

**Private Authority, Technical Authority, and  
the Globalization of Accounting Standards**

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## **Private Authority, Technical Authority, and the Globalization of Accounting Standards**

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While the globalization of finance has been widely recognized as centrally significant to globalization, and as such to contemporary life more generally, recognition of the role played in globalization by one of the most important aspects of finance—accounting—has mostly been restricted to practitioners, accounting scholars, and financial journalists who have focused on problems specific to accounting. There have not been many attempts to link developments in accounting to broader concepts and empirical phenomena that constitute globalization more generally. This is unfortunate, not just because of accounting's direct practical contribution to globalization, but also because changes in accounting have a great deal to tell us about the ongoing history of globalization, and other aspects of globalization provide many useful lessons for understanding changes in accounting.

Recent changes in accounting present significant challenges to some widespread understandings about globalization. One widespread understanding is that the construction of effective rules in global governance is a painfully slow process in which the leading role is played by sovereign states reluctantly agreeing to vague and ineffective collaborative arrangements—arrangements that, while perhaps supported by civil society groups, are often undermined by market actors whose conduct is marked by fluidity, short-term self-interest, and hostility to regulation and to states more generally. Another widespread understanding is that globalization is Americanization—and that any effective set of rules at the international level will be ones that the US government promotes and supports. American unilateralism, especially pronounced under President George W. Bush, is often seen as a serious threat to multilateral global rulemaking, as with its hostility to a strong of important agreements, including the International Criminal Court and the Kyoto Protocol.

Recent developments in accounting do not fit at all with these widespread understandings. As will be discussed further below, a private-sector body, the International Accounting Standards Board (IASB), has taken the lead in producing a set of rules that rival or surpass the level of detailed specification that characterizes most international laws and other agreements among states, and that are taken *very* seriously by the actors that will be subject to them. Moreover the IASB has taken steps to strengthen its independence from the multinational firms that are often seen to control all significant private-sector international initiatives. Also surprising is the enthusiasm of US government officials, under the Bush administration, for bringing US rules more in line

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with multilateral ones that so far have been most seriously implemented in other countries, including Europe, Australia, and South Africa.

This paper argues that these developments in accounting are best understood with reference to two types of authority that are becoming increasingly important relative to the public authority that traditionally has been the only recognized type in international affairs: private and technical authority. It also argues that these changes in authority are best understood as involving a process of *politicized functional differentiation* in which the relationship between relatively autonomous discursive/institutional fields, including but not limited to these three types of authority, is of decisive importance. This challenges the widespread view that globalization involves a homogenizing erasure of differences.

The paper starts with a conceptual discussion of private and technical authority and then examines developments in the globalization of accounting. This differs from most discussions of the harmonization of international accounting standards in starting with a conceptual discussion of rule making at the global level rather than a description of harmonization activities or a comparative analysis of particular national regimes in relation to one another or across time. The organization of this paper reflects its assumption that understanding global-level institutional and discursive constraints and possibilities are important in understanding the globalization of accounting standards, and that it is useful to discuss these constraints and possibilities in relationship to other global trends and issue areas that bear some similarities to accounting.

### **Private Authority, Technical Authority, and Politicized Functional Differentiation**

For hundreds of years rulemaking in international affairs was seen as exclusively the prerogative of self-interested competitive sovereign states, and therefore inherently weak and ineffective. Realist international relations theory tended to dismiss international rulemaking as useless given the power and interests of states, but even others more enthusiastic about the potential of international rules, such as international lawyers and liberal international relations theorists, generally assumed that only states would be the subjects and sources of those rules, and often saw those rules as primarily designed to reinforce state sovereignty (Claude, 1971). These themes have been evident in the most prominent contemporary approaches to theorizing about international rulemaking, including theories of hegemony that suggest that the only source of effective rules is likely to be a single dominant state, such as the US, regime theories (Hasenclever, Mayer and Rittberger, 1997), neoliberal institutionalism, and theories of legalization (Goldstein et al, 2001). Even more critical approaches that have stressed the explanatory importance of capitalism have often tended to assume that international rules reinforcing the rule of the dominant class are likely to be developed by the US government or public-sector international institutions such as the International Monetary Fund that it controls.<sup>1</sup>

This traditional emphasis on the centrality of self-interested states does not adequately consider two aspects of our contemporary world that are important for

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<sup>1</sup> Two important exceptions to the neglect of accounting standards among those working in the field of international relations are the analyses of the IASC and IASB by Eaton (2004) and Martínez (2001), both of which have informed the present paper.

understanding developments in global governance in general and accounting in particular. The first, which had attracted an increasing amount of attention among international relations scholars, is the role of non-governmental actors. While non-governmental actors include global social movements and “norm entrepreneurs” that reshape broad cultural understandings and state policies with respect to social justice, more important for accounting, as with many other business-related issue areas, are the private-sector actors that construct “private authority” to enhance their own power or efficiency, or to complement or substitute for the power of states. The second aspect of our contemporary world that has attracted an increasing amount of attention among international relations scholars is the importance of knowledge. Knowledge has been seen as important in shaping and constituting the identities and interests of states and other actors. Increasingly common at the global level is a form of applied knowledge that elicits compliance with its rules in its own right rather than due to its connection with state power. This can be labelled “technical authority”. I briefly look at private and technical authority in turn before discussing their relationship to one another and to public authority.

“Authority” refers to an actor or a set of rules that is able to elicit compliance as a result in the belief that it is right, and as such it lies between coercion and bargaining. An initial effort to develop the notion of “private authority” in international affairs conceptually (Cutler, Haufler and Porter, 1999) focused on its institutional properties, for instance by identifying a sequence of increasingly institutionalized types running from business practices through trade associations to more elaborate “private regimes” governing an issue area. We identified three main factors that could explain the emergence of private authority: efficiency, power, and long-range historical trends such as the growth of global markets. We noted that these were entangled with one another in complex ways, such as when an authoritative private-sector institution is developed to exercise power more efficiently. We noted a number of advantages enjoyed by private authority relative to states and vice versa. In a subsequent analysis of the concept of private authority Hall and Biersteker (2002) usefully identified a category of private authority less directly connected to institutions that they labelled “normative private authority”. This could be summed up as a belief in the inherent superiority of the private-sector way of doing things rather than a commitment to a specific set of private-sector rules.

There are a number of empirical and theoretical reasons to see the concept of “technical authority” as useful. There are key implications of the increased knowledge-intensity of our contemporary world for the character of its social ordering. Knowledge increasingly reshapes or constitutes aspects of our world that previously were usually taken instead to be an independent reality from which knowledge could be derived through observation. This is in part due to *reflexivity*—actors’ altering of their social practises by an ongoing analysis of them—and in part due to the development of *technical systems*, in which the effectiveness and momentum of rules associated with knowledge may be increased by their integration with machine systems, procedure manuals, and operating routines (Porter, 2003). “Best practices” are an example of a common type of knowledge-based rules that are simultaneously a summation of lessons from the past and a guide to future conduct. Like private authority, technical authority can involve varying degrees of institutionalization, and also involves a normative

dimension in which compliance with rules is elicited as a result of a belief in the inherent superiority of a technical or scientific way of doing things.

How should we understand the relationship between public, private, and technical authority? One possibility is that public authority is being displaced or captured by the growing power and autonomy of private or technical authority. In this paper I argue instead that their relationship is best understood as involving a process of politicized functional differentiation. The concept of functional differentiation has a long and somewhat troubled history in attempts to discern long-historical trends in social integration. The concept refers to the apparent widespread tendency for multi-functional units to evolve into more specialized and distinct units, as when the functions carried out by families in earlier historical periods evolve into workplaces, schools, fast food restaurants, retirement homes, and other such specialized institutions. In global finance functional differentiation can be observed in the emergence of a series of specialized but interconnected regulatory committees such as the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors, or the Committee on Payments and Settlements Systems, which, along with other institutions, are connected to one another through the Financial Stability Forum, the G7, the G10, and the Bank for International Settlements. Functional differentiation can also be observed within particular regulatory fields, such as the huge increase in differentiation of risk-weights between the BCBS's 1988 Capital Adequacy Accord and its 2004 agreement that replaced it.

Large but dated sociological and international relations literatures on functional differentiation associated with Talcott Parsons, David Mitrany (1975), and others suffered near fatal blows from critics who argued that they were excessively determinist and insufficiently aware of the enduring significance of political power and conflict. More recently there have been significant efforts on both sides of the Atlantic to correct these problems while retaining valuable insights from previous efforts to understand processes of functional differentiation (Alexander, 1985; Alexander and Colomby, 1990; Colomby 1990; Long and Ashworth, 1999; Luhmann, 1982; 1995). For instance scholars have highlighted instances of "de-differentiation" associated with political resistance to dominant trends and have pointed to the role of political power and conflict in promoting differentiation.

While a full conceptual discussion of functional differentiation goes beyond the scope of this paper, its basic significance for understanding the globalization of accounting can be stated relatively succinctly. In contrast to approaches that see globalization as signifying homogenization or the centralization of authority in hegemony or Empire, it will be argued that the crucial development is the connections that are established between relatively autonomous institutional/discursive fields. Political power and conflict skew these relationships singly and in the aggregate so that they favour one or another set of actors, but at the same time the relative autonomy associated with functional differentiation is also important, both for understanding developments in particular specialized fields and in the evolution of the system as a whole.

Two main axes of differentiation will be explored in this paper's analysis of the globalization of accounting. The first is the differentiation between public, private, and technical authority. The second is the differentiation within private-sector accounting standards, practices, and institutions. The basic argument of the paper is that political

power and conflict are important in the globalization of accounting, but that these are mediated through their relationship to these processes of differentiation.

### **The Globalization of Accounting**

There are three main ways that the globalization of accounting could occur. Firms could increasingly use accounting standards from foreign jurisdictions because they wanted to raise capital in those markets, the most common instances of which are firms entering the US market and having to reconcile their accounts to US GAAP. Accounting firms from one jurisdiction could open offices in another and in so doing transfer accounting practices across borders. Finally, convergence could occur between public and private-sector authorities responsible for the setting of accounting standards, through unilateral adjustment, mutual recognition, or deliberate harmonization. I will briefly discuss the first two of these, which are more straightforward, and then discuss the third in more detail.

#### *The globalization of accounting through cross-border financial transactions*

Cross-border financial transactions can contribute to the globalization of accounting as investors and firms in one country learn about accounting in another country in the course of engaging in financial transactions with actors in that other country. Most important, however, is the use of foreign accounting standards in the preparation of a firm's accounts in order to satisfy requirements of the foreign government or stock exchange, or in order to gain the trust of investors in that foreign country. As noted, by far the most significant instances of this involve firms coming into the US that are required to reconcile their accounts to US GAAP in order to participate in US capital markets.

New York Stock Exchange (NYSE) statistics provide a convenient measure of the significance of this form of globalization, especially since foreign companies traded in the OTC and NASDAQ markets are not required to use US GAAP (Tarca, 2004: 70). In 2004 there were 460 NYSE non-US issuers with a capitalization of \$6 trillion out of a total of 2,800 companies listed on the exchange with nearly \$18 trillion in global market capitalization. By comparison, the combined 2004 capitalization of the Tokyo, London, Deutsche Börse, and Euronext exchanges totalled \$9 trillion. Between 1996 and 2004 the share of non-US companies of total New York Stock Exchange capitalization increased from 25 percent to 33.7 percent, although the share of non-US companies of the average daily value of trading only increased marginally, from 8.25 percent in 1996, to 10.32 percent in 2000, and then back down to 8.47 percent in 2004, indicating that stocks of foreign companies were traded less actively than those of US companies.<sup>2</sup>

Other forms of voluntary adoption of accounting standards outside the home jurisdictions of firms are also significant. For instance in Germany's "Neuer Markt" firms have been allowed to use either IAS or US GAAP and one study found that as of 2001 the 342 firms listed there roughly evenly divided in their use of these two sets of standards, although "the results unveil a considerable extent of non-compliance in the application of US GAAP...the average US GAAP firm in the New Market publishes only 86.6% of the required disclosures" (Glaum and Street, 2003: 65, 92). A study of the voluntary use by

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<sup>2</sup> Data from [www.nyse.com/audience/researchers.html](http://www.nyse.com/audience/researchers.html).

firms of international standards in Australia, France, Germany, Japan and the UK in 1999-2000 found that the more internationally active firms tended to use non-national standards, with more using US GAAP than IAS (Tarca, 2004: 86).

### *Cross-border activities of accounting firms*

A study by the US General Accounting Office (2003) found remarkably high levels of industry concentration in accounting and auditing. The Big Four accounting firms, PriceWaterhouseCoopers, KPMG, Deloitte and Touche, and Ernst and Young, audit over 78 percent of US public companies and 99 percent of public company annual sales. Due to specialization in many industries the top two firms account for over 70 percent of the market.<sup>3</sup> The Big Four had over \$47 billion in total global net revenues in 2002, and concentration ratios in other jurisdictions are reportedly similar to the US, with the Big Four accounting, for instance, for virtually 100 percent of audits of major listed companies in the UK, over 80 percent in Japan, 90 percent in the Netherlands (US GAO 2003, 18). This gives these firms a remarkable opportunity to shape accounting and auditing world wide, either directly or by lobbying governments (Caramanis, 2002). For example, Glaum and Street (2003: 86) found “markedly higher” compliance with IAS or US GAAP accounting standards by companies on Germany’s “Neuer Markt” when they were audited by Big Four accounting firms, and while this may be a reflection of a prior commitment to the standards by the audited firms, it likely also reflects an independent effect of the Big Four on Germany’s accounting practices.

### *Convergence of standards*

While the story of the convergence of international accountings standards is centred around the International Accounting Standards Committee (IASC) and its successor, the International Accounting Standards Board (IASB), it is also important to understand the relationship between this private-sector body and a variety of other public and private sector institutions, such as the US Securities and Exchange Commission, various European Union bodies, the International Organization of Securities Commissions, and the International Federation of Accountants (IFAC) which has been responsible for global auditing standards. I start by giving an account of the evolution of the IASB, and in doing so I will comment on its relationships to other bodies. Accounting and auditing in government and other public-sector bodies displays a close relationship to private-sector accounting, but goes beyond the scope of this paper and will not be addressed.<sup>4</sup>

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<sup>3</sup> The political economy of these firms is discussed in more detail in a draft paper by Sarah Eaton and Tony Porter “Globalization, Autonomy and Global Institutions: Accounting for Accounting”, presented at the Third Globalization and Autonomy Team Meeting, October 1-3, 2004, McMaster University, Hamilton, Canada. This paragraph draws on that paper.

<sup>4</sup> The key body has been the Public Sector Committee (PSC) of IFAC. In 2003 IFAC’s Board commissions a review of the PSC and the review proposed to change the name of the PSC to the “International Public Sector Accounting Standards Board”. The review called for efforts to promote convergence between public-sector and private-sector accounting and for the PSC to be put on a firmer financial footing (IFAC, 2004). The International Organization of Supreme Audit Organizations is a public sector body concerned with auditing government. INTOSAI was founded in 1953 by 34 countries and now has a membership of

The IASC and IASB are private-sector standards setting bodies. The IASC was created in 1973 at the initiative of Henry Benson, of Coopers and Lybrand in London, who also headed the association that historically had been the most important in accounting, the Institute of Chartered Accountants of England and Wales.<sup>5</sup> Its founding members were the accounting associations of Germany, Australia, Canada, France, Japan, Mexico, the Netherlands, the UK, Ireland, and the US. The following year associations from Belgium, India, Pakistan, New Zealand, and Zimbabwe joined. In 1977 the International Federation of Accountants (IFAC) was formed, and in addition to supporting the work of the IASC and IASB financially, it would take the lead on the development of international auditing standards through its International Auditing and Assurance Standards Board. The history of the IASC and IASB can be conveniently separated into the periods before and after the former was converted into the latter in 2001.

The history of the IASC was marked by a number of significant challenges and accomplishments. In its first decade it successfully fended off efforts of developing countries and other actors that wanted instead to give the UN the leading role in accounting, and to include standards that would go beyond the relatively narrow financial measures traditionally associated with accounting and bring in standards aiming the assess the social conduct of firms. From the beginning it had to cope with the division between more flexible private-sector Anglo-American approaches to accounting, which focused primarily on the interests of investors in competitive capital markets, and the more legalistic and cautious European approaches that were oriented much more to the needs of banks and other creditors, and to the governments' collection of taxes. From the beginning many continental Europeans saw the IASC as biased towards Anglo-American approaches, and in potential tension with a European-focused approach that many hoped would develop through the process of European integration. Many of the individuals active in the IASB had worked at the five or six leading firms from the UK or the US that dominated the industry. However the desire of European firms to see accounting standards that were well-suited to European traditions were offset by the strong desire of many to be able to access US capital markets by using one set of international accounting standards, instead of having to use both their home jurisdiction's and US GAAP.

In the IASC's second decade, from 1983-1993, its efforts to harmonize accounting standards were disappointingly slow. Its standards were seen as insufficiently specific and rigorous, including by the SEC. Nevertheless it began to make some progress in enhancing its legitimacy by improving its standards, by adding a Consultative Group to bring representatives of other international institutions concerned with accounting, such as development agencies, into the standard-setting process, by expanding the Board to make it more representative, by adding a Standing Interpretations Committee in 1997 to reduce interpretive inconsistencies, and by appointing high profile standards setters like Sir David Tweedie, chair of the UK's accounting standard setter, to the Board. Most important was the IASC's success in beginning to get IOSCO's recognition of IASC standards, starting in 1993, and in general in establishing a closer

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over 170 ([www.intosai.org/Level2/2\\_OVERVe.html](http://www.intosai.org/Level2/2_OVERVe.html)). IN 2004 INTOSAI and IFAC drew closer when they signed a memorandum of understanding (Anerud, 2004).

<sup>5</sup> The history in this and the next paragraphs relies especially on the discussions in Martínez, 2001 and Eaton 2004.

working relation with that body of securities regulators. From 1999 to 1998, with IOSCO's encouragement, the IASC embarked on and completed an ambitious "Core Standards Work Program". In 2000 IOSCO's recommended that its members allow foreign firms to use IAS in accessing their securities markets. IASC's stature was enhanced further as a result of the global financial crises of the 1990s, when the G7, the Financial Stability Forum, and the World Bank,<sup>6</sup> and other intergovernmental bodies began to promote the IASC's International Accounting Standards as a solution. The IAS were also recognized in the 1994 General Agreement on Trade in Services as useful as an alternative to national standards that might be used as barriers to trade in accounting services.

The transformation of the IASC into the IASB involved a number of institutional changes. The number of representatives on the Board was reduced from 17 part time members to 12 full time and two part-time members. It was made clear that they would be selected on the basis of expertise rather than geographical representation. A four-level structure was created with a separation between the Trustees, who would manage the finances and appointments to the Board, the Board, which would focus solely on standard setting, free from direct external influence in its technical work, a Standards Advisory Council which provided a consultative mechanism for actors not on the Board, and a Standing Interpretations Committee, to deal with ongoing interpretive questions. The new structure was endorsed by IOSCO, the SEC and Financial Standards Accounting Board (FASB)<sup>7</sup>, suggesting a greater possibility that its standards would be accepted in the US and elsewhere. The disproportionately high number of American members of the IASB and the parallels between its structure and the FASB's provoked criticism of it for being too attentive to US interests.

Despite the perception that the transformation of the IASC into the IASB had moved the body closer to the US organizationally, the most important boost for the IASB was the announcement by other jurisdictions, most dramatically the EU, that they would adopt IAS, renamed International Financial Reporting Standards (IFRS). The EU decided that it would not set its own standards, but that it would seek to have input into their formulation and implementation through two regional bodies, its Accounting Regulatory Committee, and a private-sector European Financial Reporting Advisory Group (EFRAG). By 2004 Australia, New Zealand, Russia<sup>8</sup> and South Africa had joined the EU in requiring the use of IFRS and it was estimated that 92 countries and 100 stock exchanges involving 9500 listed companies would require or permit the use of IFRS by January 2005. A wide variety of countries had adopted a policy of convergence with

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<sup>6</sup> For instance in 2004 Nigeria came under pressure from the World Bank to amend its accounting law after a World Bank Report on Observance of Standards and Codes on that country (Vanguard, 2004).

<sup>7</sup> The FASB was created in 1973, replacing the American Institute of Certified Public Accountants (AICPA). The AICPA continued to control US auditing standards until 2003 when oversight of auditing became the responsibility of the new government-appointed Public Accounting Oversight Board (Benston, 2003). Part of the complexity of US GAAP comes from the multiple levels at which standards or interpretations can be made. In addition to the FASB's official standards, less authoritative but still significant standards can be issued by the AICPA's Accounting Standards Executive Committee (AcSEC), the Emerging Issues Task Force (EITF) and the FASB staff (SEC 2003, 2.A.ii).

<sup>8</sup> A partner at Ernst and Young estimated in 2004 that "The top 5 percent of Russian businesses are well prepared and have been using IFRS reports for a number of years. The rest are at the beginning of the process" (quoted in Balayasny, 2004).

IFRS (IASCF, 2004, Temkin, 2004: 15). In 2004 the Accounting Standards Board of Japan announced plans to establish a panel with the IASB to deliberate about bringing Japan into line with IASB standards, including harmonizing some major standards by 2006 (*Nikkei Weekly* 2004).

Also very significant for the harmonization of accounting standards were the changes in the US following the accounting scandals at Enron, Worldcom, and elsewhere. The Sarbanes-Oxley Act enacted by the US Congress in 2002 established series of changes designed to strengthen US accounting, including creating a new Public Company Accounting Oversight Board (PCAOB) appointed by the SEC to oversee the work of the FASB, and arrangements to increase the independence of the FASB from the accounting industry, including replacing funding from accounting firms with a surcharge on all publicly traded companies. Sarbanes-Oxley (under Section 106a) also applies to non-US firms in the US market. These changes were echoed at the global level in proposals in 2003 and 2004 for the creation of a Public Interest Oversight Board (PIOB), selected by regulators organized in a “Monitoring Group” to oversee the work of IFAC, the body responsible for international auditing (Kennedy, 2003).

An equally significant change in the US was a remarkable shift in its view of the relationship between US GAAP and the IFRS with regard to harmonization. Before Enron the US had been confident that US GAAP was superior and had generally treated recognition of international standards as a concession to be granted to foreigners at the pleasure of the US, or as an incentive to hold out to get non-US accounting to converge to US GAAP. After Enron grave doubts set about whether the “rules-based” character of US GAAP, ostensibly designed to ensure compliance or to protect firms from the litigation that is so characteristic of US markets, had become dysfunctional. The sheer volume of rules, including “bright-line” rules with precise percentages separating one accounting treatment from another, had encouraged “financial engineering”—the creative use of the details of the rules to evade their spirit.<sup>9</sup> The “principles” based approach of the IFRS, in which the general intent was more consistently defined and the implementation guidelines were less detailed, seemed to offer some important advantages.<sup>10</sup>

In a report mandated by Sarbanes-Oxley the SEC (2003) came out in favour of moving away from a rules-based approach to an “objectives-based” approach which, while having more detail than some of the international standards, was a significant move away from its prior unquestioned enthusiasm for US GAAP in the direction of standards much more like those developed by the IASB. This was accompanied by the appointment of Robert Herz as chair of the FASB in 2002, and Don Nicolaisen as Chief Accountant of the SEC in 2003, both former PriceWaterhouseCoopers partners who were known to be enthusiastic about promoting international convergence, by a formal “Norwalk Agreement” in 2002 between the FASB and the IASB to work on convergence, and by the announcement of plans for a “roadmap” for the acceptance by the SEC of statements

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<sup>9</sup> For instance, Benston notes that 45 pages worth of FAS 133, 137, and 138 standards specifying fair value accounting for derivatives are supplemented by 158 pages of an Implementation Guide, and 576 pages of a PricewaterhouseCoopers guide to their use (Benston, 2003: 1334).

<sup>10</sup> For a dissenting view on the advantages of moving towards a principles-based approach see Bratton, (2003: 1037) who argues that issues such as the lack of independence between managers and auditors means “the incentive problems have to be solved first”. Bratton contrasts accountancy to law. In law there is a virtual guarantee that there will be lawyers to line up on opposite sides, enhancing the potential for critique and correction. Moreover “law-to-fact” decisions are transparent.

prepared using international standards (Eaton, 2004: 79-80). By 2004 there was a full-time IASB Board member who had an office at the FASB and participated in their deliberations, the boards were meeting twice a year, video links between each others meetings had been established, and they had established joint teams to work on some major projects (Tweedie, 2004). In 2004 the SEC and the Committee of European Securities Regulators (CESR), which had been recently set up under the EU's Lamfalussy process, took steps to strengthen their collaboration on accounting and other matters (Michaels and Parker, 2004).

Two serious political conflicts in 2004 were a reminder that the global harmonization of accounting standards would not necessarily proceed smoothly. The first was an effort in the US Congress to prevent the FASB requiring companies to expense stock options, a conflict that was echoed in Europe around IFRS 2 on the same topic. This issue had been the focus of intense conflict and lobbying in the history of both the FASB and the IASC, and on a previous occasion, in the mid 1990s, the FASB had abandoned its efforts in the face of this pressure (Kosseff, 2004, Zeff, 2001: 11). Many companies, especially in the high-tech sector, had used these options as a cost effective way to reward CEOs and employees, but by not including these on the balance sheet they had not made the very large contingent liabilities this could involve apparent to investors.<sup>11</sup> Moreover, questions were growing about the effectiveness of stock options as an incentive since they seemed to encourage a short time horizon and insider trading on the part of senior managers (Anabtawi, 2004). The efforts of Congress to intervene politically in a the FASB that had just been given renewed autonomy, and on an issue that had seemed about to be resolved in favor of the type of transparency that was called for post-Enron, created much anger among critics,<sup>12</sup> but is also significant for the IASB since the active involvement of legislators in standard-setting will make convergence much more difficult. In Europe in 2004 the heads of the Quoted Companies Alliance and the European Employee Stock Option Coalition criticized the effort to require expensing of options in IFRS 2 (Knight and Pierce, 2004), but the conflict was likely to be less intense because of stock options are not as important for executive compensation as in the US<sup>13</sup> and as of 2004 the EU was expected to adopt the standard (Franklin, 2004).

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<sup>11</sup> An attorney for the International Employee Stock Options Coalition, in opposing the FASB efforts to expense these options, noted "They're in Norwalk, Conn....They're most familiar with and most comfortable with the old-line companies. There's just not enough experience there with companies on the West Coast" (quoted in Kosseff, 2004). According to the head of the IASB the profits of US high tech firms were overstated by roughly three quarters in 2001 as a result of not expensing options (*Financial Management*, 2004).

<sup>12</sup> See for instance the letter by the Trustees of Financial Accounting Foundation, which oversees the FASB, which stated that they "strongly oppose any current or proposed legislation that would undermine the independence of the FASB by pre-empting, overriding, or delaying the FASB's ongoing effort to improve accounting for equity-based compensation...If Congress sends that message that special interests are able, through legislation, to overturn expert accounting judgment arrived at through open and thorough due process, necessary and timely improvements in financial reporting will likely become impossible...it will severely impede the important ongoing efforts by the FAF Trustees and the FASB to achieve international convergence of high quality accounting standards" (*Business Wire* 2004). The Financial Accounting Coalition for Truthful Statements (FACTS), representing more than 40 pension funds, labour unions and consumer groups, expressed similar views (FACTS, 2004).

<sup>13</sup> Although the head of the IASB warned that if IFRS had been in effect in 2002 it would have knocked 10 percent of EU companies' profits (*Financial Management*, 2004).

The second political conflict was over IAS 32 and 39 that had been developed by the IASB to account for derivatives. These standards required either more careful hedging of one derivative-related risk against another, or the use of fair-value accounting to make the contingent liabilities to which firms were exposed apparent in their balance sheets. Unlike historical-cost approaches to accounting, which value derivatives at the cost when they were created, fair-value approaches require an estimation of value based on the price that would obtain in current markets. Often derivatives such as the right to buy a stock at a “strike” price above the market price at the time of the derivative’s creation could have a historical cost of zero, but then become very valuable as the stock price rises above the strike price. IAS 39 was modelled closely on FAS 133, which had been promulgated by the FASB in 1998 and had itself experienced some difficulties.<sup>14</sup> However in 2004 intense opposition to IAS 39 developed in Europe at a crucial point in the lead up to the EU’s promised 2005 adoption of international standards. Driven by European banks concerned that the greater volatility of statements prepared with fair value accounting would make them seem less stable, and amplified by the concerns expressed by EU Commissioner for the Internal Market, Frits Bolkestein and French President Chirac, the EU decided not to implement key elements of IAS 39. Supporters of the IASB saw this as a self-serving political intervention by European banks that threatened the integrity of the international standard-setting process, while many Europeans saw the problem as evidence of the IASB’s excessive orientation to US practices and its failure to adequately consider the specific needs of the EU, the jurisdiction that was actually most affected by the standards.<sup>15</sup> Danish regulators warned that IAS 39 could destabilize their whole financial system because of the volatility that it could introduce into their mortgage market, which accounts for about two-thirds of all credit in the company, a value larger than Denmark’s national output (Tricks, 2004). Nevertheless, in the midst of the conflict support for IASB autonomy was expressed by Bolkestein (2004) who commented “The Commission has made it perfectly clear that it does not intend to act as a standard-setter. That was why scrupulous care was taken not to add any text to the standard. Second, these carve-outs are temporary and will be filled in once the IASB has resolved the problems”.

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<sup>14</sup> “The United States has had to delay the implementation date and then amend that standard on three separate occasions” (Cherry, 2004, FP11). The operational cost of complying with FAS 133 was estimated at \$500,000 to \$2.5 million per company but once companies began to implement it opposition began to subside, in part because the software was useful for firms for monitoring their own risks (Reason, 2003 and Frieswick 1999).

<sup>15</sup> For instance Paul Rutteman, Secretary General of the European Financial Advisory Group (EFRAG) commented “there is a view in some parts of Continental Europe that this body in London, so heavily influence by Americans who don’t use the standards, is pushing through things which don’t take account of European culture” (*International Accounting* 2004b). Although France led the charge against IAS 39, in other respects “changes to accounting rules and regulations in France, especially in relation to non-audit services like tax and consulting, have arguably gone further than anywhere else in the world in the last 12 mnths” (Theodorou, 2004). On political conflict in the process in which Australia is adopting IFRS by 2005 see “Australian standard-setters, businesses demand clarity as deadline fasts approaches for IFRS” *Accountant* October 2004, p. 1.

## **Analysis: Public, Private and Technical Authority and Global Accounting**

What lessons can be drawn from the above discussion of the history of attempts to develop global accounting standards? In this section and the conclusion that follows I consider the relevance of theoretical points made earlier in the paper, counter-posing my arguments about differentiated forms of authority relative to alternatives that see the process as a homogenising and centralizing one involving the imposition of US standards on the rest of the world, or that assume that any successful and meaningful global rulemaking capacity will be controlled by states. In this section I comment on the degree to which history discussed in the previous section provides evidence of differentiated public, private and technical authority. In the subsequent concluding section I then consider the degree to which the evidence supports approach of this paper relative to competing explanations.

It is clear from the above history that traditional forms of public authority remain important to the success of efforts to the globalization of accounting standards. The acceptance or promotion of international standards by public sector regulators at the SEC, IOSCO, the EU, the World Bank, the Financial Stability Forum, the G7 and elsewhere, has always been critical to the IASB. Initiatives taken at the national level by public authorities, such as changes at the FASB, or the creation of EFRAG and the ARC by the EU, and the political initiatives related to stock options and derivatives, have a major impact on global standard setting, both in terms of the process though which the IASB interacts with markets and standards setters in those jurisdictions, but also in the substantive content of the standards it develops.<sup>16</sup> It is clear as well that the political features we traditionally associate with public authority, namely the significance of power differentials and the dynamics of strategic bargaining, are very evident in global accounting. The SEC, either independently or through its role in IOSCO, has always been a dominant player as a result of the power it enjoys through its relationship to the world's most powerful state and largest capital markets. The growing influence of the EU in global accounting is enhanced by similar considerations as it more effectively exercises its increasingly unified and institutionalized political and economic power. Public authorities continue to provide crucial financial support to global standard setting, either directly through contributions to the IASB's trustees, or by their financial support of standard-setting work at the domestic level.

There are four main ways in which private authority is evident in the history above. First and most obvious is the fact that the IASC Foundation to which the IASB reports is a non-profit Delaware corporation, a private-sector actor, with significant private-sector contributors among its funders (including \$1 million from each of the Big Four accounting firms). Second is the degree to which standard-setting is oriented towards a private-sector way of doing things, in which efficiency, competitive markets, and shareholder value are believed to be inherently superior to alternative ways of doing

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<sup>16</sup> Another example is the US Private Securities Litigation Reform Act of 1995 and the Securities Litigation Uniform Standards Act of 1998, which made class action suits against accounting and securities abuses more difficult, and which may have contributed to the laxness that culminated in the Enron and other scandals (Benston, 2003: 1343). An example of the importance of domestic law is Section 334 of the Australian Corporations Act which gives the international accounting standards adopted by the Australian Accounting Standards Board force in law (Utz, 2004).

things, without a need to test or demonstrate the relative costs and of the differing ways of doing things in every instance. Third is the way in which the use of standards and compliance with them is dependent on their adoption by a diverse and dispersed set of private-sector actors, including in the Big Four and other accounting firms, in the internal practices of their client firms, in the national private-sector accounting associations and standards setters, in the calculations of investors acting individually or as institutional investors, in the influence of discussions in the financial press, and in the practices of individual accountants and auditors more generally. Finally, and relatedly, an aggregate effect of the adoption of global standards by this diverse set of private-sector actors is the role of market forces in promoting compliance with international standards by firms and national authorities.<sup>17</sup>

Technical authority is evident in the degree to which the solutions to accounting problems have been shaped by the possibilities and limitations of knowledge. Knowledge here refers both to *knowledge about accounting*, such as when a member of Congress learns about the problems of a rules-based approach from the SEC report on the subject, and to *accounting as knowledge*, when an accounting standard simultaneously encapsulates the accumulated past lessons learned by accountants, expresses a contemporary compromise among various judgments about the proper way to assign a financial value to an asset or a transaction, and exhorts accountants to comply with these lessons and compromises in their future activities. While much of the conceptual work in creating standards is shaped by factors discussed in relationship to public and private authority above, it is also shaped by technical problems that cannot be reduced to these other forms of authority. As an assessment by the IASB trustees (IASCF, 2004: 6) notes “Although progress towards global adoption of IFRSs is evident, there are clear challenges. Some of these challenges are intellectual.” The efforts to insulate the IASB and the FASB standard setting processes from public and private-sector pressures is an indication of the role of technical authority, both in the belief it reveals that standard setting benefits from a dispassionate science-like evaluation of alternatives against evidence and in the degree to which such independence is expected to generate the type of belief in the integrity, or “rightness” of the standards that is the defining characteristic of authority. Much of the debate over fair-value accounting for derivatives is driven by interests, but it also reflects technical disputes, for instance which complex mathematical model best approximates a market price when there is no market for a particular derivative.<sup>18</sup>

What is the relationship between the three types of authority described in the preceding paragraphs? There are sufficient indications that they enjoy some degree of autonomy from one another that none of the three can simply be reduced to an expression of one of the other two. Nevertheless, it is possible that they are headed in this direction, with for instance the Big Four or the EU likely to “capture” or manipulate the IASB in

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<sup>17</sup> As Tarca (2004) notes, “competitive market forces and managerial incentives have been shown to affect the form and content of financial statements”: use of recognized high quality standards reduces the cost of capital.

<sup>18</sup> Technical and conflict of interest problems can overlap. Benston (2003:1348 notes: “The problem is that fair values are subject to manipulation by opportunistic managers, because they are based on discounted expected cash flows or estimates of possible future transactions. The present values of these future cash flows necessarily are uncertain, because there is no objective way to determine the applicable discount rate and the future amounts and the amounts often change unexpectedly.”

the future. Alternatively they could be headed in the direction of fragmentation. However the history discussed above instead provides support for this paper's emphasis on politicized functional differentiation.

There are three overlapping ways that functional differentiation can be observed in the history of global accounting standards. The first is the way in which the above three types of authority have both more autonomous and more reliant on one another. The autonomy is evident not just in the mechanisms used to separate standard setting from political and economic pressures, but also in move towards the use of full time experts rather than part-time national appointees in the transformation of the IASC into the IASB. Yet this technical autonomy has come at the same time that public and private-sector actors have stepped up their reliance on the standards that technical authority generates. The second is in the emergence of new specialized bodies that draw their significance from their relationship to the emerging international accounting regime as a whole, rather than the inherent and specific effects of the work they do. These new bodies include EFRAG, the ARC, the SAC, the IASCF, the PIOB, and the PAIOB, among others.

The third is in the conduct of accounting itself. The SEC's description of "objectives-based" accounting captures well the direction that the US GAAP-dominated system is moving. It notes that this shift places more responsibility on accountants and auditors to document and justify conceptually, perhaps with reference to an accounting literature, the way in which a particular treatment chosen expresses the objective expressed in the conceptually-oriented part of the standard. At first the enormous detail of the rules-based GAAP might seem more differentiated than this new "objectives-based" approach. However as the SEC notes, even in all their detail the rules were too inflexible to handle the countless number of situations to which they might have to be applied "human ingenuity is such that accounting standards can never be written at a level of detail sufficient to preclude financial engineering designed to hide more than it reveals" (SEC, 2003, V.B.). Accordingly, in a process consistent with Foucault's notion of governmentality,<sup>19</sup> a separation is introduced between the judgment of the standard setters and the newly important and newly regulated judgment of the accountants and auditors: a new, decentralized and relatively autonomous practice of judgment has been added to the old one in which the standard setters were supposed to tell accountants and auditors what to do, and the latter would simply use a "check-off" approach.<sup>20</sup>

These examples of differentiation are "functional" in the degree to which they reflect the unique criteria and discourses that govern choice in each differentiated area, in the degree to which these criteria and choice pragmatically solve problems specific to that differentiated area, and also in the degree to which this differentiation enhances the performance of the system as a whole. Nevertheless it is apparent that this functional differentiation is highly politicized. Here "politicized" refers to power-based conflict not necessarily connected with the state. Each one of the differentiated areas exhibits political

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<sup>19</sup> Foucault's notion of the "conduct of conduct" in which government increasingly involves the creation of conditions for self-regulated actors to bring their conduct into compliance with the imperatives of government, and also in which problems constitute organized fields of integrated but differentiated action has a number of compatibilities with the approach of this paper. See Burchell et. al, 1991.

<sup>20</sup> As the SEC Report (2003, V.B) put it, accountants would be required to focus on the economic substance of transactions and other covered events and exercise their judgment in a manner that maximizes the information conveyed to the market...In contrast, under a rules-based regime, accountants tend to develop a 'check-list' mentality".

conflict that can either contribute to further differentiation, such as the EU's creation in effect of two IAS 39 standards by removing key parts of the original IAS 39 in the IAS 39 it intends to follow, or de-differentiation, such as the reduction in autonomy between Congress and the FASB in the conflict over stock option expensing. Some of these politicized conflicts may severely compromise the functionality of the system as a whole, as would be the case if the conflict over IAS 39 led to the collapse of the EU commitment to adopt IAS by 2005.

## Conclusion

While the globalization of accounting continues to be accompanied by uncertainties and potentials for reversals, it is clear that overall it has exhibited accelerating progress towards harmonization since the inception of the IASC in 1973. At earlier points in this process many observers might have predicted that convergence would not be achieved, or if it were that it would come about by having the rest of the world adopt or move towards US GAAP. At one point in the process there were suggestions in the US that the FASB should become the world's accounting standard setter (Eaton, 2004), and there have been recurrent complaints that the IASB is simply carrying the torch for the Anglo-American way of doing accounting (eg. Brown, 2004).

Although there is no question that the US remains highly influential in international accounting, the idea that the globalization of accounting is simply the Americanization of accounting is seriously inadequate. This is not just due to the new muscle of the EU that modifies the balance of power in a way consistent with the stress of realist international relations theory on the distribution of state capabilities and power politics.<sup>21</sup> It also crucially reflects the degree to which the power of the US government is increasingly mediated through a set of functionally-differentiated institutions, including an IASB exhibiting a significant degree of relatively autonomous technical and private authority. Important events such as the Norwalk Agreement or the efforts to insulate the IASB from political interference cannot be explained by an Americanization or power politics thesis.

Does this mean that the negative consequences of power politics are being tamed by the path the globalization of accounting standards is taking, or that the system will be more responsive to the needs of citizens? Some power politics will continue as evident in the conflict over IAS 39, but it is likely to be substantially reduced as a result of the differentiated institutions through which it will be mediated. Unfortunately this has mixed implications for the responsiveness of the process to the needs of citizens. The need for public-sector authority to operate in coordination with private and technical authority, while reducing the influence of state-centric power politics, also reduces the ability of citizens to influence policy through traditional mechanisms of democratic accountability

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<sup>21</sup> An indication of the perceived relevance of this realist idea to the Chair of the Australian Accounting Standards Board was evident in a report in *International Accounting* (2004) which noted that he "argued that a banding together of countries would benefit the region by giving it a unity similar to Europe and the US, which have receive various concessions during the process of setting International Accounting Standards." A similar comment was made by a partner at PricewaterhouseCoopers who reportedly "called for the present system of standard-setting in Australia to change if it was to have a greater influence on organizations like the IASB. She argued for companies to form a coalition of interest groups and individuals to provide feedback to the international accounting standard-setting regime" (Ravlic, 2004).

such as legislative reviews or domestic administrative law. Both private and technical authority can involve systematic exclusion as citizens may lack the wealth or specialized knowledge to know about or participate in the decision-making processes with which these forms of authority are associated.

The concept of *politicized* functional differentiation, in contrast to older models of functional differentiation, suggests that challenges to the momentum of the system as a whole can and will be expressed in particular differentiated areas. So far most of the political conflicts have been between actors who are already heavily involved in accounting. The prospects for initiatives such as social accounting, ethical investing or shareholder activism that hope to bring considerations other than efficiency and wealth generation into the system are not yet clear. The Domini 400 Social Index (DSI 400) constructed of firms with “exceptional social characteristics” has been quite successful at bringing sustainability issues into financial markets’ traditional evaluative processes, in part because it has outperformed the S&P 500 (Aitken, 224-5). It is certainly possible that the increasingly integrated and differentiated character of standard setting at the global level in international accounting will create openings for the introduction of well-argued social criteria in which investors or states are interested that previously would have been kept off the agenda by a lack of support from the FASB or the SEC. More certain is the likelihood that some of the problems that have been associated with US rules-based accounting such as the pathologies associated with financial engineering designed to get around the intent of standards will be mitigated by the requirement that more internationally-oriented standards be scrutinized by and justified to a broader, more international, and more diverse set of actors.

Consistent with the concept of politicized functional differentiation, the future evolution of international accounting will be shaped both by the past process of functionally differentiated integration that will continue, and by ongoing political conflict mediated through that process. While we cannot know with certainty the details of this future evolution, we will understand much better its general trajectory by treating it as a process of politicized functional differentiation, involving relatively autonomous but interconnected axes of public, private, and technical authority, than by seeing it as simply Americanization, or as a process dependent on traditional state-centric power politics and law. This is a lesson with relevance not just for accounting, but also for other areas in which governance is being strengthened at the global level.

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