Editorial

The Accounting Delusion: Faith and Trust in IFRS Reports

Janek Ratnatunga*

Abstract

The financial statements prepared and audited in today’s economic environment can be traced to the industrial era, or the age of the corporation (about 1850), when tangible assets such as machinery were the engines of growth. In this era, financial accountants endorsed or invented rules based on the historical cost doctrine that yielded values which had no counterparts in commercial reality.

The resulting accounting numbers resulted in a delusion of being ‘True and Fair’, which has been further perpetuated in recent times by: (1) the vagueness of the rules and principles on which the accounting framework is based (2) the drive for global consistency in accounting standard resulting in the loss of relevance in local applicability; and (3) the difficulties of verifiability resulting in intangible assets. This has resulted today in knowledge-economy companies reporting book values widely divergent of prorate-market values.

This paper argues that it is not in the interest of the accounting and auditing profession to perpetuate this delusion of a true and fair view; and challenges the profession to rethink the accounting model.

Introduction

A man was in a hot-air balloon when he drifted into heavy fog and lost his bearings. He dropped down a bit and spotted the ground. A woman was watching his descent. "Can you tell me where I am?" the balloonist shouted. "Yes" came the reply. "You are about 50 metres up in the air in a balloon." "You must be an accountant" the aviator shouted. "How did you know?" the women asked. The balloonist replied, “Because the information you've just given me, while being completely accurate, is totally useless." (Anon)

In 2004, the largest Australian accounting professional organisation, CPA Australia, gave a gold ranking to the company James Hardie Industries in the Australasian Reporting Awards, and then found the company embroiled in allegations that it has been a ‘serial liar’ in those reports. CPA Australia’s public affairs manager, Ms. Jennifer Simon, in defending the award, said that the award was for “how” reports are constructed rather than “what” is actually reported (Gettler, 2004).

Ms. Simon, inadvertently or not, was not merely making a case in defence of an award granting process that turned into a public relations nightmare, but in reality she was making a statement that all thinking accountants would surely fear, i.e. that some financial accounting reports may be simply be delusions if they place ‘form’ over ‘substance’; i.e. as long as the rules (form) required by the accounting standards of the day are followed, the accuracy (substance) of what was being reported does not matter.

According to an article in The Economist (2002), Comroad, a listed German company, invented a major customer together with the majority of its revenues and did this for a few years before being exposed. Its Auditor was KPMG, the world’s largest audit firm, which allegedly never bothered to investigate the source of revenues. Having auditors like KPMG was apparently useful to convince investors that Comroad was a credible company. Fraud, bad audit, dishonest - yes; but all within the Accounting Standards of the country at the time. The ease with which the likes of Enron, Global Crossing, MCI, WorldCom, Tyco, GE, Vivendi-Universal,
Nortel and in Australia, HIH and James Hardie can mislead shareholders and other stakeholders is surprising – or is it?

Arguably, the greatest accounting academic Australia has nurtured is the late Professor Ray Chambers. He was also a past president of CPA Australia. In the CPA Australia’s journal, in 1991, he notes the following:

“…. The accountants endorsed or invented rules that yielded values which had no counterparts in commercial reality at balance sheet dates - sheer fictions, such as valuation at the lower of cost and market, LIFO, FIFO, straight line and crooked line depreciation, and all kinds of arbitrary allocations. And they invented a doctrine of their own - the historical cost doctrine, which justified the use in dated financial statements of wildly out-of-date facts without disclosing their dates.

The only semblance of up-to-date facts that appeared in balance sheets were then amounts of cash and debts owed and owing. They added this miscellany of fictions, and out-of-date and up-to-date facts, and held that the result gave a true and fair view of the states of affairs of companies at stated balance sheet dates. And they still do”.

Professor Chambers made this statement over two decades ago. Is it still valid? Let us first take a historical perspective. Consider for example the following extract from an Australian newspaper:

“The entire accounting profession, especially auditors, has been asked by the media to explain how a set of company accounts can be signed as "true and fair" one year, only to be similarly signed a year later with $1.7 billion of shareholders' funds gone”.

When was the above explanation sought? By an Australian financial journalist in 1990!

Australia had at that time just seen a number of spectacular instances where shareholder reported values similar to the amount reported turned out to be monumental delusions. These delusions occurred in such diverse organisations such as Rothwell’s (Merchant Bank); National Safety Council (Service); and Elders IXL (Conglomerate). According to media reports, the auditor's defence in most cases has been to disclaim responsibility for false accounts and to point the finger at directors. The media of the day had many comments similar to the following:

“Auditors have got their defensive routine down pat.... 'It's not our fault. Directors have the primary responsibility to shareholders. How can we help if they decide to start economising with the truth ?'” (Kohler, 1990)

Such excuses are not satisfactory said Kohler (1990) at the time:

“Auditors have a job to do, which is to check whether company accounts are ‘true and fair’. If the accounts later turn out to be untrue, then the auditors have some (explaining) to do even if it was the directors who lied.”

Corporate bankruptcy increased to an all-time high in Australia during 1990 and 1991 (Webb, et. al 1991). During this period, media reports similar to Kohler (1990) regarding myopic auditors were almost as numerous as those regarding deceitful directors. This is what prompted the Chambers (1991) comment. What was the accounting profession’s response? Increased regulation, increased compliance, increased accounting standards worldwide that should be in ‘harmony’ with each other. That should fix the problem it promised. No more spectacular collapses, the profession at that time promised.

Then came Enron, WorldCom, Ansett, OneTel, Parmalat, Comroad. Collapses in all parts of the world. The Chambers (1991) view appeared to still prevail in the 2000s. The accounts were still based on a 500-year old framework that resulted in fictional, delusionary accounting statements. In fact, CPA Australia, as in the case of their James Hardie embarrassment mentioned earlier, was not alone in being unable to separate fact from fiction in financial reports. Enron, the most spectacular collapse in the recent past, also won many awards for its financial reporting (Hill, 2002).

What was the accounting profession’s response following the crashes of the early 2000s? It was once again to increase regulation, increase compliance, and increase accounting standards. But this time there was a twist in the form
‘convergence’, i.e. converging different country accounting standards to one set of international financial reporting standards (IFRS).

During the international role out of IFRS, Ratnatunga and Jones (2007) argued that this solution put forward by the profession merely tinkers with a ‘broken model’ and thus perpetuates the delusion that accounting reports are both reliable and relevant. They argued that if radical changes were not undertaken, the profession will continue to delude the public into thinking that further spectacular collapses are a thing of the past.

They warned that when the inevitable future collapses happen, and accounting reports prove once again to be delusionary; the accounting profession will again be found to be wanting, and that ultimately this will damage the credibility of the profession. A year after Ratnatunga and Jones (2007) made these dire predictions, the Global Financial Crisis (GFC) happened and much blame was placed on the vagueness of the rules governing the accounting of sub-prime mortgages and financial assets.

The rule that caused most concern was ‘fair value accounting’, popularly known as, ‘mark-to-market’. This accounting rule requires companies to set the value for the assets they own at the price they could obtain on the open market at the date of valuation. In late 2008, at the start of GFC, there was no market for the worthless mortgage-backed securities based on sub-prime mortgages that had, by then, defaulted. That meant that financial institutions holding them had to value them well below their former value, sometimes near zero. That made the institutions themselves worth much less, with many such as Bear Sterns and Lehman Brothers becoming insolvent.

However, when the US government announced the $700 billion Wall Street rescue plan (provided mainly to financial institutions holding these toxic assets), the application of the fair-value rule meant that these toxic assets now had a value (i.e. the expected future bailout money). This view was enhanced by the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) in the USA making an announcement just prior to the bailout that:

"When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable, i.e. holders of hard-hit mortgage-backed securities can take other factors into account when valuing them (such as the potential of these assets to get bailout money)" (Ahrens, 2008).

There were calls following this clarification for the SEC and FASB to abandon (or at least suspend) the controversial fair value accounting rule. However, this was resisted as the suspension would trigger another problem, i.e. if the government buys only some toxic assets as part of the rescue, it could force banks and financial institutions to drastically write down billions of similar assets that are not part of the rescue package. That would have created further instability unless even more changes are made to the accounting rule which requires assets to be valued at market prices, and so on (Drawbaugh and Younglai, 2009). As such, although the accounting-rule remained intact, varying interpretations were allowed by the ‘clarification’.

Financial institutions in particular have remained critical to fair value accounting; holding this accounting rule as being principally responsible for the credit crunch and ultimately the GFC. Those criticisms (Ryan, 2008; Chasan, 2008, Joseph-Bell, et.al. 2008; Wallison, 2008; Sapra, 2008) have included the views that:

- Reported losses using fair-value measures are misleading because they are temporary and will reverse as markets return to normal;
- Fair values are difficult to estimate or indeed verify for many assets and thus are unreliable;
- Reported losses have adversely affected market prices yielding further losses and increasing the overall risk of the financial system.

It is contended in this paper that the current accounting model being used still provides management with the ability to introduce ‘spin’ into financial reporting (via earnings management, income smoothing, non-statutory profit announcements, etc.), and this, coupled
with a lack of effectiveness of the audit process has resulted in a loss of trust in company reports.

The resultant corporate failures over the years, including those brought about by the GFC, has precipitated major legislative initiatives by government and regulators to try to reinstate credibility in financial statements (Tweedie, 1991; Sanati, 2009). In this paper, the author examines some of these elements and ask if fundamental principles have been missed. In the effort to clean up the accosting reporting and auditing lake, has the profession ignored what is coming down the river into the lake?

The author believes that the foundation upon which the ‘accounting reports’ are constructed is such that this trust cannot be restored unless the accounting model itself is changed. In this paper the author traces the reasons why a reporting system devised for reporting in the era of the industrial revolution is totally unsuitable for the modern economic environment. It is argued that, no matter how much the profession tinkers with its reporting model using a patchwork of accounting standards, it can no longer be relevant to today’s needs.

This paper argues that it is not in the interest of the accounting profession to continue to perpetuate the delusion of a true and fair view; and challenges the profession to rethink the accounting model to fit the new informational and influential economic paradigms within which modern corporations operate.

**The Role of Accounting in Changing Economic Paradigms**

The world economic order is changing at a rapid pace. In the last decade countries and regions have unified, large economies have opened doors to capitalism, computers and telecommunications have virtually collapsed time in linking financial and commodity markets. Competition has intensified between corporations and between nations and the virtual, real-time global economy is now a reality.

In such an economy, there is growing anecdotal and empirical evidence that our current Industrial-era accounting paradigm is becoming increasingly irrelevant within the economic paradigm of the information era. Let us trace the historical reasons for this situation.

An *Agricultural - economy* was the dominant economy for over 10,000 years. The “fuel” of this era was *food* (see Figure 1). The “economic engine” was *labour* (human/animal), and the “economic-driver” was the *farmer*. Single-entry was the dominant form of accounting. Some “trade” took place during this period - resulting in both the origins of “cost accounting” and “double-entry” accounting.

The *Industrial - economy* began to take over in the mid-eighteenth century. The “fuel” of this era was *coal* (and later *petroleum*). The “economic engine” was *machinery*; driven by *engineers and accountants*. The double-entry accounting paradigm permitted both the formation and maintenance of large, complex businesses, and the accumulation of the capital necessary to build the factories of the industrial revolution.

However, the last 25 years has seen the emergence and rapid growth of the *informational - economy*. The “fuel” of this era has been *knowledge* and *intellectual capital*. The “economic engine” has been the communication of knowledge; hence the need for information technology (IT) coupled with telecommunications (e.g. the internet, e-commerce, B2B etc.). Thus *informational professionals* were the new drivers of this economy.

In recent years a new economic paradigm has emerged, the *influential – economy*. The new thinking is that whatever new measures derived should ultimately motivate the economic engines of this economy; i.e. a *strategically motivated workforce* (Ratnatunga, 2004). Empowering the workforce, or *empowerment*, is seen as the fuel that will enable this engine to be efficiently and effectively driven, giving them a strategic ownership culture. And the driver? Many professions will vie for this role, such as industrial psychologists, human resource professionals and organisational behaviour experts.
However, it is ultimately it is how the workforce performs in meeting quantifiable organisational objectives, and the rewards they receive for good performance, that will drive their motivation to align themselves to an organisation’s strategy. Thus the ‘motivational drivers’ will come from within the ranks of the information professionals, and accountants could have a major part to play in this emerging economic paradigm, but only if the profession recognises the opportunities.

The accounting profession’s response to the spate of collapses in early 2000s was to reconsider its accounting standards under the convergence doctrine and the International Financial Reporting Standards (IFRS) regime (Unerman and O’Dwyer, 2004). However, other interested parties also responded, especially the government. The author will now consider these responses and determine if these have reduced the illusion created by accounting reports, and thus increased our faith and trust in them.

**Historical Costs – The Start of the Delusion**

Historical cost accounting has traditionally been driven by the fundamental principle of the matching process, which endeavours to
provide accurate and objective costs at the time of transaction date. Traditionally, accountants have focused on reliability equating this to the use of historical costs and have not defined income in simple terms such as the change in wealth or value. Instead, they have determined income by utilising many conventions that use allocations of historical costs (Beaton and Mard, 2003). This has incurred management criticism about the potential dilution of relevance in financial reporting that the more current value measurements might bring. MacNeal (1939) in his seminal book ‘Truth in Accounting’ was an early attack on Historical costs, warning that the accountants and their profession, by clinging on the historical cost doctrine, “may allow accounting gradually to be forced further and further into the category of non-essential endeavour”. As a result, there has been many attempts over the intervening years, some with good intention perhaps, to value assets based on useful life, replacement cost, salvage value, future net cash-flows and more recently fair-value (as discussed later).

As discussed earlier, today’s users of financial information seek both relevance and reliability. Reliability is thought of as consistently reproducible and independently verifiable information. Under historical cost standards, gains and losses on assets are recorded in the period in which the assets (or a portion thereof) earn income, while under market value standards gains and losses are recorded in the period in which the economic value of the asset changes. Supporters of historical cost reporting often cite the objectivity and reliability of historical cost numbers, while market value proponents typically advertise the relevance of market values for economic decision-making (Aldridge and Colbert, 1997).

In a modern world where prices change rapidly and technology cycles are continuously compressed, opponents assert that historical cost accounting does not reflect the economic substance of a business transaction.viii

**Accounting Standards – Regulating the Delusion**

A key attribute of accounting standards (be they based on rules or principles) is that they act to provide (1) consistency and comparability of firms’ financial reports; (2) guidelines in circumstances allowing subjective accounting choices can be made, and (3) limits in the scope for biased interpretation. The view of the International Accounting Standards Board (IASB) is that differences in accounting policy motivate a great deal of suspicion particularly when implementation of standards is slow in different countries.x Thus, the IASB claims that international accounting standards (IAS and IFRS) are required to assist consistency and comparability of accounting and reporting across countries.x The IASB believes this is a critical element in reducing suspicion and achieving trust. The view is that this consistency minimises asymmetric information and assists in making markets more efficient and transparent. Investors are supposedly able make decisions with increased confidence gained by better understanding of financial statements provided by the listed companies (Haswell and McKinnon, 2003).

The topic of vagueness is closely tied to the current discussion with many in the profession advocating a move from rules-based accounting standards (as in the USA) to those that are principles-based (IASB). These advocates stress that the exercise of professional judgment is superior to blindly following rules. As the rule-based systems are plagued by the problems of vagueness, it implies that some very important decisions cannot be objectively described as “right” or “wrong,” and must be based on an authority’s judgment; i.e. when vagueness is present in the standards, they claim that judgment becomes as important as fact-finding (Penno, 2008).

The more recent enactment of the Sarbanes-Oxley Act of 2002 appears to be implicitly acknowledging the inherent vagueness in rules-based frameworks to the extent that they explicitly recognize the importance of judgment by recommending a principles-based option.

However, the fundamental problem facing the accounting profession is that both the rules and principles based standards are built upon a faulty foundation of an accounting framework developed for an outdated economic environment. Vagueness problems become
most acute when accountants and auditors face an economic environment that has rapid technological changes, financial engineering, creative tax planning, or changes in the way that business is done (e.g. B2B, internet, etc.).

If the environment were static, explicit rules and principles could eventually be developed for each category and consulted when making classifications. In contrast, dynamic environments present new problems characterized by vagueness that affect accounting concepts of verifiability, relevance, and consistency that are fundamental to any conceptual accounting framework.

Penno (2008) argues that when moving from a static conceptual framework to a dynamic one, most acceptable notions of consistency lead to “standards creep” with vague rule systems, in which local applications of consistency may cause the overall framework to lose global consistency. This is a particularly telling point against the need for convergence in accounting standards.

This vagueness is very much present in rules pertaining to assets, with issues such as (1) how companies’ account for goodwill; (2) when should expenses be capitalized into assets, or (3) the current value of assets, continuing to be controversial (Gray, 2002).

This flexibility in accounting policy choices provided by the vagueness of rules opens the door to opportunistic behaviour of managers seeking to maximise their own utility so that accounting numbers may not necessarily reflect the real operating performance of the firm. For example, Tarca (2002) examined the extent to which firms make policy choices in five areas (i.e. tangible assets, available-for-sale marketable securities, identifiable intangible assets, research and development expenditure and goodwill amortization period) that either align with US GAAP or with IAS options that are not acceptable under US GAAP. The firms studied were domiciled in the United Kingdom, France, Germany, Japan and Australia, and it was found that foreign listing (especially in the US) and leverage were significant factors for policy choice.

Despite the introduction of IFRS and IAS, the approach to accounting standards still varies in different countries. For instance, the United States still employs a rule-based approach, while Europe follows a principle-based approach. The accounting profession claims that the collapse of Enron clearly shows that compliance with rules (form) does not mean reports present a true and fair view (substance) of a company’s situation (Chapman, 2003).

The profession claims that emphasis must also be placed on applying a principle approach i.e. an “if not, why not” explanation when there is a deviation from principles. However, collapses such as Parmalat, Maxwell Communication Corporation, Marconi and Comroad in Europe indicate that even this principles-based approach is flawed.

It is argued in this paper that both approaches are subject to manipulation as the foundation upon which accounting reports and related standards are based upon are fundamentally outdated, especially in the measurement and valuation of assets.

It is further argued that whilst internationally consistent standards are required, they must be driven from a new set of first principles based on information – economic paradigm, and not an outdated industrial paradigm based on historical costs. This will allow investors to compare companies more easily and not be suspicious of idiosyncrasies of financial statements within and across countries (see Akhigbe, et. al., 2005; Kwok, 2005). The development and encouragement of the application by accountants and auditors of principles and standards derived from a new economic paradigm will play a significant role in the governance framework and in achieving trust in the financial statements.

**Fair Value – Multiple Delusions**

Fair value accounting is a financial reporting approach in which companies are required or permitted to measure and report on an ongoing basis certain assets and liabilities (generally financial instruments) at estimates of the prices they would receive if they were to sell the assets or would pay if they were to be relieved of the liabilities.

Under fair value accounting, companies report losses when the fair values of their assets...
decrease or liabilities increase. Those losses reduce companies’ reported equity and may also reduce companies’ reported net income.

Some of the key reasons put forward by the standard setters as to why fair value accounting benefits investors include (Ryan, 2008; Sapra, 2008):

- It requires or permits companies to report amounts that are more accurate, timely, and comparable than the amounts that would be reported under existing alternative accounting approaches, even during extreme market conditions;
- It requires or permits companies to report amounts that are updated on a regular and ongoing basis;
- It limits companies’ ability to manipulate their net income because gains and losses on assets and liabilities are reported in the period they occur, not when they are realized as the result of a transaction;
- Gains and losses resulting from changes in fair value estimates indicate economic events that companies and investors may find worthy of additional disclosures.

Although fair values have played a role in U.S. generally accepted accounting principles (GAAP) for more than 50 years, accounting standards that require or permit fair value accounting have increased considerably in number and significance in recent years. In September 2006, the Financial Accounting Standards Board (FASB) issued an important and controversial new standard, Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157), which provides significantly more comprehensive guidance to assist companies in estimating fair values.

Fair value accounting has been heralded by the accounting profession as the mechanism to present relevant information to investors that more accurately reflects prevailing circumstances, especially in companies operating in the information – economic paradigm. It defines income in terms of changes in net worth or value, reflecting the impact of external events on total firm value.

However, it is a double-edged sword that opens up new prospects for manipulation of accounts and further clouds the true perspective of the company’s verifiable financial records. For example, a change to fair value from historical cost may decrease the amount attributed to the depreciation of assets and thus may increase the reported net income of the firm. Thus, managers can ‘tune’ reported net income and influence the reward (compensation) given for attaining that level of income (Bos and Donker, 2004).

Such ‘earnings management’ and ‘income smoothing’ techniques are well covered in the literature and has remained an area of academic research for well over three decades (see Healy and Wahlen, 1999; Tucker and Zarowin, 2006 and the literature quoted therein) The use of such interpretative loopholes is still present with IFRS, and provides an opportunity to presents a (rainbow) coloured perspective to the public (Quinn, 2003), i.e. the possibility of providing multiple variations of reported income and value, mostly illusionary in substance. This illusion was aptly described by Australia and New Zealand (ANZ) chief Mike Smith who attacked the mark-to-market requirements of IFRS (which has wrought havoc with ANZ’s profit and loss statement) as "gobbledegook" (Gettler, 2010).

The following is a summary as to reasons why some believe that fair value accounting provides multiple values that ultimately hurts investors (Ryan, 2008, Sapra, 2008):

- When markets are illiquid, fair value is a poorly defined notion involving hypothetical transaction prices that cannot be measured reliably, regardless of how much measurement guidance the FASB provides.
- When fair values are provided by sources other than liquid markets, they are unverifiable and allow firms to engage in discretionary income management and other accounting behaviours.
- By recognizing unrealized gains and losses, fair value accounting creates volatility in firms’ owners’ equity (including financial institutions’ regulatory capital) and net income that need not correspond to the cash flows that will ultimately be realized.
• Fair value accounting mixes normal/permanent components of income, such as interest, with transitory unrealized gains and losses.

Fair value is easily determined where assets and liabilities are actively traded on the market, as the value is the quoted market price. Difficulty arises if it is not actively traded (and for intangible assets where there is often no market). Here, an estimate of fair value needs to be based on managerial judgment. Changes in market can be accounted for in the income statement but the risk of bias, asymmetric information and smoothing of performance is a major issue (Laux and Leuz, 2009; McSweeney, 2009). Conversely, historical costs are easily determined and the cost incurred in the use of the asset (depreciation) is calculated by using its useful life.

Despite the above concerns, standard setters have been under much pressure from company management to consider approaches that facilitate fair value accounting to its advantage. Accountants have, therefore, been rather slow to adopt full fair value accounting as the opponents and proponents of fair value have furiously argued the key attributes that drive each philosophy (Chisnall, 2000).

For example, in a more recent study Cairns, et. al. (2009) investigated the use of fair value measurement by 228 listed companies in the UK and Australia around the time of the adoption of IFRS (from 1 January 2005). They tested whether policy choice had changed in relation to (a) mandatory and (b) optional use of fair value measurements, and found that whilst the mandatory requirements related to financial instruments (IAS 39) and share-based payments (IFRS 2) have increased comparability, this comparability was not significant for other assets. In relation to the optional use of fair value, comparability increased in relation to property (IAS 16) only because some companies discontinued fair value measurements. Options to use fair value in other areas (financial liabilities, investment properties, intangible assets and plant and equipment) were not generally taken up, either for on-going measurement or on IFRS adoption (under the ‘deemed cost’ option). The results suggest a conservative approach and/or lack of incentives to use fair value measurement for most companies, unless it is seen to present the organisation’s financial statements in a favourable light.

It is often forgotten that accrual accounting was implemented due to the difficulty in matching the timing of cash flows with economic activity. It has been repeatedly shown that shareholders value cash-flow measures above accrual accounts (see Frino and Jones, 2005; Jones, 2003). The use of fair value may allow significant discretion in accruals and further clouds investors’ ability to evaluate true financial performance (Cheng, 2007; Dechow, et. al., 2009). This is why the proponents of historical cost (HC) claim that whilst admittedly HC is a financial ‘hygiene factor’ that does not in itself automatically improve trust; it will be one element that will reduce trust if it is not present.

**Government Responses – Legitimising the Delusion**

In Australia, as in most countries, the Corporations Law requires directors to give a “True and Fair view” of their company’s performance. Further in consultation with the Stock Exchanges and the professional accounting bodies of their countries, many governments worldwide have introduced a range of initiatives and prescribed practices in relation to corporate governance (e.g. Sarbanes Oxley Act in the USA and CLERP 9 in Australia), auditors and accounting standards.

These initiatives and prescribed practices now have stronger enforcement powers and increased penalties than ever before. In addition, most governments are taking a greater oversight role. For example, in Australia, the Financial Reporting Council (FRC) and other government agencies such as the Australian Securities and Investments Commission (ASIC) have significant regularity roles. In terms of governance, CLERP 9 requires rotation of audit partners as well as the installation of audit committees for certain categories of listed companies.

In this regulated environment, the concept of ‘statutory profit’ has emerged, i.e. certain categories of companies must report statutory profits based on IFRS. That reported number can include fair value adjustments, impairment
losses, one-off provisions, revaluation of liabilities and significant transactions.

The various regularity authorities believe that this statutory legitimisation of the financial statement numbers will go a long way to improving disclosure and the perception, by investors, of reliable, relevant and trustworthy company information. However, the move to IFRS has coincided with more companies making one-off items and unusual adjustments to create so-called "normalised profits" in addition to statutory profits posted in accordance with international reporting standards.

"... for example, (in 2010) diversified chemicals and explosives supplier Orica (Australia) reported a lower net profit for the six months to March 31 of $55.1 million, down from $220.4 million for the previous corresponding period. The bottom line was hit by one-off costs, including $44 million in environmental remediation costs and a $192 million tax bill. Orica said that excluding individual material items, its underlying profit was $293 million. While statutory profit was lower, the figure in the underlying profit was up 11 per cent on the previous corresponding period. Orica's underlying profit was seen as a good indication of where the company was at. (With examples like this) investors and regulators have expressed concern that some companies are "window dressing" its losses to mask the impact of the financial crisis (Gettler, 2010).

In the USA, a more comprehensive and punitive set of laws were implemented with measures to hold directors, management and ‘independent’ auditorsxiii accountable to authorities acting on behalf of shareholders. This has been put in place under the Sarbanes Oxley Act (Guerra, 2004). Within this framework there are initiatives intended to create better accounting practices and improved disclosure with supervision from statutory bodies. The existence of prescriptive legislation like CLERP 9 in Australia and Sarbanes Oxley in the USA are testimony to the serious issues of trust in disclosures and company accounts. The issue not addressed in this apparently stricter regime is the core foundation of accounting, the accounting equation. Devised in the industrial era, can it cope with the information era and beyond? All of the government responses in various countries rely on advice provided by the accounting profession, which has provided this advice in a self-interested manner (Walker, 2009; Roberts and Jones, 2009). The profession’s advice has been to legislate that the preparation and reporting of numbers should according to accounting standards that are essentially globally identical, i.e. ‘convergence’.xiv

However, the issue not addressed is that the standards themselves are based on rule systems that are founded on outdated economic paradigms and are plagued by vagueness and linguistic imprecision that allows multiple interpretations. Therefore, all that this governmental involvement around the world has resulted in is to legitimise the delusion created in the financial statements.

The Statutory Audit – A Stamp of Approval on the Delusion

The quality of financial reports produced by companies influences capital markets in determining the level of risk and return required on an investment. In the absence of strong internal integrity in accounting, especially as it is based on an outdated economic paradigm, such reports have become more difficult for the auditors to ensure that the values presented are true and fair. This was further exacerbated by auditors carrying out lucrative advisory work reducing confidence of the shareholder on their integrity (Walker, 1993). However, in the context of the accounting function, it is argued that it is not just the audit process that needs attention in the long term, but also the outdated accounting framework that creates the delusionary income and asset values in the financial reports that are then expected to be audited.

Penno (2008) argues that because vagueness is a part of a rules based conceptual accounting framework, the role of verifiability in such a framework is limited because regardless how much effort is put into obtaining evidence, the resulting classification problem remains indeterminate in some cases. Take for example the difficulties of verifiability that auditors have in applying ‘fair-value’ rules that are particularly vague. Under fair value
accounting financial assets are divided into three categories--those held ‘to maturity’, those held ‘for trading purposes’, and those ‘available for sale’. Each of these categories is treated slightly differently. Assets held to maturity are valued at amortized cost; assets held for trading are marked to market, with unrealized gains or losses included in earnings; and assets deemed available for sale are marked to market, with unrealized gains or losses excluded from earnings but included in shareholders' equity.

These three categories provide many opportunities for the manipulation of earnings. For example, a management that wanted to increase earnings during a reporting period could transfer appreciated assets from the available-for-sale category to the trading category, where the appreciation would add to the bottom line; in the same way, moving a depreciated asset from the trading category to the available-for-sale group would reduce reported losses. To prevent this kind of manipulation, accounting standards contain a number of rules about how assets are to be valued when moved from one category to another. The held-to-maturity category is particularly difficult for accountants and auditors to police because its key element is an assessment of management's intent, which is always difficult to determine. Ultimately, the practical applicability of this guidance were tested and found wanting by the extreme market conditions during the credit crunch (Ryan, 2008; Chasan, 2008, Joseph-Bell, et.al. 2008; Wallison, 2008).

Understandably, auditors have gone along with the delusion presented in accounting reports and been satisfied with minimum compliance arrangements for it is in their self-interest to do so (Sikka, 2009; Humphrey, et. al., 2009). They have often succumbed to management pressure and often became part of the illusion (St. Pierre and Anderson, 1984; Schuetze, 1993; Cuccia, et.al.,1995; Schipper, 2003)

One can understand the auditors maintaining the status quo and not questioning the accounting delusion they are part of. After all, if the extent of the delusion is exposed, will there be a need for a statutory audit? It is interesting also to note that although auditors sign annual accounts they never appear to comment on the analysis or views of the senior management who write the report.

The objective of accounting is to provide investors with ‘true and fair’ feedback on a firm’s performance to enable effective decisions on placement and allocation of shareholders’ funds; a fundamental aspect of the operation of our capitalist free market system. Unfortunately, accountants have not been able maintain a strong stewardship perspective, thus exacerbating the likelihood of major corporate problems. This situation has resulted in a reduced capacity for firms to provide credible, accurate, relevant and timely information to enable the pricing and allocation market mechanisms to work. The public has been quick to blame the auditors. The failure of audit firms to attain independence and highlight misleading disclosures and company accounts have been major causes of concern. But can accountants and auditors be held liable if the very framework they use to provide such reports is flawed? Clearly a new reporting paradigm is required.

Reducing the Delusion – Rethinking the Reporting Model

Evidence of a Diminishing in the Role of Accountants

There is a significant amount of evidence that indicates that accounting (and accountants) have not been able to meet the challenges of the relatively new economic paradigms shown in Figure 1. The result is that in the informational-economy, accountants have struggled to remain as one of the economic drivers. The diminishing role of accountants is evidenced via a number of ‘signals’ as follows:

- divisions are arising among academics and practitioners over the ‘fundamentals of measurement’; with conventional cost-based procedures being no longer generally accepted (Sapra, 2008; Allen and Carletti, 2007; Plantin, et. al. 2008);

- the relevance of the financial statements in terms of both accuracy and timeliness is being increasingly questioned (Kemp,1963; Vishnani, and Shah, 2008; Amir, et.al., 1993; Barth, et. al., 2001;
the audit expectations gap in public accounting is growing to a point of questioning the relevancy of the audit process itself (Adams and Evans, 2004; Swift and Dando, 2002; Bostick, 2009; Boon, et.al., 2008; Lee, et. al., 2007; Monroe and Woodliff, 2009; Leung and Cooper, 2003);

• other corporate management positions are being compensated at levels higher than that for accountants (Olivier, 2009; AIM, 2010; Mercer, 2010);

• accountants are coming increasingly under attack for tax frauds (Gosnell, 2008; Wells, 2010; ATO, 2010); corporate collapses (Epstein, 1992; Clarke, et. al.1997; Clarke and Dean,2001; Cooper, 2005); and contributing to polluting the environment by not recognising sustainability and climate change issues in financial reports (Ratnatunga, 2007; Wild, 2008).

Given these ‘negative signals’, there is some evidence that that many accountants are leaving the financial accounting and auditing profession by metamorphosing into roles that use their financial acumen, but are vastly different from traditional financial reporting roles. These ‘new roles’ are in areas such as strategic management and business analysis.

“We are seeing more accountants moving out of the backrooms and into the boardroom. In the boom years, a CEO with marketing experience may have been valued for his ability to build a brand. Now in the period post-recession, accountants’ firm grasp of financial issues and ability to provide reliable, sensible expertise greatly improves their prospects. Of course accountants have always been best placed to contribute on fiscal matters, and the recessionary environment has made that more important, but it is their strategic insight which is most sought-after now. This has resulted in more than twice as many FTSE100 companies now having a chairman or CEO with an accountancy or finance background (58%) than in the mid-1990s (24%). Fully qualified accounting chairman or CEOs, account for 40% of FTSE100 company leaders.” (Way and Sattin, 2010).

The most compelling evidence pertaining to the shift away from the conventional-accounting role can be seen in the behaviour of the Big-Four Chartered Accounting firms. During the last decade every one of them has stopped describing themselves in their promotional material as “Chartered Accountants”. Further, one of the professional bodies in Australia, the Australian Society of Certified Practising Accountants has undergone a name change, calling itself, simply, CPA Australia. The reference to being an accounting body has been completely downplayed.

Such evidence, even from within the accounting profession, strongly indicates that our industrial-era accounting paradigm is retarding the profession, especially with the need for expanded information and new measurements demanded by organisation facing increasing global competition.

Why is it that many professional accountants are still supplying information-era managers and owners with information better suited to industrial-era managers? The reason stems from the role of accounting in the industrial era and the formation of corporations.

The current accounting paradigm is a remnant of the needs of an industrial-era enterprise - where the “brains” were provided by white-collar workers; the “brawn” was provided by the blue-collar workers; and the “capital” was provided by investors and other parties external to the enterprise. The role of accounting was to enable the “brains” to monitor and control the “brawn” (i.e. the area of management accounting); and to report on the success of such controls in terms of ‘return’ or ‘profit’ to the providers of the “capital” (i.e. the area of financial accounting).

The age of the corporation (since 1850) led to the enormous emphasis on the determination of profit in the past accounting period. Now the focus has widened. Owners, investors, creditors, bankers, government now all need leading indicators. Accounting - especially
financial accounting - is still preoccupied by *lagging indicators*. For example:

- Historical records
- Financial statements (including cash flow statements)
- Ratio analysis
- Auditing
- Variance analysis.

Such a preoccupation with the past is akin to “navigating by looking at the wake created by the ship”. This is only possible, if one is sure one is going in the right direction, and if one is sure there will be no unexpected ships, icebergs and floating debris crossing the ship's path.

**The Need for Leading Indicators**

Today, the providers of “capital” require far more information than past performance - they are becoming far more preoccupied with the future safety and performance of their investments. Further, governments (infrastructure); employees (human assets) and environmental groups (the Earth) are also claiming to be providers of capital. In an informational-era enterprise, the distinctions between white and blue-collar workers are far less pronounced, as all workers become *knowledge workers* (see Figure 1). The role of an accountant (or other informational professional) in this new era is to present the available data and provide the information in terms of the new measures demanded by these knowledge workers. This requires the simultaneous provision of *both*:

- Strategic and control information;
- Future-orientated and historical information;
- Relevant and reliable information
- Financial and non-financial information;
- Profit-motivated and socially-responsible information;
- Timely and accurate information; and
- True and motivational information

In order to provide such diverse (and often conflicting) decision information, a new paradigm needs to be developed in designing an accounting framework. First, the provision of accounting information to the management of information-era enterprises must keep pace with their *timing* requirements for decision making. Information technology (i.e. computers and telecommunications) is speeding all functions and turning them into virtually continuous processes. Management needs *process measures* in “real-time”, not event measures after the event. The frequency and freshness of measurements must be related to how fast environmental change is occurring in the process/enterprise being managed. The current interest in “one-day reporting” is an indication of the importance of this area. Further, it is not only management that requires timely information, so do investors and other stakeholders of the enterprise.

Second, *Information stability assumptions* should also be rethought in this new economic environment. In an unstable environment, one cannot expect measurement systems to remain stable. The Key Performance Indicators (KPIs) themselves need to be regularly monitored to ensure information usefulness in a changing global environment. Measures must report not only rates of activity, but rates of change in rates of activity.

Third, serious consideration should be given to the *nature, recognition, and measurement of* information-era assets. The most significant area in which the traditional financial accounting measurement model fails is in the area of recognising and measuring *intangible assets*.

The engine(s) that drive information-era enterprises include: reputation, knowledge, communication, learning, and innovative capability. However, such intangible assets are still systematically excluded from our industrial-era balance sheets; resulting in a significant understating of the total “capital” of the enterprise. Take for example Microsoft, with physical assets that are approximately only 4% of the book value of total assets and less than 1% of its market value. This gap between market and book values has been the source of many criticisms of traditional financial accounting, which encounters growing difficulty in reliably valuing intangible assets that are the backbone of informational-era companies such as Microsoft.

Another consequence of an outdated
accounting framework is the focus on “short-term monetary capital maintenance” instead of "long-term comprehensive capital maintenance"; which includes intangible assets. This short-termism tempts some managers to reduce investment in such intangible assets for the sake of short-term earnings; e.g. enhancing the capability of knowledge workers by investing in their training.

It should also be noted that many economic estimates indicate that manufacturing and agriculture in more developed countries account only for between 20-40% of output and employment. At the same time the service sector is generating a growing share of output and employment. This same trend is occurring in both developed and developing economies.

Economic activity in all sectors increasingly involves the processing and analysing of information, making judgments and providing services, rather than the manufacturing and marketing of physical commodities. Even in manufacturing, science is breeding new industries and information technology is making both production processes and products more technologically complex. In the service area, activities like entertainment and tourism are employing a growing share of the workforce. This means that in both manufacturing and services, intangible assets - brands, intellectual property, know-how and copyrights - are more valuable to companies than ever before.

Competitiveness is thus increasingly based on how organisations harness these intangible assets. Thus, in an increasingly open world economy, it is harder to sustain competitiveness purely on the basis of the traditional tangible assets, as these are also easily available to the competition. It is the intangible assets that now provide the true competitive advantage.

Today, organisations no longer base their future prosperity solely on the technological and financial strengths they may have in the more traditional assets of the industrial economy, such as raw materials, land, machinery and labour. In increasingly open global markets, products can be made and shipped anywhere. Financial capital is less scarce and production technologies can be copied by emerging industrial nations with increasingly well-educated workforces. All of the more traditional assets are available to such emerging competitors on equal if not better terms. Organisations must therefore, base competitiveness on distinctive assets that can be used to generate high-value added products. These assets are know-how, skills, creativity and talent. Examples abound: Google on the use of information and Dell in supply chain management. How do accountants measure the value of Google’s computer algorithm based search engine or Dell’s channel selection? Current accounting standards, even with ‘convergence’ and IFRS do not attempt this. Yet, the reports compiled and audited state that they provide a ‘true and fair’ view of the value of the company. This is the delusion the profession still persists with.

The above are merely indicative of the areas that need to be considered in order to broaden the subject-matter of accounting and in order to increase its relevance to information-era decision makers. There is no fundamental reason why the accounting profession cannot become the information professionals of the information-economic era. A case has been made for the need of a new paradigm in accounting properly directed research and education should bring it about.

**The Need for New Types of Measurements**

It is clear that new types of “measurements” are needed for both tradable and non-tradable assets in order for organisations to meet the challenges present at the corporate, national and international levels, in today’s information economy. New measurements are particularly needed to measure and value of intangible assets. However, due to Generally Accepted Accounting Principles (GAAP), financial professionals face a dilemma when it comes to valuing intangibles. This is because they want financial statements to be both reliable and relevant. Reliability is easy to achieve, but relevance is not. This is especially true when it comes to knowledge-based organisations such as Google, Dell and Microsoft, because the intangible assets are not referenced in their statements, yet these assets are highly relevant to its stakeholders.
The Accounting Profession insists that financial statements must be ‘reliable’, i.e. they must be both accurate and supportable. Such reliability would suggest that if two different accountants prepared the same statements, the two answers should come close to each other, particularly if they each relied on the same hard evidence. This is why the profession has worked hard over the last 40 years to issue ‘Accounting Standards’ to ensure that as much subjectivity as possible is removed in their preparation. Accounting standards achieve ‘reliability’ by requiring evidence of an arms-length transaction between two parties. Thus when an organisation buys an asset, such as a truck, from an external supplier, and cash changes hands, this is good evidence that the organisation now has an asset that exists (and in most cases can be physically verified, thus increasing reliability) and that a sale has been made by the supplier company, and thus a profit (or loss) can be recognised by it. The convergence requirements of IFRS is another step towards ‘reliability’

The GAAP in most countries recognising that the purpose of financial statements is to also provide investors and creditors with information about future earnings prospects and cash flows (i.e. be relevant). However, in the case of intangible assets, because an ‘arm’s length’ transaction has not occurred (and thus their valuation fails the ‘reliability’ test), these are kept off the balance sheet, or the amounts paid in creating them are expensed. Unfortunately, the result is that the financial statements of knowledge-companies lack any ‘relevance’ with many such companies reporting balance sheet values widely divergent to what the market places on it.\textsuperscript{xvi}

It is important to point out that values of intangible assets are highly context-dependent. They increase in value when deployed in competition to serve consumers, thereby providing a source of competitive advantage which competitors find hard to imitate. Knowledge assets that are valuable in one setting may lose their value elsewhere. Attaching a durable value to a piece of information, a brand or a competence, is difficult, especially in fast moving markets driven by fashion, branding or rapid technological change. For example, although accountancy and computer games companies depend heavily on human capital, they do so in quite different ways. A qualification-based measure appropriate for an accountancy firm would be next to useless for a computer games company which is ‘ideas’ generating. Ratnatunga, et. al., (2004) argue that in terms of Defence capabilities, this ‘capability’ value is particularly relevant. For example, youthfulness may be particularly relevant for ground troops, but in terms of fighter pilots the amount of flying time (experience) is the key-indicator that determines capability. Thus, whilst promotion of more senior people to managerial tasks in the Army's may increase the strike capability of its ground troops, similar promotions may reduce the strike capability of the Air Force.

**Conclusion**

The pendulum of bias in company accounting, and to a lesser extent audit functions, has swung too far toward statutory and management compliance and therefore diminished any discussion on the integrity of the accounting reports themselves. This has veiled the underlying core reason for an upsurge in corporate failures; i.e. that an outdated accounting paradigm leads to delusionary valuations.\textsuperscript{xvii} The corporate failures of the early 2000s have resulted in major regulatory upheaval resulting in IFRS, and other related governance and statutory initiatives designed to restore trust in company reports and create incentives for proper disclosures. These initiatives, however, miss addressing the core problem - that the recognition and valuation of assets is in today’s financial statements are based on an outdated economic paradigm resulting in delusionary valuations. The ‘accounting profession’ has perpetuated this delusion by stating that the ‘convergence of accounting standards’ (all based on the industrial era economic paradigm) coupled with ‘fair value accounting’ is the answer. This results in a single set of accounts with multiple valuation-possibilities within. These accounts are then audited, and certified as being a ‘true and fair’ representation of the value of an enterprise.

The integrity and trustworthiness of audits is paramount to determine whether financial
reports are true and fair. Merely legislating and prescribing IFRS valuations and corporate governance practices for directors and auditors and will not ensure trust in the corporate reporting systems. It is argued in the paper that the key to achieving trust is to rethink the accounting model to suite the information age. If the accountants refuse to do such rethinking, then the auditors must do so, before signing off on fictitious valuations.

It is clear that accountants and auditors need to re-establish confidence in their profession and the integrity of the financial reports they provide (Alam, et al, 2003). However, an accounting profession that is still wedded to an outdated industrial era framework will not bring about this change. A new framework is required, and it is argued that the first and most fundamental requirement of such a framework is the recognition and measurement of intangible assets. The timing vs. accuracy issues, and information stability assumptions, must also be reconsidered in this new accounting framework. Finally, the limitations of both rule-based and principles-based accounting standards that are built upon a faulty foundation of an accounting framework developed for an outdated economic environment should be recognised. The vagueness problems that arise are particularly acute in dynamic economic environments in which local applications of consistency may cause the overall framework to lose global consistency.

The accounting profession can remain committed to fine-tuning the debits and credits of a by-gone era; or work closely with technical departments of professional firms and university accounting faculties, to research on how accountants could provide decision support information in knowledge-economy competitive environments.

This change in paradigm is essential in a global sense, if accountants are to regain their role as one of the key drivers of the knowledge engine in an information-age economy.

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APPENDIX A: Historical Cost vs. Fair Value

<table>
<thead>
<tr>
<th>Historical cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provides certainty on reported values</td>
<td>Potentially more relevant to understanding current performance (Lee, Choi, and Press, 2001)</td>
</tr>
<tr>
<td>Independently verifiable transactions</td>
<td>Potentially better current performance information. (Indjejikian, R. J. 1999)</td>
</tr>
<tr>
<td>Can contain very old, irrelevant values in the context of replacement costs</td>
<td>Reflects current value of resources.</td>
</tr>
<tr>
<td>Limits manipulation of values based on objective values</td>
<td>Transaction audit trail is lost</td>
</tr>
<tr>
<td>Economic decisions in future can be clouded</td>
<td>Better economic decisions if Historical cost is augmented with fair value (Johnson 1984)</td>
</tr>
<tr>
<td>Allows valuation for investment analysis without impacting financial integrity</td>
<td>Subjective and difficult to enforce standards, less credibility</td>
</tr>
<tr>
<td>Tendency to under value’s assets in use.</td>
<td>Tendency to over value assets.</td>
</tr>
<tr>
<td>More transparency, less assumptions, simpler.</td>
<td>Reduced transparency due to assumptions, more complex.</td>
</tr>
<tr>
<td>Significantly less scope to manipulate, inefficiencies not obvious.</td>
<td>More scope to smooth results. Management unlikely to write down assets. E.g. Goodwill</td>
</tr>
<tr>
<td>Easy for investors to understand</td>
<td>Investors need to investigate assumptions to achieve understanding</td>
</tr>
<tr>
<td>Comparing companies is easier</td>
<td>Difficult to compare due to varying assumptions</td>
</tr>
<tr>
<td>Self-evident</td>
<td>Requires more transparency and stronger standards to gain confidence</td>
</tr>
<tr>
<td>Earnings can be volatile due to difference values (real vs. nominal)</td>
<td>Can smooth results when there is volatility – is it real?</td>
</tr>
</tbody>
</table>

Endnotes

1 Whilst the words “serial liar” was used in the newspaper reports, this does not necessarily mean delusionary accounts, because the two terms are very different. Substance over form can be a very different argument to material omissions as in the case of James Hardie.

ii There were ‘third-party’ transactions between the company and its fictitious customers, and cash was received for ‘sales’ thus its recording was in compliance with accounting standards.


iv Kohler, A. (1990), “Australia's Accountants have a lot to Answer for”, The Sunday Age, Money Section, 30 September, pp 1.

v The collapse of Bear Sterns and Lehman Brothers were ever bigger in terms of sheer monetary values, but related to the banking sector. These, of course heralded the Global Financial Crisis (GFC).

vi This is based on the historical cost doctrine in which transactions impact the ‘accounting equation’: Assets – Liabilities = Equity, and changes in equity through operations was given by the equation: Profit = Revenue – Expenses. Of the four variables that impact on equity, i.e. assets, liabilities, revenue and expenses, the non-current assets value is subject to the most manipulation.

vii Convergence is the project under which the International Accounting Standards Board (IASB) based in Europe and the Financial Accounting Standards Board (FASB) based in USA joined to bring consistency in
accounting standards around the world. The project resulted in the issuance of International Financial Reporting Standards (IFRS).

This is not the only difference between the fair value and historical cost paradigms. Appendix A contrasts fair value with historical costs.

The major difference between IAS and IFRS is that the IAS’s were issued by the International Accounting Standards Committee (IASC) from 1973 to 2001, while the IFRS’s were issued by the International Accounting Standards Board (IASB) from 2001 onwards. The IASB is basically the successor for IASC. When IASB was installed in 2001, it adopted the existing IAS and decided to name any future standards as IFRS.

In Australia, there are both International Financial Reporting Standards (IFRS) and Australian International Financial Reporting Standards (AIFRS). The differences between the AIFRS and IFRS are indicated for each of the standards in the Members’ Handbook of CPA Australia.

ASIC found reported in 2010 that 78 per cent of companies disclosed an alternative profit measure. It also found that 11 per cent of listed entities included alternative profit measures in their financial reports. It should be noted that alternative profit measures are legal, provided they are supplied alongside statutory profits. However, note also that these non-statutory profits are unaudited numbers (Gettler, 2010).

The increasing regulatory burden on auditors, some have cynically suggested, is because they carry the best insurance.

The World-Bank and other agencies were recruited to pressure developing countries to pass legislation and accounting standards based on ‘convergence’, by insisting that reports pertaining to the financial aid provided had to be based on IFRS.

Some may argue, however, that this downplaying of the ‘accountant’ descriptor by the Big-4 is because they have expanded to include additional services sought by clients, e.g. HRM, Valuations, Corporate Advisory, IT, etc. However, these complimentary services were always provided by those previously calling themselves ‘accountants’.

‘Fair-value’ accounting does not help narrow the gap in such companies, as the outdated accounting framework on which IFRS is built does not recognise most intangibles at ‘whatever’ value.

The link between corporate failures and lack of international consistency in accounting standards was the rationale for IFRS and the convergence project. However, the outdated accounting model on which GAAP is based remains. It must be noted that the upsurge in corporate failures seen in the early 2000s was more to do with fraud and the lack of cash flow, and not due to the divergence of accounting standards. This indicates that the need for a global convergence of accounting standards may have been built on a ‘straw man’ argument.

However, the academic community and the publication policies of the leading journals of the area have been found wanting in conducting any research of relevance in the information era (Hopwood, 2007; Arnold, 2009; Hopwood, 2009). A study by the U.K. professional accounting body ACCA of the articles published over the 10-year period leading up to the sub-prime crisis, credit crunch and global financial crisis – 1999 to 2008, in the six top-ranked academic accounting journals during the period reviewed provided conclusive evidence that the focus of the research was primarily on the traditional accounting orthodoxy of the last three decades – i.e. the role of accounting within an industrial economic paradigm (Unerman and O’Dwyer, 2010).