Accounting practices ultimately affect global economy

May 14 2008

How much a particular hill of beans is worth may depend on who’s counting the beans. When it comes to accounting standards in the business world, every bean counts, but the quality of financial reporting differs from country to country. In a recent study, a University of Missouri researcher found that uniform and strict auditor enforcement may be more important than a country’s accounting standards, and the quality of reporting can affect the whole economy.

“To improve the quality of accounting, which improves the flow of capital to the right places in the economy and facilitates economic growth, you must have an environment that includes scrutiny by corporate regulators and independent auditors,” said Jere Francis, MU chair of accountancy in the Robert J. Trulaske, Sr. College of Business. “The auditor’s job is to be the local policeman on the beat, making sure people aren’t crossing the line. We need those cops to help good people stay good.”

According to Francis, there is a movement toward adopting International Financial Reporting Standards (IFRS). The goal of implementing the IFRS is to establish a single set of globally accepted accounting standards. The concept is rapidly gaining support by key groups such as the Securities and Exchange Commission (SEC) and the World Bank. IFRS are now used for public reporting purposes in more than 100 countries. According to financial services firm Deloitte and Touche, by 2011, almost every country, including the United States, will be using IFRS.

"On one hand, some SEC representatives think that because people are using these standards, their financial reports are going to be of good quality, but not necessarily," Francis said. "IFRS, in principle, are a good idea but the only thing being adopted are the standards themselves. We don't know how well those standards are being implemented; that's a function of the auditor looking over the company's shoulder to see if they are dotting the 'i's and crossing the 't's."

Francis found that, in countries that have stronger investor protection (for example, the ability of an entity like the SEC to punish misconduct), the quality of reporting is improved. The quality of accounting reports is as much a function of the auditors' incentives to do a good job as it is the adoption of standards, according to Francis. Auditors have stronger incentives to do rigorous audits in countries like the United States where they will be more severely punished if they fail to perform at an exacting level.

According to Francis, one result of implementing global accounting standards is increased investment in global capital. Transparent and regulated financial reporting facilitates global capital flow which, in turn, yields increased confidence in the economy.

"A common accounting basis seems to simplify global economic activity, but quality is currently country specific due to poor enforcement," Francis said. "Accounting quality is clearly on the front burner. For example, the World Bank now requires countries to show progress in order to get loans, grants and other financing from the international donor community. Countries need to commit to reforming their accounting practices and this includes the all-important incentives for the local cop on the beat, the auditor, to do a good job."

Source: University of Missouri-Columbia

Citation: Accounting practices ultimately affect global economy (2008, May 14) retrieved 2 May 2024 from https://phys.org/news/2008-05-accounting-ultimately-affect-global-economy.html

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