continue our day by addressing more specifically the topic of accounting standard-setting. We will present the ANC's latest major works and some of the projects that are important to us. Here again, we would like to gather your reactions.

- We will then hold two debates on the truly fundamental issue of the representation of performance. I have no intention of starting to present the debate now, other than to say that this has become a global issue mainly in response to the strategic consultation launched by the IASB on its agenda for the coming years. So we are most fortunate to be able to hold a preliminary debate on this point with so many participants here in Paris.

# Accounting Research

The French Autorité des Normes comptables (ANC) is seeking to optimise accounting research. In this, it strives to align supply with demand. It therefore felt it was vital to give a voice to members of the accounting profession, businesses, users and academics well placed to represent the accounting research supply and demand, to present their different accounting research needs and expectations, and to propose ways for those to meet.

## Accounting research to serve original French proposals?



### **Agnès Bricard**

*Chair of the Superior Council of the Ordre des experts-comptables (OEC)*

Accounting is key to management of businesses in highlighting their performance and financial health. We started out essentially with accounting techniques, which we developed to the extent that we were able to establish the first accounting Act on 30 April 1982. Since then we have used the term accounting law. Yet this does not mean that accounting, as a discipline, is set in stone. Developments with economic models impose us a great amount of research and adaptation. The French Autorité des normes comptables (ANC), under the leadership of its President Jérôme Haas, is helping us by organising this second symposium on accounting research to channel the works of leading French accounting research players.

The Conseil supérieur de l'Ordre des experts-comptables is also making its own contribution by engaging in various actions, commensurate with the performance of our businesses.

I will first mention La Revue Française de Comptabilité, which targets a wide audience encompassing all accounting practitioners. Every month, it publishes articles on well-known authors' reflections on legal, accounting, auditing and management issues.

We have also, at William Nahum's proposal, set up the Academy of Accounting Sciences and Techniques (ASTCF). This academy gathers private and public



accountants, financial directors, and so on – from a range of countries. Working groups develop doctrinal and practical thinking. Their conclusions are brought to the wider audience through conferences, publication of technical articles and so on.

Again, in order to improve our efficiency, the French CNCC, chaired by Claude Cazes, and the Conseil supérieur de l'ordre des experts-comptables decided to merge their respective accounting doctrinal commissions on 1 January 2012. I would like to take this opportunity to thank here, on behalf of these two institutions, Jean-Charles Boucher and Jérôme Dumont, the chairs of each of these two former commissions. We have conducted this merger together as part of a business intelligence approach to pool our knowledge and resources in order to increase our performance. This strategic decision will streamline the functioning of our institutions by creating value, in particular intangible value. Our research will show us how to best incorporate such intangible assets, for which our measurement systems have yet to be improved.

Last but not least, we all need to come up with constructive ideas for original French input into the European Union's plans to merge the fourth and seventh directives into a single directive by the end of 2012.

# The expectations of Midcaps



## **Philippe Santi**

*Executive President of Interparfums*

I am speaking with my two hats, as a representative of both Interparfums and MiddleNext.

Interparfums is a company that creates, produces and distributes perfumes under licence contracts. As you may already be aware, it is not, for example, Armani that manages its perfumes, but L’Oreal. It is not Hugo Boss that manages its perfumes but Procter and Gamble. Thus Interparfums produces perfumes for Burberry, Lanvin, Van Cleef, Montblanc,

Jimmy Choo, and so on. We entered the Second Market in 1995. So we have some experience of both stock market quotation and accounting standards. We are very fortunate to have founders who started business in the United States and who are today majority shareholders of the parent company of Interparfums. We are also fortunate to have US GAAP accounting standards. Accounting standards are therefore an important subject for Interparfums.

I am also speaking on behalf of MiddleNext. This association, which includes around one hundred and fifty Midcaps from segments B and C, has its own views and expectations in this respect, particularly with regard to accounting research.

Let me give you some very practical and pragmatic information which throws an interesting light on the expectations of Midcaps – naturally, my remarks are not intended for very large companies. We do of course need to represent the economic situation and performance of our companies. Because of our size, however, we have specific requirements and limited resources and therefore we need to take a pragmatic and simplified approach. This is not the current trend. Our research requirements are directed towards the latter. I will give you two very specific examples.

I speak frequently with financial analysts and French and foreign investors. I meet them very often in relation to our quotation. I notice that very few questions are raised on the Weighted Average Cost of Capital (WACC) or on fair value, etc. Their questions relate more to strategy, to development, to the acquisition of new brands, overseas development and the increase in the workforce. The economic performance of businesses depends on all of these issues and not on purely technical information which is more a matter for specialists.

I will give you another very practical example. We export 90% of our production and a third of our turnover is billed in dollars. Euro/dollar exchange rate variations have been very important for us since we have been listed. In November 2008, the exchange rate, which I still recall, was 1.265. At that time, we decided to hedge 80% of the forecast billing for 2009 denominated in that currency, thus enabling us to protect our profit margin. So we hedged about one hundred million dollars spread over twelve months. I will not say the transaction was a nightmare because we were ultimately pleased to obtain an average rate of 1.29 for 2009 as opposed to the effective rate that we would otherwise have mechanically been 1.39, so that it was profitable for us. But transactions using financial instruments and how they are reported under IFRS were the subject of many discussions internally, in relation to research and with the auditors. Six quarters were ultimately impacted by these transactions with a result considered to be satisfactory. However, we would hesitate to do it again today. Indeed the reporting of certain transactions in our accounts and the monitoring of the relevant accounting standards lead us to reconsider the very reason for carrying out these transactions. This doesn't make any sense.

At present we would like to have simpler standards that are easier to understand and more pragmatic.

I would like to conclude with two remarks: first, in our business we pay royalties in respect of long-term contracts over periods of ten, twelve or fifteen years. And of course we disclose in the notes the total of all our royalty commitments on all of our licence contracts. Today we are talking about commitments of 250 million over the next ten to twelve years. But I have heard about a proposal which would lead to capitalising assets of an amount of 250 million and liabilities of 250 million. This does not however reflect economic reality. We agree with disclosing details of our commitments as required in the notes but we find the idea of capitalising assets in the balance sheet rather surprising.

It appears that there also plans to capitalise leases. Interparfums leases a building situated next to the roundabout on the Champs Elysées which costs one million two hundred thousand euros per year. I cannot imagine any other accounting treatment than recognising the expense as and when it occurs. It is simple and pragmatic.

We need research to look for greater simplification and to spend more time on Small and Midcaps.

## A year of dialog between the standard-setter and accounting researchers



### **Christine Pochet**

*Chair of the Association Francophone de Comptabilité (AFC)*

I would like to start by saying a few words about the Association Francophone de Comptabilité (AFC), an academic association that brings together French-speaking lecturers and researchers in the areas of accounting, control and audit. Its roughly 400 members are drawn from French universities and business schools, thus providing a place for exchange between these two types of higher-education institutions.

The goal of an association like ours is to extend and disseminate knowledge. One of the principal means of doing so is our journal, *Comptabilité Contrôle Audit*, a forum for accounting research in French. It is not the only such publication since our Canadian colleagues also publish French-language academic journals, and other countries do as well. But it is the preferred vehicle for publishing French accounting research. Today, French lecturers are under a great deal of pressure to publish, and their research work is assessed, which is a relatively recent phenomenon. Performance evaluation criteria include the number of publications in double-blind peer-reviewed journals. Prior to publication, each article is reviewed by two experts, from whom the author's identity has been concealed. Likewise, the author does not know the names of the reviewers. Evaluations are thus completely independent and ensure the quality of the work to be published, which is vital.

The journal is also a place for dialogue. An example of this was an article by professors Burlaud and Colasse, which fostered a series of exchanges between accounting academics that were so lively and interesting and stimulating that the journal considered it was pertinent to republish them and make them available to a wider audience of lecturers and researchers.

The AFC also uses the means at its disposal to stimulate accounting research. For example, it subsidizes translations and reviews by English speakers of articles written in English by French authors in order to adapt the articles to the editorial line of the targeted international review ("copy-editing"). It also grants subsidies for conferences and trips abroad. This is of particular interest for doctoral students and young researchers, who benefit from exposure to other research environments. These are often, but not always, in English-

speaking countries; recipients have also visited research centres in Scandinavia, the Netherlands and Germany. The goal is to receive helpful input from one's peers and to experience other ways of conducting accounting research.

The Association also carries out targeted actions towards doctoral students that will ensure the renewal of generations within accounting researchers. Thus, the first day of the AFC annual conference is always devoted to this group. Several times a year, seminars are organised on methodological topics. All of this is in addition to the work carried out in doctoral institutions, but with an approach that is more focused on the areas of accounting, control and audit. Our annual conference is also a venue for researchers from the French-speaking countries to present their work.

Let us now return to what accounting research involves. My colleagues here already know the answer to this, but I would like to address representatives from the business world and professionals, in order to get across certain messages that were also expressed last year in this very place by Hervé Stolowy. I would like to start by reviewing the various approaches that exist in accounting research.

Accounting research can be carried out in different ways. At first, researchers conducted 'normative' research, by questioning what was needed to issue useful standards. This "normative" research was then abandoned in favour of what we call "positive" research that consists in understanding and describing the practices of those who establish financial statements, those who audit them, and those who regulate them. This approach is obviously a more distanced one, as we attempt to observe and explain, for example, business accounting practices. The third approach is what we might call 'comprehensive'; it consists in understanding the meaning that the stakeholders themselves assign to their practices. In this context, researchers speak to accountants, regulators and auditors, and look into how they view their own actions. Each of these approaches produces fairly diverse results.

The first approach seems to best correspond to expectations of both businesses and regulatory bodies. Bernard Colasse has studied the shift in approaches to accounting research. Normative research was abandoned in favour of positive accounting research, an area in which Anglo-Saxon researchers are particularly strongly established. This is the approach that is most massively and predominantly represented in international academic accounting literature. It is thus important that other journals, particularly French-speaking ones, give voice to other views, allowing researchers who have a different approach to express themselves and make themselves heard by other audiences such as businesses, regulators, etc.

It is vital for lecturers and researchers to remain independent. Thus, when research is financed by major audit firms or by the standard-setter, researchers

must maintain an independent position. Researchers must be free in their choice of methodology and in their epistemological approaches.

The time horizon for research is also an important factor. Between the start of a research and the publication of its results in an academic journal, three years may easily go by, sometimes more. This fact often surprises our partners, and may lead to the publication of results that are somewhat dated. This is a major constraint.

Finally, since the first Symposium on accounting research in which we took part, I would like to point out that we have discussed and exchanged with the standard-setter. The accounting research community is pleased that the standard-setter is supplementing initiatives implemented by the AFC, in supporting both doctoral work and efforts by the larger community. I think that the community has shown its interest by responding to these calls for projects, and will continue to do so. The dialogue has only just begun between our two institutions, and it will be an extremely fruitful one for the entire research community, with benefits for both businesses and regulatory bodies.

## Promote accountancy to students



### **Sabine Sépari**

*Director of the Economics and Management Department of ENS Cachan*

I am Department Head and lecturer/researcher in Accountancy, Management Control and Management and Strategy at the *Ecole Nationale Supérieure de Cachan*. Because of this position, I see many young, brilliant and competent students from the *Ecole Normale* who would like to conduct research and develop partnerships in the process. But I also note that they are not drawn naturally towards accountancy and management sciences. I am not sounding the alarm, but I would nevertheless like to assess the situation and attempt to identify two stakes.

The first challenge is situated prior to the research process. It consists in giving students an understanding of the field of accountancy by helping them to overcome certain deep-rooted preconceived notions. To do so, one must explain the boundaries and scope of accountancy. You cannot imagine to what extent such extremely brilliant young people consider accountancy to be just a technique, just tools and figures with a static, inflexible approach. You have to show them that accountancy, in addition to the methods and procedures it includes, interacts with other fields. First with the field of strategy, as the first speaker, Monsieur Santi, demonstrated, but also with the field of organisation. You have to show them that every economic actor uses accounting in a different way. In first year – students are by then at degree level – the study of accounting does not begin with “debits and credits” or making accounting entries. On the contrary, you show them that balance sheet interpretation is an aid for forecasting and management. Business games are used to show that accounts are a genuine lever for action, controlling, managing and assisting strategic decision-making. In addition, we invite professional speakers to explain, over and beyond the technical aspects, the extensive scope, interest and advisory dimension of accountancy.

It is in this context that I wished to reply to the ANC’s call for projects which seemed very interesting for those students who start with an introduction to research before perhaps pursuing doctoral studies. In this introduction to research for the second year, we attempt to establish links between the theoretical framework and practice. I therefore suggested that four pupils from the *Ecole Normale* and a doctoral student work on the topic proposed by the ANC (“the relevance of accounting indicators and standards for monitoring

performance considering the specific characteristics of different businesses”) in order to illustrate the diversity of this field of investigation.

The second challenge, this time at a later stage, is about defining the career opportunities, the needs of business and practitioners. They want to write theses, to carry out research and to be useful. This is about informing them of the possible applications, the careers in the fields of accountancy, finance and cash management, etc.

These students from the *Ecole Normale*, who are often qualified to teach in high school, who are focused on economy and finance, may be attracted to other fields of activity. Our role – and for me this is important – is to show them not only that there are needs in the field of accounting, so that they are not all competing in the same fields of economic research, but also that there is support for this research work, like that of the ANC. I therefore try to stimulate them by giving them the information.

I am making use of this platform to request you to come to the ENS to meet these competent and interested students and show them all the potential for research and its applications.

The supply exists, but impetus must be provided...



## The Perspective from Germany



### **Carsten René Beul**

*Legal Committee Chairman, Wirtschaftsprüferkammer*

I am here today as a member of the Board of Directors of wp.net, the organisation of small and mid-sized audit firms in Germany. The aim of wp.net is to develop networking among audit firms that lack the resources of larger outfits so that they can counterbalance those large structures.

On behalf of our Chairman, Johannes von Waldthausen, I wish this Symposium every success.

To address today's topic, I would like to begin by highlighting four possible areas for research that may help us get our bearings, because I sense we have been blown off course.

The first one is a discussion on the purpose of accounting. Should our primary concern be to protect creditors or to protect all those who invest their money, either in the stock market or through banks, by providing them with greater security and more information? In the past, the first person to be informed always had the edge. Today – at least in theory – everyone has access to the same information, found in financial reports and notes. So having the edge now means possessing information about information – in other words, knowing where the key information is hidden in the welter of published information. But who has the time to read through thousands of pages to dig up a couple of rare pearls?

Secondly, we need to take a closer look at the historical record. In basic terms, we need to study economic history. Indeed, we tend to have insufficient awareness of past economic crises. Germany experienced a major crisis caused by "fair value" in 1873. So did France in 1857. The parallels with the crisis today are striking. The system "current value", objective value or fair price was already known in the nineteenth century. Railway construction offers a good example. Train stations, tracks and so on were not accounted for at construction cost, but at prices in a non-existent market. People at the time should have realised how risky such an approach was. As far back as in 1675, Savary wrote (in *Le Parfait Négociant*) that one should not present oneself as being richer (in the accounts) than one really was, "for that would be like getting rich in thought". For that reason, "[book value] should be equal to cost". After those crises in the late nineteenth century, the current, objective value approach was abandoned, and accountants adopted

the prudence concept, which imposes to record only the costs (in 1884 in Germany).

Thirdly, I will mention the issue of legal tradition. The Continental tradition is based on codification. To prevent a legal vacuum from arising, it provides general principles of law. The obvious question at this stage is whether abandoning a tradition with common roots from Roman law, can be justified. This is particularly important because, from the historical standpoint, the casuist system is the oldest one.

Fourthly, I will mention a series of questions:

- Should business decisions be made on the basis of the required accounting treatment?
- Should business strategists go along with what analysts and credit rating agencies say, even changing their accounting methods to get a more favourable rating?
- Who should be imposing standards in the democratic legitimization process: lawmakers or a club of stakeholders?

Finally, I would like to go on to say a few words about the current situation. We have a draft directive from the European Commission. If you read the draft, article by article, you realise that there is no fit with the underlying concept. In the 1970s, the drive to harmonise accounting law was halted after the United Kingdom joined the EEC. The effort shifted to achieving a compromise between the two systems. The fourth and seventh directives were transposed into national law in the 1980s. In the case of SMEs, it became easier to compare the balance sheets of companies from different Member States. But the current proposal runs counter to the harmonisation trend. That is why it has drawn widespread criticism in Germany. The Association of German Chambers of Industry and Commerce, the National Association of Cooperatives and the German Chamber of Public Accountants have all spoken out against the proposal. We wish to preserve our common roots and address the future of our Continental tradition together.

# Discussion on the ANC's initiatives

in progress in support of research:

**The first step in the ANC's accounting research work is to define the most important issues for targeted action now and in the future. The list of these issues is published on the ANC website in the Research Programme section<sup>1</sup>. Call for projects subjects are included in this list and are chosen in line with the latest international standard-setting areas of focus. The selection committee examines the research proposals sent to the ANC and determines the projects that should be supported.**

## Activities of the ANC's Selection Committee

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### **Jean-François Belorgey**

*Ernst & Young Partner and Member of the ANC Selection Committee*

Together with Dominique Bonsergent, I would like to tell you about how the ANC Selection Committee works to promote research and decide which projects we consider important.

The first step is selecting the areas for researchers to study. After that, we publish calls for projects and the Selection Committee is tasked with examining the submissions on the basis of predetermined criteria. The Committee is representative since it includes a variety of stakeholders (auditors, preparers, institutions like the *Cour des Comptes*, represented by Daniel Houri, regulators such as ACP (*Autorité de contrôle prudentiel*), represented by Fabienne Lasserre, and AMF (*Autorité des marchés financiers*), represented by Fabienne Colignon), which ensures that a wide range of viewpoints are heard. Our discussions are lively, and in the end, we usually reach a consensus, both on the subjects worth addressing and on the amount of funding to be awarded.

What takes up the most time in the selection process is reading the projects with our criteria in mind. To be accepted, a project must address the areas of focus set by ANC; it must take a Continental standpoint, with greater emphasis on qualitative issues than in the primarily quantitative approach that tends

1 - [http://www.anc.gouv.fr/sections/la\\_recherche\\_a\\_l\\_anc/programme\\_de\\_recherch/folder\\_view](http://www.anc.gouv.fr/sections/la_recherche_a_l_anc/programme_de_recherch/folder_view)

to dominate the management research field; and it must require a maximum of three years to be completed at an appropriate funding cost. Last of all, the research output must be usable in a variety of ways.

The ANC aims to encourage research projects and build partnerships with labs and institutions with which it can establish long-term working relationships in order to align supply and demand.

### **Dominique Bonsergent**

*Deputy Chairman of Acteo, member of the ANC Selection*



Today we are still at a preliminary stage, since we have not yet received all the responses to our call for projects. So we can't draw any conclusions. However, the first positive point we can highlight is the broad geographic range of proposals we have received, with a large number of Parisian universities and business schools along with universities from the rest of France. The other positive aspect I would like to point out is that this research is not

meant to defend the colours of the ANC or the businesses' positions. It is entirely neutral.

The ANC wishes to create a research activity at the crossroads of the business world, of which I am a member, and the academic world. This activity should be capable of producing concrete results in a reasonably short space of time.

The ratio of response to the number of calls for projects is 50%. There are two ways of looking at this figure. First, you could say that only half of the subjects found resonance. This is not due to a quality problem, but to a mismatch with the particular issue proposed. It is therefore important for research, businesses and the standard-setters to agree on the subjects proposed. However, we could also see this figure as positive since 50% of the calls for projects found takers. From this point of view, I think the future looks promising.

The international standards concern a few regulated players such as listed companies. Yet this does not mean that these research topics have little practical scope.

With respect to performance, there are two standards in the pipeline on revenue recognition and leases. In other words, we need to define what goes in the balance sheet. The ANC and ACTEO (association for the participation of French business in the harmonisation of international accounting) have

expressed categorically their opposition to both these texts. It's what you would call a hot topic.

Turning to the principle of prudence, we wonder, about it having been given up as evidenced in the work programme of the IASB with the idea that assets should be symmetrical with liabilities. Yet assets are cash flows receivable from others, while liabilities are cash flows dependent on the company itself. What happens if the company does not receive these cash flows? At some point in time, you have to get to the crux of the matter and refrain from imposing concepts such as the balance sheet or fair value approaches. In France, we accept concepts provided they are put to the test in real conditions. The research world should help us do it.

Coming to the evaluation of accounting standards, you could consider that a standard is a convention. Why would you evaluate a convention? This is another hot topic. The Americans have taken a position on the IFRS voiced by the Securities and Exchange Commission (SEC) and the Foundation that steers the FASB. They clearly state they will never incorporate supranational texts into their national legislation. Yet Europe has said it would incorporate such items. We therefore have every reason to check that what is imposed on us works, either before the standard is endorsed or after. I cannot wait to see what the researchers will come up with.



## Laureates of projects supported by the ANC

**Charlotte Disle (Grenoble 2):** Relevance of a business model approach in accountancy - **Isabelle Martinez (Toulouse-Paul Sabatier):** From the notion of performance to the graphic presentation by listed companies - **Sabine Sépari (ENS Cachan):** How to use indicators and accounting standards for truly relevant performance steering by stakeholders and activities? - **Laurent Pieirandrei (IAE Paris Est-Créteil):** IFRS and performance for better risk management - **Aude Deville (Nice Sophia Antipolis):** Analysis of the performance of banks' business models - **Paul André (ESSEC):** The principle of prudence in Europe and the implications of IFRS on the actual economic indicators - **Yuri Biondi (CNRS, école polytechnique):** Accounting standards in context and their impact on interactions between agents



## René Ricol

*General Commissioner for Public Investment*

What a pleasure it is to see you all here again, especially Jérôme Haas, who I have often said is the best ambassador I know not only for accountancy, but also for the vision of what accounts want to give of a society. For this is really the point.

The very long discussion on market value has lasted almost all of my generation's working life. We heard about the project, we saw the preparations being made... But the further down the road I get, the more I think we got the question wrong in the first place. The question is not to first decide what accountancy rules we want. It would be better to start by asking ourselves what type of society we want. This is a fundamental question that I could illustrate with an example: in all my work for the President of the French Republic, one was a matter of immediacy: we needed to finance businesses. Yet where I had to put a figure to this task, which I did, it was indisputably at market value, naturally. The societal choice we made was to say that we needed to save all the businesses we could, regardless of the cost, firstly because men and women are concerned and secondly because expertise once lost cannot be rebuilt. We set out to do this as intelligently as possible. Yet our approach was clearly one of market value.

Today, my work is completely different. I, with my teams, am investing €35 billion in the future, which, with leverage, will make €70 billion; a figure never made nor even dreamt of in France. The idea is to finance research where we believe we have the capacity to attain world-class excellence and to bring this public research to the private business world in order to create an ecosystem that will generate wealth and employment. The market value model is obviously totally unsuitable in this case, since we will only know in five to ten years whether we have made the right or wrong choices in the many areas concerned – 400 projects have been chosen from among the 1,400 submitted. We find ourselves in an accountancy situation where, if we use market value, we completely destroy what we have set out to do because we are looking at the long term.

What strikes me today when I talk to people I meet in my work is the clash of two antagonistic views. There are those with a short-term vision, whose most

accomplished form is high frequency trading, and those who have a vision of the future that takes in future generations and sustainable business, encompassing both technology and environmental concerns.

I must confess that, when we started discussing fair value, market value, we took the problem back to front. We did not ask ourselves what society we wanted. We took as our starting point society as it is with financial transactions as they are. We therefore considered that the fair value approach, mainly an immediate here-and-now approach, was the best reporting method. And that might be where the real original system failing lies. Accountancy is a language. Men and women fight to protect their language, which they do not want to see destroyed, since they consider it to be a fundamental element of their culture and identity. The intention is not to reject other languages; it is to protect their own. This is a recurring subject of debate. Language affects the way we behave. We say things differently in different languages, and this affects our life and societal choices. So here is some food for thought: what do we want? Faced with the financial mayhem, the regulators – the FASB and the IASB – decided to base their observations on what people were doing in the here-and-now. They nigh on preached, not against the whole world, but against the lunatics who put society in danger because of their one-track finance-driven minds. That's how they themselves became procyclical, because they swept along with them people who did not want this here-and-now view. Take a listed company. Accountants start by looking at the fundamentals and asking how much they are really worth or, in other words, asking what a sensible, well-advised investor would be prepared to pay. Such is the view of managers, manufacturers, the general public and accountants. The other view is to look at the stock market price, or more precisely the CDS, linked to the stock exchange price, and derive the risk exposure in order to place a value on it. Both approaches are correct. They could be open to technical discussion. But the real question is what type of society we want. I sincerely believe that the debate we are seeing today is a furious battle between two worlds: there is the world where money is king, where money is law, where it is the only guide, the only religion, the be-all and end-all, the only priority; and there is real life in which we strive to protect our future and the future of those who will come after us. The situation has come to such a head that, today, we are seeing speculation attacking governments, but also men and women who have lost so much taking to the streets to protest. We are seeing the clash of two worlds. I hope that the world of real life, real solidarity, and real entrepreneurship will win out.

We have reached a crucial point. I pay close attention to e-mails and blogs because, with €20 billion in academic research to manage, I really should know what people think. We have a team reading them at the French Investment Agency. And they reflect precisely this debate. Some write that the €35

billion would be better back in the state coffers and advocate solving the problems by no longer subsidising people's lives, ending pensions, social security and supplementary pension schemes and cutting healthcare expenditure in a return to a voluntary system. Where the English can save €5 billion in healthcare expenditure, we could save €30 billion given what we spend. The authors of these e-mails and blogs are from leading French and foreign universities. They come from Japan, the United States and France. Others, however, reject the world of money and advocate solving the problems by doing away with nuclear energy. I think that real life is somewhere between the two.

We should stop discussing whether those who came before us fifty years ago made a good or bad decision. We need to take the situation today as our starting point and explain the investments we make.

What I am really delighted about here is the new focus on accounting by academia and research. Accounting is not just a technique. It reflects a societal choice in the directions we take to express our values, our measurement tools. This choice needs to be explained by people connected with what we call the hard sciences – the mathematics schools and the financial mathematics schools – but also with the social sciences that reflect other values. They can take a multidimensional approach to their observation of what we do. A multidimensional approach looks at more than just financial criteria. It looks at real balance sheets, such as carbon footprints. It looks at real human impacts. Note that sustainable development also concerns human well-being which we, accountants, know can be measured. Simple criteria can be used to gauge this, such as the repercussions of change and the rate of antidepressants taken.

I am here to say let's not get caught up in a crusade for or against market value or fair value. Our difference of opinion with a group of highly reputable people is a difference in views on life. They take the world as it is as their basis from which to build what they need. We, however, reject the world as it stands because, if nothing is done, there is no possible tomorrow. This is our belief. We need to give all these research debates the space to breathe, as they will take the heat out of the discussions. I must say that what I like about the English is their ability to put problems on the table (task forces), discuss them calmly and try to find what can be done to solve them. What value instrument do we want to produce? And, ultimately, what is a standard transaction? You will help restore calm to the debate and, in so doing, will combat a form of pro-cyclicality born of a technical combination of accounting standards and prudential standards. This means that we cannot accuse the accountants on one side and forget – although it is more practical and less dangerous – the regulators on the other. When I look at the worrying changes to the regulations governing banks and insurance companies, I can see that we are standing on



the brink. We have won on a great many points, but we have lost where we needed countercyclical regulations for the banks and insurance companies. Today, they are, in all objectivity, procyclical.

Does the fact that a bank has a balance sheet presented at market value have any real impact in the world today? Objectively, none. Three things are important: the bank's liquidity, the value placed on the risk associated with the share, the loan, etc., and the bank's solvency. Question number one for a banker is therefore not what will come out of his accounts. These are not criteria for financiers who want to buy or sell. They will instead look at the value of the CDS or other values. And yet this is where market value hit centre stage with a force beyond the wildest dreams of those who write to us. There are much more serious consequences beyond the realm of accountancy. When I look at countries like France and England, I realise that the problems are the same. We will see a slight downturn due to two relatively simple technical reasons. We will first of all reduce the size of the balance sheet by cutting down on consumer loans, which are the most capital hungry for the investment banks. We will then mechanically reduce the "business" risk exposure. We have cases that I am handling today of companies established in France, Germany, England and Spain that we do not know how to finance in any one of these countries.

This is where the real debate lies. We have played around discussing market value and fair value on balance sheets and we have established a new grammar, a new language.

Thank you, Jérôme, for having invited me to the Etats Généraux of Research in accounting. I am a great admirer of the work being done at the ANC. Investments for the Future can also fund research.

# Report on the discussions

## in the two workshops

### Workshop: The perspective of business people and auditors

**Companies and auditors can contribute to research projects by identifying topics related to the list of priority issues not yet addressed, which could then provide the basis for a future call for projects. They could also carry out analyses to identify narrower accounting issues that would lend themselves to research topics. They can also facilitate research by granting access to data and staff from businesses and audit firms, by allowing research workers to study the problems encountered by companies and auditors and by encouraging more research on qualitative issues. This means being available for surveys and interviews with researchers.**



#### **Agnès Lepinay**

*MEDEF's Director of Economic and Financial Affairs*

During this workshop, the questions and proposals revolved around two main points.

The first point was to question the companies and audit firms representatives on the topics of interest to them, with the aim of getting them more involved in the process of listing research topics. The list of topics selected by the ANC was judged appropriate and relevant to the areas of concern stressed by the companies' representatives and

auditors. The latter also made suggestions for supplementary research on the users of accounting data, on cash flow statements as tools for measuring performance, on accounting in the European environment and on the predictive ability of accounting data. During the workshop, the suggestion was also made to invite researchers to attend the "Journées de la Doctrine" to be jointly organised by CNCC (the French National Institute of Auditors) and OEC (the chartered accountants' organisation) so that they can better identify the issues of concern to the accounting profession.

The second point involved the connections that need to be made between businesses and researchers, i.e., the steps to be taken so that companies can

monitor research work more effectively. The business representatives stated that they received a huge number of queries pertaining to research. They admitted that when this was done by questionnaire, the questionnaires sometimes wind up in the wastepaper bin. For this reason, they urged researchers to seek direct personal contact. The business representatives accordingly suggested that the ANC organise conferences bringing together researchers and business people at a rather early stage in the research process so that the researchers may present their topics, get feedback and, where relevant, arrange one-on-one interviews with the interested business contacts. The business people also expressed concern about the utilisation and confidentiality of data obtained by researchers on such occasions.

Last of all, it was suggested to the ANC to create a suggestion box to help collect research ideas from the business people.

# Workshop : Research supply – the perspective of professor–researchers

The goal of this workshop is to enrich the discussion process between researchers and the ANC on how research should be conducted. The workshop is an opportunity for researchers both to ask the ANC a number of questions and to offer suggestions and advice so that the ANC can organise the demand side of research more effectively.

## Reminder of the ANC's objectives

- Building cooperation and encouraging accounting research people to address issues with potential influence on accounting standard-setting (with findings available within a time frame consistent with the process).
- Structuring proposals for collaboration with professor-researchers into a variety of formats.



## Isabelle Laudier

*Scientific Director for the CDC Institute for Research*

Questions and recommendations from professor-researchers revolved around two main points:

The first point had to do with research as such. A number of interrelated questions were raised:

- Questions on intellectual property and confidentiality (results owned by the research sponsor, by the researcher, jointly owned). There can be no single right answer, and the jurisprudence will take time to emerge.
- Questions on how to exploit the results of research (whether scientific research papers or other types of papers).
- Questions and comments on agreements between the ANC and researchers. The researchers suggested that the ANC establish a standard agreement that would apply to all researchers.
- Questions on how calls for projects are publicised and the need to adjust to the teaching agenda of researchers in order to ensure a high response rate. In specific periods, that agenda can be particularly heavy, which may explain why some calls for projects get more responses than others that suffer from bad timing.
- Questions on the narrow focus of calls for projects. It was emphasized that a number of topics revolve around the ultimate purpose of accounting

research. The question is, how we can support research on such structural issues and at the same time, promote blank calls for projects, meaning calls not focused on a specific topic, as a way of encouraging research ideas that were not initially identified.

The second point involved research topics. A number of participants observed that research projects tended to focus more on large companies than on SMEs and unlisted companies, although these are of greater numerical importance. This perception does not appear to be attributable to a problem of access to data.

It was also pointed out that the issue of performance drew an extraordinary amount of attention – much more than the issue of prudence (19 for performance versus just 4 for prudence). While this may stem from a problem of scheduling, it could also reflect greater interest in cross-cutting issues like performance. In all likelihood, prudence was perceived to be a narrower, more technical and targeted issue, thus requiring longer response time. This brings us back to the observation on the value of “blank projects” that give researchers opportunities to propose their own topics and guide the ANC towards issues of potential interest to the organisation.

# The history of accounting standard-setting

## French standard-setting: a transfer of authority



### **Béatrice Touchelay,**

*Professor of Modern Economic and Social History,  
University of Lille 3 Nord de France*

My research has led me to study the history of accounting standard-setting up until the 1970s. Several previous presentations have shown the importance of taking an historical, multidisciplinary approach.

Standard-setting in France which occurred between the First World War and the 1970s, brought about a transfer of authority, opening up the exclusive domain of business accounting to outsiders (accounting and tax professionals).

This transfer was met with resistance. The opposing sides consisted of:

- The State, which wanted to set standards.
- The tax authorities – a State unto itself?
- The businesses representing the stakeholders.
- Investors, who called for greater transparency in the 1920s in the wake of endless scandals, and who formed leagues and committees that carried weight in electoral campaigns.
- Accounting professionals, who stayed in the background, for the simple reason that there were very few of them at the time. The *Ordre des experts-comptables et comptables agréés* (Association of Chartered Accountants) did not exist prior to 1942. In 1914, accounting professionals were a disparate group, and even though there were chartered accountants, the profession had not yet been organised.

Standard-setting took place in four phases:

- At first, it was business owners who called the shots. They were XIXth century-style bosses who did not allow anyone from the outside to meddle in

their business. In this respect, one can understand how difficult it was to introduce labour laws. There was resistance to the Child Labour Law of 1841, just as there was to the 1898 Law on Workplace Accidents.

- Subsequently, regulations were very progressively put in place, thanks to accounting rules introduced by the tax authorities, which laid the foundations for both regulation and standard-setting.

- Then came the Vichy regime, during which the French Government arrogated all rights with respect to (any remaining) businesses. It was a time of particularly severe constraints.

- The final phase arose from what Bernard Colasse terms «a French-style compromise» as French standard-setting began to rely on regulatory and consensus-seeking bodies.

Two preliminary remarks are to be noted. Firstly, accountants and chartered accountants played a relatively minor role in this change, and secondly, the standard-setting process was rather unique in comparison to what was being done abroad, particularly in the Anglo-Saxon world and Germany.

### **Business owners in command: the lack of constraints on businesses in the 19th century**



Business owners were completely in command; they counted as and when they wanted. They were under no obligation. They paid the *Patente* (a sort of ancestor of the local business tax) on what businesses earned and produced. No one, however, audited their books. In the end, they had little contact with the tax authorities. As for accountants, they were completely disorganised, since there were no professional organisations.

### **A progressive regulation**

The break with the past came during the First World War, and the major change brought about by the reform of income tax, to the great joy of Joseph Caillaux. After having been debated for at least two decades, income tax was voted on and adopted by both houses of Parliament. It became law in July 1914, and was based on voluntary declaration. However, business owners had no idea how to declare or calculate profits, and had few, if any, accountants to help them.

Mention should also be made of the extraordinary tax on war profits introduced by the Act of 16 July 1916, which was the source of a great number of litigations between the tax authorities and businesses. Thus it was that a certain number of businesses began keeping accounts; among them was Marcel Boussac, who hired accountants to put together his books and limit the taxes he owed on war profits in the 1920s and 1930s.

Better record-keeping was thus imposed by force and in a rush on many busi-

nesses. However, this new direction did not last. In the 1920s, the pre-war laissez-faire attitudes returned, to the detriment of the many reforms that had allowed the Government to play a greater role in the economy. Standard-setting languished. No professional organisation of chartered accountants was set up to support businesses. There was, however, a Company, accountants' associations, which trained experts, eminent figures such as Reymondin and Faure, and other high-level professionals, who helped businesses complete their earnings statements and supported them when they were challenged by the tax authorities. But until 1927 there was no official accountancy diploma, and «financial advisers» with varying degrees of skill and honesty operated openly. The introduction of the famous *brevet d'Etat d'expertise comptable* (Chartered Accountancy Certificate) in 1927 ought to have improved matters, but tensions ran so high amongst professionals that even this diploma could not sort out the situation.

### **The government intervention in business accounting (1940–1944)**

Under the German occupation, chartered accountants managed to organise their profession, along the lines of the various associations that had already been established for physicians, pharmacists, lawyers and architects. The *Ordre des experts-comptables et comptables agréés* was set up concurrent with the publication of the French first general chart of accounts (*Plan Comptable Général*, or PCG) by the Interministerial Commission established by the Decree of 22 April 1941. The Government had finally intervened, but it stayed in the background. The PCG was not mandatory; it will become, only after the Liberation and only then for businesses which had been awarded procurement contracts or which benefitted from tax advantages such as revaluation of balance-sheet items.

### **A «French-style compromise» based on regulatory bodies**

After the Liberation, accounting practices were subject to a «French-style compromise» based on regulatory bodies. Business owners were sanctioned for having collaborated with the enemy, the country was in a shambles, and reconstruction efforts were under Government control. During this period, there was widespread Government intervention (nationalisations, centralised planning, etc.). However, unlike what happened after the First World War, this time it was permanent. New accounting regulatory bodies saw the light. A Higher Council, which became the *Conseil national de la comptabilité* (National Accounting Board – CNC) was entrusted with drafting a new chart of accounts adapted to the needs of businesses. Its members consisted primarily of representatives of the *Administration des Finances* (today's Ministry for the Budget), and in particular the Direct Taxation Directorate, which had been responsible for the original PCG. There were also representatives from institutions set up to advise and oversee economic policy, such as the Planning



Office and the INSEE. The CNC was chaired by François-Louis Closon, the first Director-General of the INSEE. Gradually, the CNC's membership expanded to include more representatives from civil society – representatives from trade associations, from the *Ordre des experts comptables et comptables agréés*, from family associations, etc.

Over time, this accounting regulatory body brought together public and private interests. The *Administration des Finances* slowly faded into the background, making the CNC a forum for relatively democratic discussion.

Two more general charts of accounts were introduced, the first in 1947, as a replacement for the one drafted under the Vichy regime that was thought to be too German-influenced, and the second in 1957, which continued to be optional. Finally, the 1959 Budget Act provided for mandatory bookkeeping for businesses within five years. The professional associations were entrusted with adapting the framework of the 1957 PCG to their sectors; thus, for example, tradespersons were responsible for defining a chart of accounts for retail stores. Progress on this was impeded by resistance from some sectors, particularly those made up of a number of small and medium-sized businesses. Widespread implementation of the PCG did not take place until the 1970s.



In conclusion, I would like to point out the remarkable slowness with which accounting standard-setting was introduced in France. The entire process took more than sixty years, and it had to be driven by taxation concerns and by the exceptional circumstances of two World Wars. Moreover, standard-setting both serves the interests of the tax authorities and results in better economic information, which in turn facilitates economic policy decision-making and choices in the private sphere.

This background gives us an idea of the scope of what is involved in standard-setting, and helps us to understand how it is a channel for power struggles between public and private stakeholders, who nonetheless both pursue the same goal of growth. It also provides insight into the current process of standard-setting, and explains how businesses, by agreeing to take part, participated in a transfer of authority. Is it going too far to posit that European States at the beginning of the twenty-first century, by relinquishing the definition of accounting standards to private bodies outside their borders, are also taking part in a transfer of sovereignty?

# Roundtables on the definition

and representation  
of performance  
in the financial statements

Roundtable 1: Is accounting a film  
or a photograph?

## Anchoring Accounting in Civil Law and the Consequences for Underlying Concepts of Accounting Standards



**Marie-Anne Frison-Roche**

*Professor of Law, Director of The Journal of Regulation*

I would like to approach the very broad question of the concepts underlying accounting standards by asking if accounting should be a «photograph» or a «film». Photographs are more about the past, while films illustrate movement and an action whose completion is expected by the viewer. The accounting «film», however, limits itself to a single point of view, which is generally a legal one. This legal perspective is perfectly acceptable. More specifically, it should be a traditional legal perspective, because accounting – often described as legal algebra – is the quantitative expression of legal concepts, mechanisms and reasoning represented by assets, contracts, payments (whether made or deferred, as payment is a means for discharging obligations), loans, collateral, etc. Thus, although it may be true that accounting also concerns corporate law – because corporate officers must examine the books in order to report to their shareholders, investors and other stakeholders –, it is essentially a matter of civil law, in which the above-mentioned concepts are to be found.

One of the very real difficulties one encounters has to do with the fact that accounting professionals are not very interested in civil law, while civil law specialists know nothing of accounting. Of course one could say that every legal expert is also a civil law expert, because civil law includes ordinary law, even if the expert adds on a specialty, such as business or financial markets law, since civil law underpins contracts, loans, assets and collateral. As knowledge increases, it inevitably brings segmentation with it, but there would be tangible results if we could bring experts in civil law and accounting together. Civil law is not just the cornerstone of accounting<sup>2</sup>, its goal is also to build a system. Systems are crucial in law: a legal system combines concepts, definitions, classifications, categories and regimes, and mandates certain principles such as non-contradiction, the need to provide means that match (explicit) ends, the inadmissibility of gaps, and so on.

The concept of a system, embodied in the Civil Code, runs counter to the idea of regulation, which consists of amassing intermittent responses to intermittent problems as they arise. This leads to a pile of normative solutions rather than a system. Both the law and accounting benefit from being perceived as systems rather than regulations, although it appears that current trends are driving both systems towards an accumulation of intermittent standards that respond to specific problems – a process that will never result in a system. This is serious, because it makes it difficult to interpret the whole, thus rendering it unpredictable. It becomes deficient the moment a specific standard is not immediately, or even preventively, adopted in order to specifically resolve the problem, since the lack of a system means that general arguments are unavailable.

There are thus major practical drawbacks to the lack of a system, such as civil law had built. Accounting, which IFRS have turned into a mere regulation, was originally a quantitative projection of civil law, and therefore a well-organised system. This view of accounting as a system appears to be losing ground; we may posit that abandoning the link between accounting and civil law has something to do with this regrettable shift.

Based on these introductory remarks, let us return to the legal categories of civil law, since accounting is its quantitative translation (a service or a transfer of ownership that is not immediately paid for – the assets in a company's net worth, the collateral that guarantees payment lead-times). This is a useful exercise, even though in earlier times it went without saying: nowadays, although civil law is the cornerstone of accounting, it seems almost irrelevant. Instead, accounting is seen as a sort of handmaiden to the proper functioning of the financial markets, which is not without risk. Both auditing and accounting are perceived as a function of the financial market. We must try to better understand how the situation deteriorated and what the consequences are.

<sup>2</sup> - We are herewith asserting origin, since one might respond that it is time for the winds of change to blow.

Accounting is a tool, and we define a tool by the use to which it is put. What do we use accounting for? For this sort of question, a legal expert naturally turns to civil law (1), which begs the question of the relevant accounting time-frame – past, present or future (2).

### **Accounting, the algebra of the Civil Code**

A (French) legal expert will turn to the Civil Code and to the contract law and land law that it contains. It is often been remarked that the Civil Code is an owners' code. And indeed, credit provides accounting with its *raison d'être*. In order to obtain credit or to grant it, we must keep track of receivables held over, and debts owed to, third parties, a company's current assets and the assets of other economic agents. Hence contract law, land law, the law on assets and collateral – i.e. civil law, as expressed in the Civil Code of 1804, is the foundation of accounting. More specifically, credit is naturally guaranteed by the assets that the company holds, by the common pledge of creditors who may seize the assets of a debtor who does not pay<sup>3</sup>.

Moreover, a very special group of creditors who are almost never repaid what the company owes them – the company's shareholders – is also interested in accounting. Shareholders are not the company's owners, but rather its creditors by dint of their equity interest. Here again, it is the Civil Code (Article 1832, to be precise) that defines the contract establishing a firm. It is a common venture by which the shareholders make contributions to form a firm whose goal is to earn profits that they will then share; if there are losses, these will also be shared. This contract is an aleatory contract. It presents a risk for all unit holders. If these units are freely tradable, they are called shares.

Note that at no time does the concept of a market enter into these legal definitions. Thus, accounting is a vital tool for recording two types of concrete, intermittent economic transactions: credits and transfers. However, accounting does not in any way internalise the overall functioning of the market for goods and services, nor does it internalise the idea of a «liquid» market. Of course, accounting, like civil law, embraces the concept of «liquid receivables» but this corresponds to a different legal concept, i.e. the fact that a receivable must be valued or measurable in money (which may be done at historical cost), a concept that is distinct from the category of «liquid markets». Indeed what is at stake here is the implicit reference made by accounting standards to the liquidation value of goods or receivables, as if the market were liquid, which corresponds to another definition that is not legal but financial. A «liquid» market assumes that there will always be a buyer and a seller, as well as a price that is known and applicable to all. This is most often accomplished via pricing, which led Walras to observe that the only «pure» market is the financial one. However, the market for goods and services, whose legal transactions (transfers and credits) are outlined in numerical form by accounting,

is not liquid: the price of transfers is determined bilaterally between a specific buyer and seller. The price is set according to subjective data, i.e. the reasons that led both parties to conclude the contract, which changes the price (for example, depending on whether or not they are in a hurry to carry out the transaction in question). Moreover, there is neither pricing nor a price index. Only the prices for the transfer of very specific financial assets (securities and financial instruments) are both shared by all and constantly fluctuating, since a transfer changes the pricing for everyone. But what is true on the financial market is not true for the markets for ordinary goods and services.

Accounting cannot function along the lines of the financial market; that is, a valuation that is equal to a price that changes with each transfer and which is the same for all, because accounting relies on the so-called «larger» economy, that of the market of (non-financial) goods and services, even when it is a question of the activity of publicly-traded companies. But the larger economy turns on transactions and credits that are simultaneously intermittent, bilateral, and which are all different – the conditions for one transaction have no immediate effect on those of the next.

Of course, competition law, which is the law of the markets of goods and services, encompasses a «market price», but corresponds only to an assessment range of behaviours that are evaluated ex-post, such that the price of a transaction that is out of range may be proof of anti-competitive behaviour. Competition law does not require the markets for goods and services to produce exact, long-standing prices corresponding to the liquidation value of goods, particularly when the goods are not subject to transactions. This is a matter of common sense, at least within the legal meaning of the Civil Code. And yet when we examine the current situation, we see the exact opposite. In what appears to be a version of the Quarrel of the Ancients and the Moderns, must traditional law lay down its arms because they have become rusty? Should the categories developed under Roman law make way for the brand-new categories of the financial market?

If we consider the sources of the technical structures in question, accounting is simultaneously:

- A tool for measuring the status of debts and receivables. The moment that economic operators began to offer and receive credit, it was necessary to take stock of the assets of companies and entrepreneurs.
- A tool for monitoring the money that the company has and that it knows that it will have, either because it will pay out or receive money (debt/receivable)
- A monitoring tool for the shareholders who have made contributions, in order to know the results as well as the profits and losses to share; accounting

is, literally, what induces corporate officers to report to investors

- One of a number of scorecards that provide a management tool for corporate officers
- A tool for measuring (and proving) solvency for the purpose of informing third parties planning to enter into agreements or continue to provide credit, etc. with the business (such as supplier credit)
- A tool for calculating a company's tax base

Thus, accounting is less a tool for measuring financial performance (there are other sources of information for this, which are more anchored in corporate law, particularly reporting requirements for the benefit of the shareholders, investors and the financial markets) than one that measures the solidity and assets of a company, a legal entity, which itself is based on the «contract establishing a society» stipulated in Article 1832 of the Civil Code.

Although the law makes scant reference to the concept of «performance», it is very well acquainted, on the other hand, with the concept of «warranty» via land and contract law (collateral, credit, insolvency). The very concept of assets expresses the idea of warranty, since the Civil Code reminds us that creditors have the above-mentioned common pledge on the assets of their debtor. This is directly related to accounting, as it allows the creditor who offers credit to know the terms of its warranty. Thus, if we return to the idea that accounting is the algebra of the law, we could say that accounting expresses the soundness of a company's assets.

From this point of view, financial performance appears to belong to a different system than that of the law, since performance is the use – in a way that attempts to be optimal – of the means for obtaining an end. Thus, income statements do allow for a «financial analysis», which is an analysis of performance since it establishes the use of those means and compares it with the results. However, a distinction must be made between income statements and their analysis by a third-party. If, instead of approaching accounting from a legal perspective, we approach the law from an accounting perspective, the income statement is a matter of civil law, since it conveys receivables, payments, collections and debts, whereas a performance analysis is a matter of corporate law, since it is connected with the reporting obligations with which corporate officers must comply with respect to stakeholders, particularly investors. Of course, financial statements and income statements are only part of the information, on the same level as the status of the company's employees – and yet, one would not confuse labour law with financial markets law, except to say that the market finds its way into every branch of law via the disclosure principle. The undeniable importance of this principle makes such a deviation both palpable and dangerous. And yet, if we consider that

accounting is connected via civil law to the concept of solidity, which allows shareholders/entrepreneurs/creditors to understand the basis on which they may take risks, we see that accounting is a sort of fixed present tense based on an observed past tense (assets, liabilities and certain forecasts in the balance sheet, past and sometimes expected performance in the income statement).

### **The relevant «tense» of accounting and the attraction of the financial market «tense»**

The relevant tense of accounting is the present, to the extent that the past allows us to reconstruct it. In this, accounting is an immovable present, because it draws on past elements (acquisitions, sales, contracts signed, etc.) which are by nature fixed. Accounting is immovable, stable and annual because it is information about the soundness of the company's assets, not information about the entire life of a business, which is a living being.

Thus, the correct metaphor for accounting is the image of the photograph, rather than the film. There are successive photographs, and the observer may compare and contrast them. By comparing the results of a company year after year, we are approaching the realm of the animated cartoon, in which superimposed images produce the illusion of movement.

It is hardly surprising that the financial markets, by speeding up the succession of images, wind up wanting to have an animated film. In their impatience, they demand not only the moment-to-moment superimposition of images, in which the concept of annual accounting is replaced by nearly fluid accounts, but they also want to know the outcome of the film before it ends, using the astonishing concept of predictive accounting<sup>4</sup>. And yet, based on this information, the ordinary law of capitalism calls on stakeholders (corporate officers, but also third parties, credit institutions, creditors, etc.) to add information of another type, such as forecasts, labour information, technological information, and so on, in order to make decisions.

We must not confuse financial information with accounting information: they are complementary, not substitutes for each other. It is not accounting's role to be an autonomous, complete source of information for investors, but one element that they must factor in to take risks by taking a global view of the company's performances. Accounting does not claim to provide this global view, because it is simply «checking off the boxes» in a civil law system. It is subsequently snagged by corporate law and financial markets law via other categories, primarily reporting and accountability obligations<sup>5</sup>. From a standpoint of global assessment and risk-taking, in which accounting is only one of the many elements, the «tense» in question is the future.

But there are two types of future, which civil law has always carefully distinguished.

- First, there is potentiality – the future that is already contained in the present. Over time, a seed becomes a flower. Or, to take an example from the Civil Code, the forest (immovable) becomes firewood (movable), and one can qualify the forest as firewood even when the trees' roots are still in the ground (the legal category of «movables by anticipation»). In the same way, assets depreciate, successive performance contracts will be executed tomorrow, and we integrate future profits that will result from a signed contract, because this sort of future is virtually part of the present. This certain future is welcome in the world of accounting, because we are not integrating uncertainty, or a decision that is dependent on a third party. Rather, it is the anticipation of an effect that the passing of time will inevitably cause to occur. We have seen that the need for accounting comes from credit, i.e. the deferred execution of contracts: one day, payment will be made, we must pay or be paid. Potentiality, therefore, is a tomorrow that is already here today.

- But there is also an uncertain future. This is dealt with rather circumspectly by the law, because the law is wary of the unexpected and the random, of a lack of foresight, wagers, etc. We are dealing with a tomorrow of whose content we are unaware, because it will be genuinely new. This may consist of a decision to be taken, in respect of an event external to the company, either in the market (entry of a competitor, concentration, etc.) or outside the market (amendments to legal rules, political decisions, and so on). What happens in the market is unpredictable. The market is fluid, dispersed and instantaneous. It is by nature uncertain, risky, full of a future that is not the repetition of the present, a mere mechanical succession of events. In this, the uncertain future does not belong in accounting as it is perceived by civil law.

What is the role of «fair value»? To indulge in some wordplay, we might imagine that «fair» (in the sense of «just») implies an ethical aspect, as one finds in the notion of «fair competition». This has a semantic effect of discouraging challenges: who could be against something that is «fair»? Fair value assigns market values to assets. The «tense» of the market is a present that is not fixed in relation to the past; rather, it is a feverish present that is constantly carried forward to an uncertain future, from transaction to transaction. Thus, via the concept of «fair value», a transaction acts as if it were a pricing operation. This definition is all the more unsatisfactory as this market value corresponds to elements that are external to the company (and its corporate officers) that holds the assets or liabilities to be measured.

The market is the venue where businesses and individuals take risks on this uncertain future. However, the obsession with winning but not losing – the obsession of lay, uninformed investors who cannot tolerate risk (which runs counter to the very definition of a shareholder given in Article 1832 of the Civil Code) – has led lawmakers to require accounting to inform these investors



who must be protected from the risks of an uncertain future (for example, the failure of a bank because the government has suddenly decided that it will not support it, although it supports others). How can we explain such an obvious contradiction? Perhaps we are no longer following the advice of Stendhal, who advocated using the Civil Code as bedtime reading. His words have been forgotten, and the civil sources for accounting have been swept aside. This legal amnesia goes hand-in-hand with the fact that accounting has forgotten the crucial notion that assets and liabilities are to be assessed on a «going concern» basis, which suggests that the company will continue to function, and «liquidation value» measurement becomes increasingly difficult to justify because it cannot be sold and because the market is illiquid.

And yet, investors have «financialised» accounting – which was originally founded on the economic reality of intermittent transactions on tangible markets – in order to bring the time spans of asset and liability measurement into line with the redemption of securities that they hold in publicly-traded companies. In other words, because at any moment I can sell, or «liquidate», my shares on a stock market, accounting must be able to supply me with the liquidation value of this transaction. International accounting has thus become a handmaiden to finance, and has cut all ties with civil law, contract law and land law. In doing so, accounting contributes to financial markets overheating. Is this reasonable? Let us pass on Stendhal's wise words to our new legislators. It is not accounting's role to be the self-fulfilling prophecy of the financial market, pointing out risks that – simply because they are pointed out – occur. The demand for «predictive accounting» is proof positive of how the financial markets have beggared accounting, and how civil law, of which accounting is the algebra, has been completely forgotten. By severing the ties between ordinary law and accounting, the new accounting standards, and other standards that international organisations and financial regulators would like to see in place, have torn accounting from its natural «tense», which is the past. Roles have become blurred, and we forget that it is the job of entrepreneurs and businesspeople to take risks concerning the future, and to run the risk that they may lose. Of course, these risks are based on the picture that «past tense» accounting can give of the strengths of a company, but they are also based on other sources of information that investors may have. Information, especially financial reporting, is based on a different rationale than the rationale of accounting, which should not get involved in financial market liquidity. For supporters of civil law, the crucible of accounting, this is a disappointment; more than this, it erodes the very utility of accounting itself, which has become unrooted in time.

# The use of market value in accounting representation



## Guillaume Plantin

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I am speaking today as an economist who was once an actuary. I would like to say a few words about the opportunity to use more intensively market measurements in accounting representation.

One criticism that is often raised, at least in the press, is: «such a measurement cannot be satisfactory because the markets' time horizon is too short compared with the horizon required for most industrial projects or with the timeframe in which businesses create value». This is tantamount to saying that the agents that create the prices that will be used for reporting have short-term horizons that do not reflect the horizons of the projects that they seek to measure. As an economist, I do not have a great deal of sympathy for this argument, which I find to be woefully incomplete.

There is a classic inductive argument that is quite easy to explain, which suggests that the short-term perspective of investors is not at all prejudicial to the use of market values. The argument is as follows: suppose that you have a project that will produce a base value, i.e. cash flow, in twenty years' time. Suppose that this project has been financed by issuing shares that will be traded and exchanged by two successive groups of investors who have ten-year horizons. To simplify matters, I am using two groups, but I could use many more. At the starting date, on the primary market, the initial investors, who are trying to come up with a share price, are focused on the short-term – they are not interested in the base value in twenty years' time. What matters to them is the value at which they will be prepared to sell their shares in ten years' time. We are in the realm of speculation: what will the price of the share be in ten years? And this is where subtlety plays a part: one can have a short-term attitude and remain rational. We must think about the formation of the price in ten years' time, i.e. the price that buyers will be willing to pay for the share ten years from now. The buyers know that in ten years' time, the proceeds from sales will reflect the base value. Thus, by induction, these short-term investors, if they are fairly rational and reasonably well-informed, should want to pay a price that will reflect this base value. This is why I do not think that the short-term horizon of investors is a good enough argument to challenge the use of market value. Allowing people who are very impatient and who have

significant needs for liquidity to invest in very long-term projects is one of the fundamental functions of the financial markets. Short-termism is thus necessary, but it is not enough to question the use of market value.

On the other hand, I would like to describe two flaws in the market on which a fairly large number of financial economists are in agreement, even those who are fervent believers in the efficiency of the markets. In my view, these two flaws should be modelled and seriously taken into consideration when indexing accounting representation to market values. I am speaking of short-term overreaction to new information, and the creation of self-fulfilling prophecies.

### **Short-term overreaction to new information**

In every market, whether centralised or over-the-counter, there is a great deal of empirical evidence to suggest that in the short term, let us say between one day and one month, the markets overreact to both positive and negative information. This results in yield predictability. There are a great many speculators who attempt to profit from this, but apparently not enough because the phenomenon persists. There are three reasons for this short-term overreaction:

- first, there is a psychological explanation: everyone, investors included, is partly ruled by emotion, and do not base their investment decisions on statistics, actuarial tables and measurements.

- But there are other reasons that are not based on irrational behaviour or psychology, but on the fact that the market is a sort of mechanism for aggregating millions of pieces of information in order to create a consensus. This aggregation process is amazing, but it is flawed. It proceeds by trial and error, and this trial and error systematically gives rise to excesses of interpretation before consensus is reached.

-The third explanation has to do with difference of opinion. If there is disagreement about a share or about a possible future, agents are prepared to pay more than what they think is the base value for this share. If I know that there are many people who do not agree on what will happen in the euro area, then I am prepared to pay more for Italian debt than my personal assessment of its value. Why? Because I am prepared to pay a premium in order to have the option to sell the debt to someone who is more optimistic than I will be tomorrow. If everyone does the same, the asset becomes overvalued. This has been thoroughly tested and is fairly well understood.

There are thus several reasons why markets overreact, sometimes in a significant manner in the short term.

## The creation of self-fulfilling prophecies

The second flaw in the market that I would like to speak about is the fact that the markets sometimes become trapped in self-justifying equilibria that are inefficient. Recent examples of this are not in short supply. The perfect illustration is Italian sovereign debt. Everyone more or less agrees that there are two possible equilibria in this situation: if everyone thinks that Italy will not be able to repay its debt according to schedule, then the spreads increase and the equilibrium is self-justifying because, as it turns out, those spreads make it impossible to repay the debt on schedule. There is also a virtuous equilibrium in which the stakeholders think that Italy will be able to repay its debt, and therefore the spreads decrease and thus do not compromise the payment schedule.

It does not always work out this way: there are not always two possible futures and two possible prices for every asset. Let us take another example – that of Greece. For Greece, even the most optimistic of observers have, for several months, believed that Greece will not be able to repay its debt on schedule no matter what happens. Here, there are still not multiple equilibria, but there are several.

And this is true not only for exchange-rate crises or sovereign debt crises. It is also true for businesses. Companies take the signals supplied by market prices to make real decisions, because the signals generally contain relevant information. However, a significant number of investors may take a short position, even though they have no basic information. Agents who make real decisions on the basis of prices do not know if these prices are the result of self-fulfilling equilibria or if they are based on real information that they do not have. They can react by making decisions that destroy value, which justify ex-ante those uninformed decisions. At corporate and social level, this is extremely inefficient.

Why am I speaking about these particular flaws? Because when one is thinking about introducing more market-sourced information into accounting representation, these are the flaws that we should be looking at. Why? Because in this case, we will create feedback loops that will intensify these flaws, which do exist but they do not imperil capitalism, or the use of markets and price signals to allocate capital. We attempt to limit their impact by regulating the markets. But if the accounting system creates significant feedback loops, then it is not certain that these flaws will remain at a level that is acceptable. This is the primary issue that I have been working on in my accounting research, and it is a subject on which we are focussing at the *Université de Toulouse*.

So why does the use of market value in accounting representation destabilise the system and create feedback loops? When it comes to reactivity, it is very simple: if we add overreaction to overreaction, we create a problem. It is more

complicated when it comes to self-fulfilling prophecies because, by definition, when we are in a situation in which several equilibria are possible, it is very difficult to predict what will happen. We do not know how to assign probabilities to future events, and all it takes is for peoples' beliefs to change to shift from one equilibrium to another. Over the past decade, there have been new developments in economic theory that describe self-fulfilling prophetic models like the ones I have just mentioned. These allow us to better determine the probability that the wrong equilibrium will come to pass. By applying these models, even if they are still new and imperfect, we can observe that market measurement increases the probability that the wrong self-justifying or self-fulfilling equilibrium will occur.

These two market flaws are well-established and relatively well understood by economists. In my view, they are theoretical points that must be taken into account in economic and financial theory concerning market values, in order to achieve a more balanced profit/cost vision.

# The place and role of the enterprise entity in the representation of its accounting income



## Yuri Biondi

*Tenured Research Fellow of the CNRS, appointed to Ecole Polytechnique of Paris*

Currently as a tenured research fellow of the CNRS [Centre National de la Recherche Scientifique – French National Centre for Scientific Research], I have been working on accounting issues for some twenty years. I first took an interest in this area for theoretical reasons, but little by little, particularly as I was writing my French-Italian doctoral dissertation (2000-2003), I observed the advent of a new trend initiated by the international standard-setting body with the aim of imposing a new accounting paradigm that had been theorised as early as the 1970s, above all by researchers in North America. In fact, the new paradigm had been termed an “accounting revolution” in the 1980s (Beaver, 1981). This revolution changes the status and role of the firm as an enterprise entity – formerly the locus of accounting – as well as the way in which its income is defined and represented.

Because my background was in mathematical economics rather than in accounting, I spent about ten years studying a large number of major authors to carry out my research. In the process, I became familiar with several accounting traditions, to be dealt with in a forthcoming collective work (Biondi and Zambon eds., 2012).

In the nineteenth century, accounting theorists and practitioners discussed how to classify accounting elements into several account classes. Concerned with “form” and technicalities, they gave little thought to the economic “substance” of accounting. Starting in the late nineteenth century and extending into the first three decades of the twentieth, the proponents of a scientific revolution heralded the emergence of a new accounting paradigm. This latter paradigm made the firm as an enterprise entity the centrepiece of accountability (Biondi, 2008; Biondi, 2010; Biondi et al., 2007). How accounting elements are defined and classified acquires meaning and purpose based on the scope and purpose of this accountability, which is to define and represent the income and position of the enterprise entity. Accounting thought of that time can be broken down into four basic models:

- In the traditions of Continental Europe, a static model focused on measuring changes in wealth through the enterprise properties in contrast to a dynamic

approach that seeks to determine the operating (i.e. productive) results generated by the enterprise as a whole.

- In the North American tradition, the distinction is between an ownership perspective concerned with representing the wealth accruing to the proprietor-entrepreneur, and the enterprise entity approach, which well may be related to both the Marginalist Revolution in economics, and the emergence of institutional economics at the time, with its focus on representing the generation of income for the satisfaction of all stakeholders, including shareholders.

Although the dynamic approach and the entity approach dominated the twentieth century prior to the advent of the new financial reporting paradigm, all four models placed the enterprise entity at the centre of the accounting system. The main scope and purpose was not to produce information for investors in financial markets, but to design a control system useful to all stakeholders (including partners and shareholders) with joint interests in a business venture whose profits and losses they share. Thus, whether preference was given to an ownership and static approach or to an entity and dynamic approach, the enterprise and its accountability invariably remained the primary focus.

In the 1970s, however, a number of regulators and theorists began shifting away from this view of the accounting information and representation required for the enterprise and its income to an emphasis on the market, particularly the share market. Their belief was that current market prices at closing dates should be used as the basis for information provided to investors in financial markets. They therefore developed an approach that more or less explicitly viewed the enterprise as a portfolio of disparate assets and liabilities, to be considered separately at an arbitrary moment in time. The entity was thus redefined as a legal-economic vehicle, to be used by active investors in benchmark financial markets to hold such assets and liabilities (Biondi 2011).

The effect of this view of accounting has been to rule out any concern with the income generated over time by the enterprise entity as a whole. In this financialised approach, the collective, dynamic dimension to the enterprise has lost its central status. These regulators accordingly issue special accounting standards for each individual accounting item. In doing so, they are rejecting more than a century of progress in accounting theory and regulation. It should be stressed that the conceptual frameworks underpinning the work of the American and international standard-setting bodies do not have a “constitutional” character – in other words, they cannot be used in practice, nor can they serve as a reference for application of the standards. Each individual standard has its ad hoc validity; there is no requirement to refer to key foundational concepts. Moreover, their sets of standards contain no clear definition of the enterprise entity, while standards are typically applied on a case-by-case

basis, transaction by transaction, and thus independently of each other. This amounts to a genuine revolution that creates a whole series of problems. I will attempt to deal with them in historical perspective. From the latter, I draw three lessons that I will present in a somewhat provocative manner:

- The first lesson is that the enterprise should not be equated with the market.
- The second lesson is that fair value is not accounting.
- The third and final lesson is that accounting should not take its lead from the market; the market should take its lead from accounting.

### **The enterprise should not be equated with the market**

If the enterprise were the same thing as the market, the market point of view would prevail and market forces would be omnipresent, determining all types of transactions and economic activities. This is simply not the case, however. Strictly speaking, on the one hand, there are share market prices and an investment assessment logic that should be part of how the value of a company is estimated, and therefore of the task facing investors, at least so-called fundamental or long-term investors. On the other hand, the accounting system defines and tracks performance achieved over time, as transactions are completed and the potential becomes actual. This is a logic of control, of accountability. But it is also the management logic that any enterprise needs to be able to function over time and address a wide range of issues spanning industrial organisation, finance and economic relations with stakeholders, both investors and non-investors.

Seen in this light, accounting information should supplement market information rather than following it. On the one hand, you have the market with its price system, which generates market information through interaction among investors, each having only limited and dispersed knowledge. Just how relevant and trustworthy such market information is will depend on the state of the market and the opportunities for market participants to access firm-specific information. On the other hand, you have an enterprise entity that is fundamentally distinct from the market and that cannot be comprehended without genuine accounting information, which provides that critical firm-specific knowledge that is common to and shared among investors.

This means that you need two systems of information, representation and control rather than just one (Biondi 2003; Biondi 2010).

### **Fair value is not accounting**

This brings us to my second lesson: fair value is not accounting. If you go back and reread the great authors on accounting, the ones who wrote before the new wave of financial economists inspired by modern financial theory, you observe that they provided a critique of the idea that company accounts should include profit and loss estimates, i.e. a whole series of valuations gues-



sing on transactions that may never be realised. Other, more recent authors like Ijiri (2005) have echoed their concerns in a theoretical debate that is far from over at this stage.

Yet fair value requires such estimates. It portrays the enterprise as a collection of disparate resources that are assumed to be liquid, given that they can be measured at their current market value or by using mark-to-model estimates of that value (Biondi, Chambost and Klee, 2008; Biondi and Fantacci, 2012). Estimates of this kind thus result directly from a vision of accounting as an instantaneous valuation system, with markets supposedly providing the most reliable indication of business value.

Needless to say, this approach subjects the enterprise to the market, whereas the business performance we are discussing today can only be produced over time, and with the involvement of the whole enterprise (Biondi, 2011). In any enterprise, the outcomes of the various processes, activities and segments overlap and offset each other. That, in fact, is part of the rationale for creating complex enterprise groups spanning several industries and several countries (Strasser and Blumberg, 2011). This highlights how regrettable it is to disregard the enterprise entity as a whole that generates business income over time. The firm as an integrated entity and going concern should indeed be the focus of any accounting model. In the older accounting paradigm, the principle of the firm as an enduring economic entity was universally recognised and upheld in all countries and regulatory contexts (Hoarau 2006). It follows that there was no need to displace this principle to achieve international accounting harmonisation. The reasons for this displacement must therefore be sought elsewhere – in the financialisation imposed on business activity and accountability.

### **Accounting should not take its lead from the market; the market should take its lead from accounting**

This brings me to the third lesson from history. Should we accept the new role assigned to accounting or stick to the old one? The traditional accounting paradigm serves to remind us that the firm is an enterprise entity located in space and time, an enterprise entity fundamentally different from the market. This paradigm distinguishes between and compares cost and revenue streams, instead of lumping them together in discounted present value estimates. The older model does not, however, entail a net loss of information for investors, because it avoids the use of fanciful profit and loss prophecies (Savary) and discount rates that introduce other forms of pro-cyclicality, due to the volatility of interest rates used as benchmarks. In this way, a genuine *accounting* logic emerges. Rather than seeking to achieve the impossible estimate of enterprise value (in the form of market or discounted value), this approach focuses on economic and financial flows in a relevant, reliable representation of invested

cost and revenues generated over time by the enterprise as a whole. This kind of accounting, along with the information it produces, can contribute to price formation in the market and be of use to investors, financial analysts and other stakeholders (Biondi 2003).

### **Concluding remarks**

The new financial reporting paradigm has driven accounting into a dead end. Just how badly it has failed is highlighted by the recent scandals and shortcomings related to the global financial crisis. Nor should anyone forget that emergency intervention by treasuries and central banks were required to save many of the banks and financial institutions, which were the most subject to the new fair value model. We should drive all the relevant implications on the economic consequences of this model from this natural experiment.

To get out of this dead end, we need to make a few basic observations and lay the theoretical groundwork for an acknowledgement of the role of accounting as a mode of representing, governing and regulating business activity that has relevance and reliability for all stakeholders, including shareholders. An enterprise accounting system fulfils a variety of functions in business and society. It provides information to shareholders (including investors in the share market), while also helping to measure production costs and operating results and regulate dividends, taxes, prudential ratios and the like. Although this is only a statement of fact, it also points the way toward a redefined purpose or underlying principle of accounting standardisation that still supplies investors with firm-specific information. Such a common source of accounting information on business performance achieved over time offers financial analysts and investors a template for validating their valuations and expectations. Investors must constantly be reminded that they are investing in an enterprise, and not just in a supposedly liquid financial security (i.e. one they can sell on the market at any time). The losses triggered by scandals and financial crises offer just such a reminder, but only when it is too late.

The time has come to impress upon financial analysts and investors that because they invest in enterprises, investors are exposed to the risks and hazards inherent in the activity of those enterprises. It follows that they, too, need a common, shared, reliable source of information that trustworthily represents the performance of each enterprise entity over time. It is only on the basis of that performance that they can arrive at objective, realistic valuations and expectations. Accounting, then, should not be responding to the market; the market should rather be responding to genuine accounting information.

## Why doesn't the IASB speak properly?



**Tim Bush**

*Local Authority Pension Fund Forum (LAPFF)*

I have spent a lot of time thinking about IFRS because I came into investment having previously been an auditor. So I was quite unusual in coming into fund management in my late thirties and in actually understanding how accounts are prepared and audited and therefore what the expected quality should be. And I will be honest; I could not believe my ears when I was hearing some of the concepts that were appearing around international

accountings standards. They were just bizarre!

I think it is particularly interesting to see the background of some of the previous speakers: Marie-Anne Frison-Roche is a lawyer and Guillaume Plantin is an actuary. So we have somebody who understands the law and somebody who understands how to add up. And what I am going to cover in my speech is quite clear. Not only does the IASB not know how to add up, but it can't even speak English properly. I have done a paper showing the migration from plain English to words that don't mean what the IASB is pretending they mean.

Is accounting a photograph or a film? In truth, some things in accounts need to be forward looking. The very concept of a provision is forward looking. It is the likely realisable value of something in the future. If you are holding an inventory at year-end, you may need to make a provision because you don't think you will sell it in the future. So there is an inherent "forward lookingness" in accounting. The problem is that the IASB model is being confused as to whether it is looking forward or backward. It is schizophrenic. It has a backward looking model for bank loan losses, so it is not looking into the future in precisely the place where you would want it to look into the future. That is replicated in aspects of tax accounting. Our government has proposed and done everything except legislate for bonus tax so the banks have a problem in actually accruing for that in their IFRS accounts. And actually committed bonuses are not appearing in the accounts either: for Barclays, the missing sum is about 2 billions in the accounts. Although mentioned in the slides at the end of their presentation, they are not accounted for in the accounts.

But as we know, on aspects of profit taking, the IASB model is actually looking forward. So it is looking forward precisely to the things you don't want to recognise in the accounts, the things you have not yet earned. The problem is IASB standards have been "causative" of the banking crisis. There is little point

in accounting for forward profits if any losses, even projected, can be avoided, creating a capital deficiency. When business is conducted inside a limited liability company you are not dealing in a symmetrical world, you are dealing in an asymmetrical world.

Limited liability status means that a company is an option: it's a call option for the shareholders to take the profits but they can put the losses to the creditors. The risk and reward model is asymmetrical. Therefore, any leaving out of losses and particularly at the same time you try to pretend you've made the profits you have, is actually ignoring the fact that there may be no funding for those profits in the future and the company collapses. The mathematical deficiency in going through a neutral model, when the thing you are actually reporting in an asymmetrical limited Liability Company, is so obvious that the Board must be mindless. Limited liability shareholders regard future profits and impute losses differently. If anybody is just valuing a company using a plain net present value cash flow projection, then they should not be investing. I wouldn't want them to look after my money. As I said, risk is not symmetrical. So then we come to the point: how does a board become mathematically mindless? It is interesting because book-keeping was invented by an Italian mathematician, Pacioli, in Renaissance Italy, someone who was very rigorous in mathematics, as Madame Frison-Roche points out, there's an interface with law, where the State decided what the interest in accounting was, particularly in the French Civil Code. But I think that the problem with the IASB goes deeper than not grasping mathematics. The words the IASB has surrounded itself with do not even represent proper English.

Here are some examples:

- The plain English word is « valuation », but the IASB conceptual framework and standard-setting have replaced it with « measurement ». The two things don't mean the same thing: if there is a car parked out in the street and I want to buy it, I will say "what is the value of that car ?". If I were to go to somebody and say "what is the measurement of that car", they will think that I am trying to squeeze it into a small parking space. Those two things do not mean the same thing. Why does the IASB use the word "measurement"?
- Another example : the plain English expression "provision for bad and doubtful debts", which clearly has a future element in it, has been replaced by this word "impairment". What does impairment mean ? Literally that you have poor vision, you can't see properly, so you are squinting a little. Why is the IASB model talking about "impairment" rather than "provision for bad and doubtful debts"? Why is it relevant? If you look at IAS 39, it isn't valuing held-to-maturity loans at all, it's taking the cost and deducting this synthetic number called "impairment". Therefore the bulk of the asset's value is a balancing number. There is no objective test in IAS 39 to actually say what the value of that loan portfolio is. Impairment is produced by the IAS 39 methodology itself. Paragraphs AG 89

and 90 give an example of applying its concept of losses, no matter how likely or not they materialise: it gives an example of a loan portfolio where the major credit risk is that of people dying. It specifically states that you do not make any impairment now for people who haven't yet died at the year end. Now that is actuarially nonsense. If I am lending 100 million Pounds to a portfolio of people who are 90 years old, knowing that half of them would die in the next year, I am not going to pay full value for that loan portfolio. But the methodology of IAS 39 instructs you not to look into the future at all, which is quite remarkable. Interestingly, with that embedded into IAS 39, I refer you to the IASB website, where Sir David Tweedie did a speech to the Empire Club of Canada in April 2008 during which he specifically states that no bank is ever required to hold assets at more than their realisable value. He clearly hadn't read IAS 39 because IAS 39 is precisely telling you not to take account of that thing that is coming or going to come which is loss.

So, over a period of time, one of the fortunate things or unfortunate things of living in London is that you tend as an investor to have fairly regular access to the IASB members. When they are consistently challenged on points of logic that they are continually getting wrong, they then start into speaking in faulty language and get into word-play. This has interestingly happened in a House of Lords enquiry : the debate goes on between a member of the House of Lords and an IASB board member about whether prudence is in the IASB standards or in the IASB framework or not. It clearly is not in the framework because it was taken out and it clearly is not in particular standards because it is extremely imprudent to tell somebody not to account for a loss that he knows is coming. That board member basically failed to tell the truth to the Committee. He went around as many houses as he could to convince people that prudence is still in there, even though it is not in the framework and the standards are not prudent.

To sum things up, faulty words lead to faulty ideas, which lead to faulty numbers. It is quite clear that there is a cultural problem within the IASB's organisation. The fault in maths is the fault of effectively vague and truth-avoiding language.

I'll run down some other terms.

- A precise term "accounts" has been replaced with the more vague term "financial reporting". The accounts mean the numbers, whilst reporting is a more amorphous thing that includes the words and narrative. Accounts are accounts.

- The word "Capital" has been replaced by the word "Equity". In English, capital is not synonymous with equity. "Equity" means "to share fairly the capital", so that equity is what you do to the capital that is not the capital. An example of this is: there is no such word in English as "share equity" because it is repeating

the same concept twice, but the IASB uses the word “equity” and consistently avoids the term “capital”.

- “Profit” has been replaced by this vaguer word “Performance”. Profit is something that is earned. Performance in English means either “to put on a play” or to actually achieve something. But now with the IASB methodology, performance includes things that are not achieved because they’re market values by using the market as analogy. Some of them are never achievable, because markets work by pricing at the margin: being able to price one percent of an asset because only one percent is trading is not the same as the other 99% out there. Therefore, this inherent cyclical in IFRS is partly caused by this very odd concept of performance and not distinguishing between realised and unrealised profits, with a disastrous effect.

Also, accounts are being degraded by having to be useful for users. Actually, the accounts are essential for the execution of legal things, not least because of dividend distribution. The term ‘useful’ is a downgrade from the term “essential”. I don’t know how any company, let alone a bank, knows whether it is a going concern unless it has a set of reliable accounts. If banks are producing two sets of accounts because the international standard numbers are not designed to be reliable, I will ask you to read the report on the Bank of Scotland collapse which was published in the House of Commons this week and in which it is clear that the bank was using only one set of accounts, IFRS accounts. So were all the banks which collapsed in the British Isles.

Interestingly, and you may not be aware of this, the UK and Ireland were the only countries, because of having only one accounting standards board for both countries, to copy IAS 39. That was an absolute disaster because the EU IAS Regulation only mandates the use of IFRS for the group accounts of listed companies. By copying IAS 39 into UK GAAP, there was no option for banks to do anything else other than use the faulty standards in their standalone accounts. What is interesting is that UK GAAP is not only used by UK and Ireland. There are other jurisdictions that impose UK GAAP as well (Isle of Man, Jersey, Guernsey). There are actually five separate legal jurisdictions that use UK GAAP. Each of them has its own financial services regulator and two of them have different currencies. But the common thing in all these jurisdictions in connection with the banking collapses are the same accounting standards. What is interesting if you look at the collapse of the Icelandic banks, is that there are not many people to lend to in Iceland, and a lot of losses in Iceland actually happened in the UK-domiciled companies because it is where the major part of the business was conducted.

If some of you think I am critical or rude about the IASB, my analysis makes me say that they deserve it and this analysis is shared by more than a few other people. The IASB are in denial and I would probably be as well if I had created such havoc.

## We should abandon the IFRS bureaucracy in Europe and find our own accounting solutions



### **Stella Fearnley**

*Professor in Accounting, Bournemouth University Business School*

Can I remind you of the wonderful fable by Aesop about belling the cat? When the mice decided they needed to do something about the cat killing them, one bright young mouse said: let's put a bell around the cat's neck. This was greeted with cheers until a wise old mouse said: OK guys, but who is going to do it?

We have been told that it is a good idea to have global accounting standards and that it is a good idea to have a common currency in the EU. But what at first seems to be a good idea may not be achievable in practice, as was the problem with the Aesop's mice, and all grand ideas, whether successful or not, have to be properly managed by people who can be trusted. Take the dream of common global accounting standards. It was clear from the start that there is more than one way of accounting for some transactions, for valuing certain assets, for recognising liabilities and for determining what is a profit. In the financial sector, what was originally determined by the IASB as the 'right' way of accounting for financial instruments has obscured reality in accounting numbers. So, I wonder how we could be get to a position in Europe of entrusting determination of the whole set of views to the IASB. This body claims to be independent but yet in 2002 the IASB agreed to converge its standards with US GAAP without a full public consultation with its European constituency. Since then, the IASB has not been independent, because it is not independent of the US accounting standard setters.

I was asked to speak about whether accounting is a film or a picture? It is a film because it looks backwards and it looks forwards. The balance sheet and profit and loss account (or income statement) show the past and how effectively the management has been running the business. From that information, users of the accounts should get an understanding of how the business may continue in the future under the stewardship of the directors. But the IFRS accounting model has obscured reality in accounting numbers by allowing suspect valuations and therefore suspect profits to be recognised.

Annual accounts have never included profit or cash flow forecasts because management has never wished to produce them, but they do produce forecasts when they want to raise capital either by flotations or rights issues. I would

like to see the cash flow forecasts, which directors expect to arise from their IFRS balance sheets and their business models, published under safe harbour rules. If we can have cash flow forecasts as part of annual accounts, they will expose where the numbers are not sufficiently related to cash. Businesses don't go bust when they have got a lot of cash. They go bust because they have run out of it. Furthermore, businesses do not go bust overnight. Some go bust because they behave like ostriches sticking their heads in the sand and hoping it will not happen. When regulators know things are starting to go wrong, they should intervene immediately. But who does?

So what sort of film is accounting? At the moment, I see it as somewhere between science fiction, Rocky Horror Show, and the Chain Saw Massacre with a giant vampire squid in the middle of it. We have to think about what we want accounting to deliver. I believe we want it to deliver reality.

Now, I am going to speak about research I've done in the UK with a two colleagues in 2007/2008. We surveyed chief financial officers (CFOs), audit committee chairs (ACCs) and audit partners (APs) of five hundred listed companies in the UK about their views on the UK's post Enron regulatory framework for accounting and auditing, including IFRS. This was followed by nine company case studies where we interviewed the CFO, the ACC and the AP in each company on a range of issues related to the post Enron reforms. They did not complain much about the effort of implementing the changes because, although the changes were major, professionals are used to change. They get taxation changes; they get regulatory changes; and they get legal changes frequently. What they complained about was the accounting model. We were shocked about some of the criticisms they made: one ACC said that IFRS produces magical results! Well, accounting shouldn't be magic. Another ACC said: it's impossible to explain (IFRS) to non-accountants. An AP said *'the directors glaze over when we talk to some of them'*. A CFO said *'the technical departments of the firms are taking over'*. Another CFO said *'it's counter intuitive'*. There was unhappiness because they felt they were delivering accounts that they thought were untrue, unfair and imprudent. Some liked the idea of common standards but they did not like the IFRS model. It seems to me that the IFRS model was given to Europe before it was ready, and the IASB was spending too much time trying to converge its standards with US GAAP, instead of looking after Europe.

I am a European as well. I don't care about US GAAP convergence. I don't know how many of you care about it. Even though I love my US friends and colleagues, I do not love their system of financial regulation. Look at what it has exported in the last ten years. So why do we want to converge with it?

We also have the monopoly problem. Do we just want one global standard-setter? It may be a radical proposal but why don't we have European GAAP? We've got the IASB's standards and it will take ages under the current system to put



them right. Some of the derivative standards will not be ready in 2015 or later. We should be looking at what we want in Europe, not what the IASB thinks we should have.

We could lobby in Europe for the standards to be changed quickly for Europe without the IASB global baggage. I believe that bringing IFRS into the EU was a big mistake. We did not know what we were getting. We trusted a private sector body and we had no idea whether that private sector body was trustworthy.

When I gave evidence to the UK House of Lords Economic Affairs Committee in October 2010, I described the IASB as a dangling regulator, sitting in a hot air balloon just off the East Coast of the US. I said this because I believe that the IASB has little accountability and has been too committed to the US GAAP convergence project<sup>6</sup>.

6 - Depuis que ce discours a été prononcé, un document de travail publié par la *Securities and Exchange Commission* (SEC) le 13 juillet 2012 a jeté le doute sur l'avenir du projet de convergence entre les normes IFRS et les normes américaines. Ce document intitulé *Workplan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for New Issuers* [Plan de travail pour l'examen du projet d'incorporation des normes IFRS dans le système d'information financière pour les nouveaux émetteurs] provient du Bureau du chef comptable (*Office of the Chief Accountant*).

# Roundtable 2: Can business model and fair value be combined?

## It is time to solve the conceptual issues around net income and OCI



### **Wei-Guo Zhang**

*Board Member of the International Accounting Standard Board (IASB)*

Good afternoon Ladies and Gentlemen. I feel excited to come here. The last speaker criticised the IASB so much. It's hard for me to feel targeted as much. I don't want to respond to criticism. We can debate later.

Tim, you raised very interesting issues as to the understandability of the words. The problem is that I can't speak French; my English is not so good, so

it would be harder for me to respond on the terms you invoked. The fact is that the international standards are based on the Queen's language, which is very different from the Chinese. One question that may be addressed by the IASB is that there are 27 words representing something related to probability, for example: likely, reasonably possible, probable, reasonable assurance, etc. According to what the Korean standard setter told us, it's very hard to translate them into Korean, which is based on Chinese. As you can see it's very hard, even in Asia, to follow all the debates. But we have the responsibility to reduce the possible misunderstanding of the words in IFRSs.

I don't want to debate with you or to fight against you. I just want to go back to the issue assigned to me which is the definition and presentation of performance. I found this topic very interesting and that's why I accepted the invitation to come here.

As you know, we have had an agenda consultation and are asked to finish the conceptual framework. But people don't care so much about all the phases of our conceptual project, including about the definition of the elements. But there's an area where people call us very often: "please make it clear: What is OCI? What should be placed in OCI? Why?" And related to that, there is a common call: "you must do something related to common presentation and disclosure framework or standards". That's why I think the topic of this debate is so good.

I will tell you my own key opinion, which is not representing the boards. Concerning performance, many people think that the standard-setter should keep silent on how to present income and expense items in the income statement. I totally disagree with that.

We all accept that our assets should be classified into current assets or fixed assets. We all agree that liabilities should be classified into current liabilities, long-term liabilities, and that equity is a combination of capital and retained-earnings.

So the accounting standard-setter has been required to do so. It is therefore necessary for accounting standards to provide guidance on how to distinguish between net income, OCI, comprehensive income and other subtitles such as operating income or current income, etc.

So I don't think it is acceptable for the standard-setter to say: "I don't care or I don't want to answer you because I should be neutral." It is not acceptable.

To follow the above idea, it would not be acceptable or logical for the standard-setter to make any decision around OCI without giving the reasons, or with giving non consistent reasons. I don't think it is neither acceptable nor appropriate. I criticise it myself. In my view, the key logical basis for providing the consistent reasoning around the OCI is to make it clear what operating income is, and what are differences from OCI, and why?. People have different views. But the standard-setter should have clear views.

And some people would say: why focus on income while income stems from assets? It is questionable, but personally, I think it should be income. And that's why I like the topic you assigned to me. And my feeling is that the standard-setters should focus in the discussion around income no matter whether we define income from asset or vice versa..

I cite a sentence of one famous professor, Littleton, who said in 1953: "the center of gravity of accounting is income". I like this notion.

And my next point is, since income is the result of various factors, and some of the participants mentioned legal, contractual, and transactional factors, and some others talked about the difference between present, current, or future, and some of the factors are transaction-based whereas others are holding-based. There are a lot of factors. So how should the standard-setter address all those factors? I think a standard-setter should make every effort to find a way to present and to disclose information effectively to users and preparers.

Tom spent a huge effort on our financial statement presentation project and he was unhappy that I didn't like it. The reason is not that I don't like the project, or that I think it is unnecessary to have a good presentation or disclosure model. My concern is that there are many dimensions: how should the standards react to that? Is there any way to more appropriately present income?

And of course, the financial statements presentation provides a very good structure. Maybe there are some other structures. We cannot appeal to everybody. Some like the forecasted-based and others like historical-based. Some say the moving picture is good and other say the photo is much better. In my mind, it should be multidimensional and have a long-term prospective.

In the future, the financial reporting will be like the creation of a real estate site. It's hard to say which building is good or not, or how much it is worth. It depends on the taste. And different buildings have different attributes or dimensions: different colors, different locations, and different histories. Financial reporting is the same. The purpose of accounting is to try to keep all those attributes and to find some structures to present them to the users, and to let them clicking in the network, and finding the appropriate way to evaluate things according to a particular combination of these attributes.

My last point is that if you want to provide more guidance, it requires more presentation and more disclosure. And people would say there already is information overload. My idea is that to balance the request from those who want more information, and the ones from those who complain about information overload, we should consider the future presentation and disclosure framework of the future performance reporting in the computerised and network environment.

## The use of « comprehensive income » as a main indicator, source of instability for the financial markets



### **Olivier Poupart-Lafarge**

*Board Member of the AMF and the ANC*

Before dealing with the difficulties encountered by entities in applying IFRS, which is the subject of my presentation, I would like to react for a moment to the remarks of Mr Zhang Wei-Guo. In this morning's "Entities" workshop, we agreed that presenting different results using different methods for the same entity was unlikely to inspire confidence. In other words, the idea that, because there are a multitude of users, a multitude of accounts should be produced, leads to results being differentiated by

user-group: shareholders, creditors, managers, tax auditors, etc. I fear that the effect of publishing a multitude of results would be a loss of confidence in the published results. We spoke of the case of the Royal Bank of Scotland with 2 billion pounds recognized in the result – or not. In one case, RBS recognizes a one billion pound loss, in the other, RBS recognizes a one billion pound profit. This is not likely to win the trust of observers.

Let us return to the difficulties encountered by entities. These difficulties are highlighted by the relatively frequent use of non-GAAP indicators. Pascale Besse will deal in detail with the difficulties encountered by large and small entities in applying IFRS; I would like to concentrate on one specific point: the use of "Comprehensive Income".

All users of the accounts, analysts, investors or management, use "Net Earnings" as the main indicator. The IASB wants to promote the concept of "Comprehensive Income" as the main measure of performance in place of "Net Earnings". The IASB defines "Comprehensive Income" as the sum of "Net Earnings" and "Other Comprehensive Income" (OCI). There is no conceptual justification for this addition, which entails serious risks for the financial markets.

In order to promote its point of view, the IASB wants a single income statement in which "Net Earnings" is just a sub-total. That would make "Comprehensive Income" the all-important bottom line in the income statement. Unfortunately, "Comprehensive Income" has none of the qualities required of the income statement.

- This account must be understandable. OCI is made up of temporary valua-

tion adjustments and not of elements of financial performance. It is a source of confusion for the financial markets.

- This account must be predictive, that is to say, it must enable estimation of future cash flows. The elements of OCI have no predictive value. They are often long-term changes in value which will not occur in the next accounting periods, or which management has no intention of realising.

- This account must enable assessment of management performance. Management performance is never measured by reference to "Comprehensive Income", either internally by the entity or externally by financial analysts. "Comprehensive Income" is not used to measure value created by the entity concerned.

- Lastly, "Comprehensive Income" includes profits and losses of an uncertain nature, and sometimes of a very material amount. The use of this indicator as the main indicator can only increase the instability of the financial markets and the lack of confidence of investors.

The IASB must not make this indicator mandatory without having first defined the Conceptual Framework for the measurement of the financial performance of the entity.

Why are the elements of OCI not currently included in the income statement?

Because:

- They will possibly be an element of future performance of the entity but they are not an element of its current performance.

- They are not yet realised and may be offset in the future. I am thinking in particular of hedging transactions about which we have spoken at length today.

- The exclusion of OCI reduces the volatility of "Net Earnings".

Thus:

- The effect of "cash flows hedges" or exchange differences is not relevant to the performance of the entity because there will be a balancing entry at a later date

- Elements such as changes in the fair value of financial instruments or pension provisions do not relate to the performance of the current period otherwise they would be included in the income statement.

For all of these reasons, entities wish to keep two financial statements:

- The first which is the existing income statement, a profit and loss account with "Net Earnings" as the bottom line.

- The second, which is useful, presents OCI and provides an analysis of changes in equity between the beginning and the end of the period. For this reason,

it would be preferable to call these elements "Other Changes in Equity" rather than "Other Comprehensive Income".

I will stop there for the time being, there are many other points which cause entities problems. Pascale Besse will present them now.

# The business point of view of Midcaps : Pleading for a more pragmatic approach to the standards based on the income statement



**Pascale Besse**

*Finance Director of Solucom*

I would like to present the business point of view, especially for mid caps. What is this point of view? In fact, we mid caps believe that the international financial reporting standards (IFRS) are drastically out of tune with the business reality on the ground. As Philippe Santi said this morning, there are a certain number of reasons for this view. First of all, there is how complicated it is to implement these standards. Then there is their instability and, thirdly, the volatility of the income statements they generate. Consequently, we mid-cap companies have gradually lost sight of what was, for us, a true and fair view of our business performance. I am talking about operating income. Businesses have come up with two responses to this IFRS failing:

The first has been to take the liberty of inventing income statement intermediate balances, "current operating income", "operating margins" and "income before stock option charges". In other words, we have surreptitiously introduced non-GAAP elements into our financial statements;

The second response, which is actually a get-out, has been to set up a double reporting system. On one side, we have the regulatory accounts that have become incomprehensible and now officially have nothing to do with the economic reality. On the other, we have aggregates and indicators used in house to properly measure the performance of our businesses.

At the risk of sounding clichéd in my evidence of the IFRS being out of tune with our daily reality, I would like to take a few examples to show you just how complicated it is to manage our operations on a day-to-day basis, both in terms of organisation and from a more forward-looking angle.

Mid caps' accounting teams simply do not have the wherewithal to maintain the technical level required for the IFRS. So we have to use external contractors. Quite aside from the cost this entails, it means that we do not have total in-house control over the elements in our accounts.

Most of our in-house teams were trained in the depreciated cost school and, for them, the notion of fair value is the dark side of the force. It is radically



different from everything they learned at school and radically different from their traditional practices. I also think the cost problem is compounded by a cultural problem and, as we have already heard mention, management no longer controls or understands its accounts.

Looking to the future, the instability of the standards is not merely an acclimatisation problem for us. It is also a problem in terms of financial communication. It is vitally important for a mid cap to be seen and heard on the market. Having to explain why the standard has changed and how it has affected our income statements undermines our visibility when I would prefer to spend time explaining our medium-term strategy. In addition to this problem, I am really worried about the scheduled standards projects, such as revenue recognition. I believe these standards could influence how we manage our operations and how we draw up our contracts. And, consequently, they could prompt us to take options that are not in the company's interest. Even as a finance director with accountancy training, I hardly find this prospect exhilarating.

Aside from the day-to-day problems with the IFRS, how do we interpret our business performance? In answer, I will take the example of Solucom.

Solucom is a listed mid cap with some one thousand staff. Now, for an SME like ours, long-term industrial performance is key. So what counts for us is the income statement, and I would even say it is what counts for the people who watch and analyse us. The balance sheet serves our strategy as it is one of the means used to create future wealth. And it really is a means, but certainly not an end in itself. What counts in the income statement are firstly growth and turnover, which reflect the success of our positions on our market, and secondly current operating income, which represents the repeated, sustainable profitability of operations? This aggregate is key; because it captures both the value-added we give our customers and our investment in Solucom's future development. We also have indicators that we do not necessarily publish, but that we use to rank our performance relative to our business model and our competitors.

To conclude, I ask you and my eminent co-participants in this round table the question: what point, what need is there to have such a financialised picture of the accounts? I think that the 2008 crisis and the repercussions on our businesses' published earnings blatantly showed just how short-termist and arbitrary a full fair-value approach can be. And, basically, I know that few people understand or have a real handle on the IFRS. Our stakeholders openly admit that they give our accounts a wide berth, especially our balance sheet.

On this basis, and I would say personally and on behalf of mid caps, I plead for a more pragmatic approach to the standards based on the income statement, which takes a long-term economic view, rather than a balance sheet

approach, which is way too financial and short-termist.

One last word – because these are the national research round table talks – I would like to add that we have a great demand for your work. And we have a great demand for your ability to bring all our points of view and considerations to the table and, more than that, to objectivise the long-run impacts of each of the standards on the economy so that they do not harm our businesses.

# Titre Accounting Standards and Banking System Stability



**Gilles de Margerie**

*CEO, Ricol Lasteyrie*

The methods used to value assets and liabilities and their impact on profit or loss have become a huge issue for the banking industry. This means that the distinction between what gets included in the income statement and what is presented outside of the income statement in “Other Comprehensive Income” (OCI) is of major importance to anyone concerned with fathoming and understanding the

key issues in banking.

I’ll give you a few recent examples and suggest some of the inferences we may draw from them.



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- When IFRS were first introduced, Europe fought to get the point across that measuring instruments at market value which were used to hedge items not measured at market value was, to say the least, a strange approach. In economic terms, it is utterly meaningless to record this asymmetry in the income statement, because a hedge doesn’t generate income unless it is effective. So this asymmetry called for special accounting treatment. The European Union has provided for it, but this has remained a European exception.

- The subprime crisis offers a second example. To put it simply, securities backed by subprime mortgages were created in the United States, but purchased in Europe. When the banks realised they were holding them on their balance sheets, they marshalled teams of lawyers and accountants to try to figure out what the economic impact of these securities would be, as well as how exactly to account for them. Some people recommended market value as a basis, while others suggested that a new measurement model should be designed. The trouble is that no one had any idea of how to design it, since no one understood the product.

- Our third example has to do with the changing value of debt issued by banks during the period of incredibly volatile interest rates. This effect of current accounting standards seems highly paradoxical, even completely counter-intuitive. People lose confidence in you, your debt declines in value and you wind up with less debt, so there’s a gain to be recorded in your income statement, given that you’re less leveraged than before. Since then, we’ve all

realized that this wasn't entirely absurd, because if you wanted to buy back your debt, you could get it for 80, whereas you'd previously sold it for 100. But while this makes sense after a fashion, you'd still be better off waiting for actual cash inflows before recognizing any such change in the income statement.

- Our final example pertains to sovereign debt. On this burning issue, the flames were fanned by a letter written last summer by IASB Chairman Hans Hoogervorst to the Chairman of ESMA, Steve Maijoor. In the letter, the IASB Chairman criticised the banks for using the rescheduling plan as a basis for recording a 21% discount on the Greek government bonds in their accounts at 30 June, whereas what little trading there was in the market pointed to a 50% haircut.

These examples tell us a number of things.

- To start with, the eurozone regulatory authority set capital requirements for banks on the basis of market value. This was a disastrous mistake, and we can only hope it will be corrected. In fact, it is the epitome of a self-fulfilling prophecy, of procyclical accounting. Suppose you bought Italian debt for 100 and it's now going for 80 in the market. That means you've lost 20. If you're worried the price will continue downward, you sell. In doing so, you push it down even further. So you wind up with the obligation to bolster your capital base to comply with regulatory rules. If you hadn't been subject to that requirement, you would have held on to the Italian debt and you probably wouldn't have had to take such a serious haircut. If we had handled the sovereign debt crises of the 1980s in the same way, we would have failed – with Latin America and with South Korea. In this area, interaction between regulators and accountants is extremely important.

- A second question is: how do you deal with a rescheduling plan? Oddly enough, ESMA opened a small window of opportunity by stating that with a plan that provides for swapping 95% of the existing debt for new instruments, it makes more sense to base measurement on the value given in the plan than on thin trading in a market that no longer really operates and that offers meaningless indications of value. I consider this a step in the right direction, one that leads away from the initial position and that fortunately runs counter to the letter from the IASB Chairman, whose aim was to denounce a few French banks publicly.

- In the absence of a rescheduling plan, how do you measure sovereign debt in your accounts? This brings us to the issue of management intent. Both the FASB and the IASB hold that whenever management intent varies over time, the entity is engaged in potentially "criminal" behaviour; in other words, the entity should be assumed to be acting with fraudulent intent in the way it presents reality. I believe we need to get away from this idea and to introduce a certain amount of flexibility in our definition of management intent, and

therefore in the accounting treatment for sovereign debt on bank balance sheets. That is how we can counter the procyclical, self-fulfilling effects we are currently experiencing. Reforms of this kind would be most welcome.

What all of these proposed solutions have in common is the underlying principle that the best approach is to recognise in profit or loss those items that have a very good chance of leading to cash flows within a reasonably predictable time frame. There is a clear connection here with the questions raised earlier by Professor Frison-Roche on certainty or uncertainty. The point to be stressed is that an income statement should maintain a strong cash focus, with items pertaining to "other comprehensive income" presented in notes, tables and exhibits so that investors can assess the risks involved and make informed investment decisions. There is no need to pollute financial statements. Returning to such an accounting principle would be a positive development. The distinction between what belongs in the income statement and what calls for separate disclosure would then be drawn in more relevant terms. Accountants could prepare financial statements in accordance with existing standards, accompanied by whatever information people may require to estimate the risks entailed by the riskiest balance sheet items. In this way, as risk shifts, you focus on the most relevant information. During the subprime crisis, there were pages and pages on subprime exposure; today, you get pages and pages on sovereign debt. What it ultimately comes down to is distinguishing between financial and accounting information.

## Remarks in response to the other panellists remarks



**Thomas J. Linsmeier**

*Board Member of the Financial Accounting Standards Board (FASB)*

I'm abandoning sharing my planned remarks and am instead going to share my views about the issues that were raised by members of the panel today because the panellists have raised many interesting issues relating to standard setting and they deserve a response. Given I am the last panellist; it seems the appropriate thing to do.

When I participate in discussions about accounting, one thing I observe is that the discussions sometimes end up resembling a dogmatic war between amortised cost and fair value. These discussions often start with the view that amortised cost is backward looking whereas fair value is forward looking; I happen to disagree with that view, because while historical cost starts with an original transactional price, it then requires that that price be allocated over time based on a forward projections of useful lives, salvage value, patterns of benefit, percentages of bad debts and percentages of warranty losses, on and on and on...

So the income under a historical cost model is determined based on forward views. As a result, I don't see that there's a great dichotomy between fair-value and amortised cost based on their focus on the past or future. I do see though, that in the allocated amortised cost model, we tend to use the forward views of management to determine how to do the allocations. And in fair value we use as a benchmark the forward views of the market. At least that's the goal. There are problems in both. Markets can be pro-cyclical and can have the problems that our friend the economist was talking about today. But the managements' views can be biased too. Managers sometimes fail to recognise that a downturn has occurred and even if they recognise it they have incentives not to report it. Financial statement users, therefore, sometimes experience difficulties in understanding when firms are in trouble under a historical cost model.

So, in our discussions about accounting maybe we should re-evaluate whether the argument should be about whether management is always right, or the market is always right and instead we could rethink about in what circumstances we might rely on one or the other or on both views. In the financial crisis, if I look at how managements' views affected the timing of the recognition of the lower valuation of assets, the timing of the recogni-

tion of impairments were slower than probably was useful to the users of the reports and the amounts recognised were higher than those of the market . In contrast, though, markets might have been pro-cyclical and with market prices possibly going down too far. In times of such uncertainty it increases the likelihood that both management's and the market's views may be flawed and quite different from each other. That raises the question as to whether markets would be better served in those circumstances by providing participants with both amortised cost and fair value measures. Would knowing management's view of the potential higher asset value and the market's view of the potential lower asset value provide more useful information for market participants, challenging them to ask further questions and to do further analysis to determine where, between the reported high and low amounts, they believe lie the economics of the entity? That's a possibility that would move the discussion away from historical cost versus fair value to what is necessary to inform markets, especially in times of greater uncertainty. However, that approach would complicate reporting.

I heard from the panellists today a lot of criticisms about the fair value. Tim Bush, however, also provided criticism about the allocated cost model partly due to the quality of financial reporting standards, but also due to delays by management in the timing of impairment of securities in this crisis. Management wrote down assets too slowly, not permitting market participants to understand where the problems were. In my observation, in the United States where the crisis started, everybody recognised there were over-valued assets in the banks in the US. They just didn't know which banks had the greatest problems that might affect their viability. And if we don't know where the problems are and things keep getting worse over time markets can become extremely, sceptical about all banks. In such a situation, the lack of quality accounting information could cause markets not to trust all banks, affecting their ability to raise capital and ultimately limiting their ability to issue credit, exacerbating the crisis. So, I believe we need to think about the role of financial reporting in helping us avoid having markets conclude that all banks are in trouble We've got to figure out ways to make transparent earlier the institutions that really are in trouble so we don't get into crisis situations where the market penalizes all banks due to insufficient information about where the biggest problems reside. In these situations accounting becomes a problem not a transparent helpful solution to the problem. Accounting- both amortised costs and fair value- will never be unflawed. So, we need to evaluate whether the solution is to provide both measures rather than relying on one flawed measure over another. I believe this is one of the key accounting issues we have to think about before the next crisis.

I agree that the income statement is the most important statement. And even if some people say we have a balance sheet view in our conceptual

framework, I don't believe it is a balance sheet view. It is an asset-liability view that focuses on assets and liabilities in order to better define what income is. Revenue and expense are accounting constructs. I can't walk down the street and observe a revenue or an expense. But I can see an asset. As the lawyer on the panel eloquently indicated, there's an inherent observable external construct based on rights in legal contracts that helps us identify assets in the real world. The same is true for liabilities that are based on legal contracts that create an obligation. So assets and liabilities are grounded in the real legal constructs grounded in contracts. Revenues and expenses instead are accounting artefacts with no real world foundation. Through the history of accounting standard-setting, all the accounting standard-setters argued differently about what we want to recognise as revenues and expenses with no ability to agree because revenues and expenses are not real world constructs. In the conceptual framework standard-setters have decided to determine income based on a foundation in legal reality that determines what assets and liabilities are and bases income on observed changes in those real things. This asset-liability view is inconsistent with the view that the conceptual framework privileges the balance sheet and therefore fair value and I assure you my fellow board members share this same view. Our focus is getting income right!

More generally I view the income statement as broken. We, standard-setters, haven't done a good job at all with this statement. The proliferation of non-GAAP measures is how people follow companies in the world, which suggests not only that "comprehensive income" is not the right number but "earnings or profit and loss" is not the right number either; because non-GAAP numbers fail to include some components of both earnings and comprehensive income. Unfortunately, discussions between standard-setters and our constituents tend to focus on whether or not we should include other comprehensive income items in the measure of financial performance. I think this is the wrong focus; the focus should be on making the income statement useful overall.

FASB and the IASB co-sponsored a conference in Connecticut two weeks ago. The title of the conference was "Other comprehensive income and the presentation of earnings". The conference is attended by about forty academics and forty others, including standard-setters, regulators, users, auditors, and preparers. The first case used at the conference asked participants to identify the key characteristics of other comprehensive income items. The case then asked participants whether there were items in earnings with the same characteristics. For every other comprehensive income item examined, we identified something with the same economic characteristics within earnings. So, there's no good explanation for what items are included in other comprehensive income other than that standards-setters decided for political reasons to



present those items below the line profit or loss or net income. Because items with similar characteristics are included in both profit and loss and comprehensive income, that's potentially one reason why "earnings" also is not what the market pays attention to; instead the market pays attention to non-GAAP measures of earnings.

So if we say the income statement is broken and other comprehensive income has no conceptual justification behind it, what should we do? One could say that we should focus on presenting another number that captures what investors are interested in similar to the non-GAAP numbers currently provided by management. The more I think about that number, the more I believe investors want a number that portrays the outcomes of the core, operating activities of the entity. When I decide to invest in a company and decide to continue holding an investment in a company, I primarily seek to understand the outcomes of the core operating activities of the entity, which is a measure of operating income. To gain this understanding I certainly do not focus on other comprehensive income items, but that is not the only income items to which I do not pay as much attention. I also am not as interested in the financing components of income and I also am not as interested in the outcome of non-operating investing activities of the entity. Said differently since I am most interested in the core operating activities of a company, I want to strip out from comprehensive income and profit and loss income items that are not as important to understanding the key reasons I am investing in the company; its potential success in its core operating activities. However, while I want to pay most attention to core operating earnings, I also don't want to ignore other income items in their entirety because the outcomes of investing and financing activities and of other comprehensive income items change the overall wealth of the company and that will affect the amount that I can get distributed in dividends or the amount I have if the company fails.

The notion of comprehensive income portrays the need for a performance statement that indicates the specific underlying activities that caused the change in balance sheet accounts for the period, other than contributions from and distributions to owners. I believe for reasons just mentioned that investors need to know this total bottom line amount. However, the biggest problem in our markets is that investors do not recognise there is different types of income and instead focus primarily on the bottom line not recognising that while there is value to understanding the total change in wealth of the entity, the bottom line number does not reflect what they should be most interested in – the outcome of the core activities of the entity. Why do investors concentrate on the bottom line, when it is not the driving force of the success of a company? If we reconstruct the statement of financial performance holistically to address this issue, what we should do? Should it be to focus on defining other comprehensive income and whether or not we

should recycle those amounts to profit and loss or should the primary focus be on making sure we provide users with an income subtotal that reflects that the outcome of the key operating activities of the company, the reason why investors invest in a company? I believe it is the latter, but our primary focus has been on the former. Our focus should not be on other comprehensive income and recycling but on making sure we provide a consistent measure of operating income that is followed by presentation of the outcomes of other non-operating activities of the entity so that investors also can understand the total change in wealth of the entity for the period that is not associated with transactions with owners. In reformulating the statement of comprehensive income to make sure the key division is between operating and non-operating income rather than on the division between profit and loss and comprehensive income, we also should consider whether we should present two statements of financial performance or just one; where the two statements might differentiate the reporting of operating and non-operating income items. Would this cause investors to pay attention to both numbers?

When we talk about reformulating the statement or statements of financial performance, we also need to think very carefully about what measures of income we want. Should it be fair value, should it be historical cost, or should it be a combination of both? One thing I completely agree with Tim Bush about is that in statement of comprehensive income, you need to distinguish realised gains and losses from unrealised gains and losses in a very consistent way. In some situations where the entity can continue operating its current business model, you may be able to focus primarily on what the entity has realised during the current period. But in other some situations you might want to know the unrealised amounts because if the business model can change rapidly, you might want to know what is going to arise when it changes.

One curiosity I find in IFRS is that it more often requires fair values for non-financial instruments than it does for financial instruments. Fair values are most relevant for financial instruments because with financial instruments a value often is realised through market transaction. Or if it's not been realised by market transactions, it might be very cost-beneficial for management to go to the market when economic circumstances change. And for financial instruments, since they are so easily traded when financial circumstances change, it might be very cost-beneficial to change from the cash collection model to a market model. The same often is not true for non-financial instruments.

As we know, unfortunately, there are boom and bust cycles that regularly occur in our economy. In bust cycles, you may rationally decide to sell a financial instrument that you intended to cash collect if by selling it you expect to realise more value than by attempting to collect the cash due to you. Or in

boom cycles, you might be able to securitise assets that you must cash collect in the bust cycle. This suggests that the form of value realisation – which often is viewed to be the business model for financial instruments - may change in boom and bust cycles. And for financial instruments, since they're so fungible, those changes in business model may be easily made.

So if the business model can be expected to change rapidly for financial instruments what should we be reporting in the statement of financial position and statements of financial performance for instruments that an entity intends to cash collect? Is the amortised cost amount the only amount we should report in profit and loss and comprehensive income or would fair value information also be useful to indicate what might happen when the entity rationally changes its business model for realising value as economic conditions change? If fair value also would provide useful information along with historical cost information, could we better portray the cash collection business model by having amortised cost measures reported in profit and loss and the incremental fair value measures in other comprehensive income to indicate what it is going to happen if and when there is a change in business model from cash collection to selling. Alternatively, should we provide fair value information through disclosures in the footnotes or parenthetically on the face of the statement of financial position and leave the statement of comprehensive income at historical cost? It's something we should think about carefully, especially because some recent academic research has shown that if you want to understand the interest rate and credit risk of banks, fair value numbers give you a much quicker understanding of those problems and make you understand better which banks are experiencing impairment losses than does losses reflected by management within the amortised cost model. It also is true that we may have problems in our impairment requirements? This is the reason both boards have decided to change the impairment model for financial instruments from an incurred to an expected loss model.

My closing remark is that both boards were criticised today for being inconsistent in our following of the conceptual framework, for not using precise and consistent language in our standards and for being slow in arriving at quality solutions. Those are all fair criticisms. But I also want to put those views in context. We have heard many differing views about the same issues from the panellists today. Now consider with those differing views if we asked the panellists today to deliberate together to come to a standard-setting solution. Would you expect these panellists to arrive quickly at high quality solutions or would you expect our differences to result in slower and compromised decisions? In addition hearing the differences of fundamental views today, would you be surprised if consensus decisions would be explained by imprecise and inconsistent language that is not always consistent with any one conceptual framework? This is an observation that standard-setting naturally is a politi-

cal, imprecise process that reflects individual differences and compromises amongst them. We are currently at a key point in standard-setting history that requires that we ask ourselves if we can make that process work well for the world or should we go back to striving to make that process work well country- by-country? That is not an easy answer because politically there are key differences in cultures across the world that make standard-setting even more challenging the more countries that are brought to the table. And so, I don't know what the right answer is, and I feel for the SEC in having to make such a decision because it is not an easy thing to decide.



# Conclusion and future prospects

**Jérôme Haas** , *Chairman of the ANC*

By way of a conclusion, I would like to say that you cannot set the historical cost system against the fair value system. You can, however, and the ANC will be launching in-depth studies on this, determine which system is closest to the reality.

In a fair value system, everyone is convinced that the value obtained is fair. However, in an amortised cost system, everyone knows that the value is not fair and that it depends on the amortisation method the company has used. This means that you have to assess the intrinsic value that management, in exercising their judgment, has placed on their assets.

During the subprime crisis, everyone thought it was all well and good to use fair value accounting for CDOs (Collateralised Debt Obligations). But, in fact, it was not. Had they been valued at the amortised cost, observers would have been forced to ask questions and make judgements. We would then have noticed that the values obtained were wrong. We could have subsequently prevented the boom and bust cycles.

I would also like to raise two points for discussion about the balance sheet:

- First of all, the balance sheet contains too many concepts. For example, making a leasing arrangement virtually a usufruct item produces, not an asset, but a mental construct to which it is hard to put a value.

- Secondly, I think we should do away with concepts and go back to flows. You can see a flow. It is tangible. When a company sells a good, it receives a price for it. In addition to the economic tangibility, you have legal tangibility in the form of the payment.

We need to address a number of questions. Are all these differences real or false? How can they be brought together?

We need to find a shared solution to set us on the road to a global standard. The coming year will be pivotal as we will have to define a procedure to set down the conditions for our discussions with the IASB.

We need to work together to develop a solution to our undeniable cultural differences. All the national standards bodies have this same concern. It is our challenge.

Thank you for your input and ideas.

# Annex: Speakers' Biographies

**Jean-François Bélorgey** has been a partner with Ernst & Young since 1993, having embarked on his career with the firm in 1982. He graduated from the HEC School of Management in 1980 and is a qualified chartered accountant and auditor. He works mainly for leading industrial groups established in France and abroad, especially in the motor vehicle industry. He is Director and Treasurer of the HEC Foundation and has headed up Ernst & Young's training for ten years, first for France, then Europe and now in his position as Global Director of Learning. He has represented Ernst & Young on IFAC's International Accounting Education Standards Board (IAESB) for five years. He has sat on training commissions for the French Order of Chartered Accountants (OEC) and the French Auditors' Association (CNCC) and on the final examination jury for the French chartered accountant qualification (DEC). In these capacities, he has contributed to the development of research at HEC and has formed close relations with academics and faculty members.

**Pascale Besse**, graduate from the HEC School of Management, is Finance Director and Member of the Management Committee at Solucom. She started her career with Deloitte in 1997, where she conducted auditing and due diligence assignments for leading financial establishments such as Crédit Agricole SA, BNP Paribas and Merrill Lynch. In 2000, she joined the Investment Banking Department of CA CIB (Crédit Agricole group) as Associate Director providing consultancy on mergers and acquisitions and equity capital market operations. In 2005, she was appointed Finance Director of Solucom, a consulting firm listed on NYSE-Euronext Paris. In this position, she is responsible for producing financial and legal information for all stakeholders. She is also in charge of raising the financial resources required to develop the company (liaison with markets and banks) and securing operations (internal controls and legal support to operational teams). She oversees process efficiency and steers the external growth strategy. She joined Solucom's Management Committee in 2007. In late December 2010, she was appointed Member of the Consultative Committee to the French Accounting Standards Authority (ANC).

**Carsten René Beul** is a German Doctor of Law, solicitor and attorney at law, and certified accountant and auditor. He was authorised to practise as a certified accountant in Italy in 1995, in Luxembourg in 2007, and in Switzerland in 2010. He has been a member of the National Wirtschaftsprüferkammer Council (Order of Auditors) and President of the Business Law Commission since 2011. He chaired the Genf-Gesellschaft from 1992 to 2006. He has published books on national and international tax law and European law.

**Yuri Biondi** is tenured research fellow of the CNRS, appointed to Ecole Polytechnique and affiliated Professor at CNAM, in Paris. Graduate of Bocconi University of Milan, of Lyon University, of Brescia University and of Paris Sorbonne University, he is editor in chief of the Journal *"Accounting, Economics and Law – A Convivium"* (published by The Berkeley Electronic Press), editor in chief of the collective work *"The Firm as an Entity: Implications for Economics, Accounting and Law"* (Routledge, 2007), co-editor of *"The Socio-Economics of Accounting"* (Socio-Economic Review, special issue, October 2007), as well as co-editor, with Stefano Zambon, of the collective work *"Accounting and Business Economics: Insights from National Traditions"* (Routledge, 2012). His research interests include economic theory, accounting and financial regulation, as well as the relations between economy, accounting, and finance in for-profit and not-for-profit entities. (<http://yuri.biondi.free.fr>).

**Dominique Bonsergent** is a graduate of HEC and a qualified Chartered Accountant. He has shared his career between auditing and accounting with responsibility for the accounts of large groups and most recently for Total. He is a member of the International Accounting Standards Commission of the ANC and Vice-Chairman of Acteo. He is co-author of the "Que sais-je?" edition of the university publishers (PUF) *"100 mots de la comptabilité"* ("100 words of accounting").

**Agnès Bricard**, President of the Supreme Council of the French Order of Chartered Accountants, chartered accountant, auditor and financial consultant, has managed her chartered accountancy firm Bricard-Lacroix & Associés ever since she established it in 1983. She has long been involved with professional bodies: President of the French Association of Trainee Chartered Accountants (ANECS) from 1981 to 1983 and Founder President of the Young Chartered Accountants Club (CJEC). She was elected member of the Council of the Paris Region Order of Chartered Accountants from 1987 to 2001 and President of this Council in 2001 and 2002. From 2002 to 2004, she held the Deputy Presidency of the Information and Prevention Centre (CIP) for the Paris area and nationwide. She was elected to the Supreme Council of the French Order of Chartered Accountants in 2005 and served as President of the Public Sector Club and the Local Government and Associations Committee through to 2008. She is also expert to the Economic Observatory for Public Procurement (OEAP) for the Supreme Council and member in an official capacity of the Working Group on Economic Intelligence reporting to the Senior Official for Economic Intelligence at the French General Secretariat for National Defence. She is Member of the Board of the French Business Start-Up Agency (APCE) and member of the Club Présence et Promotion Femme Française. She is Vice President of the Club Action de Femmes. She holds the titles of Knight of the Legion of Honour and Officer of the National Order of Merit.



**Philippe Bui**, Research Director at the ANC

**Tim Bush**, BSc FCA. LAPFF – Local Authority Pension Fund Forum, London. Is an activist investor, and financial analyst, originally having trained as a Chartered Accountant with Ernst & Young, then becoming a Senior Manager with PWC. He presently sits on the Urgent Issues Task Force of the body responsible for setting accounting standards in the UK, the ASB. In 2010 he set out concerns about IFRS and their application in the UK to the House of Lords' Select Committee on Economic Affairs. He revealed information that regulatory authorities had either been withholding in evidence or were unaware of. He was asked to make recommendations which appeared in the conclusions of the Committee's report. He has also recently undertaken an analysis of the failings of the UK and Irish banks, which sets out how the capital adequacy regimes failed due to their reliance on IFRS, and the IFRS duplicate standard FRS 26. <http://www.lapfforum.org/node/99>

**Stella Fearnley** is Professor in Accounting at Bournemouth University Business School and she spent 16 years as an auditor with Price Waterhouse and Grant Thornton before starting her academic career. In 2007 she was awarded the Deloitte/American Accounting Association Wildman Medal as co-author of the book *Behind Closed Doors: What company audit is really about*. Her 2011 co-authored book *Reaching key financial reporting decisions: How directors and auditors interact* formed the basis of her evidence in 2010 to UK House of Lords Inquiry into *Auditors, market concentration and their role*. Stella was a member of the UK's Professional Oversight Board from 2004 to 2009.

**Marie-Anne Frison-Roche** is a Professor of Law and Doctor of Law. She started her career as Professor at the University of Angers before joining the University of Paris-Dauphine, and has taught at the Institute of Political Studies, Paris (IEP) as Full Professor since 2001. As Director of the Cours Dalloz collections – a private law series (published by Dalloz) – and Droit et Economie (Lextenso – LGDJ), she founded and manages The Journal of Regulation ([www.thejournalofregulation.com](http://www.thejournalofregulation.com)). She serves as member of the French Council on Compulsory Levies (CPO) and the National Commission for Self-Employed Professionals (CNPL), among others. Most of her work is on the legal, economic and political aspects of regulation. She has written many articles and books, including her latest *Les 100 Mots de la Régulation* (PUF, 2011) and *Vers Quelle Régulation de l'Audit faut-il Aller?* (LGDJ, 2011) on which she was editor.

**Stéphane Gallon** is Chief Civil Engineer. He has been head of the Economic Studies and Strategic Planning Department at the French Deposits and Loans Fund (CDC) since 2009. After specialising in economics and finance at the Ecole Polytechnique (institute of technology) and the Ecole des Ponts Paris Tech engineering institute (ENPC), he spent most of his career at the French Ministry of Finance Treasury Directorate, also working for the French Ministry

for Ecology. This work led him to address both microeconomic issues (energy, industry, environment, etc.) and macroeconomic concerns (cyclical and structural). From 2006 to 2009, Stéphane Gallon headed the Bureau for International Macroeconomic Projections at the French Treasury Directorate. He teaches economics at the French Senior Civil Service School (ENA) and the Ecole des Ponts Paris Tech (ENPC).

**Jérôme Haas** holds a degree from the Institut d'Études Politiques de Paris ("Sciences Po") and a degree in Law from the University of Paris. He joined the French Treasury after his studies at the Ecole Nationale d'Administration where he has held several positions: In the field of public sector management, he has been Secretary General of the Comité Interministériel de Restructuration Industrielle (CIRI) and Deputy Head of the Agency in charge of State-owned companies. In the field of international finance, he has served as Alternate Executive Director at the World Bank in Washington and Secretary General of the Paris Club (negotiation of non-OECD sovereign debt). In recent years, he has been active in the field of financial regulation, serving on regulatory committees at the national, European and international levels, including the Haut Conseil du Commissariat aux Comptes in France and the Financial Stability Board at international level. He was named Chairman of the Autorité des Normes Comptables (ANC) in January 2010. He is also a member of the boards of the French market regulator (Autorité des Marchés Financiers - AMF) and of the French prudential supervisor (Autorité de Contrôle Prudentiel - ACP).

**Christian Hoarau**, is Professor with a chair in financial accounting and audit of CNAM and Director of the laboratory CRC-GREG EA n°2430. He is "Agrégé des Facultés en Sciences de Gestion", doctor of management science, diploma qualifying him to direct research (Paris XII Val de Marne University) and qualified Chartered Accountant. He is Member of the Board of the ANC and previously Member of the Conseil national de la comptabilité (1989-2009). He is also a member of several scholarly organisations such as the Société française de management ("SFM"), the Association Francophone de comptabilité (AFC) of which he was the chairman, the American Accounting Association (AAA) and of the editorial committee of several journals such as *Comptabilité-Contrôle-Audit* of which he was chief editor. He has published several works and articles including recently one on international accounting regulation "*La régulation comptable internationale*" in *Les concepts émergents en droit des affaires*, Éditions LGDJ- Montchrestien, 2010; on the interaction between research and accounting standard-setting "*Les interactions entre la recherche et la normalisation comptables*", *Revue française de comptabilité*, n° 433 special edition on accounting theory.

**Isabelle Laudier**, is a graduate from the Ecole des Ponts Paris Tech engineering institute (ENPC) and the Institute of Political Studies, Paris (IEP). She also

holds a Master's in Currency and Financing (DEA) from the University of Paris X Nanterre. She has held a number of economics research positions at the French Centre for Research and Studies on the World Economy (CEPII), on the French Minister for Industry and Foreign Trade's Staff (1991-1993) and at the French Deposits and Loans Fund (CDC), spending five years with the General Directorate. She created and currently co-ordinates the research funding programme for the CDC Institute for Research, of which she is Scientific Director. She also teaches, sits on editorial committees for peer-reviewed journals, on scientific councils and teaching councils for doctoral schools, and takes part in networks to support research in business. She wrote the preface to *Philosophie de l'Environnement et Milieux Urbains* (Ed. La Découverte, coll. «Armillaire», 2010) edited by Thierry Paquot and Chris Younès, and wrote *Territoires et Identités en Mutation* edited by RESEO (Collectif) jointly with Catherine Gorgeon (L'Harmattan, Sciences Humaines et Sociales, 2009), *Changement Technique, Changement Social*, edited by RESEO (L'Harmattan, Sciences Humaines et Sociales, 2007), and *Le Travail Sans Fin ? Réalités du Travail et Transformations Sociales*, which she jointly co-ordinated with Thierry Ménissier (Revue Cités No. 8-2001 – PUF).

**Agnès Lepinay**, has a Master's in Econometrics from the University of Paris I and a Specialised Post-Graduate Diploma (DESS) in Banking Economics from the University of Paris I. She embarked on her career as External Adviser to the Centre for Studies and Projections (CEP). She then became Adviser to the French Office of Industrial Studies and Statistics (SESSI) and the Observatory for Industrial Strategies at the French Minis has a Master's in Econometrics from the University of Paris I and a Specialised Post-Graduate Diploma (DESS) in Banking Economics from the University of Paris I. She embarked on her career as External Adviser to the Centre for Studies and Projections (CEP). She then became Adviser to the French Office of Industrial Studies and Statistics (SESSI) and the Observatory for Industrial Strategies at the French Ministry for Industry (1979-1987). She joined the National Council of French Employers (CNPF) in 1987 as Adviser on Sector Affairs and then Financial Affairs. Following this, she held the position of Financial Affairs Director with the CNPF from 1993 to 1997. From 1999 to 2007, she served as Director of Economic, Financial and Tax Affairs for MEDEF (the French business federation). Subsequently, from 2007 to 2009, she was MEDEF's Director of Economic and Financial Affairs, Research and New Technologies. Today, she is MEDEF's Director of Economic and Financial Affairs, also in charge of VSE/SMEs and intermediate-sized companies, and serves as Chair of Business Europe's Financial Affairs Committee.

**Thomas J. Lindsmeier**, Ph.D. and MBA from the University of Wisconsin – Madison and BBA from the University of Wisconsin-Milwaukee, was appointed as a member of the Financial Accounting Standards Board (FASB) in July 2006, reappointed to a second term in 2011. An award-winning teacher and research

cher with particular expertise in financial reporting for derivatives and risk management activities, He was formerly Russell E. Palmer Endowed Professor and Chairperson of the Department of Accounting and Information Systems at Michigan State University. He also has served as Academic Fellow and Special Consultant to the Office of the Chief Accountant at the U.S. Securities and Exchange Commission (SEC), where he was responsible for developing U.S. financial reporting disclosure rules relating the market risk inherent in derivatives and other financial instruments. In addition, he has held professorial appointments at the University of Iowa and the University of Illinois at Urbana-Champaign. Throughout his academic career, his research has explored the role of accounting information in securities markets, including the usefulness to investors of fair value and market risk management disclosures, the valuation-relevance of earnings component information, and the economic effects of changes in accounting regulation. His work has been published in *The Accounting Review*; *Journal of Accounting Research*; *Review of Accounting Studies*; *Accounting Horizons*; *Management Science*; *Journal of Accounting, Auditing, and Finance*; *Journal of Business, Finance and Accounting*; and *Financial Analysts Journal*. He has served as chairman of the Financial Accounting Standards Committee and president of the Financial Accounting and Reporting section of the American Accounting Association.

**Alain de Marcellus**, graduated as a chartered accountant from Paris ESCSLA Business School in 1977 and worked for STRECO and Arthur Young for seven years. In 1985, he joined Club Med as Controller of Club Med Inc in New York and went on to become Accounts Director of the group in Paris. In 1994, he was appointed Director of Financial Services with the Capgemini Group. He has been an active contributor to work on international accounts standardisation (ACTEO, AFEP, ANC and MEDEF) for the last 15 years.

**Gilles de Margerie**, started his career as Inspector of Finance when he graduated from the French Senior Civil Service School (ENA) before moving on to various positions in the public sector, including Senior Private Secretary to Roger Fauroux at the French Ministry for Industry, and Technical Adviser in charge of Industrial Affairs on Michel Rocard's Staff. He entered the banking world first with Rothschild & Cie Banque before joining Banque Lazard in 1992 and Banque Indosuez in 1994. In 2002, he was appointed Crédit Agricole S.A. Financial and Risk Director in a move from Crédit Agricole Indosuez where he had served as Executive Vice President Finance & Operations. From 2007 to 2011, he held operational responsibilities in insurance, assets management and private banking. In October 2011, he was appointed Partner with Ricol Lasteyrie, a leader in independent financial consultancy in France.

**Guillaume Plantin**, PhD in Economics from the University of Toulouse. He is a member of the Institute of French Actuaries. Prior to joining TSE, he has

been an assistant professor of Finance at Carnegie Mellon University (U.S.) and London Business School (U.K.), and a research fellow at the London School of Economics and Political Science (U.K.). His research interests include financial regulation and norms, risk management, insurance, and the determinants of liquidity and financial stability. His work has been published in the *Review of Economic Studies*, the *Journal of Finance*, the *Journal of Accounting Research*, and the *Journal of Risk and Insurance*. He is an associate editor of the *Review of Economic Studies*.

**Christine Pochet**, graduated from the Cachan Ecole Normale Supérieure and holds a PhD in Economics from the University of Paris-Dauphine. She is Professor of Management Sciences and Dean of the Sorbonne Graduate Business School (IAE de Paris), where she teaches management control and corporate governance. She chairs the Association of French-Speaking Accountants (AFC). Her research focuses on corporate governance and accounts regulation and audits.

**Olivier Poupart-Lafarge**, diploma d'HEC, he has spent most of his career as Chief Financial Officer of Bouygues, international industrial company diversified in construction, telecom and media. He was Deputy General Manager and a member of the board of directors of Bouygues when he left the company in June 2008 to retire. Since this date, he has devoted his business experience to public standard-setting, and he has been launching a company which serves as an angel investment firm for small and promising entrepreneurs. He is a member of the Board of French Financial Markets Authority (AMF), he chaired the working group in charge of specifying the missions of audit committees as stated by the Statutory Audits of Accounts European Directive. He is a member of the Board of French Accounting Standard Setter (ANC).

**René Ricol** set up Ricol Lasteyrie, a company specialised in independent financial expertise and financial risk management, in France in 1987. He was President of the French Institute of Auditors (CNCC) from 1985 to 1989, Founder and Honorary President of the French Institute of Financial Consultants and Experts, and President of the Supreme Council of the French Order of Chartered Accountants from 1994 to 1998. In 1997, he was elected to the Board of the International Federation of Chartered Accountants (IFAC), on which he served as Chairman from 2002 to 2004. Nicolas Sarkozy tasked him with a report on the financial crisis to inform talks among EU countries in connection with the French Presidency of the European Union. He was appointed National Credit Mediator for businesses in late October 2008 prior to his appointment as General Commissioner for Public Investment on 22 January 2010. He is also tasked with co-ordinating the government's business financing and support measures.

**Philippe Santi**, a graduate from Reims Management School and chartered accountant, served as Audit Manager to Ernst & Young in Paris before moving on to become Chief Financial Officer of Stryker France. In 1995, he joined Interparfum, which develops, manufactures and distributes perfumes and cosmetics under licence for luxury brands (Burberry, Lanvin, Montblanc, Jimmy Choo, Van Cleef & Arpels, etc.). Here, his brief was to work on Interparfum's initial public offering on the Paris Stock Exchange's Unlisted Securities Market. He was appointed Executive Vice President and Chief Financial Officer in 2004.

**Florence Segurel**, Project Manager at the ANC

Sabine Sépari graduate from ENS Cachan, Professor in Economics and Management and Doctor of Business Studies, is Associate Professor with Research Director Accreditation in Business Studies and Director of the Economics and Management Department of ENS Cachan. She conducts management control research and provides businesses with training and consultancy on scoreboard steering.

**Stéphanie Talbot**, General Manager of the ANC

**Béatrice Touchelay**, is Professor of Modern Economic and Social History at the University of Lille Nord de France (Lille 3) with Research Director Accreditation. She is an expert in the history of official figures, i.e. statistics and their uses (public policy and business practice), and the history of private figures (business accounts), their "producers" (accountants and chartered accountants, including their training and corps formation), their political uses (taxation and national accounts) and their private uses (wage practices) in contemporary France. She is more broadly interested in economic and social information, its formation, dissemination and uses. She is currently working on an analytical, critical and historical dictionary of private accounting, and on organising four annual conferences on employer organisations in Europe (beginnings, forms and practices) and round tables on economic and management history. She has published *L'Etat et l'Entreprise. Une Histoire de la Normalisation Comptable et Fiscale à la Française*, (Rennes, PUR, 2011) and has co-written two books, one with Luc Marco and Samuel Sponem entitled *La Fabrique des Experts-Comptables, Une Histoire de l'INTEC*, (L'Harmattan, 2011), and one with Philippe Verheyde entitled *La Genèse de la Décision, Chiffres Publics, Chiffres Privés dans la France du XXème Siècle* (Bière, 2009).

**Wei-Go Zhang**, PhD in economics, is a board member of the IASB. He previously worked as Chief Accountant and Director General of the Department of International Affairs at the China Securities Regulatory Commission (CSRC). He has been actively involved in accounting standard setting and implementation issues, auditor oversight, and cross-border regulatory co-operation issues at the CSRC and through his work with the International Organization of Securities Commissions. From 1998 and 2004 respectively, Dr Zhang was

a member of the China Accounting Standards Committee and the China Auditing Standards Committee. He has published a number of articles and monographs on issues related to accounting, corporate governance, and globalisation.

The French Autorité des normes comptables (ANC) held the Second Symposium on Accounting Research on 16 December 2011. These are the proceedings of this event.

The Second Symposium was a forum for intense debate. It highlighted:

- Like last year, the accounting standard-setting challenges and their need for a considerable amount of first-rate research;
- From discussions among practitioners, the need to match research demand (from businesses and accountancy professionals) with research supply (from academia) throughout the research cycle in order to foster exchanges between the communities;
- Through debates on changes to international accounting standards, the need for standard-setting work to take into account the economic models used by different sectors and countries to be able to develop internationally accepted global accounting standards.

