Legitimacy Theory May Explain The Failure of Global Adoption of IFRS: The Case of Europe and the U.S.

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Abstract

We investigate the reasons why "adoption" of one set of globally accepted accounting standards is presently unachievable. By "adoption" we mean that a jurisdiction incorporates IFRS instantly as its national accounting as issued by the IASB. We state that the IASB has used a Legitimacy Theory strategy to gain acceptance of its standards by more than 120 countries across the globe but it has only gained pseudo-"adoption" (not as published by the IASB) of its standards by many countries. We contend that achieving policing and enforcement of its standards globally has proven to be empirically illusive. This legitimacy deficit may explain why convergence between the IASB and FASB is currently idle. We offer a possible solution to bridging the legitimacy gap of global adoption of IFRS. We propose an internationally respected regulator and suggest the IOSCO for this role through its participation in the IFRS Foundation Monitoring Board for policing and enforcement of IFRS for cross-listed firms reporting in compliance with IFRS so that the IASB's output legitimacy may be achieved globally.

1. Introduction

The objective of this study is to address the debate about the "adoption" of one set of globally accepted accounting standards, to explain why it is presently unachievable and finally to suggest an international regulator to achieve output legitimacy of the IASB's standards. We consider "adoption" in the sense that the IASB is acknowledged as the *legitimate* body to draft and issue, through its due process, accounting standards but that jurisdictions incorporate IFRS nationally, oftentimes *not* as published by the IASB.

We support that presently, the IASB has only gained pseudo-"adoption" (not as issued by the IASB) of its standards by many but not all countries. Legitimacy is defined as the "generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions" (Suchman, 1995, p. 574). If we refer this definition to the due process of the FASB, the Securities and Exchange Commission (SEC) has attained national authority to adopt, police and enforce compliance with U.S. GAAP: this aspect of the legitimacy theory is policy efficacy or *output legitimacy* (Richardson and Eberlein 2011). The IASB has achieved a recognized and respected accounting

board (consistent with *input legitimacy*) and an internationally recognized due process (consistent with *throughput legitimacy*). In fact, for specialized rulemaking bodies, this technical competence is a necessary condition to establish legitimacy with constituencies but this may not be sufficient to gain legitimacy because of the relevance of political aspects (Richardson and Eberlein 2011). In this instance, *output legitimacy* of the IASB's standards at a global level has been compromised because of the unwillingness of national jurisdictions to give up their sovereignty to an international organization. This could be an explanation for why only a few countries have "adopted" IFRS as published without any internal process of endorsement or revision (FASB 1999).

Our study of the literature confirms that national politics remain a critical component of standard-setting within and across countries and has eroded the output legitimacy strategy consistent with that taken on by the IASB to globalize its accounting standards (Dahl 1999, Grant and Keohane 2005, Richardson and Eberlein 2011). There is GAAP competition in the U.S., where foreign private issuers can list on a U.S. stock exchange using IFRS as published by the IASB without reconciliation to U.S. GAAP and domestic registrants list using U.S. GAAP. It then is a matter of fact that currently there is competition amongst standards setters for financial reporting. Larger countries such as China, India, and Japan have not "adopted" IFRS, in the above sense, and are waiting to see the results of convergence between the FASB and IASB before deciding whether to adopt IFRS (Tweedie 2011). We believe that legitimacy theory offers a solution to global acceptance of one set of accounting standards. We propose and explain why we believe that the SEC could be a legitimate global regulator in policing and enforcing IFRS as published by the IASB for firms cross-listed in more than one legal jurisdiction.

We compare the standard setting process of the FASB with the IASB as we believe that the IASB has patterned its standard setting process similar to that of the U.S. to gain global legitimacy. We use the due process of the EU to point out the complexities of the political process of IFRS endorsement as we believe that is has one of the most complicated IASB endorsement processes of all countries. For example, the endorsement process in the EU includes The Accounting Regulatory Committee, The European Commission, The European Financial Reporting Advisory Group that operates through a Technical Expert Group and in some instances consultation with the Basel Committee of Banking Regulators and European Banking Federation. This EU endorsement process is instrumental in explaining why we support that a global GAAP may be impossible at present. We include Table 1 to summarize the current state of adoption or pseudo-adoption of IFRS across the world.

-Insert Table 1-

The IFRS Foundation and the IASB support a single set of global accounting standards. Some believe that a monopolistic standard setter for transnational financial reporting is not desirable or optimal (see Ball 1995; Dye and Sunder 2001; Sunder 2002; Benston et al. 2006; Meeks and Swann 2009 and Stulz 2009). We do not argue for or against this proposition. In this paper, we use legitimacy theory as a framework for understanding why we have not yet gained global acceptance of one set of generally accepted international accounting standards.

Previous studies (Zeff and Nobes 2010) argued that no country has "adopted" IFRS in the sense that they have incorporated the complete text of IFRS with no changes directly and instantly into their national accounting laws. Empirical results of accounting studies find that comparability, usefulness, and cost of capital are applied differently in U.S. GAAP and IFRS (see Prather-Kinsey and Tanyi 2014). Older studies find that legal origin, market infrastructure, and culture explain differences in financial reporting and regulation between legal jurisdictions (Jaggi and Low 2000; Ball, Robin and Wu 2003). Convergence of accounting standards has been desired by many multinational corporations, cross-listed firms and investors wanting to understand and compare the performance of companies across the world (see Choi and Meek, 2008, Chapter 9). The FASB has a securities regulator, the SEC, to police and enforce its standards in the U.S. However, the IASB has no global securities regulator to police and enforce its standards. In fact, unlike a national standard-setting body, the IASB has no legal jurisdiction over national governments, so promulgation of a single set of global accounting standards would not, in itself, guarantee that those standards would be adopted, policed and enforced universally by each national jurisdiction.

Some are discouraging about IFRS global adoption. For example, Hans Hoogervost (see Cohn 2014), chairman of IASB, at the Singapore Accountancy Convention stated that "one single set of global accounting standards is no longer achievable." Selling (2013) considers the convergence process too problematic to be worth moving forward and provides several arguments against the "adoption" of IFRS in the U.S. Unlike Selling (2013) and De Lange and Howieson (2006) we present a commentary on the FASB's and IASB's local regulatory environments as a "legitimacy deficit" to global acceptance. Legitimacy deficit or legitimacy gap is a term used to explain those mechanisms that deter an international body's governance across nations (Johnson and Solomons 1984; Richardson and Eberlein 2011 and Savage and Callaghan 2007). Any global standard setter has to gain its legitimacy through sufficient acceptance and authority from other governing bodies to be effective. This legitimacy deficit partially explains why convergence between the IASB and FASB is currently idle and thus offers a possible solution to global adoption of one GAAP.

We contend that these endorsement differences between countries, consistent with legitimacy gap, hinder the adoption of the IASB's IFRS's, *de jure and de facto*. Bridging this legitimacy gap using an internationally respected regulator and firm level adoption of a global GAAP may be the output legitimacy approach needed to gain adoption of one set of accounting standards globally.

This paper proceeds as follows:

- First, we present the legitimacy theory as applied in the field of transnational accounting standard setting through its articulation into input, throughput, and output legitimacy.
- Next, we analyze the role of politics in international accounting standards setting through a preliminary review of prior studies and a description of the EU due process as one of the most complicated IASB endorsement processes of all countries to highlight the effects of outright political interference on the output legitimacy strategy of the IASB to globalize its accounting standards. We also present the voice of supranational organizations asking for convergence between the SEC, FASB, IASB and the world, that is, for one set of globally accepted accounting standards. Examples of encouragement and impediments to convergence from political and transnational bodies are provided as well.
- Next, we compare the standard setting process of the FASB with the IASB as we believe that the IASB has patterned its standard setting process similar to that of the U.S. to gain global legitimacy.
- Then we explain that convergence is idle because of the output legitimacy deficit/gap emanating from the differing political, business and legal environments between legal jurisdictions.
- We use the legitimacy theory approach to offer a roadmap to the IASB for global enforcement and "adoption" of one set of accounting standards.
- Lastly, we conclude and offer suggestions for a follow-up study.

2. Legitimacy Theory in Accounting Standard Setting

Traditionally, positive accounting theory has been based on agency theory (Lionzo 2012) and explains accounting practice by predicting which firms will and which will not use a particular method without providing any normative contribution (Watts and Zimmermann 1986). On the other hand, legitimacy theory and stakeholder theory focus on the role of information and disclosure in the relationships among organizations, the State, individuals, and groups. Given that the entity is influenced by, and influences the society in which it operates, legitimacy theory and

stakeholder theory are both *system-based theories* and derived from political economy theory, particularly from the so-called *bourgeois* branch of it (Deegan 2006), according to which economic issues cannot be investigated without considering the political, social and institutional frameworks within which economic activity takes place.

Basically, *legitimacy* is the status or condition which exists, when an entity's value system is consistent with that of society, and *legitimation* is the process which leads to an organization being viewed as legitimate (Deegan, 2006). Therefore, society allows the organizations to continue operations to the extent that it meets its expectations. Unlike positive accounting theory, legitimacy theory relies on the notion of "social contract" rather than on the economics based assumption that all action is driven by self-interest and wealth maximization or on assumptions about the efficiency of markets.

According to legitimacy theory, the legitimacy of a privately organized accounting authority is linked to its ability to provide an "optimal" information or pay out determination system that institutions accept as a result of decisions from bounded rationally acting individuals (Schmidt 2002). It follows that legitimacy of a standard setting processes is therefore not subject to the individual's ability to provide an "optimal" system of rules, but to their ability to develop rules acceptable to its constituency. In other words, to pass the consent test, the rules provided by the authority must be appropriate to substitute or supplement individually negotiated incomplete contracts. Superior rules must be understood as the result of a hypothetical negotiation of all affected individuals, meaning that all of them will benefit from the rules under consideration.

Moreover, the field of transnational accounting standard setting is more than a technical exercise in producing the optimal solution in standardization: "instead, the politics of accounting regulation shows that economic globalization is constructed by many actors and succeeds when carefully linking the normative content of standards to organizational structures, consultation procedures, and stable actor coalitions" (Botzem 2012, p. 7)

Legitimacy is the acceptance of an entity's audience to act within the entity's social values. This acceptance may be based on pragmatic, normative or cognitive foundations (see Suchman 1995; Richardson and Eberlein 2011). Legitimacy theory can be summarized as including three parts: input, throughput, and output (Richardson and Eberlein 2011).

Input legitimacy refers to the qualifications of rule-making participants and their ability to connect with the will of its constituents (Scharpf 1999). The rule-making body should be seen as credible, independent and qualified to use their expert knowledge and logic to make technical decisions in the standard-setting process. The standard-setting process should reflect the will of the

affected parties. If the rulemaking body is international, then the technical rules should reflect the needs of a transnational environment. For example, the legitimacy of international accounting standards may well depend on the credibility, independence and expert knowledge of the IASB as well as its ability to reflect the will of the global business and capital market environments.

Throughput legitimacy is the fairness of the process used to convert inputs into outputs (Richardson and Eberlein 2011). For example, do the deliberations on accounting standards reflect a due process, logical and rational discourse, and the voice of others? Throughput legitimacy is different from input legitimacy as the former is about increasing the rationality and transparency of the discourses used in decision making whereas the latter is about the qualifications of the standard-setter and representation of their constituencies. Throughput legitimacy is about how the decision is made and providing that constituents have equal access and equal voices.

The third prong, output legitimacy, has to do with policy efficacy. This results-based concept implies political salience. Once a good standard (a standard that resolves technical problems and furthers the common good) is developed, it is accepted and adopted into law with sanctions for non-compliance. This enforcement mechanism assumes that the rulemaking body is perceived to be experts that deliver results to which constituents agree to be compliant. In an international context, output legitimacy requires a supranational organization to have significant reach into national jurisdictions requiring and enforcing compliance with the international rule-making body's standards.

3. The role of Politics in International Accounting Standards Setting.

3.1 Literature background

In general, accounting standard setting process is considered a political lobbying process through which participants have several means to influence outcomes (Sutton, 1984). In other words, standard setting becomes a political process when involved parties lobby both to safeguard their interests and to persuade the standard setter to approve the rules to their advantage. Consequently, the IASB has the role of resolving conflicts among interested groups by trying to find a solution acceptable to various constituencies.

In this context, it is necessary to point out that lobbying does not always have a negative meaning: Tandy and Wilburn (1992) recognize in the lobbying process the assurance of the legitimacy of a standard setter and its standards. Further, the participation in the standard setting

measures the extent of interest about an issue and it reveals some information regarding the potential implementation problems and the costs of future standards. In terms of possibility of lobbying, Sutton (1984) uses the Downsian voting model, and develops a cost/benefit model according to which a party lobbies only if the benefits of lobbying exceed the costs of lobbying. As a consequence, Sutton states that for the preparer of financial statements, the potential economic benefits of lobbying may be greater in absolute terms than the benefits to the users of the financial statements.

Sutton's cost/benefit model is based on differences between preparers and users of financial statements, and verifies the hypothesis that preparers of financial statements lobby as much as users of such statements. Moreover, within the group of preparers, it results in mostly very large corporations lobbying standard setters because lobbying is too costly for small entities and large entities usually have more to gain from lobbying than smaller entities (Watts and Zimmermann, 1978, 1986, Kenny and Larson 1995, Larson 1997). Furthermore, Watts and Zimmerman's positive theory recognizes that negative cash flows induce a company to lobby, independently of its size. They derive the assumption that the lobbying of the firms depends on the impact of the proposed standard on their cash flows. According to McArthur's (1996) analysis of comment letters on a single issue, corporate responses reflect the cultural influence of their home country as suggested by the work of Hofstede (1980) and Gray (1988). In a specific way, Gray, who provides an application of Hofstede's assumption using a theoretical model based on cultural factors to investigate the reasons for accounting differences. A similar approach is proposed by Doupnik and Salter (1995). They provide a list of previously proposed differences in national accounting standards, e.g., taxation, inflation, stage of economic development, culture, history, geography, etc. It occurs that many different context variables might influence the accounting systems of countries (Nobes 1998).

While the above studies focus on the motivation to lobby, other studies analyze the means through which lobbying is mainly exerted. Lobbying could take place in formal and informal meetings with members and staff of the standard setter and unwritten conversations between regulators and interested parties which take place informally. Georgiou (2004) examined the use of different methods of lobbying, and explained that comment letters appear to be a good surrogate for the minimum explicit use of other lobbying mechanisms. Most of these studies, some of which are based on the analysis of comment letters, pay attention to lobbying efforts of national standard setting bodies such as in the U.S., the U.K and Australia (Walker and Robinson 1993, Watts and Zimmerman 1978, 1986, Kelly 1985, Sutton 1984, Tandy and Wilburn 1992, Sikka 2001). Other

studies (Zeff 2002 and Jorissen *et al*. 2006) explored the lobbying behavior towards the IASB to explain the influence of comment letters on the final international financial reporting standard.

Instead of considering the lobbing activity of private actors (preparers, users, auditing firms, and others), it appears to be more consistent to our analysis, to examine the studies which specifically focus on public and/or political organizations which have veto power over accounting standards. Kwok and Sharp (2005) conducted a comprehensive study that reveals the influences from four key stakeholder groups (users, preparers, accountants, and regulators) toward International Accounting Standards (IAS) and their empirical results suggest that the process is subjected to a mixed power system where no one party appears to have the absolute power potential to shape IAS content.

Königsgruber (2010, 2011) developed a model to identify situations where companies have incentives to lobby the political principal instead of participating in the usual due process of accounting standard setting. His model has been subjected to criticism and considered in some aspects counterfactual. Anyway, Camfferman and Zeff (2011) support that the Königsgruber findings are still relevant because the author tries to provide a realistic representation of the political influences on accounting standard setting at an international level. Königsgruber (2013) proposed a further study by designing a model to demonstrate that interested parties could use information to exert their lobbying power especially in situations where the regulator has to make a decision on whether to promulgate or endorse a new accounting standard and does not have an extensive knowledge of all connected aspects and potential consequences following the adoption of the new standard. Politics of accounting standards setting at a "transnational" level is also the subject of a study of Botzem (2012), who started from the study Camfferman and Zeff (2007) on history of the IASC, and considered the IASB evolution with a simultaneous functional, institutional, and political perspective. This study makes reference to the legitimacy concept and posits the Anglo-American orientation of the IASB. However, Botzem (2012) does not deeply consider the implications and the role of the convergence of IFRS with U.S. GAAP and how the convergence project has raised the main concern of the legitimacy weakness of the IASB even after its transformation from the former IASC.

Therefore, the present paper aims to contribute to this relevant debate in order to devote more attention to the effects of outright political interference to the still evolving process toward a possible global adoption of IFRS. Our study follows a hardly predictable scenario which presently sees the IASB as the actor in search of its legitimation and the U.S. environment as the main jurisdiction that does not yet require IFRS for its domestic issuers.

3.2 The role of Politics in the EU adoption of IFRS through the endorsement process

In today's capital markets, enforcement of accounting standards takes places at a national level through various types of regulatory structures such as local stock exchanges, government agencies, and regulatory organizations. In the European Union (EU) countries, standards must be endorsed by the EU before they are sanctioned by the EU and its member states. The EU endorsement process is set forth to provide IFRSs with the power of law. This process probably represents the most complicated example of IFRS endorsement in the world and it is useful to raise some issues regarding the political interference within the accounting standard setting process.

The EU's IFRS endorsement process includes several bodies, one of these is the Accounting Regulatory Committee (ARC). ARC is composed of representatives from the Member States, chaired by the European Commission and established by the Commission in accordance with the requirements contained in Article 6 of the IAS Regulation (EC/1606/2002). ARC has a regulatory function of providing an opinion on Commission proposals of whether to adopt an international accounting standard, as stated in Article 3 of the IAS Regulation and comprised of Member State Representatives.

Following the enactment of Regulation no. 1606/2002 on International Accounting Standards, the application of IAS/IFRS by listed companies in the EU from 2005 onwards became subject to EU endorsement. The endorsement procedure in the EU gives them the power to accept, amend or reject newly promulgated IAS/IFRS standards into EU law. Any decision of the Commission to endorse IAS/IFRS is based upon the opinions of ARC and the technical advice of the European Financial Reporting Advisory Group (EFRAG). EFRAG is a private sector body in Europe known as 'Member Organizations'. As a technical committee, EFRAG provides the European Commission with technical advice before the Commission endorses any IAS/IFRS. EFRAG participates with the ARC as an official observer. Additionally, EFRAG invites IASB members as observers to its Technical Expert Group meetings and holds joint public meetings with the IASB regularly. EFRAG operates through a Technical Expert Group (EFRAG-TEG), composed of highly qualified experts. EFRAG-TEG assesses whether the standard to be endorsed complies with Community law and in particular, the requirements of Regulation 1606/2002 as including understandability, relevance, reliability, and comparability as well as the true and fair principle as set out in the 4th Directive 78/660 and the 7th Directive 83/349. Opinions are issued after a wide consultation with interested parties in the European area, in accordance with its due process

(EFRAG 2013). EFRAG also participates in the IASB's due process. Except for the chair, voting members of EFRAG provide their services gratuitously. It appears that the EC has an important role in issuing accounting standards. In fact, although the EC does not issue accounting standards directly, it participates actively in standard issuing by involving EFRAG in IASB's due process and by endorsing IAS/IFRS if they meet the requirements in the European Directives.

During the same period of issuing Regulation 1606/2002 (June 2002), EFRAG gave its opinion on the endorsement of all existing IAS/IFRS/SICs. They stated that all existing IAS/IFRS/SICs were not contrary to the 4th Directive and 7th Directive and met the requirements of understandability, relevance, reliability and comparability and the true and fair principle. Thus EFRAG suggested IAS/IFRS endorsement. However, in 2002, EFRAG took note of IAS 39 because of its complexity and effect on hedge accounting standards and reporting. They welcomed that the IASB was currently in the process of improving IAS 39.

By July 2003, ARC had voted unanimously, favoring the draft Commission Regulation proposing endorsement of all existing IAS/IFRS/SICs, with the exception of IAS 32 and 39. The ARC Chairman insisted on the IASB and the banking and insurance industries finding an acceptable and prompt solution for IAS 32 and 39. In fact, European Regulation no. 1725/2003 endorsed all existing IAS/IFRS/SICs with the exception of IAS 32 and IAS 39. Based on EFRAG and ARC recommendations, the Commission decided not to endorse IAS 32 and 39 on financial instruments' disclosure, presentation, recognition, and measurement. The EC stated that accounting for financial instruments and derivatives required a high-quality standard relevant for the Community capital market. Therefore, they elected not to adopt IAS 32 and 39.

By 2004, EFRAG and ARC had endorsed the IASB's amended standard on financial instruments, IAS 32, but not IAS 39. The failure to endorse IAS 39 became known as the "carve out" of IAS 39. This "carve out" illustrates the strong intervention of third parties, EFRAG, ARC and the EC in the accounting standards setting endorsement process in the EU. Later in 2004 the IASB, using its due process, amended IAS 39. EFRAG voted 5 supporting endorsement and 6 opposing endorsement. These voting results failed to meet the two third's majority needed for a non-endorsement advice. EFRAG decided not to issue any advice on whether or not to endorse IAS 39.

The "carve out" of IAS 39 was predicated on two EC concerns. One concern was the possible inappropriate use of the full fair value option for all financial assets and liabilities, especially regarding a company's liabilities. A second concern was of European banks, the hedge accounting provisions, which presented an issue for banks operating their risk management.

After these concerns were debated and comments from the ARC and EFRAG were considered, the EC considered the "carve out" as the best alternative for endorsing IAS 39. In September 2004, the EC presented a draft Regulation of IAS 39 with the exception of the full fair value and portfolio hedging of core deposits. In October 2004, ARC expressed its opinion in favor of this draft even after considering some of EFRAG's concerns (EFRAG 2004). Finally, the EC issued Regulation no. 2086/2004 endorsing the "carve out" version of IAS 39 (European Commission 2004). A year later, EFRAG and ARC gave support to the IAS 39 "carve out" version. By the end of 2005, the EC endorsed and the EFRAG and ARC expressed positive opinions on Regulation no. 2106/2005, that is, the "carve out" version of IAS 39.

While the Commission confirmed that it had no intention of becoming an accounting standard setter, its actions regarding IAS 39 highlight its strong influence on standard-setting. In fact, the IASB agreed to discuss with the European Banking Federation its proposals on a new hedging method and to revise IAS 39 regarding the full fair value option and to consider concerns expressed by inter alia the European Central Bank and the Basel Committee of banking regulators.

During the financial crisis of 2007, the EC again intervened on the IASB standard-setting process. Specifically, the EC was concerned about fair value accounting of financial instruments as issued in IAS 39 and in the more recent IFRS 7-Financial Instruments: Disclosures "Reclassification of Financial Assets". Initially, the IASB issued an amendment to IAS 39 and IFRS 7 that permitted an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition (also referred at as the fair value option)) out of fair value through the profit or loss category in specific circumstances. This amendment was issued without the normal due process of the IASB, that is, no exposure draft was published. EFRAG endorsed this amendment without following its usual due process and the EC issued the Regulation no. 1004/2008 to endorse the above amendment. These swift leaps to action were in response to the urgency of the financial crisis.

After a meeting with European stakeholders, the EC voiced to the IASB an urgent need for more guidance on the application of fair value in inactive markets. Given the global nature of the financial crisis, the EC preferred a globally coordinated solution. This ongoing financial crisis further exacerbated the EC's concern for urgency on this guidance. The IASB's reaction should have been an appropriate due process. On October 31, 2008, the IASB published a document setting forth guidance that stated that transaction prices and broker or pricing service quotes could be inputs when measuring fair value if an active market did not exist. This clarification was

acceptable to European companies, that is, to apply internal models to calculate the value of financial instruments in inactive markets[1].

Even more recently, in November 2013, before a meeting of the European Union's Economic and Financial Affairs Council (ECOFIN), the special advisor to EU Commissioner Michel Barnier, Mr Philippe Maystadt, presented the following report (Maystadt 2013): "Should IFRS standards be more 'European'? The mission was to reinforce the EU's contribution to the development of international accounting standards". It provides several recommendations for enhancing the EU's role in promoting high quality accounting standards. Since the Commission does not have the necessary technical resources, EFRAG is responsible for technical discussions with the IASB in the name of the European Union. Therefore, Maystadt primarily suggests consideration of the option of transforming EFRAG with the aim of reinforcing its structure and giving it a legitimate voice to represent European positions to the IASB when the IASB's standards are being developed.

Moreover, Maystadt asserts that EFRAG should focus on its responsibility regarding IFRS standards, in accordance with what the IAS Regulation proposes:

- to analyze the legal possibility of establishing a system of compulsory contributions/levies paid by listed companies that use and benefit from IFRS;
- to extend the current General Assembly membership to include National Funding Mechanisms and other private and/or public organizations that are contributing financially or in kind and invite the European Commission to attend the meetings of the General Assembly;
- to replace the current Supervisory Board with a *high-level Board*, which would approve the comment letters addressed to the IASB and the endorsement advice letters to the Commission, relying on the work of a technical group; and
- to change the role of the Technical Experts Group (TEG) by turning it into an advisor to the Board instead of having full authority to determine the positions of EFRAG.

These recommendations are addressed mainly to strengthen the role of EU into the decision making process prior to EU endorsement.

In fact, Maystadt proposes that the *high-level Board* should be composed of 16 members belonging to three main groups (European public institutions, Stakeholders, National Standards Setters) and a president. The new Board would approve letters prepared by TEG, in particular, comment letters addressed to the IASB and endorsement advice letters addressed to the Commission. According to Maystadt, this could also allow a comment period extension on IASB exposure drafts, as EFRAG could need more time to collect comment letters from European

[1] This same clarification was issued by the FASB and SEC with the Release 2008-234.

stakeholders, including the national authorities. The modification of the comment period may increase the European influence on the IASB and facilitate the involvement of ARC.

The Maystadt report and its recommendations received wide support from the Member States and the European Parliament. Therefore EFRAG undertook to implement them swiftly. The new governance structure became effective on 31 October 2014 with the appointment of the EFRAG Board and EFRAG TEG assuming its advisory role. The EFRAG Board became fully representative of European interests and decides on all EFRAG positions. EFRAG's mandate has been widened to include economic policy and strategic considerations other than technical assessments. Moreover, in order to make EFRAG a fully representative, legitimate, and all-inclusive organization, the different stakeholders (preparers, auditors, regulators, investors, National Standard Setters) have substantial influence in EFRAG's due process as they are full members of the EFRAG Board. Since the relationship with ARC and the European Parliament has been also enhanced, European Commission considered the new EFRAG able to make Europe more influential and cohesive in its participation in the IFRS standard-setting process.

If all these efforts are seriously addressed at the European level to enhance the European Union's influence on international accounting standards, it does not sound strange that the IFRS Foundation raised some concerns about the Maystadt Report (IFRS Foundation 2013). For example, the IFRS Foundation is concerned that the proposal of "Transforming EFRAG" might result in further lengthening of what is already a very lengthy due process procedure. At the same time the IASB has concerns about the risks associated with Europe introducing an endorsement mechanism that has the potential to introduce changes to European accounting standards that deviate from international norms. It is useful to highlight that, according to the IFRS Foundation's comments, the modification of the endorsement process could be worthless in terms of the European Financial Reporting Strategy as the European endorsement process already represents the EU's regulatory sovereignty in accounting that was not "renounced" in the Maystadt Report (IFRS Foundation 2013, 2).

The above described concept of endorsement is not unique to Europe but is used here to understand how politics and business environment can influence the "adoption" of IFRS in countries and legal jurisdictions around the world.

3.3 The role of Politics in the path to IFRSs as Global GAAPs.

We suppose that the IASB has emulated the FASB's organization structure and due process in order to gain its legitimation throughout the world and result in the legitimate body to issue accounting standards to be adopted by all countries. Its actions consistent with legitimacy theory input and throughput appear successful in producing globally recognized high-quality transparent accounting standards. Furthermore, world organizations supported the IASB and its IFRSs and encouraged further convergence of the IASB with the FASB. At this same time, political actions slowed down the convergence process and/or resulted in modifications not always consistent with the initial commitment between IASB and FASB. Following are some examples of encouragement and impediments to convergence from political and transnational bodies.

Political representations of world nations, in responding to the financial crisis, urged the IASB and the FASB to converge. At the G-20's April 2009 meeting, they concluded that (G-20 2009, 5): "*Standard-setters should make significant progress toward a single set of high-quality global accounting standards*." In June, the U.S. Treasury made the same recommendation (Department of the Treasury 2009, 17): "*We recommend that the accounting standard setters make substantial progress by the end of 2009 toward development of a single set of high-quality global accounting standards*."

These cries for convergence were fully supported by the Financial Crisis Advisory Group (FCAG) that was established to advise the IASB and the FASB about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment. FCAG expressed that while the maintenance and enhancing of high-quality accounting standards are of utmost importance and difficult issues remain to be resolved in the convergence process, they shared the sense of urgency expressed by the G-20 and U.S. Treasury. FCAG however, disagreed with any attempt on the part of national, regional or global entities to amend any standards of the IASB as published. They stated the following (FCAG 2009, 12).

> "*we disagree strongly with any attempts on a national or regional basis, such as occurred in 2005 and again in late 2008 and early 2009, to allow either "carve-ins" or "carve-outs" from full IFRS. Any retreat from IFRS as issued by the IASB to national or regional standards would have serious consequences for the global financial system. First, it would limit the ability of financial market participants, prudent regulators, and others to compare the economic performance and condition of financial institutions and industrial companies operating similar businesses but based in different jurisdictions. Second, it would reinstate impediments to cross-border capital-raising and, in particular, the flow of capital to developing countries. Third, it would subject non-US companies that are SEC registrants that do not follow IFRS as issued by the IASB to US GAAP reconciliation. Finally, and perhaps irretrievably, it would dissuade countries on*

the verge of adopting or converging with IFRS from doing so, and it would halt the momentum that has been created for convergence between IFRS and US GAAP and, potentially, for "adoption" of IFRS in the United States."[2]

By March 2008, the IASB and FASB had published a discussion paper, *Reducing Complexity in Reporting Financial Instruments*. Subsequently, the IASB decided to reconsider accounting for financial instruments in three phases: (1) classification and measurement; (2) impairment methodology; and (3) hedge accounting.

The first phase of this project, IFRS 9 which partially replaced IAS 39, was issued in November 2009. In December 2011, the IASB amended IFRS 9 to make the effective date for annual periods beginning on or after January 1, 2015, and to not require the restatement of comparative-period financial statements upon initial application. Then on November 28, 2012, the IASB issued an Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)). For the second phase of this project, the IASB issued the supplementary document *Financial Instruments: Impairment,* published in January 2011. The comment period closed on April 1, 2011, but redeliberations are on-going. For the third phase of this project, the IASB published on September 7, 2012, a draft of the forthcoming general hedge accounting requirements to be added to IFRS 9: Financial Instruments.

Financial instruments came to the attention of the IASB and FASB at about the same time. However, the FASB took a different approach to modifying its *Accounting Standards Codification* (ASC) Topics 825, *Financial Instruments* and 815, *Derivatives and Hedging*, in using a single solution. This represented a non-linear progression between the IASB's FASB's standard setting agendas.

This marked the height of the FASB and IASB Convergence projects. By 2011, the IASB went alone in developing its conceptual framework. The SEC's 2012 work plan stopped short of recommending "adoption" of IFRS for its domestic registrants. Finally, in July 2014, Hans Hoogervorst, chairman of the IASB stated (Cohn 2014):

"*The FASB decided to stick to current American practices and leave the converged position. It's a pity. Convergence would have allowed the U.S. to make the ultimate jump to IFRS. FULL convergence with the U.S. leading to the creation of one single set of global accounting standards is no longer an achievable project*."

It appears that the two Boards are working in a non-linear trend in developing accounting standards. The largest nations in the world, including Japan, China, India, and the U.S. have not

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[2] Available at http://www.ifrs.org/News/Press-Releases/Documents/FCAGReportJuly2009.pdf (downloaded 2/28/2013).

adopted IFRS for their domestic registrants. In fact, it is true that China has largely based its domestic accounting standards on IFRS. India's current accounting standards are based on the older IAS, with some large Indian companies using IFRS for their consolidated financial statements. Japan now permits most listed companies to use IFRS. So this precludes one from saying that with regard to the largest nations IFRS is the "adopted" global accounting standard. We contend, as presented by legitimacy theory, that convergence may be unachievable when the diffusion of decision-making is voluntarily applied to multiple democratic nations of delegated authority, blurring the responsibility for decision-making at the global level. That is, because of varying national influences of political, business and legal environments of each of the jurisdictions' standard-setting bodies, global acceptance of one set of accounting standards has been elusive. Following is an exposition of how the IASB appears to be emulating the FASB in achieving global IFRS adoption.

4. Legitimacy of the IASB Compared to the FASB Standard Setting.

4.1 Gaining Input Legitimacy—Organization Structure

-Insert Figure 1-

The IASB sought input legitimacy by implementing a formalized organization structure similar to that of the FASB. The organization structure of FASB and IASB are now similar in that they both have a board or commission that monitors them, a foundation or board of trustees, an advisory council, and an interpretations committee or emerging issues task force as is depicted in Figure 1.

The SEC's mission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (SEC 2013). The Securities Act of 1933 requires that investors receive financial reports and other significant information about a security. The SEC Act of 1934 empowered the commission to require periodic financial reports of companies with publicly traded securities. The SEC recognizes the FASB's pronouncements as authoritative as they rely on the FASB to establish accounting standards. The SEC and FAF regulate and oversee the stable and independent financing of the FASB through the PCAOB.

Like the SEC, the IFRS Foundation Monitoring Board is responsible for appointing Trustees and ensuring that the Trustees discharge their duties as published in the IFRS Foundation

Constitution and insuring an independent and stable source of financing for the Foundation. The IFRS Foundation is responsible for developing 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." (IFRS Foundation 2017, 9). They also serve to enhance the public accountability of the IASB, safeguard the independence of the IASB and promote the rigorous application of its standards. Similar to the SEC, the IFRS Foundation has delegated standard setting to its board: the IASB. Like the FASB, the IASB is the independent standard-setting body of the IFRS Foundation, made up of full-time experts who are responsible for the development and publication of accounting standards and for approving interpretations as developed by the IFRS interpretations committee.

Both boards, FASB and IASB, have an advisory council that advises them on technical issues and project priorities. They also have an interpretations committee that is responsible for interpreting standards promulgated by the boards. Implementation of these similarities in organization structure was a strategy consistent with that used by the IASB in achieving legitimacy as the global standard setter. This strategy gained momentum as many countries considered adopting IFRS. IFRSs were touted as high quality and transparent, thus resulting in comparable financial reporting for domestic and cross-border filings.

The IASB's actions consistent with input legitimacy strategy became further enhanced when the FASB became a member of the newly formed Accounting Standards Advisory Forum (ASAF). The ASAF is composed of 12 national and regional standard setters charged with improving cooperation among standard setters from across the globe and advising the IASB in promulgating IFRS. The convergence process heightened when the SEC began a work plan to consider incorporating IFRS into the financial reporting system for U.S. issuers (SEC 2012). The IASB's actions consistent with input legitimacy theory seemed to be working.

4.2 Gaining Throughput Legitimacy—Due Process

In order to continue gaining global acceptance of its standards, the IASB sought throughput legitimacy by adopting a due process similar to that of the FASB. To garner global authoritative support for its standards (Keohane, 2006; Lehman, 2005; Arnold and Sikka, 2001; Ashbaugh and Pincus, 2001), the IASB affirmed that its standards are developed through a formal and broad consultation from a due process that involves accountants, financial analysts and other users of financial statements, academics and organizations from around the world. The IASB, like the

FASB publishes exposure drafts and/or discussion papers and considers comment letters before issuing a final standard. Sometimes this due process includes round table discussions.

-Insert Figure 2-

The due process that leads the FASB and IASB to the development of any new codification/standard and revision of existing ones includes the following steps, with the Trustees having the opportunity to ensure compliance at various points throughout (IFRS Foundation 2013, FAF 2014).[3]

1. Setting the agenda and planning the project. The Board Chairperson decides whether to add a project to the technical agenda after consultation with stakeholders, Board staff, and the foundation trustees.
2. Developing and publishing the discussion paper. After a project is added to the technical agenda, the board deliberates in public meetings. Sometimes the Board publishes, as its first publication, a *Discussion Paper*. The discussion paper explains the issue and provides possible approaches in addressing the issue. The discussion paper is used to solicit early comments from constituents.
3. Developing and publishing the *Exposure Draft.* The board is required to issue an *Exposure Draft*. The *Exposure Draft* is in the form of a proposed standard (or amendment to an existing standard) and is a means of eliciting comments from stakeholders.
4. Public roundtables. The boards may elect to hold a public roundtable meeting on an *Exposure Draft* if deemed necessary.
5. Research. The staff considers all inter alia comments received on any discussion paper, *Exposure Draft* and suggestions made by their respective advisory councils, working groups and other stakeholders.
6. Published codification/standard. The Board re-deliberates publically and votes. If there is a majority affirmative vote, the accounting codification/standard is published.
7. Post implementation. After the codification/standard is issued, the staff and the Board members are devoted to hold regular meetings with interested parties to help understand unanticipated issues related to the practical implementation and potential impact of its proposals.

-Insert Table 2-

[3] Source: http://www.ifrs.org/How-we-develop-standards/Pages/How-we-develop-standards.aspx (downloaded 2/27/2013) and http://www.fasb.org/facts/due_process.shtml (downloaded 9/24/2014).

The IASB does not have a stable source of funding. While the FASB can rely on "assessed fees" under SOX, the IASB is entirely dependent on voluntary contributions from countries that have put in place national financing regimes. This voluntary contributions process may also have implications on "legitimacy". In fact, this voluntary funding mechanism differs between countries. Most countries have either established a levy on companies or provide an element of publicly supported financing to the IFRS Foundation. Our review of the 2013 annual report of the FASB and IASB suggests similar sources of funding in terms of gross contributions. Both Boards generate a significant proportion of their operating income from fees assessed on stock exchange registrants. However for the IASB the fees are collected voluntarily and raise by its monitoring board where the feel are collected by law by the PCAOB independent of any FASB body. However, even though the IASB receives contributions for its operations from several contributing countries, both Boards generate between 20% and 30% of their income from sources other than assessed fees.

5. Gaining Output Legitimacy—Deficit or Gap between the FASB and IASB

It is important to say that neither the FASB nor the IASB has any enforcement powers, being reliant on securities regulators to enforce (or not enforce) their pronouncements. In other words, any standard-setting body is ultimately answerable to national governments, and adoption of a single set of global accounting standards would not, in itself, guarantee that those standards would be accepted, policed and enforced similarly by differing national securities regulators. Therefore, we posit that the IASB has achieved input legitimacy and throughput legitimacy, but not output legitimacy.

Initially, the IASB faced difficulties in establishing itself across the globe. In fact, the institutional legitimacy of a private standard setter could indeed be difficult to assure, since there are various conflicting interests that could be affected by its accounting rules (Schmidt 2002). The IASB used a strategy, consistent with legitimacy theory, to gain recognition across more than 120 countries (Richardson and Eberlein 2011). The IASB assessed that the FASB had gained authoritative support by countries outside of the U.S. as well as at home. That is, many multinational companies outside of the U.S. were using U.S. GAAP to achieve cross-listing outside of their home country. The IASB then used a method consistent with input legitimacy by replicating the FASB whose perceived independence and technical expertise in accounting standard-setting was respected across the globe. In this sense, the IASB was probably influenced

by the U.S. SEC to adopt the FASB's structure/processes (Zeff, 2012). With the advent of the IASB's Memorandum of Understanding with the FASB in 2002 and comprehensive reorganization in 2000 – including the IASB as full-time independent board members, an IASC Committee Foundation, an advisory council and interpretations committee in 2000 – the IASB began to legitimize itself by emulating the due process and organization structure of the FASB.

The implementation of U.S. GAAP by non-U.S. companies was often voluntary and without threat to non-U.S. companies' domestic standard-setting bodies. To achieve throughput legitimacy in the exercising of its power, the IASB adopted the FASB's due process. This open forum standard-setting process, requiring input to be considered from all interested parties, gained the respect of many national capital markets and global organizations like the International Organization of Securities Commission (IOSCO).

However, the IASB's strategy consistent with legitimacy theory strategy came with "immanent" (IASB's commitment to due process) and "transcendental" (rational reconstruction by comparing the IASB due process to a standard based on potentially unattainable standards of rational engagement, dialogue, and decision-making") criticisms (see Antonio 1981; and Habermas 1994). That is the due process of the FASB was attainable at a national level where the SEC adopted, policed and enforced compliance with national GAAP. While the IASB is committed to a due process where "adoption", policing and enforcement of its standards at a global level are desired, this goal has been empirically illusive. Our study of the literature confirms that national politics remain a critical component of standard-setting and has eroded the strategy taken on by the IASB, consistent with output legitimacy, to globalize its accounting standards (Dahl 1999, Grant and Keohane 2005, Richardson and Eberlein 2011). The IASB does not have the rulemaking authority or policing and enforcing of its standards on a global level. In fact, most countries claiming to have accepted IFRS have not "adopted" but have pseudo-"adopted" IFRS. We argue that the IASB has used a process similar to input and throughput legitimacy to pursue its global GAAP adoption. We contend here that output legitimacy is eroded when the diffusion of decision-making is voluntarily applied to multiple democratic nations of delegated authority, blurring the responsibility for decision-making at the global level.

National democratic processes have impeded the IASB's actions consistent with the output legitimacy theory strategy (Dahl 1999, and Grant and Keohane 2005). The FASB promulgates financial accounting standards, now referred to as FASB Accounting Standards Codifications. These codifications are part of U.S. GAAP. We use descriptions of the IASB's and FASB's organization structure and due process along with empirical findings to explain why differences in

the standard-setting process may impede the convergence of accounting standards between the IASB and FASB. There are differences in how the Boards interact within their political and business environments to affect the due process for standard-setting.

The FASB is surrounded by pressures from the SEC, Congress and the business community. A few examples reveal the interplay between the FASB and its environment. The FASB is recognized by the SEC as the source of authoritative accounting standards for its registrants. While the FASB is the private sector body that issues accounting standards, the SEC is a governmental agency that has statutory authority to issue accounting standards for publicly held companies under the Securities Exchange Act of 1934. The SEC recognizes the FASB as the standards setting body in the U.S. in its Accounting Series Release No. 150, codified in Financial Reporting Release No. 1, Section 101 and again in its Sarbanes-Oxley Act of 2002. However, should the SEC deem that the FASB ceases to adhere to the provisions of the SEC Act (i.e., standards that do not protect the interests of investors), and then the FASB may lose its role as the U.S. standard-setter. The SEC can veto the FASB, but the FASB cannot veto the SEC (Horngren 1985). Hence, the SEC's veto power over the FASB is the link between the FASB and politics.

The FASB's authority and independence have been challenged by the SEC. For the most part, the SEC has accepted the FASB's standards, but in a few instances, has not. The SEC has vetoed the FASB's proposal, suspended a prevailing FASB regulation or at other times issued a superseding regulation. For example, Melumad and Shibano (1994, 6) state that the:

"*FASB-SEC disagreements occurred over standards regarding:*

(1) oil and gas (the SEC rejected SFAS No. 19 in 1977),

(2) software costs (the SEC suspended SFAS No. 2 in 1983),

(3) defeasances (the SEC suspended FASB regulations in 1982),

(4) leases (the SEC superseded Opinion No. 31 in 1973),

(5) investment tax credits (the SEC superseded Opinion No. 2 in 1962)

(6) changing price levels (the SEC superseded the FASB Exposure Draft in 1976),

(7) *goodwill and intangibles in bank acquisitions (SEC Bulletin 42 superseded the FASB's policy).*"

These are just some of the disagreements that have been vetted publicly. Some theorize that when the FASB's position is not close to the SEC's, it affects the standard-setting performance (Melumad and Shibano 1994).

While the FASB is supposed to be an independent standard setter, more recently its independence has been challenged; specifically when making changes on mark-to-market fair

value accounting standards in response to political pressures. A disagreement occurred when the SEC expressed enforcement concerns about the FASB's fair-value accounting standard. The SEC and U.S. Congress put strong pressure on the FASB to change its fair value rule (see Laux and Leuz 2009; Wallison 2008; Whalen 2008; Forbes 2009). Bankers put pressure on the FASB as it was concerned that marking assets to market during the financial crisis might have unintended consequences regarding violation of company contracts and debt covenants (Laux and Leuz 2009, 826):

"*The American Bankers Association in its letter to the SEC in September 2008 states:*

'The problems that exist in today's financial markets can be traced to many different factors. One factor that is recognized as having exacerbated these problems is fair value accounting.' Similar concerns were also shared by the U.S. Congress, which put strong pressure on the FASB to change the accounting rules. See also, e.g., Wallison (2008), Whalen (2008), and Forbes (2009)."

FAF has also been challenged by its constituents. The Investors Technical Advisory Committee (ITAC) in 2009 recommended that FAF reverse their decision of 2008 that reduced the size of the FASB from seven to five and further suggested that FAF act as a buffer, "protective shield" for the FASB to enhance the Board's independence. By 2012 FAF's revised due process brought the board size from five members back to the original size of seven members. In FAF's 2004 Annual report they state (FAF, 2005, 3):

"*While the Trustees of the FAF leave the complex task of accounting standard-setting to the experts who make up the FASB and the GASB, the FAF has a responsibility to respond when the independence of the standard-setting process is at risk. This occurred during 2004 when legislative interference was threatened in connection with the share-based payment project. While we respect the right of Congress to set accounting rules if it chooses, we believe that doing so would dangerously compromise the independence of the FASB and, by politicizing standard-setting, would compromise the credibility of the resulting accounting standards. Consequently, the Trustees issued a public statement expressing "[their] strong and unanimous opposition to 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 or any other topic." Our message was reinforced when individuals and organizations stepped forward to express similar sentiment and to reiterate the message that if special interests are able, through legislation, to overturn expert accounting judgment, necessary and timely improvements in financial reporting will be delayed or denied. Congress has thus far*

chosen to leave accounting standard-setting to an expert process conducted by the FASB and subject to SEC oversight, a choice that we believe is very wise".

Even with this threat to the FASB, the SEC chose to change the date of compliance for the share-based payment standard (see SEC 2005). These examples support the belief that the SEC does at times exercise its statutory power and may continue to do so if IFRS is adopted by the FASB (Hail, Leuz and Wysocki 2010).

There is the influence of not only the SEC but the business and political environments that have strong-armed the FASB. There was a political battle over stock options during the 1990s (Frontline 2002). Companies had avoided expensing stock options and recording them on their balance sheet in the 1990s. Remember, this was when technology companies were paying their CEOs almost exclusively with stock options. If the FASB finalized its proposed rule requiring expensing of stock options, high-tech companies' profits would have, on average, plunged downward by 60% (see McNamee et al. 2000). In fact, the Senate passed a non-binding resolution to condemn the FASB's proposed recording of stock options. James Hooton, (2002) chief of Andersen's worldwide auditing firm, said that this was the first time the FASB had been so influenced by political and commercial interests. He also commented that moving accounting into politics moves the focus of the FASB from the best standard and instead to commercial interests. Arthur Levitt, then chairman of the SEC, said that never before had so many CEOs come to his office to urge the SEC to prevent the FASB from enacting this proposed rule (Levitt 2002). In fact, Mr. Levitt went to the FASB to urge them not to enact the proposed rule. The result was that although options represent a claim on the company, the proposed FASB rule did not pass and stock options continued to be treated as a footnote disclosure.

These examples help to understand how the convergence of the FASB with the IASB may be impossible. The FASB cannot ignore the power of its local business community and the SEC. Further, FASB paychecks are funded by the business community through the PCAOB as mandated in the congressional Sarbanes-Oxley Act. The SEC and congress may fear losing control of standard-setting if *cart blanche* authority for financial accounting standard-setting is given to the IASB. Hence the political and business communities' influence on U.S. GAAP standard-setting may preclude convergence of U.S. accounting codifications with IASB international financial reporting standards.

Moreover, during this financial crisis, several issues emerged resulting in the IASB's commitment to work with the FASB to effect globally consistent solutions. Together, the IASB

and the FASB established a process for the rapid consideration of issues raised by the EC and by other stakeholders.

More recent convergence projects that have resulted in possible divergence include revenue recognition, financial instruments, leases and insurance contracts. For their joint project on leases, both boards received over 600 comment letters, held eight public roundtables and dozens of meetings with issues on every front. Stakeholders commented that the proposed lease accounting would require liabilities on the lessee's balance sheet (PWC 2012). Stakeholders in the U.S. were concerned about the definition of a lease, scope exceptions, income statement recognition and measurement. They contended that putting more liabilities on the balance sheet may result in counter-intuitive reporting causing higher liabilities and thus hamper firms' ability to maintain debt covenant requirements. The revenue recognition project was to conclude in 2015 but has been extended until early 2017. The current chief accountant of the SEC, James Schnurr has suggested allowing voluntary incorporation of IFRS into U.S. firm's financial statements. Barlas (2015) states that there is continued "support for a single set of high-quality globally accepted accounting standards." Moreover, convergence projects continue to be in redeliberations and in some instances not jointly between the FASB and IASB.

6. Roadmap to IFRS Global Adoption: Proposed Solution

The IASB is seen as legitimate in organization structure (input legitimacy) and due process (throughput legitimacy). What the IASB is lacking is output legitimacy or policing and enforcement of its standards consistently, worldwide, and with rigor. In fact, the IASB followed a blueprint of U.S. standard setting for configuring its own organization. Botzem (2012) observed that this blueprint includes a consultation procedure, i.e., due process, a board membership of highly competency professionals with practical expertise. Botzem also advocated a governance and administrative function independent of any direct control over standard-setting activities at the state level as well as of reliance on special interests arising from contributions to funding the IASB's standard-setting activities. The current institution, IASB, is characterized by "expert-based and self-regulation but without accountability" (Botzem 2012, p. 123).

This could be the reason why many countries have pseudo-"adopted" but not "adopted" IFRS. For example, if one is trying to compare an Australian pseudo-IFRS-compliant company's financial report with that of a European's pseudo-IFRS-compliant financial report, these financial statements may not be comparable, as each country has endorsed its own version of IFRS. Also,

IFRS must go through a national endorsement process where pseudo-adoption timelines may also vary by national jurisdiction.

We propose an internationally legitimate regulator (IR) to police and enforce IFRS. IR board members would need to be viewed as highly qualified and representative of the countries and stock exchanges worldwide. This IR would be the output legitimacy arm needed of the IASB to insure rigor in compliance with IFRS as published by the IASB. The IR would clarify the standard setter's authority and would be charged with reviewing applications for IFRS certification. The IR would work to gain acceptance of its IFRS compliance certification from all stock exchange across the world.

We suggest that this role could be exerted by the already existing organization IOSCO. In fact, IOSCO is the international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector. IOSCO develops implements and promotes adherence to internationally recognized standards for securities regulation. It works intensively with the G20 and the Financial Stability Board (FSB) on the global regulatory reform agenda[4]. Moreover, IOSCO has already started the collaboration with IFRS Foundation by signing in 2009, and revising in 2013, a Memorandum of Understanding to strengthen the institutional framework of the International Financial Reporting Standards Foundation. The European Commission, the International Organization of Securities Commissions, the Financial Services Agency of Japan, and United States Securities and Exchange Commission, together represent the authorities responsible for setting the form and content of financial reporting in the majority of the world's capital markets. The Trustees of the International Financial Reporting Standards Foundation (IFRSF) agreed to strengthen the linkage between capital markets authorities and IFRSF. Given that IFRS are increasingly used around the world, its regulatory union with the G20 countries and other regulatory bodies would further enhance the public accountability of the IFRSF to support the increasing use of IFRS around the world.

To this end, they established the IFRSF Monitoring Board (MB) to serve as a mechanism for formal interaction between capital markets authorities and the IFRSF, thereby facilitating the ability of capital market authorities that allow or require the use of IFRS in their jurisdictions to effectively discharge their mandates relating to investor protection, market integrity and capital formation[5] (IFRSF MB 2013).

[4] Source: IOSCO website.

[5] Source: Memorandum of Understanding to strengthen the institutional framework of the International Financial Reporting Standards Foundation (2013), Article III, par. 6.

The MB operates by developing a work plan and intends to update it periodically. The 2017 work plan (IFRSF MB 2017) focuses on three key areas: a) reviewing the Trustees' oversight of the IASB's standard-setting process; b) monitoring and conferring with the Trustees on their responsibilities; and c) overseeing the Monitoring Board´s organization and governance activities. While the second and the third areas concern control activities on IFRSF governance, the first one refers to the dialogue with the Trustees on accounting matters of broad public interest for consideration by the IASB. In respect to this, the MB may refer accounting issues to, and will confer regarding these issues with, the Trustees and the IASB Chair.

This is an example of how the MB could have a strategic role in enforcing accounting standards worldwide. In fact, in their 2017 work plan, the MB and IFRSF agree to discuss the following accounting issues:

- the IASB´s effects analysis in setting and revising accounting standards;
- achieving consistent implementation of new accounting standards, including IFRS 15 on Revenue from Contracts with Customers, IFRS 9 on Financial Instruments, IFRS 16 on Leases, and IFRS 17 on Insurance Contracts.

The IOSCO, through its participation to IFRSF MB, could represent the "international enforcer" of IASB and it could achieve its legitimacy mainly by the fact that capital markets authorities that participate in the Monitoring Board are already responsible for setting the form and content of financial reporting in jurisdictions where the use of IFRS is mandated or permitted, and they are able to more effectively discharge their mandates regarding investor protection, market integrity and capital formation through the IFRSF MB. In this sense, this "international enforcer" could more easily gain acceptance of its IFRS compliance certification from all stock exchange across the world.

For example, the U.S. SEC, which represents one of the largest and most respected regulatory bodies in the world and is a member of IFRSF Monitoring Board**,** has experience in regulating foreign private issuers complying with IFRS as published by the IASB. Its history in enforcing IFRS reporting has been rigorous and transparent. Presently, the U.S. SEC has a ten-year history in overseeing the financial reports of foreign issuers preparing their financial statements in compliance with IFRS, since 2007 when the SEC disseminated international series release number 1306 entitled, "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S.

GAAP[6]." According to SOX instructions, the SEC reviews, every three years, firms' financial reports to assess issues that might impair its capital markets. The exchange of letters between the firm and the SEC is transparent as they are released publicly. In some instances, the SEC's review results in an enforcement action against a firm. The rigor in strength of the law and regulatory practices in the U.S. of protecting investors is also supported in the accounting literature (La Porta et al. 1998, Campos 2003, De Lange and Howieson 2006).

Of course, the SEC, as well as the other members of IOSCO and of the IFRSF MB, are national enforcer and could not operate as a "stand-alone" international enforcer, but they all have experience in legitimacy about enforcing international standards in their own capital markets. They are considered as highly qualified and could therefore join efforts in protecting investors across international capital markets through their participation in IOSCO and in IFRSF MB. In this sense, IOSCO and IFRSF MB could make a step ahead toward becoming the output legitimacy arm needed of the IASB to insure rigor in compliance with IFRS as published by the IASB.

These efforts from IOSCO and IFRSF MB could also result in encouraging cross-listing worldwide (McGregor 1999, Schapiro 2009, Gietzmann and Isidro 2013) because of its presence as an international enforcer insuring compliance with IFRS as published by the IASB.

Finally, we propose that firms seeking IR certification would be required to pay a fee to the IR. The IR, upon reviewing a firm's financial reports would deem the financial reports as "compliant with IFRS as published" or "not compliant". The results of the compliance testing would be published instantly and available on the IR web page. There would then be an agreement with securities regulators that upon a company receiving the IR's certification of IFRS compliance, firms' financial reports would be accepted as their reporting requirement for listing.

7. Conclusions and Proposed Follow-up Studies

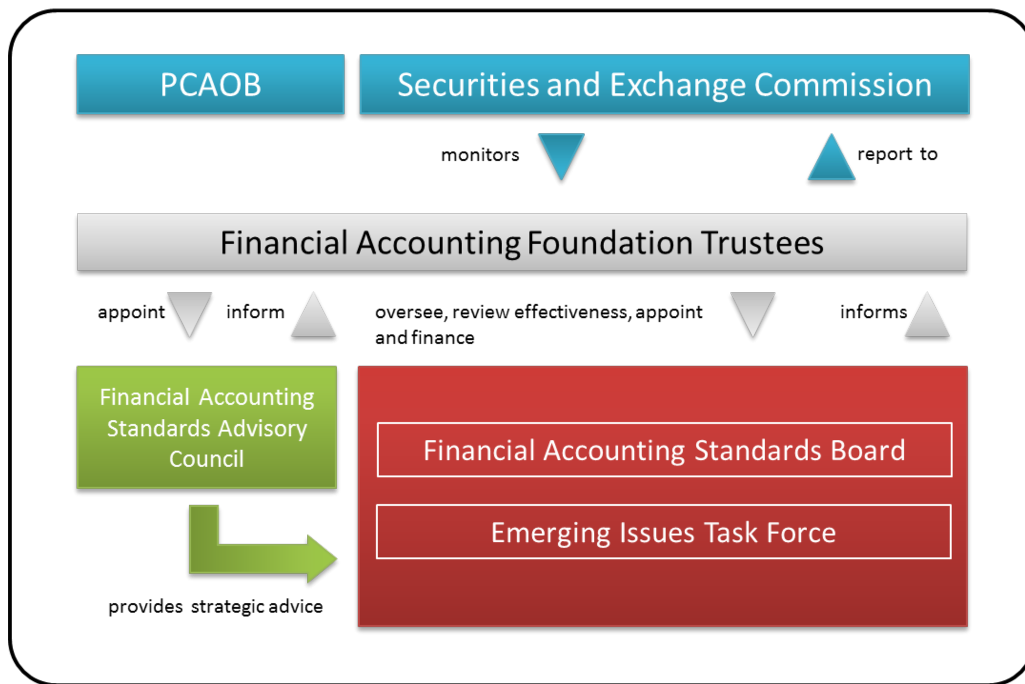
In this study, we use an interdisciplinary approach to conclude that acceptance of one set of accounting standards policed and enforced similarly in the global marketplace may be desired but not yet achieved. We use legitimacy theory to evaluate whether a single set of globally accepted

[6] "A foreign private issuer means any foreign issuer other than a foreign government except an issuer that meets the following conditions: (1) more than 50 percent of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents; (ii) more than 50 percent of the assets of the issuer are located in the United States; or (iii) the business of the issuer is administered principally in the United States" (SEC 2007, 2).

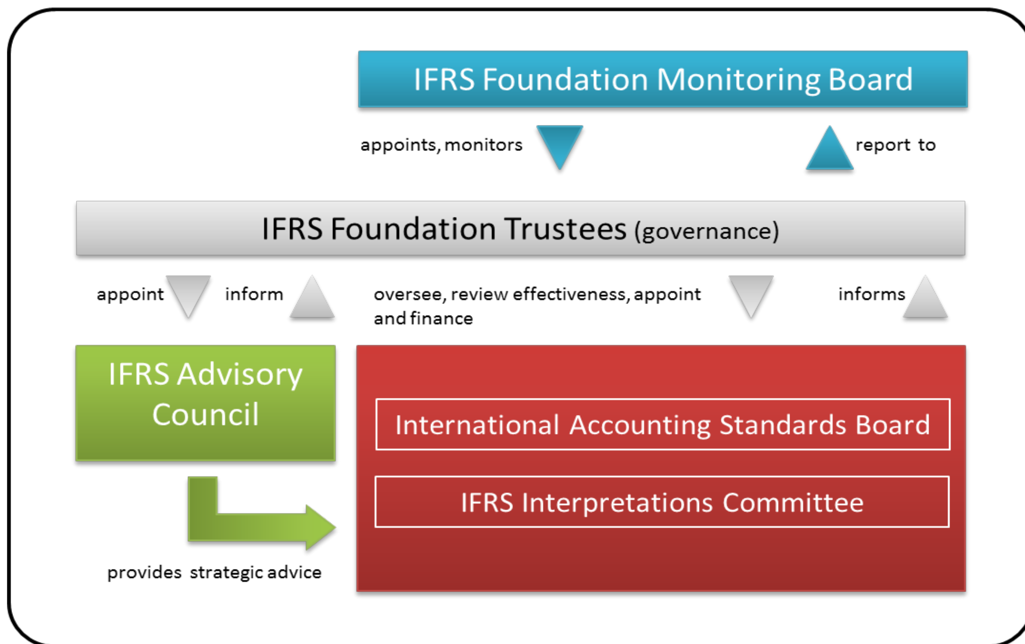
accounting standards is possible. This analysis provides evidence that adoption of IFRS worldwide is possible. The legitimacy gap would have to be minimized as currently democratic processes of national standard setters impede the global "adoption" of IASB as published. We posit that currently U.S. GAAP and IFRS are basically competing within the US capital market for cross listed firms' "adoption." Furthermore, the co-endorsement process has resulted in different versions of IFRS being accepted across different national jurisdictions. If there is a legitimate international regulator (IR) that polices and enforces IFRS as published by the IASB, then adoption of IFRS globally could be achieved. Such a global regulator would have to be seen as legitimate by national regulators across the globe and this role could be assumed by the already existing IOSCO through its participation in the IFRSF Monitoring Board. Because we suggest the IOSCO as the enforcer and policer of cross-listed firms' financial reports prepared in compliance with IFRS and published by the IASB, a follow-up study on the rationale used by multinationals who self-select into using IFRS is needed. Such a study may suggest to the IASB why and how its standards are used by multinational corporations around the world. Moreover, these results may suggest what the IOSCO might do to become the international regulator given firm incentives to comply with IFRS, the dependency relationship between the FASB and SEC in U.S., and the role of EU where IFRS are subjected to endorsement at the national democratic level.

Figure 1: Organization Structures Diagrammed to Reflect Similarities

FASB Organization Structure



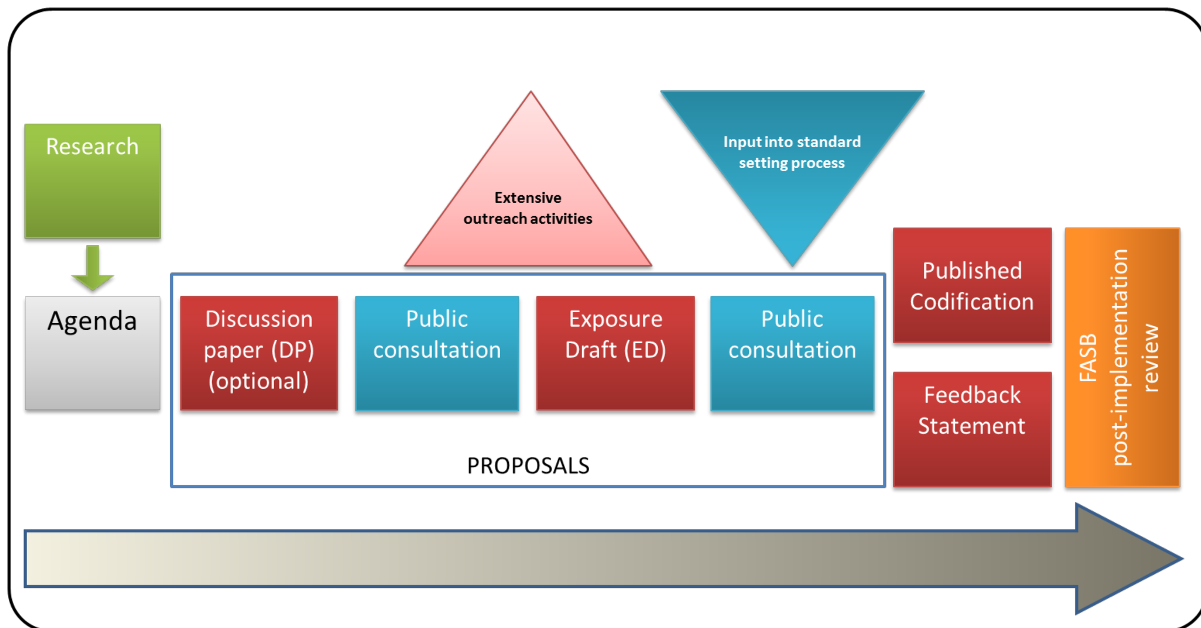
IASB Organization Structure



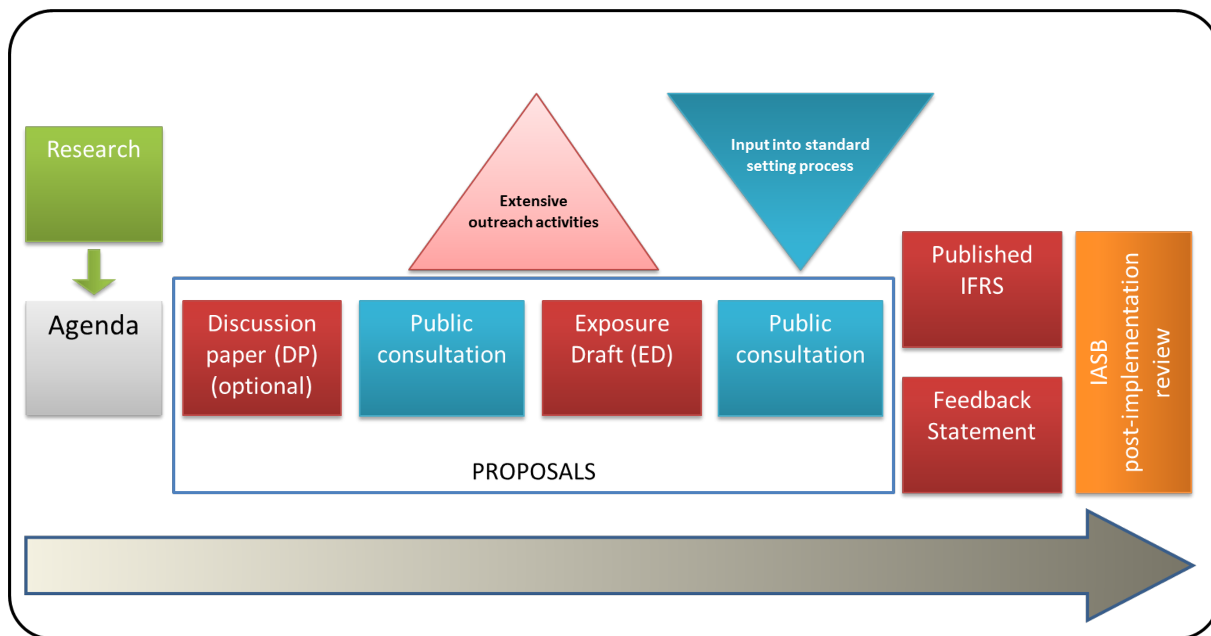
Our elaboration from the following sources: http://www.ifrs.org/How-we-develop-standards/Pages/How-we-develop-standards.aspx (downloaded 9/24/2014) and http://www.fasb.org/facts/ (downloaded 9/24/2014).

Figure 2: Due Processes

FASB Due Process



IASB Due Process



Our elaboration from the following sources: http://www.ifrs.org/How-we-develop-standards/Pages/How-we-develop-standards.aspx (downloaded 2/27/2013) and http://www.fasb.org/facts/due_process.shtml (downloaded 9/24/2014).

Table 1

Required Use of IFRS Standards for Listed Companies—by Jurisdiction

Countries	**Full Adoption**	**Pseudo-Adoption or endorsement**	**Not adoption**
Afghanistan	X		
Albania		X	
Angola	X		
Anguilla		X	
Antigua and Barbuda		X	
Argentina	X		
Armenia	X		
Australia	X		
Austria		X	
Azerbaijan	X		
Bahamas		X	
Bahrain		X	
Bangladesh		X	
Barbados		X	
Belarus	X		
Belgium		X	
Belize		X	
Bermuda			X
Bhutan			X
Bolivia			X
Bosnia and Herzegovina	X		
Botswana	X		
Brazil	X		
Brunei Darussalam	X		
Bulgaria		X	
Cambodia	X		
Canada		X	
Cayman Islands			X
Chile	X		
China		X	
Colombia	X		
Costa Rica	X		
Croatia		X	
Cyprus		X	
Czech Republic		X	
Denmark		X	
Dominica		X	
Dominican Republic	X		
Ecuador	X		
Egypt			X
El Salvador	X		
Estonia		X	
European Union		X	

Countries	Full Adoption	Pseudo-Adoption or endorsement	Not adoption
Fiji	X		
Finland		X	
France		X	
The Gambia	X		
Georgia	X		
Germany		X	
Ghana	X		
Greece		X	
Grenada		X	
Guatemala		X	
Guinea-Bissau			X
Guyana	X		
Honduras		X	
Hong Kong		X	
Hungary		X	
Iceland		X	
India			X
Indonesia			X
Iran		X	
Iraq	X		
Ireland		X	
Israel		X	
Italy		X	
Jamaica	X		
Japan		X	
Jordan	X		
Kazakhstan	X		
Kenya	X		
South Korea	X		
Kosovo		X	
Kuwait	X		
Latvia		X	
Lesotho	X		
Liberia	X		
Liechtenstein		X	
Lithuania		X	
Luxembourg		X	
Macao			X
Macedonia	X		
Madagascar			X
Malawi	X		
Malaysia		X	
Maldives	X		
Malta		X	
Mauritius	X		
Mexico		X	
Moldova	X		

Countries	Full Adoption	Pseudo-Adoption or endorsement	Not adoption
Mongolia	X		
Montenegro	X		
Montserrat		X	
Myanmar		X	
Namibia	X		
Nepal	X		
Netherlands		X	
New Zealand		X	
Nicaragua		X	
Niger			X
Nigeria	X		
Norway		X	
Oman	X		
Pakistan		X	
Panama		X	
Paraguay			X
Peru		X	
Philippines		X	
Poland		X	
Portugal		X	
Qatar	X		
Romania		X	
Russia	X		
Rwanda	X		
Saint Lucia		X	
Saudi Arabia		X	
Serbia	X		
Sierra Leone	X		
Singapore		X	
Slovakia		X	
Slovenia		X	
South Africa	X		
Spain		X	
Sri Lanka		X	
St Kitts and Nevis		X	
St Vincent and the Grenadines		X	
Suriname		X	
Swaziland	X		
Sweden		X	
Switzerland		X	
Taiwan		X	
Tanzania	X		
Timor-Leste		X	
Thailand		X	
Trinidad and Tobago	X		
Turkey	X		
Uganda	X		

Countries	Full Adoption	Pseudo-Adoption or endorsement	Not adoption
Ukraine		X	
United Arab Emirates		X	
United Kingdom		X	
United States		X	
Uruguay		X	
Uzbekistan		X	
Venezuela		X	
Vietnam			X
Yemen		X	
Zambia	X		
Zimbabwe	X		

Source:

IFRS Foundation. 2017. *Pocket Guide to IFRS Standards: the global financial reporting language*. London, United Kingdom: IFRS Foundation.

Table 2

Operating Income (in percent)

2013 Annual Reports

Sources of Operating Income		FASB (in percent)	IASB (in percent)
Assessed fees on registrants		70	78
Subscription/publication revenues		29	21
Other Income		1	1
Total		100	100

Sources:

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