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The limits of accounting standards

Chartered Institute of Management Accountants' Conferring Ceremony

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Ladies and Gentlemen: It is a great honour for me to attend this graduation ceremony. For those of you here – with your exams successfully behind you – tonight must be a great relief.

Since the days when I was studying for my accountancy exams, the complexity of the accountancy world has greatly increased. The explosion in financial innovation, in regulation, and in an ever increasing range of complex financial instruments has made things much tougher. But hopefully the increased complexity has made your qualification tonight more valuable, and the careers it equips you to embark upon more rewarding and interesting too.

You are familiar no doubt with the well worn jokes about accountants. I am not going to tell any.

But I am certainly happier to have qualified as an accountant than I think I would be if I had qualified as an economist. I don't know why I veered towards accountancy rather than economics. Maybe because I could never see value in working for a qualification that would equip me to tell people tomorrow why the things I predicted yesterday didn't happen today. Although having gone into politics subsequently, I did come to realise the value of being able to explain why the things that were promised the day before the election couldn't be delivered the day after it.

Sometimes accountants go into politics to get away from accountancy. If that was my intention when I first stood for election to the Dail 28 years ago, it hasn't quite worked out like that. As Minister for Finance and now as the EU's Internal Market Commissioner I remain knee deep in accountancy issues.

But it couldn't be happening at a more interesting or challenging time.

I am very conscious in my new role of the crucial importance of international cooperation between all key players – those involved in regulation, in supervision, in the oversight bodies and in the profession itself. The world economy and the world's capital markets are more interwoven and inter-dependant than ever. That's why it's important that we all pull in the same direction.

Global growth has been impressive over most of the past 15 years. Corporate performance has greatly improved. This is in part thanks to more incentive-based remuneration structures- especially share options. They have provided a greater stimulus to management teams to deliver shareholder value. But there has been downside to those remuneration structures too. In some instances they seem to have enhanced the temptation and therefore the risk of account manipulation and led to corporate scandals. These scandals do untold damage – way beyond their immediately obvious impact...

They undermine the trust which must at all times be at the heart of financial markets. A small number of high profile misdemeanours – in industry and in the accountancy profession itself- have long term, lasting consequences. The incremental risk premium this gives rise to for investors get priced in to a higher cost of capital for companies.

One of the lasting consequences of the scandals of recent years has been the destruction of one global accountancy business, and a substantial increase in the regulatory burdens and risks for others. The higher professional indemnity insurance costs and higher audit fees that have inevitably followed get passed on to the end-client and then the consumer. Inevitably they also result in directors- executive and non-executive – seeking higher remuneration to compensate for the heightened risks and more onerous regulatory responsibilities that they now face.

I worry that there is a real danger that the downside risks now facing non-executive directors will deter talented and experienced people from sitting on boards and providing their experience and wisdom. There will be no winners from that.

The challenge that regulators face is to tackle mal-practice and lack of transparency without stifling the economy and laying down unnecessary red tape for entrepreneurs. Across most of Europe the business culture is generally ethical compared to many other parts of the world. Standards of corporate governance are generally improving and I believe that the establishment of the Corporate Governance Forum Group will help facilitate convergence in corporate governance standards without necessarily requiring legislative action at EU level.

While we must have a framework that minimizes the risk of fraud and malpractice if we are to sustain and nurture investor confidence, no investor should delude themselves. Tougher regulations and laws may help stamp out *false* accounting. But creative accounting will always be with us - even if recent developments in international accounting standard setting makes it more challenging. That's why the task of the non-executive director, of the fund manager, of the banker, of the supplier or of any other interested party in a company's underlying financial health is to ask the many questions that the published accounts don't answer.

Published accounts will always be like bikinis - much more interesting for what they conceal than for what they reveal -regardless of more exacting accounting standards,

The view that more frequent reporting by companies increases transparency is one about which I am deeply sceptical.

It is too easy to massage a set of quarterly or half yearly figures.

Take a branded goods business. Put it on a brand investment diet for a short time – say one accounting period. That will save costs and boost margins – for that accounting period. But in the next accounting period margins, brand equity, and sales will suffer.

Take a service business. You can skimp on investment in staff training and investment and thereby boost profits in one period. But probably at the expense of customer service quality, loyalty, and profitability in the following period.

Take a manufacturing business. You can stuff distribution channels to the benefit of sales and margins in one accounting period. But it will surely be at the expense of those same sales and margins in the following period.

Take any balance sheet. By manipulating working capital, a company balance sheet that looks cash rich at the end of one quarter could, as you well know, be facing a liquidity crisis in the following quarter.

That is to say nothing of the manipulation opportunities from capitalization of expenses as assets in the balance sheet that might more appropriately have been expensed as costs in the profit and loss account.

Some changes in accounting rules may have reduced the scope for some of these practices. But none has stopped them- nor are they likely to.

That's why wherever you plan your future career – be it in banking, fund management, industry or anywhere else, never let satisfaction about a business's compliance with the fine print of accounting standards overcloud your better judgements about the underlying commercial realities.

The best way to capitalize on the qualification you are receiving today is to be able to support it with a good nose – and sound, commercial common sense. To be able to ask the searching, non-accounting questions. To understand the dynamics of the businesses you work with or work for. To understand their market and competitive positions; the strengths they have and the threats they face. And to be able to assess the calibre of their management. These things are at least as important as understanding the make up of the numbers.

Many people who have obtained the qualification you have received tonight have gone on to achieve great things. The opportunities at home -and abroad- have rarely been greater. I wish you well in what I hope will be long and promising careers for all of you, and enjoy the rest of the evening.