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# An accounting revolution? The financialisation of standard setting

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ABSTRACT

This paper analyses the political-economic content of the recent 'revolutionary' shift in financial accounting rules for listed companies, specifically the rise of IFRS and fair value. It connects this shift to the socio-economic changes that are currently being discussed in the literature on financialisation, e.g. the rise of shareholder value and the proprietary view of the firm. Two ideal-typical accounting systems are constructed on the basis of normative accounting theory and extant standards – historical cost accounting (HCA) and fair value accounting (FVA). The 'accounting revolution' of the past 10–15 years can be understood as a qualitative shift from HCA to FVA. It is further argued that these ideal-typical systems are related to different circuits or forms of capital – productive and money capital respectively – and to the particular perspective that these afford on the, capitalist firm. Inasmuch as financialisation is related to the circuit of money capital one can make sense of the rise to prominence of FVA, which represents the dominance of a financial view of the firm in the field of financial accounting. Throughout this paper, however, the limits to financialisation are also highlighted and traced back to the ineradicable manifestation of the circuit of productive capital.



## 1. Introduction

What are the form and social content of the recent changes in financial accounting standards epitomised by the rise of IFRS and the increasing use of fair value accounting over roughly the past ten to fifteen years? And how are these changes related to the dominance of finance that is currently being discussed in the financialisation literature? These are the questions that this paper addresses by providing a systematic theoretical account of accounting change that focuses on the political-economic content of accounting standards.

Profound changes have taken place in the regulation of financial accounting for listed companies in the recent past, and IFRS are just one, albeit very important part of this. It has provoked proclamations of an 'accounting revolution' or a 'paradigm shift'. Such claims may be exaggerated, but we are indeed witnessing a *qualitative* and *systematic* change rather than a string of unconnected modifications that leave the fundamental nature of the accounting system untouched. There are two important aspects to this shift: the first concerns the *governance* of accounting regulation. Here we have seen the shifting of sovereignty from national regulatory institutions to a largely unaccountable transnational private body. The other concerns the *substance* of accounting regulation, i.e. the principles and objectives that inform accounting standardisation. It is this second aspect in particular that has been labelled, both by professionals and academic observers, as 'revolutionary',

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and I will analyse it in terms of *ideal typical* accounting systems which I construct on the basis of normative accounting theory and extant accounting standards. The aim is to provide a conceptually grounded account of this change that makes sense of its systemic dimension, its profound nature and its political-economic content. This is more than just an understanding of this or that individual accounting standard; it provides a comprehensive view and an understanding of the meaning and general direction of accounting change. Apart from getting to grips with current developments, this description and its unique methodological approach can also direct further research into accounting change. Moreover, the two ideal-typical accounting systems can be linked to different circuits of capital as described by Marx in *Capital* Vol. II, namely those of productive and money capital. That makes it possible to make *causal* sense of the current shift by linking it to financialisation, the preponderance of financial incomes, motives and strategies both in the wider economy and the management of individual businesses.

The literature on accounting and financialisation now covers a broad range of topics. Some studies examine how management accounting is implicated in the financialisation of businesses (Ezzamel et al., 2008; Gleadle and Cornelius, 2008). The connection between financial accounting and financialisation has also been discussed. Newberry and Robb (2008), for instance, examine how financial reporting is complicit in that "endless series of cheap financial dodges" (Froud et al., 2000, p. 109) that companies driven by the doctrine of shareholder value tend to engage in so as to 'make the numbers' that impatient capital markets want to see. Another strand in this debate is concerned with the inherent connection between financialisation (and/or the advance of shareholder value) and accounting *standards* – particularly the switch to IFRS and the increasing use of fair value (Andersson et al., 2006, 2007a,b, 2008; Nölke and Perry, 2006, 2007; Walker, 2010; Zhang, 2010). In this context it is usually claimed that recent changes in accounting standards do not merely reflect a financialised view of the firm, but that they reinforce financialisation at the level of individual companies because they favour "the penetration of enterprises by the logic of finance" (Aglietta and Rebérioux, 2005, p. 114). Another goal of this paper is to contribute to this last strand of debate through an analysis of the political-economic content of accounting change. Grasping the general tendency of accounting standardisation helps us understand why IFRS and fair value may reinforce financialisation.

First, I will discuss the various ways in which terms like accounting *revolution* or *paradigm shift* have been used, and I will argue that they are an expression of the *systemic* nature of the current accounting change. This change, however, is more adequately grasped through the lens of a binary typology of (ideal-typical) accounting systems. I will then construct those ideal types as logically consistent combinations of three dimensions, based on two key works in normative accounting theory and on publications by standard setters IASB and FASB. After explaining financialisation and introducing Marx's circuits of capital, I will finally connect the discussion of accounting systems to the issue of financialisation by demonstrating the link between the two ideal types and the circuits of productive and money capital respectively. The conclusion – which is preceded by an excursus on the work of R.J. Chambers – draws together the argument.

## 2. An accounting revolution?

Accountants may be a conservative bunch, but recent developments have prompted commentators, from academics to journalists to standard-setters themselves, to use vocabulary that suggests fundamental upheaval. Nobes (1999), a former member of the British delegation to the IASC, proclaims "The beginning of the end of conventional accounting", referring chiefly to the expansion of fair value. Barker (2003) and Damant (2003b), both also previously involved with the IASB and/or other standard-setters, see "The revolution ahead in financial reporting" in the context of the then plans to re-format the income statement. Elsewhere Damant sees "a new era" dawning and predicts that the consistent application of fair value in international standards and the shift towards decision-usefulness for investors as primary purpose of financial reporting will have revolutionary consequences (Damant, 2003a; cf. Baetge et al., 2002). He stresses in particular the *systemic* nature of the connection between the elements of these frameworks and therefore the *qualitative* nature of the resulting changes (Damant, 2003a:12). One can agree or disagree only with the entire set of principles, but one cannot pick and mix.[1]

In some cases, the term "revolution" simply points to the perceived magnitude of accounting change (e.g. King, 2008; Biondi, 2011). Others are more aware of its implications. They may, like Damant, stress the inter-connectedness of the principles behind the revolution; or they may cite Thomas Kuhn's theory of *scientific revolutions* (1996) according to which natural science does not progress through incremental additions to the sum of knowledge, but through periods of upheaval in which disciplines are thoroughly redefined, followed by periods of unspectacular 'normal science' *within* an established paradigm (Barlev and Haddad, 2003; Dodd et al., 2008, p. 43; Nölke and Perry, 2005, pp. 1–5; Wells, 1976). Such scholars also use Kuhn's concepts of "paradigm" or "disciplinary matrix". Wells in particular noted how a "historical cost disciplinary matrix" (1976, p. 474) was giving way to a new disciplinary matrix, although at the time it was too early to predict the eventual winner in the competition to replace HCA.

The revolution (if it really is one) did not start at the level of accounting *practice*, but on the level of academic accounting theory and the work/thinking of standard setters, though by now this has obviously influenced practice too. As Wells' (1976) article, which refers to accounting *theory* alone, demonstrates, the fundamental shift then underway was first observed in

[1] Examples from the financial and professional press include: "Accountants of the world uniting in IFRS revolution", *Financial Times*, 21/06/2007: 26; "Fair-Value Revolution: Historical cost accounting is fading as Corporate America marches into a new era", *CFO*, September 2008, www.cfo.com/article.cfm/11957243/c_11991481?f=magazine_coverstory [accessed 12.07.11].