# The IASB and the shareholder value priestly cult!

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## Abstract

Associated with neo-liberalism, shareholder value is at the origin of the financialization of the economy and the current financial crisis. Indoctrinated by neoliberal economics, accountants set themselves the objective of ensuring the efficient functioning of financial markets instead of re-establishing accountability as fairness. The IASB project is in line with this logic. Its fair value accounting strengthened the resilience to the principle of governance by markets, which becomes a priestly cult. As a response to the financial crisis, the IASB published in October 2008 an educational guidance on the application of fair value measurement when markets become inactive. We make obvious how this amendment contributes to maintaining the status quo and preserving the primacy of the shareholder value as governance model. More problematic are its implications on the revered principle of conservatism which is institutionally abolished.

**Keywords.** IASB – Governance – Shareholder Value – Fair Value – Conservatism – Financial Crisis

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## 1. Introduction

The global financial crisis sparked off by subprime mortgages in the United States marks the bankruptcy of neoliberal economics. Conceived on the basis of the welfare state critique, it is opposed to all forms of state intervention and advocates the ideology of *laisser-faire* and markets self-regulation. Deployed thirty years ago under Ronald Reagan and Margaret Thatcher, the neoliberal approach has been largely spread to the developing countries, by the enforceable requirements of the World Bank and the International Monetary Fund. On the academic level, it has been supported by economists of the School of Chicago. Milton Friedman and the financial economists provided the scientific justification for the denigration of Keynesian economic policies and the glorification of market finance. The growing inequalities of income and excesses in credits - which are behind the current crisis - are rooted in trickle-down economics.

Shareholder value, as a mode of governance associated with this economic model, has given rise to the financialization of the economy. It has enabled investors to pocket illusory profits thanks to financial instruments over the stock market boom. According to Jacques Attali, in 2008, the mass of money created by the proliferation of derivatives amounted to more than €350 billion, whereas worldwide GDP is only €50 billion[1]. According to Attali, this disproportion is a real threat and a premise to a financial disaster at any moment.

Macintosh (1999) notes that since the New Deal the principle of total disclosure for investors has been in force in the United States. To re-establish confidence in the markets, shacked by the 1929 crisis, the Securities Act (1933) and the Securities Exchange Act (1934) institutionalised the responsibility of managers towards shareholders. The rise of neoclassical economics denies the role of the state but without reconsidering the primacy of shareholders' interests. Rather, it consecrated a new governance model by "efficient" and "self-regulated" markets, which has been celebrated by accountants. Since 1960's, accounting has been "colonised" by neoclassical economics (Williams, 2004). This affiliation has purged accounting from its legal substance and moral considerations traditionally

[1] http://www.lexpress.fr/actualite/economie/jacques-attali-alain-minc-et-la-crise-financiere_584833.html

associated with the concept of “accountability” (Williams, 2004). Accounting has become an information (Williams, 2002) and a language (Amernic & Craig, 2004) of measurement (Tinker, 1980) required to the good functioning of markets (Williams, 2002).

The IASB project is fully in line with this logic and with the model of governance by the markets. Following the scandals which have rocked financial markets (such as Enron and Worldcom), the IASB has established an international consensus by defending its politically independence and capacity to produce ‘‘principles-based” and high-quality standards serving the good functioning of global markets (Sunder, 2009).

In this paper, we attempt to show how the IASB supports the shareholder value as a corporate governance model based on the hegemony of markets, through fair value accounting, considered to be its hobby-horse in the project for international harmonisation (Biondi & Suzuki, 2007). For that purpose, we scrutinize the response of the IASB to the G7 and the Financial Stability Forum recommendations. We ague that the educational guidance on the application of fair value measurement when markets become inactive, published in October 2008, contributes to the emancipation of fair value accounting. Obviously, the continuous pressure exerted by the European commission and the threat of a new "carve out" from part of the standards clearly influenced the answer of the IASB in quest of securing the international consensus. However, not only this underlines the political nature of the amendment and the standards, counter argument for those advocating the neutrality of the international standard-setter and the high quality of its standards. More problematic, the amendments are ideologically oriented. The IASB continues providing capitalism with the required technology to enable speculators to “become rich in ideas” and to continue speculating on the market. Moreover, by releasing the pressure on markets and postponing as long as possible the consolidation phase preceding the reform of a system (Kindleberger, 2005), it maintains the status quo. Finally, by calling for a decoupling of accounting rules from prudential requirements, the IASB plainly recognizes its affiliation to markets and supports the primacy of investors and the shareholder value cult. The response of the IASB constitutes a significant swing in the accounting thought and a serious attack to the cherished conservatism principle. Whereas the application of fair value accounting has enabled financial institutions to produce, over the last few years, abnormally high profits, the recent measures enable them to limit the losses and to justify the immoral, excessive and unrestrained bonuses paid for their high executives, after they pocked almost $4 trillion worldwide rescue packages by October 2008 (Clarke, 2010).

In the next section, we present the shareholder value model of corporate governance, its apogee and how it precipitated the 2008 financial crisis. In the third section, we recall first the partisan role of accounting and its affiliation to the neoclassical economics. Secondly, we portray the rise of the IASB and the internationalization of the Anglo-American model of accounting which through fair value accounting promoted the authority of the markets. Thirdly, we analyse the recent amendments to the application of fair value measurement when markets become inactive. We argue that, instead of re-establishing the moral basis of accounting and a multi-party governance model, the IASB is supporting the hegemony of markets and the shareholder value cult. In the fourth part of the paper, we argue that the logic underlining the new amendments constitutes a serious attack on the principle of conservatism. Drawing the consecutive steps undertaken by the IASB since the adoption of IAS 39 in 1998, we contribute to the debate on this principle and its rationale as a guide to prudential conduct.

## 2. The shareholder value governance model: origins and implications

Berle & Means (1932) outlined the separation of control and ownership in the large corporations in the United States. Since, managerialist theorists have announced the appearance of a new form of capitalism without capitalists (Dahrendorf, 1972). The dispersed shareholding structure has given rise to the accession to power of organisation man (Dahrendorf, 1972) and to the growing ascendancy of salaried managers and technocrats in charge of ensuring the best possible allocation of resources inside the company. However, the "internal" mode of governance has led to excesses which precipitated American conglomerates into vast financial difficulties in a context of growing international competition. As a consequence, many researchers advocated for governance by markets, i.e. shareholder value. The arrival of institutional investors on the markets has merely strengthened this trend (1.2). Nevertheless, the financial crisis raised to the surface the illusive markets' efficiency, yet a prerequisite for the implementation of shareholder value as corporate governance model. It is argued that the shareholder value cannot be compatible with economic growth sustainability and social justice imperatives (2.2).

### *2.1 The rise of shareholder value and the role of institutional investors*

The escalating organizational complexity, rooted in the 1960s wave of mergers and acquisitions, and the growing competition imposed by Japanese companies, have exposed the American Conglomerates, since the early 1970s, to obvious financial problems (Lazonick

& O’Sullivan, 2000). This context has encouraged some researchers to debate alternatives for a better allocation of companies’ resources. In this trend, Jensen & Meckling introduced in 1976 the agency theory offering a new approach to governance to re-establish the interests of shareholders. Admitting the limits of the managerialist resource allocation model, the financial economists of the Chicago school recommended the distribution of available cash flows to shareholders in order to be efficiently allocated on the market. As a consequence, the internal model has been replaced by an “outsider” governance model (Aglietta & Rebérioux, 2004). However, the control is not related to the percentage of interest held. Rather, it is the product of the collective force of opinion exerted by the financial market (Aglietta, 2000) which becomes the regulator of corporate conduct.

This swing has been supported by the rise of the institutional investors. Owing to financial intermediation, they manage an increasing share of household savings. Since, companies’ capital is mainly held by investment funds, such as mutual funds, pension funds and insurance companies. From the time when the ERISA amendment (*Employee Retirement Income Security Act*) has been introduced in the United States in 1978, pension funds and life insurance companies have been engaged in a fierce competition to attract households’ deposits. Regretfully, the absence of funds industry regulation enabled them to maximize their short-term performance, but without considering the risks incurred by their strategy. Instead of behaving as long term investors, they acted to a greater extent like speculators, by investing a substantial proportion of deposits in shares and risky securities such as junk bonds, and in private equity funds. Undoubtedly, they succeeded in attracting about 67% of the net increase in household savings, between 1982 and 1994 (Lazonick & O’Sullivan, 2000). However, institutional investors have disrupted the way how management performances are assessed, by giving greater importance to financial indicators such as Return on Equity, Earnings per Share and Pay-Out Ratio. As a consequence, companies are managed to maintain an abnormally high level of financial return. Since the 1980s, instead of reinvesting profits to finance corporate growth, managers changed their strategy in favour of maximising shareholder value, which became their creed (Lazonick & O’Sullivan, 2000). Under the pressure of institutional investors and in order to make substantial capital gains, managers went aboard to boost financial return and maximize the company’s share price. For that purpose, the exercised their stock options and used other mechanisms to support margins and alleviate balance sheets such as workforce reduction, streamlining of outsourcing and conversion of fixed costs into variable costs. To pick up the dividend pay-out ratio, managers have used profits to buy back the company own shares instead of investing in profitable projects. According to Lazonick and O’Sullivan (2000), the buying back by American companies of their own shares exceeded their issues during the 1980s, a trend that has been sustained during the 1990s and 2000s, with the fall of the interest rates in US and Europe. Hence, when cash flows were insufficient, managers used debts to finance share buybacks while taking advantage of the leverage effect (Aglietta, 2006).

In short, shareholder value as a mode of governance becomes a priestly cult which invents rationalizations in support of it by promoting mechanisms which ultimately lent legitimacy to the predominance of hurried speculators interests at the expense of those of the other stakeholders, including entrepreneurial long-term shareholders (Richard, 2005). This short-termism compromises the company's sustainable growth and the interests of the other stakeholders, including long-term shareholders. The consecration of the market vision of the company as opposed to an industrial conception is not compatible with the imperatives of social stability and justice (Aglietta, 2000; 2006). Furthermore, its implementation presupposes that markets are self-regulated, a hypothesis that is untenable.

### *2.2 The limits of shareholder value as a mode of governance*

Self-regulated markets as a prerequisite for shareholder value as corporate governance model, and the intrinsic instability of financial capitalism are antinomic. Markets are not efficient and crises are not exogenous to the system. They are inherent to capitalism which generates them. Aglietta (2008) argues that in the market for ordinary goods, supply and demand are independent of each other, and adjustment by price is thus possible. Yet, this is not the case for financial assets and structured credits: "*the more intense the credit, the more the asset prices increase, and the more numerous are buyers encouraged to take on debt because they can pledge their credits on increasingly expensive assets*" (Aglietta, 2008; p. 13). As credit supply and credit demand are both dependent on the increase in asset prices, which depend on anticipations of their increase, they are pushed upwards and prices keep on increasing, nourished by the abundance of credits (Aglietta, 2008). Because "*there is no saturation in abstract enrichment*" (Aglietta, 2008; p. 12), an equilibrium price becomes unattainable. The subprime crisis is the outcome of a process whereby banks, brokers and regional bucket shops granted mortgages, even to households lacking the money to own property, in order to make more and more loans and to become richer. To comply with conservative regulations, they used securitisation to increase their return without incurring additional risks. Blinded by their greed, nourished by years of booming stock markets, small investors didn't see the crack in the system and didn't ask why their investment produced better return than ordinary bonds, while they were just as well rated as the latter (Aglietta, 2008).

On the other hand, “efficient markets” theory assumes the possibility of a return of prices to the fundamental value of assets owing to arbitrage. Having no capital constraints, small diversified arbitragists are not risk-averse and take each an infinitesimal position on markets. Hence, their collective action enables prices to return to an equilibrium price level reflecting the fundamental value of the asset. For Shleifer & Vishny (1997), this hypothesis is dubious. They argue that arbitrage resources are entrusted by small investors to a limited number of highly specialised arbitragists who assume the whole of the risk and have capital constraints. For this reason, they are condemned to change their arbitrage strategies each time they should liquidate a position under the pressure of capital withdrawal by small investors; Based on the performances of arbitragists, carried out over an arbitrage strategy sequence ($t_1$), small investors may trigger decision changes at an instant $t_{2,}$ thus preventing the formation of equilibrium prices at $t_3$.

In *Manias, Panics and Crashes*, Kindleberger (2004) argues through the example of the squib that all crises are born, develop and explode in accordance with the same model: “*Students of logic have discussed the damp squib thrown by A that lands at B’s feet which is then thrown from B to C and from C to D and so on only to explode after Y throws it in Z’s face. Who is to blame? A, causa remota? Or Y, causa proxima?*“ (Kindleberger, 2004; p.123). The economist argues that the *causa remota* of all the crises was speculation and the excess of credit, while the *causa proxima* can be born out of any incident which damages confidence in the system, and leads to agents liquidating their positions, thus triggering a fall in prices, a reversal of expectations, the failure of certain institutions, and so forth. This is true for the recent crisis. The failure of Lehman Brothers was the starting point of the “financial Titanic” (Aglietta, 2008). Ultimately, those who ended up paying for the damage of the financial crisis are the small savers. They lost their deposits and as taxpayers, they funded the bank rescue packages and supported public expenditure to prevent economic recession. The privatisation of profits and the nationalisation of losses are in operation, which ultimately encourages moral hazard. What is deplorable is the fact that lost deposits are often what provide households with “a right” to pension revenue, a debt incurred by the whole of society to these savers, in respect of the work accomplished throughout their active life (Aglietta, 2000). It would therefore be dangerous to manage these deposits as though they were mere investments giving rise to revenue proportional to the risk incurred and to the performance achieved by the investment fund. Admittedly, institutional investors are private entities which pursue the objective of maximizing their profits, but the nature of their debts force them to act in a cautious and measured way. The quality of the investments made by pension funds, life insurance companies and mutual funds is a social issue and a question of public interest. Shareholder value has encouraged investors to speculate with household savings instead of promoting sustainability of the return on shares. When the market trend is no longer upwards, social stability comes under threat (Aglietta, 2000). The fall of the US stock exchange in the current financial crisis has had serious repercussions, as American households saw in October 2008 the evaporation of some 30% of their pension savings, i.e. roughly three thousand billion dollars. The generations who were able to invest massively in investment funds had taken advantage of the productivity gains of the “retain and reinvest” management. However, since the 1970s, other generations have been hit by the consequences of shareholder value as corporate governance model. They are the victims of the “downsize and distribute” doctrine (Lazonick & O’Sullivan, 2000). These generations have limited savings, and are forced to take on excessive debts to meet their consumption needs, which have precipitated the current crisis (Aglietta, 2008).

What role has accounting played in the proliferation of the shareholder value? To answer this question, we scrutinize the origins and rise of the IASB on one hand and its reaction to the financial crisis, on the other hand. Did the IASB reveal dysfunctions of governance by markets? Or did it give excuses to maintain their authority and the colonization of accounting academia and profession by the shareholder value precepts? We attempt to answer these questions in the next section.

## 3. International accounting standards and the reign of the shareholder value

Despite the transparency advocated by the international standard-setter, the financial crisis has revealed shortcomings in accounting information useless to reflect the risks incurred by financial institutions. Worse, international standards are accused of having precipitated the spread of the crisis and made its consequences more serious. Fair value accounting favours circularity between accounting information and market data (Cormier et *al.*, 2007), which exponentially amplifies incomes’ deterioration in a downfall economic context. As a consequence, the IASB has been urged by the Financial Stability Forum to reform the application of fair value measurement in the event of inactive markets. Before examining the educational guidance published in October 2008, we recall the origins and the rise of the IASB. First, we conjure the affiliation to neoclassical economics of accounting, to which supporting the market functioning became the sole objective. The Anglo-American roots of the IASB and its rise provide evidence to its association to the model of governance by markets (2.1). Second, we examine IASB amendments to the application of fair value in the event of inactive markets, as a response to the financial crisis. We argue that not only they back up the political nature of the international standards but also promote the ideology of shareholder value and contribute to maintaining the status quo (2.2).

### *3.1 The emergence of the IAS(C)B and its indoctrination by the shareholder value precepts*

According to Chambers (1980), "*there is inevitably, and in every field, a gap in time between the development of an art, the development of theoretical knowledge and the impact of that knowledge on its related art or practice*" (p.167). International accounting standards result from the culmination of a "myth" accepted by accountants by an act of faith that is the neoclassical economics dogma. Accounting literature has well documented the affiliation of accounting to this fiction. Neoclassical economists and their heirs have hypocritically removed from the debate about accounting any hint to social issues (Tinker, 1988; 1991; Williams, 2004). The negation of negation has pointed up the non neutrality of accounting, its social role and partisan status by reproducing and protecting the interests of dominant players (Cooper & Sherer, 1984; Tinker, 1985, 1988, 1991, 2001). Far from a technique faithfully representing the company's financial situation, accounting has real implications on wealth distribution and conflicts resolution to the benefit of some and at the expense of others (Tinker, 1985; Tinker et *al.*, 1982). According to Williams (2004), accounting academia and profession, at least in the US, has been indoctrinated by the precepts of neoclassical economics (Tinker, 1980; Williams, 2004). Few have realized that this move was a prerequisite to support the naturalization of capitalism and to legitimate its authority (Cooper & Sherer, 1984; Williams, 2004). Accountants contributed to draw an imaginary world where the public interest is attained when individuals maximize their own interests (Williams, 2004) and where market efficiency is the only condition for social welfare improvements (Cooper & Sherer, 1984). The origins and the rise of the IASB with the consensus it established at the international level are not disconnected from this trend.

The role of the European Commission in the rise of the IASB is authoritative. Requiring the application of international accounting standards, by all listed companies in Europe for the preparation of their consolidated financial statements from January 2005 onwards, was described as an accounting "big bang". Not only had the European Union renounced to its accounting sovereignty, this decision is an official confession about the failure of its accounting directives. Admittedly it avoids the costs associated with the creation of a European standard-setter and entrusts international standardisation to another institution than the American FASB, although its conceptual framework follows the US one (Botzem & Quack, 2009), which would have raised a gigantic issue of political sovereignty. Yet, IFRS adoption by Europe marked an unprecedented change in the European accounting thought and practice; The IASB is "*anchored in the Anglo-Saxon tradition of standardisation for financial markets, and promotes a representation of the firm which is a long way from the accounting traditions of continental capitalism*" (Chiapello, 2005a; p.362). The IASB(C) was created at the initiative of the British accounting profession in the very year in which the United Kingdom joined the European Community. The IASC embodied the reaction, by the guardians of the Anglo-Saxon model, to the growing influence of the continental model in Europe (Chiapello, 2005a; Colasse, 2004). According to Botzem & Quack (2009), the dominance of Anglo-American accounting model became obvious starting from the early 1990s, when the so-called group of four (US, British, Canadian, and Australian) standard setters emerged. In 1994, the IASC has been integrated to the group as an observer. Yet, the objective was to push the IASC and the future course of international standard setting towards a clear-cut capital-market approach, on the basis of the frameworks already established in the four countries, and by promoting a fair value orientation of its standards. Concurrently, lacking coercive powers, the IASB weaved alliances to extend its legitimacy and authority on international level. In this respect, it actively collaborated with the IOSCO, which consolidated the market orientation of its conceptual framework. Finally, to overcome critics on geographical imbalances of the board, its partiality and its dependence to the accounting profession, the IASB has been restructured since 2001. Its new composition[2] and its funding do not hide the fact that it is still "*the place of infiltration by a small group of actors who have de facto control of the policy*" (Chiapello, 2005a; p. 380). The big four and the Anglo-American countries are still predominant inside the IASC *Foundation*[3] and the IASB. By espousing the Anglo-American accounting model, the IASB contributes to the dissemination of the shareholder value as a mode of governance (Hoarau & Teller, 2007).

Since the publication of IAS 39 on the recognition and measurement of financial instruments, fair value accounting became the hobby-horse and "*the cornerstone of the project led by the IASB*" (Mistral, 2003; p. 30). It is the main vehicle to propagate the shareholder value doctrine and to set up the hegemony of markets. Taken as given that a

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[2] Since April 2001, the IASB is structured like the FASB. Two separate bodies have been created: the IASB responsible for drawing up the standards, based at 30 Cannon Street, London, and the *IASC Foundation*, handling the financing and the appointment of members of the IASB, a not-for-profit entity registered in the state of Delaware, United States. Two other amendments to the organisation's structure have been decided later (January 2009). They include the creation of a Monitoring Board to appoint and to supervise the *Foundation* members (Trustees) and the enlargement of the IASB membership (from 14 to 16 members by 2012), with criteria added to ensure geographical diversity.

[3] On 1 April 2001, 11 members (out of 19) of the IASC *Foundation* were from Anglo-Saxon countries (Chiapello, 2005a). Of the 11 members, 6 were from the US, including the president, who was the former president of the Fed, the American central bank. At the time of writing, the IASC Foundation president is Gerrit Zalm, former Vice Prime Minister and finance minister of the Netherlands.

high standard of accounting is the one that promotes the proper functioning of capital markets, by rapidly revealing unrealised gains and losses required to improve investors decisions, the fair value was termed an "*unquestionable advance for financial information*" (Ricol, 2008; p. 60). It was also considered to be supportive for the function of stewardship and for the decrease of principal-agent conflicts and agency costs (Barlev & Haddad, 2003). However, fair value accounting has lost its exteriority to valuations from markets. This self-referencing could be misleading to the average investor who relies on accounting information to make assessment of firms' performances. Moreover, according to Abdel-khalik (2008), fair value accounting is contradictory. It enables debtors to recognize gains when they become more risky (failure is reported as success), and to recognize losses when they become less risky (success is reported as failure). The perverse nature of this process could lead managers to undertake flawed decisions which could undermine the continuity of their operations. It is fooling to consider that market values[4] could capture the fundamental value of assets and liabilities and are a reflection of truth which enhances transparency or information relevance. By applying "mark to market", the IASB has in a way consolidated the role of the market as a yardstick for values, and as a guarantor of justice and the public interest (Aglietta & Rébérioux, 2004) but stands close behind the financial crisis. By introducing amendments to the application of fair value in inactive markets, the IASB defends this approach and reinforces its legitimacy instead of questioning how it contributed to feeding the frenzy of self-regulated markets.

### *3.2 The financial crisis: the political and ideological nature of the IASB amendments to IAS 39*

The application of fair value convention raises serious problems in the event of illiquid and collapsing markets. According to Ricol (2008), in such circumstances, market prices lose all rational value references. Furthermore, using fair value could accentuate the losses recorded by companies holding toxic assets, by triggering a snowball effect. Hence, it is recommended to avoid reference to market value wherever possible. In this trend, the IASB urgently adopted measures to make the application of fair value more flexible. The new amendments, published in October 2008[5], enable companies to use the utility value (mark to model) in the event of market inactivity and the possibilities of reclassifying some financial assets in the trading book as long-term securities. Intended to attenuate the consequences of the financial

[4] If no market price can be observed on an active market, fair value is assimilated to the exchange value on which two independent parties can agree, the market price of an item with similar characteristics, or the discounted value of future flows, determined by the use of an appropriate model.
[5] The report is available on http://www.iasb.org/NR/rdonlyres/0E37D59C-1C74-4D61-A984-8FAC61915010/0/IASB_Expert_Advisory_Panel_October_2008.pdf.

crisis, we argue that those revisions are ideologically oriented as they deliberately perpetuate the shareholder value doctrine.

The IASB states that, in the case of inactive markets, transaction prices can provide indications for fair value valuation, but are not necessarily decisive. In this context, the fair value is applied in the sense of "mark to model". Preparers would have to make reasonable assumptions about expected future cash flows, timing and uncertainty and the relevant discounting rate to be used regarding the level of risk. The utility value was already allowed by IAS 39 under certain conditions, but was in no way intended to be generally applied. Thus, the IASB institutionalises its use for the valuation of financial instruments listed on inactive markets. Besides this measure and without respecting the usual due process, supposedly because of the urgency of the situation, the IASB allowed the possibilities of reclassifying some financial assets to put companies which apply the IFRS on an equal footing with those using the US GAAP.[6] This amendment enables an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. In the 2005 version of IAS 39, several financial assets could be valued at fair value on an optional basis which is however irreversible. In the event of the financial crisis, this situation pushed the European Commission to submit a proposal letter urging the IASB to allow the possibility of reclassifying these assets outside the fair value category through the income statement for the same reasons and under the same conditions as the transaction assets. [7] This amendment also enables an entity to transfer from the "available-for-sale" category to "the loans and receivables" category a financial asset that would have met the definition of loans and receivables if the entity has the intention and ability to hold that financial asset for the foreseeable future.[8]

These two major amendments have the same objective which is to limit reference to market value and as a consequence companies' recorded losses in the event of markets collapse. If the criteria which may suggest that a market is inactive do not apply, the company may use the reclassification possibilities in order to exclude the instrument to be

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[6] The amendments are available on the IASB site: http://www.iasb.org/NR/rdonlyres/BE8B72FB-B7B8-49D9-95A3-CE2BDCFB915F/0/AmdmentsIAS39andIFRS7.pdf.

[7] Letter sent by the Director General of the *Internal Market and Services Directorate General* of the European Commission to the IASB president on 27 October 2008, available at the following address: http://ec.europa.eu/internal_market/accounting/docs/letter-iasb-ias39_en.pdf).

[8] Available at the following address: http://www.iasb.org/NR/rdonlyres/BE8B72FB-B7B8-49D9-95A3-CE2BDCFB915F/0/AmdmentsIAS39andIFRS7.pdf

valued from the fair value's field of application.[9] As an example, in 2008, Citigroup reclassified about $65 billion dollars to held-to-maturity.[10] Conversely, If the nature of the financial asset to be valued, or the company's intention of holding do not allow any reclassification offered by the new reforms, the company can always pretend that the market on which the instrument to be evaluated is inactive to make use of the "mark to model". If the reclassification possibilities remain largely subject to the intrinsic characteristics of the instruments and to the intentions of the company, the IASB amendments only indicates, for information purposes, some characteristics which could suggest that a market has become inactive,[11] leaving for companies more manoeuvring room. Consequently, we can imagine that some of them will tend to prefer the use of internal valuation models even for financial instruments listed on liquid markets, in order to hide the losses in value to be recognised. In any case, regardless of whether the company chooses to apply internal models for valuing its financial instruments or to reclassify them, we argue that the measures recently adopted by the IASB have significant implications.

First, it seems that the IASB did not have another choice but the rapid adoption of these amendments. A serious attack by the European Commission was in preparation at the beginning of October 2008. A full meeting of the EU Council of Finance Ministers (ECOFIN) was organised in order to urge the international standard-setter to amend IAS 39 by the end of October. More specifically, the IASB was asked to bring this standard into line with its American counterpart SFAS 133, which allowed the reclassification of "available for sale" financial instruments under rare circumstances. If the deadline was not met by the IASB – which was highly probable given the length of the due process period – the European Commission would have voted a "carve out" from part of international standards. Such a "carve out" would have been disastrous for the IASB according to its chairman Sir David Tweedie in a testimony to House of Commons Select Treasury Committee on November 11th 2008. He declared, "*I think the one [battle] we are in at the minute is probably the most critical to the organisation, because if we have another "carve out" in Europe, people are going to feel that Europe has gone, and suddenly, instead of 100-odd countries using our standards, there is 75, and you then find that others will start thinking: "If we aren't going to have a unified global system, should we, in fact, simply have equivalence? We will deem the European style of accounting equivalent to the US standards equivalent to the Japanese",*

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[9] If the financial asset is reclassified in the "assets held to maturity" category for example, it is the amortised cost which applies. The fair value of the financial asset on the date of reclassification becomes the new cost or amortised cost.
[10] ContiGroup Annual Report (2008).

*and so on. That is the big danger. I think in the United States they are incredulous at what has happened. When we are just on the verge of getting the United States signed up, this happens, and that has come as a massive shock and disappointment to the United States, and also everywhere else. There is a danger now that this could be set back for a generation. That is the situation we are in*."[12] In other words, the IASB was between a rock and a hard place: loosing the coverage of the European Union on the one hand or responding to the Commission's demands at the expense of a loss of its credibility all around the world on the other hand. The IASB decided to amend IAS 39 urgently in order to keep accounting in Europe under control. Yet, this undermined the chance of IFRS being adopted by US companies. It also underlines the political nature of the standards, counter argument for those advocating the neutrality of the international standard-setter and the high quality of its standards. According to Botzem & Quack (2009), accounting standardization is more than "a dry technical debate". It is "an interest-driven affair", where "*bargaining and compromising play an important role*". To pacify the various interest groups on the route to fair value accounting, "s*ome standards have remained messy compromises*" (p.990). We argue that these amendments are even ideologically oriented.

Many researchers had already warned against the procyclical effects of fair value, whose use may amplify both upward movements during boom periods and downward momentum during periods of crisis (Bignon et *al.*, 2004; Mistral, 2003; Capron, 2005). According to Aglietta (2008), during the market boom, "mark to market" has in no small way, been a contributing factor in causing the crisis by pushing the financial system to the point of paroxysm. It supported frenetic credit activity by concealing the risk incurred by the banks: credits were guaranteed through collateral by assets valued at the market price, which has been ceaselessly increasing with the abundance of credits. Aglietta (2008) points out that the total amount of credit derivatives has been multiplied by more than 100 in ten years, to reach the sum of 62,000 billion dollars. The banks thus "*exceeded without realising it the threshold of the cushion of liquidities which was intended to guarantee financial stability and security*" (Aglietta, 2008; p.19). To make profits by speculating on prices like banks, the other players involved in the securitisation chain followed suit, like "Panurge's sheep" (Kindleberger, 2004). In its final phase, speculation freed itself of all reference to objects of value, to take on the most illusory forms (Kindleberger, 2004). Despite this warning, the IASB has turned fair value into the unquestionable yardstick and consequently has institutionalised "dreams of profits". Although "*it seems to be hard to envision flexibilising accounting standards during a crisis*

[11] These characteristics include a significant reduction in the volume and level of the trading activity, significant variations in prices available over time, or depending on the participants in the market, or prices which are no longer continuously available.

*period, because they must be credible in a long-term perspective"* (Ricol, 2008; p. 60), calling into question fair value accounting would deprive the markets of one of its main instruments. Therefore, the IASB continues providing capitalism with the required technology to enable speculators to "become rich in ideas" and to keep speculating on the market.

Allen & Carletti (2008) argue that in times of crisis market prices are not accurate measures of value for financial institutions and lead to distortions in their portfolio and to significant problems of contagion. In such circumstances, collateral should be valued weighting panic and pre-panic prices. Hence, the use of historic costs may not compromise the solvency of those entities as it does not affect the accounting value of their assets. In this trend, the IASB reclassification measures allow a return to an unusual "historic cost". It is the fair value on the date of reclassification of instruments for which the value is totally fixed by the financial statements preparers. Describing successive crises for centuries, for Kindelberger (2004), reforms become essential once the panic leaves its place to the consolidation of losses. Everything which has grown excessively should be devaluated and losses should be massively recorded. After the recession takes hold, public authorities move towards a new form of growth to overcome the crisis. New modes of regulation and governance change the economic environment to set up new sources of profit and new ways of conducting. Considering this reading, the reforms introduced by the IASB are intended to postpone for as long as possible the consolidation phase following the financial crisis. Today, the disastrous ideology of efficient and self-regulated markets and of shareholder value as a mode of governance is in difficulty. Yet, by hiding losses, shuffling the cards and masking the origins of the crisis, the IASB releases the pressure on the markets and appeases the critics against the shareholder value doctrine. Certainly, another decisive factor contributed to maintaining the status quo. The intervention of central banks and governments, during the financial crisis, has in a way prevented the *laisser-faire* approach. While in 1929, non-management – the solution often recommended by those who think the market is rational and can handle its difficulties alone – has been applied and turned into a *laisser-brûler* approach (Kindleberger, 2004), which political, economic, social and ethical implications led ultimately to the *Second* World War.

Finally, besides amendments, the IASB has also called to decoupling the financial reporting requirements from the prudential rules imposed by regulators to financial institutions. For many observers, the interaction between fair value accounting and regulatory capital requirements, namely Basel II, exacerbated problems during the financial crisis. Barth et *al.* (1995) showed that, because of the procyclicality effect in the event of market

[12] http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/uc1167-ii/uc116702.htm

downturn, credit institutions more often infringed regulatory requirements when they used the fair value convention rather than historical cost. To prevent the fair value convention from critics, the IASB argued that this situation was a result of accounting information being used too crudely in the calculation of Basel II capital requirements. Sir David Tweedie recommended disconnecting accounting rules and prudential requirements in his testimony to House of Commons Select Treasury Committee on November 11th 2008. He stated, "*You can actually break the link and still give the banking supervisors what they want and we will not affect the integrity of the accounting. It can be done.*"[13] By calling for disconnecting accounting and prudential requirements, the IASB plainly recognizes its affiliation to markets. According to the IASB, prudential authorities are secondary users of accounting information. Their objective is to insure that banks are run prudently, in order to ultimately protect depositors and policy holders. Thus, they should not base their calculation of capital requirements exclusively on published accounts and should make appropriate adjustments. As stated by Paul Boyle, Chief Executive of the UK Financial Reporting Council in his testimony to House of Commons Select Treasury Committee on November 11th 2008, "*the purpose of accounting is to present an unbiased picture of the financial health of an organisation. The purpose of prudential regulation is biased. It is properly biased; it is proper that the Financial Services Authority should be biased in favour of protecting depositors or protecting policy holders. So they have different objectives and, therefore, they can use different numbers. […] To give investors confidence you need to present an unbiased version of the truth; to give depositors confidence you need to give them some confidence that […] "rainy day" money is being built up during the good times so that it can be spent in the bad times*."[14] According to Chambers (1980), "*it is widely held that a given set of financial statements cannot be serviceable to all users, and that the interest of some class of users must therefore be taken as the primary interest to be served; if that is taken as dogma, there is no cause to explore the points in a given set of statements which are or may be pertinent to all users*" (p.171).

The statement of Sir David Tweedie approved by Paul Boyle is an obvious argument of the indoctrination of accounting by the dogmatic market and shareholder value creed. The private value of accounting information reduces accountability to be subsumed under decision usefulness (Williams, 1987) instead of making firms more accountable to society. Accounting reports serve very narrow interests, those of shareholders and financial investors. The affiliation of accounting to the shareholder value doctrine altered its conceptualisation of social welfare and indicators for its measurement. Financial indicators

[13] http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/144/08111101.htm
[14] http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/144/08111101.htm

like the ROE and the Dividend Pay out may enable institutional investors to control management actions. However, they fail to model an aggregate view of society and how distribution of wealth and power is in operation. Hence, accounting practice has no social value. Worse, by assuming a basic harmony of interests in society, accounting practice mystifies and legitimates the unfair resolution of conflicts to the profit of dominant players (Burchell *et* al., 1980; Lowe & Tinker, 1977) and prevents a fundamental improvement in social welfare (Cooper & Sherer, 1984). At last, fair value amendments constitute an unprecedented alteration in accounting thought and practice. They lead to the release of a fundamental principle in accounting, the principle of conservatism, which enabled for a long time to prevent excessive and imprudent conducts and to protect creditors.

## 4. The conservatism principle under attacks

In order to protect creditors' interests, the conservatism principle was intended to repress one of the first accounting offences, i.e. the distribution of sham dividends (Chiapello, 2005a). Its application prevents shareholders from appropriating uncertain profits leading to the potential for redistribution of capital as dividends (Abdel-khalik, 2008). Of continental inspiration, this principle also occupied an important place in Anglo-American accounting standards until fair value became the reference for evaluation. Yet, the fair value concept is not a novelty. According to Richard (2005), it has been promoted by the legal community during the static stage of the capitalist accounting systems in France and Germany during the 19$^{th}$ century. The Napoleonic Code of commerce of 1807 and the German Code of Commerce of 1857 gave primacy to valuations based on market value. Most of the doctrine and the jurisprudence were in accord with this legislation, even if other schools of thought were in favour of valuation based on "subjective" value, such as Simon's "value in use" (*Nutzungswert*), for goods meant to be used, and Seidler' discounted cash flows valuation meant to show the overall market value of a company. The dynamic conception based on cost value reappeared only at the beginning of the 20$^{th}$ century for the case of tangible fixed assets while the remaining of assets (notably financial and most of intangible assets) went on to be evaluated according to the principles of the static theory. If the dynamic conception was concerned by the measurement of business performance and the stability of earnings or dividends, the static approach was intended to assure payments to creditors in the event of a firm's bankruptcy. The balance sheet was an anticipation of the "final phase" by means of a fictitious liquidation. Since, the going concern was not postulated and fair value accounting was correlated to the principle of death. In a context where shareholder responsibility was unlimited, it was acceptable to refer to the market price, whether it was moving upwards or downwards. Since the introduction of limited liability by the legislator, for the protection of the interests of shareholders and creditors, besides keeping and publishing true records giving true representations of their profits and financial positions, companies were required to not recognize potential capital gains. Hence, the appearance of the “lower of cost or market”, a prudent variant of the static theory, was coherent with a prerequisite to make the company sustainable for all its stakeholders (Richard, 2005). The conservatism principle was the rationale to promote prudent conduct. The IASB fair value is of a quite different nature from the jurists’ fair value intended to protect public interests and which was not colonized by the present doctrine of investors’ primacy (Ding et *al.*, 2007).

In a different logic, Chambers (1965; 1966) has promoted current values to value assets at the end of each accounting period. For Chambers, market value or “exit price” (the maximum price a currently held asset could be sold for in the market less the transactions costs of the sale; i.e., the net realizable value for the asset) was indicative of the firm's capacity to adapt. For Chambers, the business firm is an entity engaged in buying and selling goods and services which implies a constant effort to adjust to the competitive environment for the sake of survival. Only the cash and current cash equivalent, which is the price of the assets, can reveal the firm’s capability to go into the market with cash for the purpose of adapting itself to present conditions. The exit price has been promoted by Sterling for whom this price is not obtained by selling to the first man on the street that one happened to meet, which is a “forced liquidation value”, but the present price which is relevant for all decisions (Sterling, 1970). Furthermore, in the same vein of the jurists argument, Chambers (1999) explains how “*the dated money's worth of property and debts are crucial in the administration of affairs in bankruptcy, legally instituted to secure fairness in dealing as between bankrupts and their creditors*” (p.245). He regrets that when going concern has been taken for granted, accountants have held altogether different information, based largely on prices originally paid for property (historic cost), even though those prices have nothing to do with the avoidance of bankruptcy. He pursues “*It is as if a chronometer is useful only for telling by how much one is late for an appointment, never for avoiding lateness*” (Chambers, 1999; p.245).

The IASB fair value accounting is a novelty only in its indoctrination by the shareholder value cult. In the context of shareholders limited liability, the use of the “mark to market” approach, when prices are moving upwards, is a legitimization of the sham dividends paid to investors. But when the trend was reversed, a utility value – determined subjectively by managers – has been substituted, in order to limit losses and to meet the appetite of hurried shareholders. The attack on conservatism principle by the IASB was progressive. The adoption of standard IAS 39, in 1998 introduced an initial obstruction to this principle by enabling to companies the recognition of unrealized capital gains in accounting income. At his Senate hearing on 2nd April 2008[15], Michel Aglietta explained how, in 2007, the US financial sector made 40% of the total profits of the private sector, compared with about 10% in the 1980s, even though the sector accounts for only 15% of value added and 5% of private American employment. This "financial windfall", which does not benefit the depositors but only market finance intermediaries, and particularly the investment banks and hedge funds, was achieved owing to fair value accounting. Aglietta argues that, with "mark-to-market", the IASB has institutionalized the recognition of illusory profits when the markets were rising. Besides threats to creditors' interests, this move in accounting thought blurs the economic significance of the accounting "income" which reveals changes in the value of financial instruments; A value, which may depend on exogenous considerations quite external to the company (Mistral, 2003). According to Abdel-khalik (2008), fair value is "*the outcome of neither arms-length exchanges nor the transfer of risk of ownership to entities outside the firm*". It expresses only "*expected prices at which the firm may be able to sell the assets*", the realization of which is conditional to many factors such as market stability or volatility. Hence, gains reported from the application of fair value could be labelled "hypothetical". An income statement giving "*the same weights to a highly probable outcome as the weight given to an outcome with a remote probability of occurrence… as that given to a sure, realized, outcome*" (Abdel-khalik, 2008; p.7-8) lose its economic significance and its factuality. Even Chambers (1999) who considers market prices to be the calibrated instrument for measurement, states that "*the products of formal mathematical processes are serviceable in practical affairs only if the symbols correspond with observable facts. If the inputs are false, or imaginary, or hypothetical, the outputs cannot be factual, and useful, as fact, in making judgments about the past or decisions about the future*" (p.242). The philosophy underlying Chambers present price (exit value) is totally different from the one justifying the IASB fair value accounting even in its "mark to market" sense. For Chambers (1980, 1999), the legal substance of accounting ensure fair and orderly conduct. "True" accounts representing the dated money's worth of properties and debts are required. Statements compounding present guesses and managerial opinions (value in use) as well as market prices, which are no more than anticipations of their own increase, would be a plain violation of the intent of the law to which Chambers' concept of present price should be understood.

The new amendments to IAS 39 introduce a genuine reversal of the logic underlying the principle of conservatism. Since October 2008, the reclassification possibilities and the use of "mark to model" in the event of market inactivity had also tolerated the non recognition of potential losses. These measures give preparers of financial statements a large

[15] http://www.senat.fr/evenement/economistes_finances.html

discretionary power and enable companies to completely avoid the recognition of unrealized capital losses in the event of a downward movement in the market. Regarding the "mark to model" approach, even though the IASB states that internal valuation models must be transparent and managers should disclose all the factors included for the value setting, such valuations are based on complex hypotheses which inevitably introduce the risk of unintentional bias (Mistral, 2003). Furthermore, the strong sensitivity of the value to hypotheses – such as of the discounting rate – opens the door to vast possibilities of manipulation. It is exactly what the international standard-setter was trying to avoid by decreeing the superiority of fair value in the "mark to market" sense. As stressed by Barlev and Haddad (2003), "*the FVA paradigm reduces the "manager's voice" in favor of the "market's voice" in an economic setting of perfect and complete markets the "market's voice" takes its power from the measurement, valuation and reporting of assets, liabilities and consequently, income, at fair values, which are independent of the manager's influence*" (p.384). However, the IASB amendment gives to management a manoeuvring room to predict the future and accounting numbers become dependent on their only good faith (Bignon et *al.* (2004). As regard to the reclassification possibilities, let's take as an example the acquisition of equity securities for short-term trading on 1 March 2007, for €40 million. The company has classified those securities for using fair value through profit or loss category. Suppose that on 31 December 2007, the fair value of the equity securities increased to €41 million. An unrealized gain of €1 million would be reported in the income statement. On 1 June 2008, the company reclassified equities from short-term trading to available-for-sale when their fair value was only €39 million. If the fair value of those securities continues falling on 31 December 2008 to reach €38 million, then only the unrealized loss of €2 million (41-39) would be reported in the income statement for the year ending 31 December 2008, provided that the loss of €1 million (39-38) is not an impairment loss. Before the amendment, the company would be required to report the unrealized loss of €3 million. The conservatism principle no longer operates as an asymmetrical filter facilitating the recognition of potential losses and postponing the recognition of unrealised gains. An asymmetrical filter is still in place, but it tends to delay the recognition of unrealized capital losses while bringing forward the recognition of illusory capital gains.

The fair value convention introduced in 1998 has undermined the conservatism principle. 10 years after, IAS 39 is reformed under the pretext of the desirability of adapting the mark-to-market approach and of attempts to only use market prices when appropriate. In reality this amendment is a significant swing in the accounting thought if not a sign of foolish stance as stated by Abdel-khalik (2008): "*on the upside, when prices were on the rise, none of the opponents of FV had any concerns or second thoughts about taking unrealized gains* *to income. Is seeking fair value on the upside and throwing it away on the downside a sign of schizophrenic preference?*" (p.6) By allowing companies to pay out billions of dollars in bonuses even in the midst of the worst banking crisis, the IASB has defeated the conservatism principle and its rationale as a guide to prudential conduct. Cynical fate for the accounting profession and academia; instead of promoting prudence, accountability and fairness (Williams, 2009), they institutionalize in the 21st century what the US president Barak Obama, described as "shameful" and "height of irresponsibility."[16] Chambers (1980) regrets that every time anomalies are observed accounting researchers rarely put under fresh scrutiny their thought-clichés. They disdain substantial topics to not explode their cherished beliefs and myths. Instead, "*the blame litigation is thrust on the stupidity of the defendants or the cupidity of the plaintiffs rather than on the inaptness of accounting practices, with little concern for the potentially damaging effect of inapt practice on the profession, or for the potentially heavy burdens, to clients of the profession, arising from litigation or mounting indemnity insurance costs*" (p.173).

## 5. Conclusion

In this paper, we made obvious the role of the IASB in strengthening governance by the market. We initially focused on the factors behind the rise of this mode of governance, and which today called him into question. Afterwards, we analysed the climb of the IASB at international level and its association with the Anglo-American model of accounting. The primacy of markets is plainly espoused by the IASB conceptual framework and has major implications on its standards. Fair value accounting is one of its expressions. Subsequently, we examined the implications of the recently adopted measures to the application of fair value in the event of markets collapse. By attenuating the consequences of the financial crisis, the IASB releases the pressure on the shareholder value doctrine and contributes to its perpetuation and to the legitimacy of markets' authority. The ideological nature of its standards is obviously established. Through fair value, in the "mark to market" sense, the IASB at a time of a stock market boom enabled financial market players to pocket illusory gains, and recently it allowed the non-recognition of potential losses due to downfall markets. By doing so, the IASB provides capitalism with the required technology. Indoctrinated by the precepts of neo-liberalism and its mechanisms, accountants didn't realize that their intellectual enterprise has been turned to an instrument which serves the new political geometry of capitalism. This move is not without serious consequences. Instead of pointing

[16] http://www.telegraph.co.uk/news/worldnews/northamerica/usa/barackobama/4392215/Barack-Obama-brands-large-bonuses-shameful.html

out shortcomings of the system and better regulating conducts, accounting figures legalize dreams of profits; authorize imprudence, nourish excesses and justify impunity to propagate the system. In a period of crisis, the role of accounting is all the more critical. Making believe to speculators that they become rich, while this is only in ideas, could incite them to commit white-collar crime: "*History tells us that swindles are always born out of an excessive desire for wealth, sharpened by the boom*" (Kindleberger, 2004; p.8). Encouraged by the number (Berenson, 2004), when people become greedy for gains during booms, swindlers "*come forward to exploit that greed. The number of sheep to be shorn increases in booms and an increasing number offer themselves in sacrifice to the swindlers*" (Kindleberger, 2004; p. 93). Madoff used the Ponzi system. No particular genius was needed to put this fraud into place, or to denounce it. But several investors were taken in by the returns offered. Their greed was the cause of their blindness; No-one wants to cut off the head of the hen laying golden eggs. If the boom favours swindles, what about periods of financial distress? When the system's limits are exposed and prices start to fall, fraud becomes widespread and the sense of panic is strengthened. It is therefore crucial not to enlarge the manoeuvring room which could encourage such conducts. When Jeffrey Skilling was appointed CEO of the Enron group, he called for using the "Hypothetic future value" in the preparation of its group's financial statements, which has been accepted by the SEC. The "Hypothetic future value" is nothing other than the "mark to model" approach to fair value, which the IASB is bringing back to the centre of the stage in a context of crisis.

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