

The role of private actors in global governance and regulation: US, European and international convergence of accounting and auditing standards in a post Enron world

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Introduction

Discussions of international economic and financial governance have generally focussed on the role of international institutions set up by governments, such as the International Monetary Fund (IMF), the World Bank and the Bank for International Settlements (BIS). However, the collapse of Enron and other financial scandals in the US, the demise of the global accountancy firm Andersens, and, more recently, major financial scandals involving European companies such as Ahold, Allied Irish Banks and Parmalat, have focussed attention on national, European Union (EU) and international frameworks for setting, monitoring, and enforcing compliance with accounting and auditing standards. A key factor in stimulating current debates at national, EU and international level has been the controversial US Sarbanes-Oxley Act 2002. The Act was designed to improve US accounting, auditing and corporate governance practices post-Enron. However, the Act has had a considerable impact on other jurisdictions.¹

International accounting and auditing standards are an essential, though often overlooked, aspect of the international financial architecture. Post-Enron hitherto obscure private actors² with links to the accountancy profession and concerned with technical accountancy practices have been subject to an unprecedented degree of attention and scrutiny, not least by academics and policy makers. Key accounting and auditing standard bodies at the international level are the International Accounting Standards Board (IASB), which assumed its present role from 1 April 2001, and the International Auditing and Assurance Standards Board (IAASB), which assumed its present role from 1 April 2002.³ The IAASB functions as independent standard setting body under the auspices of the International Federation of Accountants (IFAC). The IASB sets

¹For a review of EU policy developments in accounting, auditing and corporate governance before and after Enron, see Dewing & Russell (2004).

²The extent to which such organisations are, in fact, independent of government is an interesting question that will be explored further in the paper. In this paper the term private actor is used but similar terms used in the literature are non-state actors (NSAs) or non-governmental organisations (NGOs).

³It is outside the scope of the paper to describe the history of these bodies, outlines of which can be found in the relevant chapters of standard international accounting textbooks such as Nobes & Parker (2004) and Roberts et al (2002), and on the IASB and IFAC websites www.iasb.org.uk and www.ifac.org respectively. The paper concentrates on the current role of these bodies after their reform with effect from 1 April 2001 and 1 April 2002 respectively. The IASB was formerly known as the International Accounting Standards Committee (IASC).

International Financial Reporting Standards (IFRSs) and the IAASB sets International Standards on Auditing (ISAs).⁴ At the EU level, after long and complex debates, all EU listed companies are required to prepare consolidated financial statements in accordance with IFRSs from 2005, and it is proposed that all statutory audits in the EU should be undertaken in accordance with ISAs from 2005.

The *de facto* alternative to international accounting and auditing standards are the equivalent US standards. A major reason for this is because non-US companies seeking a stock exchange listing in the US are required to comply with US listing requirements, which includes providing consolidated financial statements prepared and audited according to US accounting and auditing standards. Thus, a non-US company listed in the US has to prepare two sets of audited accounts: one set based on the requirements of its home jurisdiction; the other set based on US requirements. The powerful US Securities and Exchange Commission (SEC) is the federal agency that regulates US capital markets. US accounting standards are set by a private body, the Financial Accounting Standards Board (FASB), and are known as Financial Accounting Standards (FASs). The FASB is recognised by the SEC as the US accounting standard setting body. US auditing standards are set by the Public Company Accounting Oversight Board (PCAOB) and are known as simply as Auditing Standards.⁵ The collection of recognised accounting and auditing standards and practices are often referred to as US Generally Accepted Accounting Principles (US GAAP) and US Generally Accepted Auditing Practices (US GAAS) respectively.⁶

The US has consistently chosen not to recognise international accounting and auditing standards as equivalent to its own. However, with the EU moving to endorse international standards and the weaknesses of US standards exposed by Enron and other financial scandals, one of the key issues

⁴Prior to the reconstitution as the IASB, the IASC standards were known as International Accounting Standards (IASs) most of which are still extant. For simplicity this paper generally refers to IFRSs, but uses the specific title when referring to a specific standard.

⁵The PCAOB was established on 1 January 2003 as a result of the Sarbanes-Oxley Act 2002. Prior this date US auditing standards were set by the American Institute of Certified Public Accountants (AICPA).

⁶By extension, it has become standard to refer to national practices as, for example, UK GAAP and UK GAAS, and increasingly to refer to International GAAP and International GAAS.

is the extent to which US and international procedures for setting, monitoring, and enforcing compliance with accounting and auditing standards will converge post-Enron. An important related question is the nature of any convergence.

The objective of this paper is to explore extent to which US and international accounting and auditing standards will converge post-Enron, and the nature of any convergence, and the role of key private and other actors in the process. The paper is structured as follows: the first section investigates the nature of two key private actors, the recently reformed IASB and IAASB, in international accounting and auditing standard setting; the second section discusses the EU's adoption of international accounting standards, especially the controversy over the adoption of IAS 39 *Financial Instruments: Recognition and Measurement* in the EU, and convergence between US and international accounting standards; the third section is a wider discussion of the role of key private and other actors in the global governance and regulation of accounting and auditing. The final section is a short conclusion.

IASB and IAASB

The International Accounting Standards Committee Foundation (IASC Foundation) is the oversight body for the IASB. The objectives of the IASC Foundation are stated its constitution as:

- (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- (b) to promote the use and rigorous application of those standards; and
- (c) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

(IASC Foundation, 2002, para. 2)

The IASC Foundation comprises 19 trustees drawn from regional groupings: North America (6); Europe (6); Asia-Pacific (4); and other (3). The chairman of the trustees is currently Paul Volcker, former Chairman of the Board of Governors of the US Federal Reserve System. The constitution of the IASC Foundation provides that the trustees shall appoint 14 members of the IASB and shall:

select members of the IASB so that it will comprise a group of people representing, within that group, the best available combination of technical skills and background experience of relevant international business and market conditions in order to contribute to the development of high quality, global accounting standards.

(IASC Foundation, 2002, para 20.)

The structure of the organisation of the new IASB with effect from 1 April 2001 is 'designed to support those features that are regarded as desirable in establishing the legitimacy of a standard setting organisation its members are technically expert, represent the wider community and are independent'.⁷ The IASB has a due process for developing and approving IFRSs. An IFRS is finally approved by a majority eight of the 14 IASB members voting on a one member one vote basis.

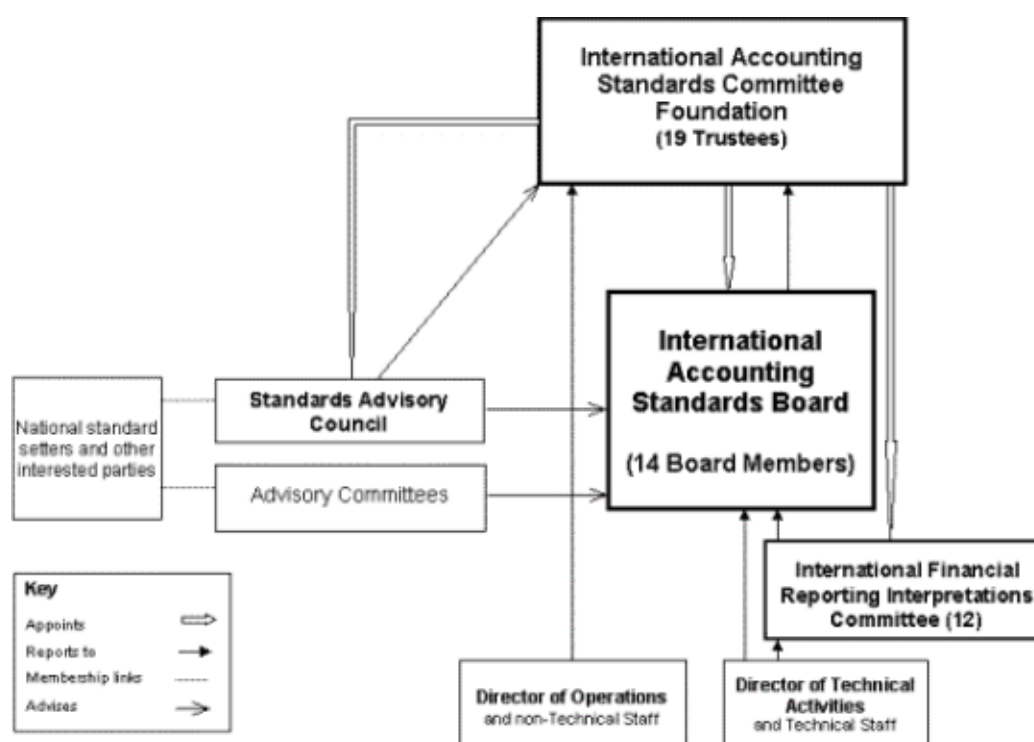
The IASC Foundation and the IASB are advised by a Standards Advisory Council (SAC) which consists of about 50 members each appointed for a period of three years and provides a forum for organisations and individuals with an interest in financial reporting. The current members are principally drawn from national accounting standard setting bodies and come from countries and regions as follows: Africa (2); Asia, excluding Japan (8); Australia and New Zealand (2); Canada and United States (10); Central and Eastern Europe (3); EU, that is, countries within the EU (12); Japan (2); Latin America (3); Middle East (1). In addition, there is a member from each of the international organisations as follows: Basel Committee on Banking Supervision (BCBS); IFAC public sector committee; International Association of Insurance Supervisors (IAIS); IMF; and

⁷www.iasb.org.uk/about/structure.asp

International Association of Securities Supervisors (IOSCO)⁸; and the World Bank. Finally, the following organisations have observer status on SAC: European Commission (EC); Financial Services Agency, Japan; and US SEC.

The International Financial Reporting Interpretations Committee (IFRIC) reviews accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance. This may arise from newly identified financial reporting issues not dealt with in IFRSs, or issues where unsatisfactory or conflicting interpretations have arisen. IFRIC is a technical advisory committee and its non-voting chairman is Kevin Stevenson, the IASB's, Director of Technical Activities and former executive director of the Australian Accounting Research Foundation. Its 12 members are primarily practitioners and/or closely involved with national accounting standard setters. In addition, the EC and IOSCO have observer status IFRIC.

The organisation structure of IASB and the links between the various committees are as follows:



⁸There are currently 2 members of SAC from IOSCO.

It would be interesting to explore in detail the career paths of and the networks to which members of the IASC Foundation, IASB, SAC and IFRC belong and have belonged.⁹ The most detailed information about members' backgrounds is available for IASB members. Nobes & Parker (2004, p. 192) comment that the IASB 'is heavily dominated by former Anglo-Saxon standard setters'. Of the current members 10 are from Anglo-Saxon countries, including the chairman and vice-chairman. The current chairman, Sir David Tweedie, was *inter alia* the former chairman of the UK Accounting Standards Board (ASB), and the current vice-chairman, Thomas E Jones, was *inter alia* a trustee of the Financial Accounting Foundation which oversees the work of the US Financial Accounting Standards Board. The Anglo-Saxon influence should not be underestimated since the four non-Anglo-Saxon members have had considerable exposure to Anglo-Saxon accounting practices. Thus, Hans-George Bruns was formerly in charge of introducing US GAAP at Daimler-Benz and head of the project for listing the company's shares on the New York Stock Exchange; Jan Engstrom's career was with the Volvo Group, now owned by Ford, where he served as a chief financial officer; Gilbert G  llard has worked with both Arthur Andersen and KPMG; and Tatsumi Yamada was formerly a partner with a Japanese accountancy practice associated with PricewaterhouseCoopers.

Before considering the IAASB, it is necessary briefly to consider its parent body IFAC. IFAC is the world-wide organisation for the accountancy profession. It made up of 156 member organisations in 120 countries.¹⁰ IFAC's mission is:

To serve the public interest, strengthen the worldwide accountancy profession, and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public-interest issues where the profession's expertise is most relevant.

(IFAC, 2004, p. 3)

⁹Again this is beyond the scope of the paper.

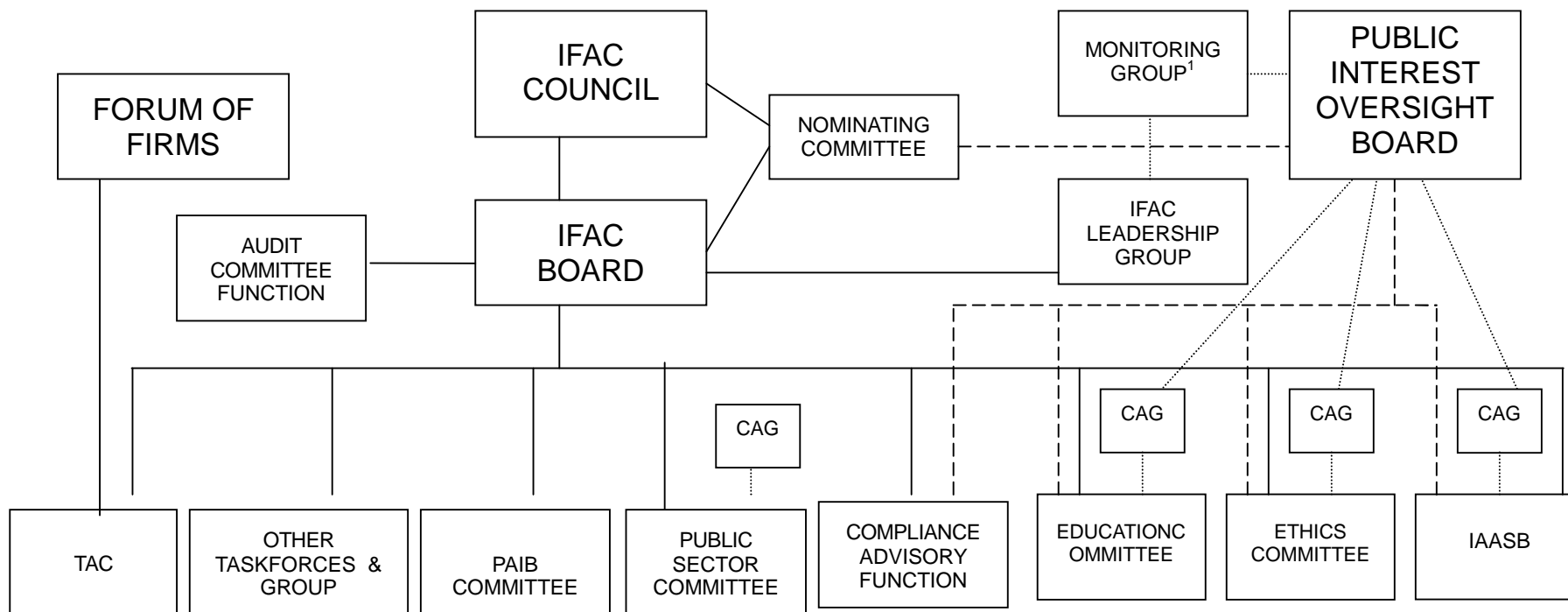
¹⁰The discrepancy is because there may be more than one professional accountancy body in a country, for example, the UK has five and the US three recognised professional accountancy bodies.

To carry out its mission it works closely with 'members bodies and regional accountancy organisations' and in additions obtains 'the input of regulators, standard setters, governments, and others' who share IFAC's commitment 'to creating a sound global financial architecture' (IFAC, 2004). IFAC is governed by a Council which is comprised of one representative from each of IFAC's member bodies. The Council elects the Board which is comprised of the President and 21 individuals from 19 countries. The main work of IFAC is undertaken by other boards, committees and task forces including: Compliance Advisory Panel; Education Committee; Ethics Committee; IAASB; Professional Accountants in Business Committee; and Transnational Auditors Committee (TAC). The TAC is the most recently established and is the executive committee of the Forum of Firms (FoF). Each of the key committees is advised by a Consultative Advisory Group for that committee. The IAASB is the most relevant to this paper, and is the only committee that can issue pronouncements without the approval of the IFAC board. Before discussing the IAASB it is necessary to consider the FoF.

The FoF and its executive committee TAC are relevant to this paper because of the influence of international accountancy firms in the setting, monitoring, and enforcing compliance with accounting and auditing standards (see FoF, 2004). The Fof and TAC were established in 2001 to represent the interest and meet the needs of accountancy firms undertaking audits of cross-border financial statements. The objectives of the FoF *inter alia* include: 'encouraging the use of ISAs and IFRSs as a step towards the global harmonization of accounting and auditing standards'; 'developing an enhanced dialogue between the firms and international regulators and other financial institutions; and 'encouraging the convergence of national systems of regulation' (FoF, 2004, p.2). The TAC acts as the FoF vehicle to 'improve the quality and consistency of auditing practices worldwide', and its responsibilities include: recommending changes to international auditing or assurance standards; provide a forum to discuss auditing 'best practices'; propose and identify members and candidates for IFAC committees; act as a formal conduit for interaction among transnational firms, international regulators and financial institutions for audit quality,

quality control of audits and transparency of international networks of accountancy firms (FoF 2004, p.3).¹¹ The organisation structure of IFAC is as follows:

¹¹There is also a proposal to establish a Public Interest Oversight Board (PIOB) (IFAC, 2003) to oversee the work of the Education and Ethics Committees and IAASB but at the time of writing the PIOB is still in the process of being established.



KEY	
ACCOUNTABILITY	—————
OVERSIGHT	- - - - -
CONSULTATION/ ADVICE

¹ The Monitoring Group's ongoing relationship with the PIOB will be one of consultation and advice (Section 3), however, it will also have appointment powers and the authority to conduct effectiveness reviews (Section 13).

The IAASB is part of IFAC but acts on its own authority. The IAASB's objective is:

To serve the public interest by setting, independently and under its own authority, high-quality auditing, assurance, quality control and related service standards and by facilitating the convergence of national and international standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

(IAASB, 2004, p. 1)

From 1 April 2002, the structure of the new IAASB comprises of 18 members, ten of whom are put forward by member bodies of IFAC, five are put forward by the FoF and three public members. The public members may be members of IFAC member bodies but may not be in public practice. The Chair's report comments that: 'The new Board continues to have broad geographic representation – Europe, the Americas, Asia Pacific and Africa' (IAASB, 2004, p. 8).

Unlike the IASB, the IAASB does not provide details of the details of members backgrounds, other than that of members' countries.¹² Advice to the IAASB is structured differently to the way advice is provided to the IASB. The IAASB is advised by a total of 15 technical advisers. In addition, the IAASB has its own CAG which comprises 21 members drawn from international organisations and trade associations as follows:

¹²Membership by region and country is in fact is Europe – 8 members; the Americas – 5 members; Asia Pacific – 4 members; and Africa – 1 member (IAASB, 2004, p. 15).

Association of Investment Management and Research
 Basel Committee on Banking Supervision
 Council of the Bars and Law Societies of the European Union
 European Banking Federation
 European Commission
 European Federation of Accountants and Auditors for SMEs
 European Federation of Financial Executives' Institutes
 European Federation of Investment Funds and Companies
 European Financial Reporting Group
 European Savings Banks Group
 Fédération des Experts Comptables Européens
 Federation of European Stock Exchanges
 Information Systems Audit and Control Association
 Institute of Internal Auditors
 International Accounting Standards Board
 International Actuarial Association
 International Association of Insurance Supervisors
 International Bar Association
 International Monetary Fund
 International Organisation of Securities Commissioners
 International Organisation of Supreme Audit Institutions
 United Nations Conference on Trade and Development
 World Bank
 World Federation of Exchanges

Source: IAASB (2004, p. 16)

It can be seen that the IAASB has a greater range of trade associations involved in a formal advisory capacity. The following international organisations are members of both the IASB's SAC and the IAASB's CAG: BCBS; IAIS; IMF; IOSCO and the World Bank. Interestingly, the EC is only an observer on the former, but is a member of the latter.

In 1995, the IASB and IOSCO agreed to work on a 'Core Standards' programme whereby financial statements prepared in accordance with IFRSs can be used in cross border stock market offerings and listings as an alternative to national standards. At the same time the EC also proposed a new strategy for EU accounting harmonisation based on international accounting standards developed by the IASB (EC 1995). Considerable progress was made and in 2000 the Presidents' Committee of IOSCO recommended that IOSCO members permit multinational issuers to use the 30 IASB 2000 standards to prepare financial statements for cross-border offerings and listings (IOSCO, 2000). In 2002 the EU adopted a regulation requiring EU listed companies to prepare their consolidated financial statements in accordance with IFRSs from 2005

onwards (EP&C 2002). An important feature of the regulation was the establishment of a 'political oversight' mechanism to assess the IFRSs adopted by the IASB and to give them legal endorsement within the EU (EC 2002a).¹³ In the IASCF 2003 annual report, the chairman of trustees Paul Volcker noted that, with the addition of the countries of the EU, 'By the beginning of 2005, nearly 100 countries in six continents will be using IFRSs directly, or are aligning national standards with IFRSs' (IASC Foundation, 2003, p. 1).

The US is the most important country that does not yet recognise IFRSs. During the work on IASB/IOSCO core standards programme the FASB published the results of an IASB-US comparison project and the SEC, building on the FASB's work, issued a concept release on international standards for comment (FASB 1999; SEC 2000 respectively). Although this work was pre-Enron, it signalled that SEC and US concerns are not only about accounting standards *per se* but about the wider structures surrounding financial reporting, of which accounting standards are but one element. This is still the emphasis post-Enron, as emphasised for example in a speech by Robert Herdman, then Chief Accountant at the SEC (Herdman 2002). Thus, the SEC is concerned about:

- High quality accounting standards
- High quality auditing standards
- Audit firms with effective quality controls
- Profession-wide quality assurance
- Active regulatory oversight

The next section deals with the first of these issues, that is, accounting standards post-Enron, which tends to receive the most attention and publicity. The following section deals with the wider structures surrounding financial reporting post-Enron, that is, auditing and regulation of the accountancy and auditing profession. These other, equally important, issues tend to be overlooked in academic and public debate. In each case the focus is on the extent of convergence

¹³The process of approving IFRSs for adoption in the EU is considered in the next section.

between US and international standards and the nature of that convergence, and the role of the EU and the EU's experience of adopting international standards.

IASB and international accounting standards

The Sarbanes-Oxley Act 2002 was designed to remedy deficiencies in accounting, auditing and corporate governance revealed that were revealed by Enron and other financial scandals. The Act has had a major influence on practices in the US, and directly and indirectly on practices in other jurisdictions. Faith in US accounting standards hitherto regarded as the 'best in the world' was shaken. US standards were castigated as too 'rules-based'. The alternative was the more 'principles-based' international standards. In October 2002, not long after the passage of the Sarbanes-Oxley Act, the IASB and the FASB announced a memorandum of understanding (the 'Norwalk Agreement') whereby: 'each acknowledges their commitment to the development of high quality, compatible accounting standards that could be used in for both domestic and cross-border financial reporting' and that each would use 'their best efforts to (a) make their existing financial reporting standards fully compatible as soon is practicable and (b) to coordinate their future work programs to ensure that one achieved, compatibility is maintained' (FASB/IASB 2002). This initiative was strongly encouraged and supported by the EC, and Commissioner Frits Bolkestein enthusiastically welcomed, perhaps prematurely, the announcement stating it was: 'a very positive move towards a single worldwide set of high quality, best of breed, principles-based financial reporting standards, which would dramatically improve the efficiency of global capital markets...' (EC, 2002b).

The IASB proceeded with two main developments: first, to complete the '2005 standards', so that by the end of March 2004 the IASB would have a broad set of high quality standards in place that could be adopted for use by the EU from 2005; and, second, to work on the eventual convergence of US and international financial reporting standards. As regards the former, the IASB's aim was to produce a 'stable platform' whereby only those standards issued prior to March 2004 would apply in 2005. Any standards issued after that date would not be applicable until 2006. Thus,

there would be 'period of calm' for about 21 months such that there would be no changes to standards during the period of changeover from national to international standards in the EU. As regards the latter, the IASB and FASB have set up a joint 'short-term convergence' project to examine differences between US and international standards that may be capable of resolution within a relatively short time. If convergence in the short term proves to be too difficult, consideration of the topic is deferred to a discrete project.

This section next investigates the process of adoption of international accounting standards in the EU, followed by consideration of the convergence of US and international accounting standards.

The EU and the adoption of international accounting standards

It is *not* the case that when the IASB issues a standard, it is automatically accepted by the EU. The EU has established a 'political oversight' mechanism for endorsing international accounting standards (see EC, 2002a; EP&C, 2002). An standard can only be approved for use in the EU if :

- it is not contrary to the overriding 'true and fair' principle established in the 4th and 7th Accounting Directives;
- it is 'conducive to the European public good'; and
- it meets basic criteria as to the quality of accounting information to be useful to users. (EP&C, 2002, para. 9 and Article 3)

Crucial to the process is the opinion given by the Accounting Regulatory Committee (ARC).¹⁴

The EC provides the chair and secretariat of ARC. ARC is made up of representatives of government department(s) of the member states having responsibility for accounting and company law matters. Observers on ARC include the European Central Bank, the Banking Advisory Committee, the Committee of European Securities Regulators (CESR) and the Insurance Committee. ARC is advised by the European Financial Reporting Advisory Group

¹⁴The ARC was established specifically to provide advice to the EC about endorsement of international accounting standards for use in the EU (EPC, 2002, Article 6).

(EFRAG) established by private sector initiative to advise ARC. EFRAG is made up of a Supervisory Board consisting of representatives drawn from a variety of European trade and professional organisations, and a Technical Expert Group (TEG) consisting of representatives from the accounting standard setting authorities of the member states.

Thus, an IASB standard is further reviewed for suitability for adoption within the EU via a political oversight process whereby: first, EFRAG provides endorsement advice and recommendations for the EC; second, these are considered by EC which submits its proposal to the European Parliament and to the ARC; if, in the ARC there is a majority of member states in favour of the proposal, and, once the opinion of the European parliament is known, the EC formally decides on the applicability of the international standard in the EU and issues the appropriate Regulation (EC 2001a; 2001b). This process was followed and the EC had endorsed virtually all international accounting standards by April 2004 (see EC 2003; 2004a), leaving IAS 39 as the only significant standard needing further consideration.

IAS 39 deals with a complex area of accounting and, after lengthy debate and discussion, the EC supported by the ARC eventually endorsed IAS 39 but subject to two 'carve outs', and issued a Declaration about the matter (see ARC, 2004; and EC, 2004b,c,d). The issue for this paper is not to judge the technical rights and wrongs of the standard, but to consider the 'political' consequences of the EC decision.¹⁵ The main reason for the EU to adopt international accounting standards pre-Enron, and actively to support seeking convergence between US and international standards post-Enron, is to achieve recognition of single set of accounting standards which can be used for cross-border offerings and listings world wide. This goal is undermined if a country or regional group opts out of or in some way alters a standard already issued by the IASB after due process.

Although the EC has presented its reasoning in detail, the perception in the economic and financial press was that the EC's decision was 'political' as a result of intense lobbying by

¹⁵Readers wishing to find an overview of the accounting issues and the EC's reasons for its decisions are referred to EC (2004d).

European vested interests. *The Economist* (2004, p. 83-84) reported on the 'continuing rumble' over international accounting standards and the EC endorsement of IAS 39:

It had been the subject of a row between the IASB and the EU for months, and was accepted only after the commission won over the most vocal critics, including the European Central Bank and much of Europe's financial industry, by deleting passages of IAS 39 to create a looser version of the rule.¹⁶

The article went on to note that several European banks, such as HSBC and UBS, stated they will use the full IASB standard and that some companies listed in the US, where the corresponding rules are 'stricter', are likely to follow on the basis that capital markets are likely to reward those adopting the 'toughest' standards. Another criticism of the EC is that it failed sufficiently to consider the unintended consequences of its 'carve out'. Danish regulators warned that the EC's compromise could 'destable' the Danish financial system (*The Economist*, 2004). UK life insurers also complained that it will distort their accounts (Felsted, 2004).

A more important issue is that of setting a precedent. If the EU, seen as the most committed to supporting international accounting standards, opts out of implementing them fully not only may the EU seek to amend future standards, but other countries in the process of adopting international standards, such as China and Japan, citing the EU as a precedent, may also seek to make amendments to reflect their special circumstances. In this respect Sir David Tweedie, Chairman of the IASB, has gone on record in an interview with the *Financial Times* saying that international accounting standards to be developed over the next 3-5 years would be on controversial topics, and that the challenges to come would 'dwarf' those already encountered. Current problems would be seen as a 'blip' in comparison. Looking to the future and referring to the expected uproar from companies over the new standards, Sir David warned 'there will be blood all over the streets' (Tricks & Hargreaves, 2004).

¹⁶The *Economist* article also noted the 'intense lobbying' was conducted 'especially by French banks'.

Finally, the EC decision has not even resolved the issue of achieving a harmonised IAS 39 within the EU. The UK ASB stated it has been following a policy of convergence towards the unamended IAS 39 and will continue to do so and announced that: 'Notwithstanding the EU's decision, the Board has decided to continue with that strategy'. The ASB intends shortly to issue 'a UK standard implementing in full the requirements of the ... unamended IAS 39' (ASB, 2004).

The convergence of US and international accounting standards

Post-Enron and other financial scandals, there has been a concerted effort on the part of the FASB and the IASB, supported by other national standard setters, such as the UK ASB, and encouraged at inter-government level by, for example, the EU and IOSCO, to seek convergence between US and international accounting standards. This has received a set back, arguably temporary, with EU adopting IAS 39 after a 'carve out' of two of its provisions. However, the question remains as to the nature of the convergence. Will it be towards US GAAP, or will there be a genuine dialogue whereby alternatives receive genuine consideration and recognition?

The principal criticism of the US approach is that it is 'rules-based' rather than 'principles-based'. The advantage of a rules-based approach is that requirements are set out in detail and compliance with the rules can be more easily monitored and enforced; the disadvantage is that there are strong incentives to create financial transactions and accounting treatments designed to avoid the rules and corresponding disclosures (see Dewing & Russell, 2004, p. 301). The advantage of a principles-based approach is that it allows greater scope for professional judgement in evaluating the overall effect of a series of individual transactions and disclosures (in other words, is the result more than the sum of its parts?); the disadvantage is that decisions are not so obviously clear cut and there is scope for professional disagreement. In practice, both approaches are needed but different legal and institutional environments have resulted in rules-based emphasis in the US and a principles-based emphasis in the UK, an interesting difference in what is often perceived to be an undifferentiated Anglo-Saxon approach.

Therefore, whether convergence is rules-based or principles-based is an important one. An interesting aspect of the Sarbanes-Oxley Act was section 108(d) which required the SEC to conduct a study on the adoption in the US of a principles-based accounting system, and stated that the study should include an examination of:

- the extent to which principles-based accounting and financial reporting exists in the United States;
- the length of time required from a rules-based to a principles-based financial reporting system;
- the feasibility of and proposed methods by which a principles-based system may be implemented; and
- a thorough economic analysis of the implementation of a principles based system.

The SEC duly reported in July 2003.¹⁷ It acknowledged there was room for improvement, but argued neither US GAAP nor international standards are representative of the 'optimum type of principles-based standards'. The SEC clarified its 'optimal paradigm' for an accounting standard as follows: first, there should be a concise statement of the substantive accounting principle or the 'accounting objective'; second, there should be an appropriate amount of 'implementation guidance'; and, third, the standard should be consistent with, and derive from, a coherent conceptual framework of financial reporting. To distinguish its optimal approach from other less well defined approaches, the SEC referred to its approach as 'objectives-oriented standard setting' (SEC, 2003, p. 5). Thus, by proposing a carefully charted middle course, the SEC (2003, p. 6) was able to advocate a variety of benefits, including facilitating convergence between US GAAP and international standards which it painted in glowing terms:

Standard setters can come to an agreement on a principle more rapidly than they can on a highly detailed rule. The benefits of convergence include greater comparability and improved

¹⁷A full review of the SEC study is beyond the scope of this paper.

capital formation globally. We believe that neither current US GAAP or nor the current array of international standards strike an optimal balance in the various trade offs inherent in standard setting, and thus we see convergence as a process of continuing discovery and opportunity to learn by both US and international standard setters.

This view was confirmed in a speech by Donald Nicolaisen, Chief Accountant of the SEC in which he stated that: 'Convergence is a two-way street... Said another way, convergence does not mean convergence to US standards. ... In converging standards, the standard setters should always choose the better model' (Nicolaisen, 2004). In practical terms, following the Norwalk Agreement, the FASB and IASB are working together on several major projects, as well as on a 'short term' convergence project. The initial signs are promising that there will be a genuine convergence or 'friendly merger' of US and international accounting standards as opposed to a 'hostile takeover' by US GAAP.

Discussion

There cannot be many private actors that can expect the rules they propose to be speedily adopted into the laws or regulations of nearly 100 countries, and countless companies across the globe be required to comply with them, including 7,000 companies approximately in the EU alone and many of the world's largest multinationals,. From 2005 this will be the case for international accounting standards set by the IASB for the regulation of financial reporting. The US will shortly be the only significant economy where international accounting standards are not recognised. However, within a few years, as international and US standards are set to converge, these, or comparable, standards are likely to be accepted by the US and applied to US companies. Moreover, it is expected that another set of rules established by another private actor, that is IAASB which is a subcommittee of IFAC, will soon be setting international auditing standards for the regulation of the audit of financial statements on the same basis. The aim of the discussion is to investigate how this has come about. The discussion is taken forward in two main parts.

First, it is necessary to set international accounting and auditing standards within the wider context of increasingly integrated and liberalised global financial markets and the supporting international financial architecture, especially as concerns the regulation of securities markets and supervision of financial services firms such as banks and insurers. This highlights a variety of state, private and 'mixed' actors operating at national, regional and international levels. Second, it is important to explore the bases on which convergence in international accounting and auditing standards is taking place. In particular, it considers power relations and the extent to which convergence is based on US hegemony and/or projection of US power, or whether a genuine international debate is taking place.

Private and state actors

Originally established by the world-wide accountancy profession, recent reforms of IASB and IAASB and other developments have had the effect of distancing these bodies from the accountancy profession. This has occurred in a variety of ways: oversight and advisory mechanisms have been strengthened by increased representation from outside the profession; they are able to issue international standards on their own authority; and their deliberations and pronouncements are subject to greater prominence and attention by others, partly because of the globalisation of financial markets, partly because IOSCO and EU has either already recognised, or is set to recognise, their standards, and partly because the main alternative, US standards, have been found wanting post-Enron.

The question to be explored is - how have hitherto obscure private actors the IASB and IAASB achieved their current authority and legitimacy? Following Strange (1994,1996) it can be argued that the source for their authority and legitimacy is the shift from relational power, that is power held by governments and states, to structural power, that is power held by markets, and, in particular, to the knowledge structure, that is power based on organised expertise, in this case of the accountancy profession (see Dewing & Russell, 2004, pp. 309-310). However, possession of organised expertise by private actors does not of itself automatically lead to a position of

dominant power and influence. Indeed, to understand the dominant role of private actors in setting international accounting and auditing standards, it is essential to consider the role of states.

In this context professions are key.¹⁸ The bargain between states and professions is that in return for the state granting special recognition over an area of expertise to a professional body¹⁹, the profession agrees to regulate its members and to act in the 'public interest', that is to maintain professional standards and not to exploit its privileged position.²⁰ The state confers legitimacy, the price is accountability. A not dissimilar bargain is struck between states and limited liability companies – the state confers limited liability, the price is independently audited accounts made publicly available. The state authorises that only members of recognised professional accountancy bodies may undertake audits of limited liability companies.

Thus, the details of accounting and financial reporting and auditing of limited liability companies are entrusted to a profession having special expertise which, to retain its privileged position, regulates its members and has regard to the public interest. A government department is given ultimate oversight of the accountancy profession and of limited liability companies. The result is a civil society or, alternatively, market arrangement of self-regulation within a statutory framework whereby the state consciously recognises the accountancy profession and consciously grants it a monopoly over limited liability company audit. Regulation of other areas of commercial activity, for example, stock exchanges, supervision of financial services firms such as banks and insurers, though having their own statutory framework with oversight by different government departments or other agencies, rests on independently audited accounts of limited liability companies. The result is that the accountancy profession, and accounting and auditing firms, although private actors are in effect agents of the state.

¹⁸There is a large but arguably dated literature on the sociology of the professions, and the accountancy profession has been relatively little studied by sociologists. Our discussion follows a traditional, stylised and Anglo-Saxon view of professions. It focuses mainly on the 'deal' made by the profession with the state in return for state recognition.

¹⁹For example, in the UK this was achieved by the granting a Royal Charter. The first UK accountancy body to be granted this status was the Institute of Chartered Accountants of Scotland in 1854.

²⁰The professional body may not necessarily be granted a monopoly position, but state recognition gives status which enhances fee earning opportunities.

This analysis is less clear cut in practice since, as the history of financial scandals demonstrates, the accountancy profession and accounting and auditing firms are more than capable of pursuing their own interests. States regularly have to step in to reform matters. Enron is simply the latest in a long line of 'failure followed by reform' (see also Dewing & Russell, 2002).

Thus, we argue that the fundamental reason why the IASB and IAASB as private actors have achieved global prominence is that it states are simply doing at a global level what they are do at a national level, that is, taking advantage of the standard state/profession bargain whereby the state grants special recognition over an area of expertise to a profession, and the profession agrees to regulate its members and to act in the public interest. It is not without good reason that 'public interest' occurs in the first line of statements of the mission or objectives of the IASC Foundation, IFAC and IAASB. Nor is it without good reason that the only organisations having membership of both the IASB's and IAASB's advisory groups are precisely those inter-governmental organisations in charge of the international financial architecture, namely, BCBS, IAIS, IMF, IOSCO and the World Bank.²¹ International accounting and auditing standards are at the very heart of the international financial architecture.

US hegemony – weakened or strengthened?

The initial signs are that the US, or at least the SEC, is prepared to view convergence towards high quality, objectives-oriented accounting standards as a 'two-way street', the question remains as to what will be the nature of the outcome. US hegemony prevails over intergovernmental organisations, see for example Foot et al (2003), and it can be argued that US hegemony will also prevail over private actors in international accounting and auditing. This may occur for a variety of reasons. First, individual members of the IASB and IAASB come from a background that, if not predominantly US, is predominantly Anglo-Saxon.²² Second, members of the advisory groups are precisely the intergovernmental organisations that stand accused of being dominated

²¹There is also the EC which is an observer on the IASB's advisory group and a member of the IAASB's advisory group.

²²This is especially true of members of IASB, see previous discussion.

by the US, especially the IMF and the World Bank. Third, standing behind the accountancy and auditing profession are the Big Four global accountancy firms,²³ which dominate the market for listed company audit and the national professional bodies and associated institutions. The Big Four and virtually all other large and medium sized accountancy firms that have an international practice have strong Anglo-American origins. Neither should it be forgotten that many of those who qualified and worked for the Big Four and other accountancy firms, move into positions of responsibility and influence elsewhere.²⁴ Certainly the Big Four take advantage of this fact and cultivate their alumni as assiduously as any ivy-league university or business school.

The result is that Anglo-Saxon accounting and auditing practice is commonly regarded without question as 'best practice', thus achieving US hegemony without the US needing to try very hard. This is further reinforced by the SEC's continuing belief that, in spite of acknowledged limitations, US accounting standards are still the 'best' in the world: 'In the staff's view US generally accepted accounting principles ('GAAP'), despite being the historical product of a mixture of standard setting approaches, constitutes the most complete and well developed accounting standards in the world' (SEC, 2004, p. 5). Thus, although the SEC may state that convergence between US and international standards is a two-way street, in practice the presumption may continue to be that even with the cards stacked in its favour, it is the US view that should count in the event of disagreement. This is why the EC 'carve out' to achieve acceptance for IAS 39 is potentially damaging to convergence between US and international standards as the EU is not prepared to accept even agreed international standards.

Finally, the US can still choose to achieve its aims by acting unilaterally, and even in accounting and auditing can 'project' its power. The most dramatic recent illustration of this is the Sarbanes-

²³They are in alphabetical order: Deloitte Touche Tohmatsu; Ernst &Young; KPMG; and PricewaterhouseCoopers.

²⁴In the context of this paper, an interesting example from the UK is John Tiner, Chief Executive of the UK's Financial Services Authority (FSA). Formerly he was head of Andersens world wide financial services industry practice. In this capacity he led an investigation into the Bank of England's procedures following the failure of Barings Bank and was instrumental in introducing a risk-based approach to bank supervision. He joined the FSA in 2001 as a managing director and became its Chief Executive in 2003. He is currently Chairman of the financial reporting group of the EU's Committee of European Securities Regulators. In this capacity he has been described as the 'Hand that guides EU accounting reform' (Parker, 2004).

Oxley Act 2002. Foreign accountancy firms that are involved in preparing or furnishing an audit report for US companies subject to US securities laws come within the scope of the Act.²⁵

Foreign companies reporting under US securities laws, and their auditors, are also subject to the requirements of the Act. Concern has been expressed in the EU and also Japan about the imposition of US regulations on auditors and companies of other jurisdictions. For further details and discussion of the Sarbanes-Oxley Act 2002 and the EU response, see Dewing & Russell (2004).

In drawing the threads of this discussion together it is helpful to refer to a study by Moran (1991) who investigated the financial services revolution of the 1980s in the US, UK and Japan from a politics perspective. Although several international financial crises and several 'failure followed by reform' cycles have since occurred, Moran's findings are of relevance to this paper. From his study of trends in financial services regulation in the 1980s Moran noted the following developments: 'the growing similarity of practices and of institutions in financial centres that once had highly distinctive regulatory regimes; the central part played by state agencies in the process of change; the way all this has altered the bias to meso-corporatism in financial services; and the increasing "Americanisation" of regulation' (p. 121). Meso-corporatism differs from traditional corporatism and has the following key features: 'the appropriation of a regulatory role by private interests; the transformation of private, voluntary associations into authoritative bodies; the restriction of economic and political competition' (p. 6). Moran (1991, further argued that there exists a bias to meso-corporatism in the financial services since 'it marks a compromise struck between demands to regulate private power and wealth, and the needs of privileged private interests to have protection against democratic politics' (p. 6). The subsequent growth in the size

²⁵A US subsidiary incorporated in foreign jurisdiction is audited under the laws and regulations of that jurisdiction. Its auditor is subject to the regulatory requirements of that jurisdiction. However, the Act requires such auditors also register in the US and be subject to US requirements for the regulation of auditors.

complexity and interdependence of global financial markets has served only to intensify the trends identified by Moran.

This paper has noted the sudden rise to prominence post-Enron of hitherto obscure private actors the IASB and the IAASB which set international accounting and auditing standards. It has investigated the nature of the IASB and IAASB and has explored their close links with other private actors, in particular their direct and indirect links with the accountancy profession and the Big Four global accountancy practices, on the one hand, and, their close links with inter-governmental actors responsible for the international financial architecture, such as the BCBS, IAIS, IMF, IOSCO, the World Bank and also the EC, on the other. In Moran's terms, the paper has identified the need to locate the IASB and the IAASB in a rich meso-corporatist regulatory space. The paper has also explored the likely nature and extent of convergence between US and international accounting and auditing standards. The initial signs are that convergence could be possible under mutually agreed objectives-oriented approach. However, the extent to which it happens will to a large extent depend on the EU accepting international standards without further amendment. Americanisation, to use Moran's term, may have received a set-back post-Enron, but US is still more than capable of projecting its power in accounting and auditing, even post-Enron, as the Sarbanes-Oxley Act 2002 illustrates.

Conclusion

The role of public and private actors in global governance is of considerable importance. Studies of the international financial architecture have focussed mainly on the roles of long established public actors, such as the IMF and the World Bank, or on the roles of significant groups of private actors, such as international banks and multinational companies. There is a danger of over-emphasising the distinction between public and private, and not recognising that certain key actors occupy an intermediate position. Professions and their organisations are seen, not without reason, as private actors located in civil society. However, they derive their power and influence from the state and in many instances are in effect agents of the state. In return they agree to

regulate their members and to act in the public interest. In the era of global markets and an ever more complex meso-corporatist regulatory environment, it is arguably necessary to 'bring professions back in' to re-evaluate their economic, sociological and political roles. As intermediaries located in both the private and the public they may be well placed to undertake what 'pure' private or 'pure' state actors, even though constituted as international organisations, are unable to achieve. New light may be shed on the structure of the international financial architecture by examining the role of the accountancy, actuarial and legal professions and their associated organisations and firms.

Thus, there is a need to view the IASB and IAASB not just as independent private actors but as actors strongly linked to the accountancy profession, which in turn should be viewed in the wider context of relationships between professions and states. The worldwide accountancy and auditing profession is a case in point where it or perhaps more correctly the Big Four accountancy firms and their alumni acting in the *public* interest may play a critical but not fully recognised role in maintaining and improving national and international financial architectures. However, it or perhaps more correctly the Big Four accountancy firms and their alumni acting in their own or their clients *private* interests may represent a critical but not fully recognised threat to the stability of these architectures. In taking forward a study of the setting, monitoring and enforcing compliance with international accounting and auditing standards, it is necessary to rethink the role of the profession in international regulation, and the international regulation of the profession.

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