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A geographic analysis of constituents' formal participation in the process of international accounting standard setting: Do we have a level playing field?

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A B S T R A C T

As a private organization, input legitimacy, being achieved when inputs received reflect the opinions of all stakeholders involved, is a key issue for the IASB's acceptance as global standard setter. To study this input legitimacy, this paper examines the evolution of constituent participation in international accounting standard setting in terms of geographic diversity over the period 1995–2007 and examines whether biases (due to differences in institutional regimes) or unequal access (due to differences in participation costs) are present in this process. Based on an analysis of 7442 comment letters we observe an increase in participation over time. However, we also find distortions in the geographic representation of constituents, due to differences in the institutional regimes of countries and due to differences in participation costs, proxied by the level of familiarity with the accounting values embedded in IFRS, with the system of private standard setting, and with the English language. These geographic biases in constituent participation might induce criticism in relation to the input legitimacy of the international accounting standard setting process.

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1. Introduction

Since the decision of the International Organization of Securities Commissions (IOSCO) (2000) to accept International Financial Reporting Standards (IFRS) for cross-border listings, and since governments and regulators (European Parliament (EP), 2002, Financial Reporting Council (FRC), 2002) started to hand over accounting standard setting authority to the International Accounting Standards Board (IASB), the IASB[1] is well under way to becoming the global accounting standard setter. For the IASB, as a private organization, gaining legitimacy is a key issue for its acceptance as a global standard setter (Johnson and Solomons, 1984; Wallace, 1990; Larson, 2007). In order to gain legitimacy, a standard setter needs sufficient authority, a substantive due process, and a procedural due process (Johnson and Solomons, 1984; Wallace, 1990). A procedural due process relates to the fact that the standard setter must provide an adequate and impartial opportunity for interested parties to provide input to the standard setting process (Wallace, 1990). However, simply affording the opportunity to provide input is not a sufficient condition to gain legitimacy. Based on a normative model of procedural legitimacy, Richardson and Eberlein (2011) define the legitimacy of a standard setter as a three stage process by which inputs are collected from affected parties (input legitimacy), these inputs are then considered, aggregated and transformed through a formalized decision process (throughput legitimacy), and finally standards are produced (output legitimacy). The contribution of our paper is to empirically investigate the input legitimacy of the IASB in terms of geographic representation.

A common view in the literature with regard to the legitimacy of a standard setter is that widespread participation of all constituents in the process of standard setting is of utmost importance (Johnson and Solomons, 1984; Dyckman, 1988; Wallace, 1990; Tandy and Wilburn, 1992; Larson, 2007; Richardson and Eberlein, 2011). Applying this common view to the international accounting standard setter implies that widespread constituent participation in terms of geographic diversity is an important condition to become 'the' global standard setter. Participation in the process of standard setting is considered important because it generates information which can help the standard setter gauge the potential reaction of interest groups to its standards (Dyckman, 1988; Tandy and Wilburn, 1992). As IFRS are applied in different institutional frameworks and national settings, the IASB needs to be aware of the economic consequences of its proposed standards in countries worldwide when developing accounting standards.

Widespread constituent participation in the international accounting standard setting process, or the lack of it, has been criticized by high-level international authorities in the wake of the financial crisis of 2008 (e.g. G20, 2009; Financial Stability Forum (FSF), 2009; High-Level Group on Financial Supervision in the EU (the De Larosière Group), 2009). In response, the IASB[2] declared that it is aware of the importance of widespread constituent involvement. Calls for more research on constituent participation in the process of international accounting standard setting have also been launched by academics (Barth, 2000; Cooper and Robson, 2006; Luthardt and Zimmerman, 2009).

In response to the concerns expressed by these high-level authorities and to the academic calls for research on constituent participation, this paper sets out to explore whether biases (due to home institutional characteristics) and unequal access (due to differences in costs of lobbying) exist in the process of international accounting standard setting, even though participation is open to all parties (see Dingwerth, 2007). Biases and unequal access would threaten the input legitimacy of the standard setter. According to Scharpf (1999), input legitimacy is attained when the inputs received reflect the will of all people. Thus input legitimacy in case of the IASB implies that all stakeholders affected by IFRS financial reporting should participate in the IASB process of standard setting.

Grounded in the theories of Sutton (1984) and of Watts and Zimmerman (1978, 1986), and based on the results of the comparative empirical international accounting research, this study investigates whether differences in the institutional background of constituents, differences in participation costs

[1] From 2001, the IASC is restructured into the IASB and new standards are called International Financial Reporting Standards (IFRS). The body of existing and new standards is referred to as IFRS in this paper.

[2] See speech of the Chairman of the IASB on 20 October 2009 and see the Joint statement of the IASB and the FASB on 5 November 2009.