

Chapter 15

National Standard-Setters' Lobbying: An Analysis of its Role in the IFRS 2 Due Process

Begoña Giner and Miguel Arce

Abstract As the IASB's due process sustains, the national standard-setters play a key role in the development of IFRS. There is still much to learn, however, about their lobbying practices, which arguments they use and when they do it. This chapter focuses on the accounting of share-based payments that were under-regulated before IFRS 2. To analyze lobbying behavior of this relevant group of stakeholders, we conduct a content analysis of the 27 comment letters addressing the documents issued by the G4+1 and the IASB that preceded IFRS 2. Consistent with institutional theory, our analysis of lobbying activity by national standard-setters shows that participation increased at the end of the process, and they supported the IASB's final proposals although they were not as much supportive at the beginning.

15.1 Introduction¹

This research addresses the lobbying activity toward the international accounting standards board (IASB) in the development of international financial reporting standard (IFRS) 2—*Share-based Payments*—by a group of relevant stakeholders: the national standard-setters (NSS). Following Sutton (1984, p. 81), lobbying

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B. Giner (✉) · M. Arce
Universitat de València. Facultat d'Economia. Dpt. de Comptabilitat,
València, Spain
e-mail: begona.giner@uv.es

M. Arce
e-mail: miguel.arce@uv.es

activity includes ‘All the actions which the interested parties take to influence the rule-making body’.

In the new international context where the IASB is the *de facto* accounting standard-setter worldwide, the complexity of this procedure has increased considerably. Besides the traditional interested groups, corporate managers, investors, and auditors, one should consider the NSS,² who play a different and very important role. Although they are not responsible for the production of the standards, their active participation in the IASB standard-setting process is necessary to achieve high quality global accounting standards. To the extent they have a good knowledge about the local institutions they are in a good position to find out how the standards may be understood and applied locally; they can undertake research, encourage stakeholders input from their jurisdictions, and identify emerging issues, in summary they can act as a channel between the IASB and the other stakeholders. An obvious recognition of this important role is the recent proposal of the IFRS Foundation³ to create an accounting standards advisory forum (ASAF). In addition as the changes in the IFRS may put pressure on the NSS to modify country-specific standards they become a potentially affected group. Moreover within the EU, the European Commission (EC) and other relevant groups, mainly the European financial reporting advisory group (EFRAG), are very much involved in the process as the standards must be endorsed to be applied throughout Europe; they are also considered in this research.

The IASB’s due process relies on wide consultation, including a formal process of inviting public comment letters on discussion chapters (DPs) and exposure drafts (EDs) (IASCF 2006). As Leuz et al. (2004) argue, the legitimacy of the standards depends on the participation of those affected, thus lack of participation suggests failure in the process. This chapter is based on the assumption that participation results in the submission of comment letters. In this respect, our investigation provides knowledge about the lobbying activities of the NSS, when their lobbying practices occur, and the arguments employed by them.

Some prior lobbying literature examines the motivations and characteristics of the groups that participate in the process (Tandy and Wilburn 1992; Kenny and Larson 1993, 1995; Tutticci et al. 1994; Jupe 2000; Larson and Brown 2001; Stenka and Taylor 2010), while other chapters focus on one particular group, such as academics (Tandy and Wilburn 1996), auditors (Puro 1984; Meier et al. 1993), or preparers (Watts and Zimmerman 1978; McArthur 1988, 1996; Guenther and Hussein 1995; Schalow 1995; Larson 1997; Ang et al. 2000; Georgiou 2002, 2004), and in particular on preparers that lobbied against SFAS 123 (Dechow et al.

² In Giner and Arce (2012) we make an analysis of the lobbying procedure by all interested groups. This paper could be considered an extension of this analysis focused on the NSS.

³ See the Invitation to Comment ‘Proposal to Establish and Accounting Standards Advisory Forum’ (IFRS Foundation 2012). As stated in the document the two main reasons behind the proposal are the end of the convergence program with the FASB and the widely spread use of IFRS around the world what make necessary to rationalize the relationships of the Board with NSS and regional bodies.

1996; Hill et al. 2002). We are not aware about any chapter that focuses on lobbying by the standard-setters, which is understandable due to the relatively new regulatory structure that makes them a potential lobbying group. Some of the prior chapters look at the content of submissions, as we also do in this research (McArthur 1988; Kenny and Larson 1993; Tutticci et al. 1994; Ang et al. 2000; Jupe 2000; Stenka and Taylor 2010).

Although most of the previous literature deals with the standard-setting process at the country level, some chapters focus on lobbying an international accounting body. Thus Guenther and Hussein (1995), Larson (1997), MacArthur (1996), and Kwok and Sharp (2005) deal with the international accounting standards committee (IASC). More recent chapters deal with the IASB, such as Georgiou (2010) who examines the users' attitudes and Orens et al. (2011) that focus on preparers, while Jorissen et al. (2012) and Giner and Arce (2012) analyze the participation of all stakeholders. Finally, Larson (2007) considers lobbying the IASB's international financial reporting interpretations committee (IFRIC).

We adopt a single-case approach that highlights some neglected aspects of the lobbying behavior. Although this type of analysis does not allow generalization of the lobbying activity, it enables to explore the sense of comments issued by the interested parties. Consequently we avoid some of the limitations noted by Walker and Robinson (1993), such as submissions are interpreted as "votes", there is failure to consider arguments provided, and shifts in preferences.

The accounting regulation of share-based payments—transactions whereby an entity obtains goods and services from other parties with payment taking the form of shares or share options—generated an unprecedented debate in the United States in the 1980s and 1990s, and the financial accounting standards board (FASB) maintained a non-expense-recognition policy. Moreover, expense recognition of share-based payments was not required in other countries. In 2001, the IASB included this project in its agenda, and 3 years later approved IFRS 2, forcing recognition of share-based payments as an expense.

In this study we analyze the lobbying activity of the NSS prior to the adoption of IFRS 2 in February 2004. To this end we analyze the 27 comment letters submitted by this interested group to the previous documents, going as far back as 2000. The IFRS 2 requires an entity to record all share-based payments as expenses, regardless of the form of settlement (shares or cash) and the counterpart involved (employees or others). We have chosen IFRS 2 as the subject of this study for several reasons. First, it deals with fundamental accounting notions—assets versus expenses, liabilities versus equity—in an area in which, as already stated, there was no previous standard. Second, it has a big impact on the two key accounting figures: net income and equity. Third, the discussion held in the United States on this topic ended with a compromise solution that allowed companies not to recognize the expense, what suggests a difficult decision faced the IASB, and provides an ideal setting to examine lobbying strategies. Fourth, the project had

three consultation periods, as the DP was initially published by the G4+1⁴ in 2000, then the IASB adopted it and reissued it in 2001, and later the IASB published the ED 2 in 2002. In particular, the second publication of the DP enables us to examine the lobbyists' attitudes as a function of the differential status of the issuer. We argue that the lobbyists' concerns might increase as a consequence of the eventual impact of the new standard which was particularly evident when IFRS become mandatory. In addition, the relevance of IFRS 2 is evidenced by the participation of interested parties.⁵

Our examination of the comment letters consists of a content analysis focusing on three key issues: recognition, valuation criteria, and reference date. Our analysis is further aimed at identifying the underlying conceptual and economic arguments that used to justify the position on each of these issues. As most of the prior literature, this study relies on the rational-choice model of lobbying developed by Sutton (1984), which explains participation by the lobbyists if their expected benefits exceed the cost of lobbying. However, the institutional theory is particularly relevant as well. Indeed as Kenny and Larson (1995, p. 288) note: 'In an institutional context, lobbying may be evidentiary of the perceived importance or viability of the organization being lobbied'; the considerable participation of NSS after the ED 2 is consistent with the insights of this theory. This theory also predicts the standard-setter 'will try to accommodate the strongest wishes of its constituency when doing so enhances the organization's acceptability without seriously impairing its integrity' (Kenny and Larson 1993, p. 214). Consequently, our investigation draws on a combination of the institutional theory and rational-choice literatures.

In order to understand the IASB's attitude it is useful to consider the IASB Constitution and the Framework. As stated in the paragraph 2 of the Constitution (IFRSF 2010), the aim of the IFRS is to achieve high quality, transparent, and comparable information to help investors, other participants in the world's capital markets (as well as other users) make economic decisions. It cannot be denied that accounting information has economic effects, but if it is accepted that information should be neutral these should be ignored when making decisions on how economic transactions should be recorded. In other words, although it is recognized that different accounting treatments will have a different impact between competing constituencies, only conceptual and technical considerations should be considered when developing the standards. In Whittington's (2005, p. 152) words: 'Ultimately, markets need full, transparent information, untainted by concessions to vested interests. The IASB is attempting to meet this need by following the ultimate objective "tell it the way it is"'. In this line of argument, in 1993, James J.

⁴ The G4+1 was an association of the accounting standards-setting bodies of Australia, Canada, New Zealand, United Kingdom and United States. The IASC participated as an observer. The G4+1 was disbanded in 2001 when the IASC was transformed into the IASB.

⁵ Between 2002 and 2006 the IASB received 103 comment letters per document on average; IFRS 6 received the lowest number (24), and the DP on share-based payments received the most (281).

Leisering, Vice-Chairman of the FASB at that time (and member of the IASB when IFRS 2 was adopted), declared in a hearing of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs when debating the FASB's proposal on accounting for stock options: 'We believe that economic goals are best achieved directly, by subsidies, tax policy, and the like. Capital markets, on the other hand, are best served by unbiased financial statements designed to inform policy makers rather than to promote policies. Decision-makers need financial statements that tell it like it is, in short' (quoted in Zeff 2002, p. 181).

This research adds to the literature on the politics of standard setting. It focuses on the IASB's due process, and given the role of the IASB as a global standard setter, it is relevant to gain insights about the standard-setting process for both the IASB and the NSS. This is particularly the case in the current context in which the producer of the standards, the IASB, has a supranational dimension, and the NSS act as interested parties. Moreover, as stated in the Due Process Handbook (IFRSF 2012) and the current developments are evidencing, the interaction of this group with the IASB is key in the development of IFRS.

The structure of the chapter is as follows. In Sect. 15.2, we provide a brief summary of the institutional developments. Section 15.3 deals with the development of IFRS 2. Section 15.4 focuses on the research questions, the data and the results. Finally, Sect. 15.5 provides the main conclusions.

15.2 Institutional Developments

Although the main purpose of this research is to analyze the lobbying behavior prior to the publication of IFRS 2, we consider it helpful to provide some background to understand the new institutional arrangements that have given wide acceptability and authority to the IASB, in other words that provide power, both competent authority and legitimacy (Hope and Gray 1982). Our analysis is consistent with the institutional theory which considers that organizations, such as the IASB, have to be acceptable to their constituency to survive; Kenny and Larson (1993) applied this framework to its predecessor the IASC, while Fogarty (1992) made an application to the FASB. The former study explains the changes that took place in 1989, when the IASC started an open due process, using the mimetic institutional influence explanation (DiMaggio and Powell 1983). Kenny and Larson (1993) argue that the IASC tried to imitate the FASB's format as it was perceived the most successful and legitimate. Although the replacement of the IASC by the IASB in 2001 was subject to a strong debate between those that preferred a bicameral solution and proponents of the independent model, the latter solution won out, and the IASB structure is very similar to that of FASB (Stevenson 2007).

The IASB members have the sole responsibility for setting the standards, so in contrast to the previous IASC in this case individuals cast votes. As for the composition of the Board, the Constitution establishes some geographical criteria to ensure a broad international basis, and the Trustees have to ensure that the group

provides an appropriate mix of recent practical experience among auditors, preparers, users, and academics. The IASB is assisted by regular meetings with the IFRS Advisory Council, also appointed by the Trustees from a wide range of nationalities and backgrounds. The Advisory Council provides advice before adding an item to the Board's agenda, and offers comments on its on-going work. In addition the IASB keeps regular contacts with NSS and with international organizations, such as the international organization of securities commissions (IOSCO) and the EFRAG. An annual meeting has also been instituted with all NSS, in order to widen the IASB's world-wide contacts. In short, these different consultation levels help to provide legitimacy of action to the IASB. A Monitoring Board created in 2007 provides a formal link between the Trustees and public authorities.

The open due process that follows the IASB before issuing an IFRS is also consistent with the institutional theory framework. This is the process by which the Board deliberates and decides on the content of its standards; it allows all interested groups to give their opinions when the standard is under deliberation. 'A proper due process ensures that the issue has been properly understood, that all sides of the argument have been identified and properly considered, and that the rationale underlying the conclusion eventually reached has been tested. It is therefore very important for the credibility and authority of the conclusion reached' (EFRAG 2005, paragraph 3.19). Indeed it is a way of receiving input from the stakeholders in order to better understand the possible divergent views, and so make more effective decisions, but it can also be seen as an attempt to capture the interest of all participants in the standard-setting process, as a strategy that helps to legitimate the organization. Another important aspect of the due process, comes from its open nature; as Richardson and Eberlein (2011, p. 219) argue, 'is a (potential) means for disciplining the exercise of power by the IASB and perhaps more importantly, for forcing influence attempts by networked entities on the IASB into a public forum'.

The IASB due process allows several opportunities to participate: developing views as a member of the Advisory Council, taking part in advisory groups, submissions of issues to IFRIC,⁶ submissions of comment letters to DPs and EDs, participation in public round-tables, as well as field visits and field tests. Those who participate in the process want to be listened and to exercise influence over the final standard, in so doing they normally provide arguments to support their positions. Comment letters is probably the most visible mechanism of lobbying to the researchers as they are available on the IASB website. As Walker and Robinson (1993, p. 15) argue this tries to 'ensure that rule-making bodies can be held accountable for the way they go about making their decisions'. Moreover, the public availability of these letters and the open nature of the Board meetings provide transparency in the formulation of the standards.

⁶ The IASB also issues interpretations that are prepared by the IFRIC. IFRIC members are appointed by the Trustees.

Once an item is on the Agenda and considered a major project, the IASB due process may start with the publication of a DP. After a normal period of about 120 days for responses, the technical staff prepare an ED, which requires the votes of nine Board members to be approved if there are fewer than 16 members or 10 members if there are 16 members.⁷ After its publication a similar consultation period starts and in the light of the responses received, a final draft standard is submitted to the Board (public hearings and field tests are conducted if desired), which requires the same number of votes to be adopted. Consequently, throughout the process the lobbyists have to decide whether to take action, when to take it, and what to argue. It is assumed that in deciding to take action constituents consider both the benefit and the associated costs. Referring to the FASB's structure, Fogarty (1992) sustains the *due process*, a *balanced background of members*, and the *public relations efforts* are three elements that provide legitimacy to the FASB. It is indeed no coincidence that these three aspects are also well-covered in the IASB structure.

Although prior research has explored the extent of political influence in the development of accounting standards through the study of the constituents lobbying activity, Walker and Robinson (1993) point out that to explain the political process undertaken attention should be paid to the manner in which responsibility has been assumed by the standard-setter, or delegated to it; thus before concluding our analysis of the current standard-setting context, we think it is useful to comment on the arrangements that give power to the IASB. The IASB has no direct powers of its own; consequently it has to persuade those with regulatory and enforcement powers to approve the use of international standards. The acceptance of IFRS in a number of jurisdictions has given the IASB a leading position in the international accounting standard-setting (and by 2002 it was clear that they were going to be used in the EU, Australia, and New Zealand), although certain organizations keep the right to endorse the standards. For instance, Europe has moved away from the previous policy of harmonizing the national standards through the Directives to apply IFRS when endorsed by the Commission (this measure had a direct impact on about 8,000 entities⁸). The endorsement mechanism is a two-tier structure that involves the technical advice given by the EFRAG, an independent private body created in 2001, and a political consultation to the accounting regulatory committee (ARC), which is a committee established under the "comitology" procedure commonly followed by the EC to make decisions. Consequently, the EC and the EFRAG have become relevant interested parties as their view on the standards is crucial to their being made compulsory in the EU. It is important

⁷ The supermajority rule was introduced in the reform on the IASB Constitution that took place in 2005. It aims to get more unity among the Board members in order to increase the perception of acceptance of the standards.

⁸ This is the estimated number of listed companies that prepare consolidated accounts. There is also an indirect and very important impact if Member States of the EU use the option included in the Regulation 1606/2002 and allow or oblige to use endorsed IFRS for individual accounts and for consolidated purposes to non-listed companies.

to remark that in order to endorse any standard it should be conducive to the “European public good”—that there should be no competitive disadvantages for European companies.

15.3 Accounting for Share Options: The Evolution Towards IFRS 2

The early inclusion of share-based payments in the IASB agenda may be seen as a clear sign to the objective of the IASB to lead the development of high quality standards especially in those areas where there is no national standard that adequately addresses the problem; Whittington (2005), at that time an IASB Board member, refers to the share-based payment project as one obvious example of this commitment. We find rather symbolic that the first ‘new’ standard produced by the Board deals with this controversial accounting issue.

The history of the SFAS 123 (FASB 1995) shows that the accounting for share-options is a very cumbersome topic. The strong opposition especially from the technology industry refrained the FASB from producing an advanced standard on this issue; accordingly it finally took a step back and did not require the expensing of these payments, but adopted a compromise solution that allowed companies not to recognize the expense (Dechow et al. 1996). The decision about expensing stock options does imply economic consequences, not only on the companies directly affected, but also on wider issues such as human resources management. It has been suggested that the recognition of an expense corresponding to promised option plans could discourage companies from introducing retributive schemes based on shares or options compensations or even encourage them to be completely abandoned. But this ‘is inconsistent with the view that current granting practices are optimal, because, if they were, imposing an accounting change should not affect option grants’ (Murphy 2003, p. 144).

Nevertheless, it is thought that the IASB might have faced lesser difficulties than NSS. As Crouzet and Veron (2004, p. 12) sustain ‘the IASB’s principal advantage over the FASB is its greater immunity to corporate lobbying, which, in principle should result in superior standards quality’. It can be argued that it is easier to be immune to the adverse consequences argument when dealing with standards to be used worldwide than when dealing with a particular country. In the words of Whittington (2005, p. 134): ‘The IASB, as an international standard setter, has the advantage of being less susceptible to the ‘level playing field’ argument, that stringent national standards may disadvantage domestic companies relative to those overseas, which have less stringent regimes. However, because international standards are not followed in the largest economy in the world, the US, this advantage is not as strong as it will be if international standards are converged with the US standards. European companies listed in the US are particularly sensitive to this issue’.

As already explained, the screening mechanism established in the EU for the legal endorsement of the IFRS requires the standards to be conducive to the “European public good”, and no doubt share-based payments is a very sensitive topic. Nevertheless in January 2005, 1 year after the promulgation of IFRS 2, the EC, with the support of the EFRAG, endorsed the standard. As explained later, the EFRAG’s position changed over the period under analysis from rejection to acceptance of recognizing the expense. To understand these positions, it has to be considered that there were parallel changes in the United States, so that the competitive disadvantages argument frequently used to justify the European constituents’ opposition to recognition lost its relevance (Giner and Arce 2012). Thus, in March 2003, the FASB added the project to its agenda,⁹ and 1 year later issued an ED showing a substantial amount of convergence with IFRS 2, and SFAS 123 (revised) was published at the end of 2004. This was an important step to avoid or reduce strong criticisms based on competitive disadvantages.

The importance of share-based payments derives from the huge development of such transactions. At the time when the DP was issued Towers Perrin (2000) reported that, in reference to companies with sales of over \$500 million, share options represented between 20 % of annual salaries in Germany, and 40 % in both Sweden and the UK (other figures included 25 % in Belgium, 32 % in France, and 35 % in Spain and the Netherlands). These percentages represent less than half of those in the US. In 2000, 99 % of the S&P 500 companies, gave share options to their employees, but only two of them registered an expense, and as such profits were overvalued by 12 %. The importance of these compensation schemes differs between industries. Murphy (2003) provides some data on the new and old economy firms. Using 1999 pretax income figures, he suggests that 45 % of the new economy firms and 16 % of the old economy firms would have had negative figures (compared with 23 and 13 % as reported ignoring compensations).¹⁰

A somewhat generalized opinion even among academic researchers (Aboody 1996; Garvey and Milbourn 2001) is that the spread of option plans for employees was at a certain extent favored by the lack of an adequate accounting treatment. Indeed companies prefer to avoid recognition and disclose the *pro forma* net income that results when the fair value of options is included as a cost. If the market were able to efficiently price the options disclosed in the notes, the discussion between recognition and disclosure could be considered irrelevant;

⁹ The comprehensive Basis for Conclusions that accompanies IFRS 2 explains that the IASB worked with the FASB after the latter added to its agenda in March 2003 a project to review US accounting requirements on share-based payment.

¹⁰ As a consequence of the accounting changes US firms reduced the use of stock options. The Towers Perrin’s (2004) report indicates that many US companies redesigned their executive incentive plans: they estimate a reduction of 16 % in the value of long-term incentives and an increase of cash compensation in 2004. According to Bear, Stearns & Co (2004) the impact of stock options on the 2004 earnings figure of S&P 500 and NASDAQ 100 is about 5 and 22 %, respectively.

however, the conclusions resulting from empirical research do not uphold this position. A number of studies carried out in the US after SFAS 123 on ‘Accounting for stock-based compensations’ evidences that prices negatively reflect the information disclosed on option costs (Aboody et al. 2001), which leads us to question the quality of the accounting earnings figure without considering this expense. Other studies show that investors have only a partial understanding of the whole reality (Garvey and Milbourn 2001); it seems the market undervalues the cost of the options given out until vesting date, meaning that those companies which agree to hand over large numbers of options tend to be overvalued. Definitively, Garvey and Milbourn (2001, p. 14) claim: ‘The aggressive use of employee stock options may thus represent a transfer of wealth from long-term to short-term shareholders’. Consequently, it could be argued that the extensive use of unrecognized performance-based schemes linked to share prices has favored the boom of the stock market during 1990s and this situation also favored the expansion of these schemes. In contrast, the great stock market crisis at the beginning of this century probably facilitated the adoption of IFRS 2. This is consistent with a causal relation between a crisis and the entrance of an issue in the political process (Watts 1977; Nobes 1991). At the time the IASB started the share-based payments project there was a major crisis of confidence in the market and in the accounting system as a whole.

In 2004 IFRS 2 was issued; the project had started 4 years earlier with the publication of the DP by the G4+1, which received 29 comment letters, 4 of them came from the NSS. In September 2001, the recently created IASB backed and reissued that chapter. Following its due process, a period for comments was established and a considerable larger number of responses were received 281 letters (83 % from the preparers), only 4 of them came from the NSS. An Advisory Group, including individuals from different countries and backgrounds (investment, corporate, audit, academic, compensation consultancy, valuation, and regulatory communities) helped the Board in the development of the ED, ED 2. It also received the assistance from experts at a panel discussion held in New York in July 2002. Thus on November 2003, the IASB published ED 2 and received 229 letters (53 % from the preparers), 19 of them from the NSS. The final step was taken in February 2004 when the standard was published, with the full backing of the 14 Board members.

Figure 15.1 is a timeline of the development of this standard in connection with some relevant events that happened at that time, such as the EC announcement after the Lisbon Council in June 2000 about the adoption of IAS, and the Norwalk Agreement in 2002.

Table 15.1 gives some details on the documents under study about the three issues of interest in this study: recognition, valuation, and reference date, and compares them with SFAS 123. It is remarkable that the three selected items were subject to different accounting treatments in the DP and the original SFAS 123.

The basic idea of the share-based project is that the transaction whereby an entity obtains goods and services from other parties, with payment taking the form of shares or share options should be recognized as equity in the balance sheet with

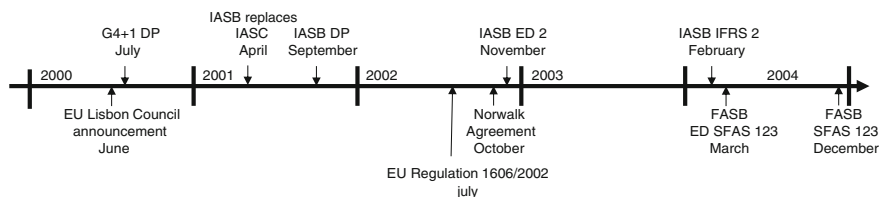


Fig. 15.1 Timeline of the standard development and other relevant events

Table 15.1 Comparison of SFAS 123, DP, ED 2, and IFRS 2

	SFAS 123 (1995)	DP	ED 2	IFRS 2
Recognition of the expense	Yes	Yes	Yes	Yes
Exceptions from recognition	Fixed plans ^a	No	No	No
Fair value of goods and services received	Yes	No	Yes, not to employees	Yes, not to employees
Fair value of share-based instruments issued	Yes	Yes	Yes	Yes
Reference date for valuation	Grant date	Vesting date	Grant date, exceptions	Grant date, exceptions

^a This option was eliminated by the revised SFAS 123 (2004)

Source Giner and Arce (2012, p. 660)

a corresponding charge in the income statement. This fundamental principle has remained in the three documents. In the SFAS 123 there was an exception to recognition for fixed-option plans (common in the USA) that did not exist in the DP; the revised SFAS 123 eliminated the exception. As for valuation, the DP established that the fair value of equity instruments issued should be used and admitted that, in most cases, an option pricing model should be applied. Nevertheless SFAS 123 allowed using this criterion or the fair value of the goods and services received the one that is more reliably valued. This was later allowed in ED 2 but not for employees. Thus ED 2 differentiated between payments to employees and those made to the providers of goods and other services, it kept the same criteria for the former, but established a refutable presumption about using the fair value of goods and services for the latter. IFRS 2 keeps this distinction. Regarding the measurement date, according to the DP vesting date¹¹ should be used to measure the fair value of the shares or options issued, while SFAS 123 required gran date.¹² ED 2 changed the criteria and established that grant date should be used when determining fair value by reference to an equity instrument, while when fair value considers the value of the goods and services, the date when the entity obtains them should be considered; IFRS 2 did not introduce any change on that.

¹¹ The date at which the other party, having performed all of the services or provided all of the goods, becomes unconditionally entitled to the options or shares.

¹² The date at which the contract between the entity and the other party is entered into.

15.4 Empirical Research

This research focuses on a detailed analysis of the public comment letters sent by NSS, we also include other institutions with the faculty to regulate different aspects of the economic activity. As Georgiou (2004, p. 230) indicates ‘overall comment letters appear to be a good proxy for the use of other, less overt, lobbying methods’. Indeed they have been often used in previous lobbying research (Tutticci et al. 1994; Kwok and Sharp 2005; Jorissen et al. 2012; Giner and Arce 2012). Lobbying research based on written submissions has attracted criticism, however, because it has frequently interpreted the submissions as “votes”, without consideration for the arguments provided (Walker and Robinson 1993). Nevertheless Brown (1982), a former member of the FASB, asserts that the standard setters are influenced by both the nature and strength of the arguments provided by respondents. Consequently, in this research we look at the arguments in detail.

15.4.1 Research Questions and Methods

The research questions address the NSS lobbying strategies. Our first question deals with the decision about *whether or not* to participate in each of the three comment periods associated with the development of IFRS 2. The rational-choice model of lobbying developed by Sutton (1984) contends that parties will take action in the lobbying process if their benefits, adjusted by the probability that lobbying will change the outcome of the standard-setting process, exceeds the cost of lobbying.

The position of the NSS can be also explained by the self-interest argument that is associated with the constituent’s position (Puro 1984). As Giner and Arce (2012) note political, economic, and perhaps social factors could explain the position of the national standard setters as they need to be considered respectful and influential to maintain their respective roles. Their special status is recognized in paragraph 28 of the IASB’s Constitution (IFRSF 2010); it is expected to establish and maintain liaison with them in order to assist in the development of IFRSs and promote the convergence of NSS and IFRSs. Moreover, as stated in the introduction, the IASB aims to establish a new group, ASAF, to strength the links with them.

There were three comment periods in the development of the share-based payments project, which allows us to focus on the two stages in the production of IFRS 2—the DP and ED—enabling us to consider the lobbyists’ decisions about *when* to participate. Sutton’s (1984) model suggests that it is easier to influence the decision maker when general views and ideas are required (e.g., when a DP is under discussion) than after the publication of an ED. Following this reasoning, respondents would be prone to providing comments in the first stage of the process, as they may think there is a greater probability of influencing the final result. As for the nature of the issuer, the DP was published twice—first by the G4+1 and

then by the IASB—implying a change in the mandatory status of the outcome of the project. In this context, non-compliance with the accounting proposal is not a feasible alternative for preparers and NSS are in good position to know the attitudes in their jurisdictions; on the contrary, it becomes costly not to follow the IASB's requirements. The model also suggests that raising the cost of non-compliance increases the lobbying efforts, as the benefits of this activity are higher. Consequently there could be an increase in lobbying activity after the second publication of the DP—once the EU and other jurisdictions announced that they were to adopt the IFRSs.

Overall, this reasoning leads to our first research question, RQ1: Was the NSS lobbying activity related to IFRS 2 equally distributed across comment periods? To address RQ1, we classify the comment letters by periods of response and use χ^2 test to compare responses among periods.

The second question refers to the decision about *what* to argue. The use of arguments to justify the opinions stated in the letters is perceived as a strategy of persuasion. In this respect, prior research distinguishes between conceptual arguments and those based on economic consequences (Tuticci et al. 1994; Jupe 2000). Conceptual arguments refer primarily to the accounting notions linked to the Conceptual Framework and to technical issues related to the topic under consideration. Arguments based on economic consequences refer to economic changes associated with the proposed standard and the implications of those changes. As economic-based arguments would conflict with the image of professionalism and objectivity (Stenka and Taylor 2010), NSS might hesitate to use them and prefer to provide erudite and conceptually based responses.

Prior research has not examined the behavior of interested parties in agreement or disagreement with the proposals on accounting standards (see Tuticci et al. 1994; Giner and Arce 2012 as significant exceptions). We assume that respondents who agreed with the proposed standard had fewer incentives to present a supporting argument than did their counterparts that disagreed with such proposals. Thus, we raise the following question, RQ2: Did the NSS provide different arguments in their comment letters to support their positions in favor of or against the proposals?

As in Jupe (2000) and Stenka and Taylor (2010), our examination related to the lobbying strategies requires us to analyze the content of comment letters. As mentioned above, we identify the issues considered (recognition, valuation, and reference date), the position (agree, disagree, or no opinion) and the arguments used (conceptual, economic consequences, both arguments, or neither argument) in each comment letter (Giner and Arce 2012).

The detailed reading of the comment letters implies a certain degree of subjectivity, which we have tried to reduce by focusing on three issues and double-checking the content of the letters. The Kappa statistic for inter-annotator agreement suggested by Cohen (1960) shows non-significant differences between the two annotators in the three issues analysed. Nevertheless, we admit some subjectivity exists in the selection of the three key issues, but we have considered the *Invitation to comments* included in the DP, the responses, as well as those

aspects that in our view are fundamental for the accounting of these transactions. It is also important to remark that the three selected items were subject to different accounting treatments in the DP and the original SFAS 123.

15.4.2 Data

As Table 15.2 shows fourteen NSS participated in the lobbying, they come from Australia, Canada, France, Germany, Japan, Malaysia, the Netherlands, Norway, Poland, Singapore, South Korea, Spain, Sweden, and Thailand. In this group we also include the EC and EFRAG that as explained above play a relevant role in the endorsement of IFRS in the EU. We also consider the responses of other institutions with the faculty to regulate different aspects of the economic activity, such as the Basel Committee and the IOSCO, one answer from a US Congress members group, other from the Securities Commission of New Zealand, and another from the Ministry of Economy, Trade, and Industry of Japan. In total there are 21 different respondents considered as NSS.

We collected the comment letters from the IASB website. As some respondents replied more than once, there are more letters (27) than respondents (21). Table 15.2 indicates the six respondents (EC, EFRAG, and the standard-setters of France, Germany, the Netherlands, and Spain) that participated in two stages (no one did it three times). They represent 28.5 % of respondents. This percentage is lower than in other groups, 45 % in the profession, but larger than in others, such users, 21 %, and preparers, only 9 % (Giner and Arce 2012).

More than half of the comment letters (17) came from the EU and Australia/New Zealand jurisdictions where IFRSs would be compulsory. It is also remarkable the high number of letters coming from Asia. These figures should be interpreted with caution however, as the small number of comments from the NSS represents a high proportion of the potential respondents in this group.

15.4.3 Results

Table 15.2 provides a detailed overview and a geographical breakdown of the sample. In the last row we include for comparative purposes the number of letters coming from all respondents. It provides evidence on RQ1 regarding the decisions of when they do the lobbying. The IASC received 4 responses when issued the DP (DP1), and then the IASB received another 4 when issued it again (DP2) and 19 when issued the ED 2. The χ^2 tests confirm that there is a significant difference (at 0.001 level) in the participation of the NSS in the three comment periods. As Giner and Arce (2012) indicate this occurs with the other groups of respondents as well, and the χ^2 tests confirm that the participation of the groups differs statistically from the first publication of the DP to its second publication and from the second DP to

Table 15.2 Respondents

Geographical zone	Name	DP1	DP2	ED2
International	Basel committee on banking supervision			x
	International organization of securities commissions			x
ASIA				
Japan	Accounting standards board of Japan	NSS ^a		x
Japan	Ministry of economy, trade and industry		x	
Malaysia	Malaysian accounting standards board	NSS		x
Singapore	Council on corporate disclosure and governance	NSS		x
South Korea	Korean accounting standards board	NSS		x
Thailand	Accounting standards committee of Thailand	NSS		x
AUSTRALIA-NZ				
Australia	Australian accounting standards board	NSS		x
New Zealand	Securities commission			x
EUROPE				
	European commission		x	x
	European financial reporting advisory group			x
France	Conseil National de la Comptabilité	NSS		x
Germany	German accounting standards board	NSS	x	x
Netherlands	The Netherlands council for annual reporting	NSS	x	x
Norway	Norsk RegnskapsStiftelse	NSS		x
Poland	Accounting standards committee in Poland	NSS		x
Spain	Instituto de Contabilidad y Auditoría de Cuentas	NSS		x
Sweden	Swedish financial accounting standards council	NSS		x
US-CANADA				
Canada	Accounting standards board	NSS		x
USA	Members of the United States Congress			x
	Total NSS responses	4	4	19
	Total responses	29	281	229

^a NSS National accounting standard setters

ED 2. Nevertheless our examination of the individual periods reveals a different pattern of the NSS with the other of respondents.

The standard setters sent 5 times more letters to the ED 2 than to the DP in each of the two comment periods (19 vs. 4 letters). This finding departs from Sutton's (1984) contention that there should be a stronger reaction in the earlier stages of the process, due to the greater effectiveness of lobbying. On the contrary, this result is consistent with Walker and Robinson (1993) who point out that those who lobby could merely be showing support for the overall activities of the regulatory agencies. As explained later, this appears to have happened in this case, as most of the responses to the ED 2 were in support of the IASB's proposals. This interpretation is consistent with the institutional theory, as it may be seen as 'a visibility-enhancing maneuver and as a maneuver to increase another organization's (the IASC's) viability' (Kenny and Larson 1995, p. 298); the same could be argued of the IASB.

We then examine the three issues under discussion on the accounting for stock options to employees (recognition, valuation, and reference date). Most of the letters (21) dealt with the key issues under consideration, as shown in Table 15.3 panel A. This strategy is common to other groups such as the profession and users, whereas preparers and consultants usually addressed only the recognition issue (Giner and Arce 2012). Notwithstanding, the European Commission in response to the DP and the accounting standards board (ASB) of Japan in its letter to the ED 2 did not address directly any of the identified issues. Instead they made general comments on accounting policy. The ASB of Japan stated: ‘We have concern about consistency between the way of applying the asset/liability approach in several major projects of IASB (...) and the explanation for the consistency with the Framework shown in the Basis for Conclusions of the ED. We do not express arguments for or against the proposals in the ED (...). However, we would like to take this opportunity to state our views on how the Framework should be applied, because we believe it is a very critical issue in conjunction with other projects’ (ED2 comment letter n. 75).

As for the supporting arguments of the opinions we identify two types: conceptual and based on economic consequences. Table 15.3 panel B summarizes them. Although most of the respondents did not justify their opinions, when they did it, they employed mainly conceptual arguments, particularly when agreed with the proposals. According to Giner and Arce (2012) NSS behaved as the profession and users, but differently to the preparers and consultants, that frequently employed arguments related to economic consequences. We found that NSS commonly provided no argument when in favor of a position, which is the strategy followed by other groups (Tutticci et al. 1994; Giner and Arce 2012).

Although the self-interest theory suggests that lobbyists could be prone to arguments rooted in economic consequences that account for unintended effects of the standards, they may be reluctant to provide these arguments, in case they are seen as self-serving, and consequently less likely to be considered by a regulator

Table 15.3 Panel A: number of comment letters that address 0, 1, 2, or all 3 of the of key issues. Panel B: Use of arguments about the three issues in the comment letters according to positions

Panel A					
Key issues	0	1	2	3	Total
Comment letters	2	3	1	21	27
Panel B					
	Agree		Disagree		Total
Conceptual	8		3		11
Economic consequences	1		2		3
Both	2		1		3
No arguments	47		4		51
Total	58		10		68 ^a

^a If one letter dealt with all three issues, we counted it three times. Thus the maximum count would have been 81

(Jupe 2000). Given the IASB's mission 'to serve the information needs of participants in capital markets' (IASB 2010: paragraph BC 1.23), respondents might have realized that the IASB would be reluctant to consider vested arguments *per se*—especially arguments in favor of a solution contrary to the interests of users—as they could seriously damage their credibility.¹³ In addition, we suggest that the economic-consequences argument might have lost ground as a consequence of the convergence policy of the IASB and the FASB that followed the 2002 Norwalk agreement. As expected, we find no economic consequences-based arguments after the ED 2 was issued among the responses of the NSS. Next we provide a more detailed analysis of the responses about the three identified issues, as well as the arguments provided by the respondents.

15.4.3.1 Recognition

Regarding the opinions on recognition to the DP (that received 8 letters in total), 4 were in favor, 3 against and 1 with no clear opinion. Thus, the DP received full support from the Deutsches Rechnungslegungs Standards Committee of Germany, the Raad voor de Jaarverslaggeving (Council for Annual Reporting—RJ) of the Netherlands, and the Instituto de Contabilidad y Auditoría de Cuentas (ICAC) of Spain. The Ministry of Economy, Trade and Industry of Japan was also in favor, but stated that it would not be applicable to venture capital companies, unlisted companies and those recently listed on the stock exchange (DP1 comment letter n. 29). The need to encourage the growth of these types of companies—and the possible detrimental effects of the proposal—as well as the difficulties involved in measuring the fair value of equity instruments were the two reasons claimed to justify its position. Even the RJ expressed its concern over the economic effects of a regulation that negatively affects earnings especially if the new treatment was not going to be adopted worldwide (DP1 comment letter n. 20).

The Conseil National de la Comptabilité (CNC) of France rejected the DP when published by the IASB using conceptual arguments mainly due to problems with the definition of expense in the IASB Conceptual Framework (DP2 comment letter n. 113). Giner and Arce (2012) also identify respondents other than NSS that rejected the expensing of stock options arguing problems with the reliability requirement, the competitive disadvantages of companies treating stock options as expenses and the convenience of maintaining a level playing field.

The EC replied twice to the DP; in the first answer did not take a clear position, but in the second was opposed and recommended to 'convert this to a two-track project with one track focusing on the conceptual, recognition, measurement and practical aspects, and the other dealing with disclosure' (DP2 comment letter n.

¹³ The experience surrounding the changes in IAS 39 and IFRS 7 that occurred in 2008 questions this assumption, however. See the Minutes of Evidence by Sir David Tweedie, Chairman of IASB, taken before the Treasury Committee of the House of Commons of the UK Parliament (Tuesday 11 November 2008).

279). EFRAG admitted that share-based payments are an expense in its response to the second publication to the DP, although suggested that due to problems with the Framework it would be better to adopt a disclosure standard as an interim measure. EFRAG also placed special emphasis on the need for worldwide convergence of accounting practices (DP2 comment letter n. 146).

However, the respondents to ED2 accepted recognition with the sole exception of the ASB of Japan that did not address directly this issue. It is interesting to note the change in EFRAG's view, which in its letter refers to the support of the Norwalk agreement on convergence and the changes in the FASB agenda (ED2 comment letter n.136). Nevertheless, EFRAG was critical about the reliability of the measurement and highlighted the strong desire from several EFRAG commentators¹⁴ to achieve global convergence on recognition and measurement; the CNC also supported recognition, but mentioned inconsistencies with the IASB Framework and competitive disadvantages.

15.4.3.2 Valuation

Regarding the valuation criterion, NSS accepted the accounting treatment as included in the DP and ED2, and only the CNC was against it not only in its response to the DP but also to ED2 because 'its valuation causes major difficulties, one of them dealing with reliability of measurement' (ED2 comment letter n. 147). Giner and Arce (2012) identify other arguments used by other groups to criticize the use of option valuation models to measure these transactions, such as the special characteristics of employees' options, the impact on taxes; they also find that many respondents proposed the use of the intrinsic value as in SFAS 123.

15.4.3.3 Reference Date

In relation to the reference date, all the NSS preferred grant date, except the Spanish ICAC that supported vesting date, not only in its letter to the DP but in the one to ED2. The Spanish ICAC stated in its letter 'as the performance occurs between the grant date and the vesting date, the entity should account for an accrual of the best estimation of the transaction amount during the performance period' (ED2 comment letter n. 31). But the use of the vesting date was rejected for the following conceptual reasons: (1) the obligations beginning and the equity instruments being issued at the grant date, (2) the contracts being established in terms of the value at that date, and (3) there are inconsistencies between the Framework and the use of this criteria, as it would require remeasurement of equity until that date. Giner and Arce (2012) also identify respondents that argued

¹⁴ When EFRAG produces the comment letters, it follows a due process as well, and requires comments to its constituency before considering them final.

about income volatility when discussing the use of vesting date as a possible reference date.

In summary there were shifts in the opinion of most of the respondents that replied more than once, and the support of ED 2 was due not only to these changes, but to the 13 respondents that participated for the first time at the end of the process to show agreement with the IASB's proposal. According to institutional theory, this may be seen as a sign of support for the IASB's role as a global standard-setter.

15.5 Conclusions

Taking the development of IFRS 2 as the case under study, this chapter considers the IASB's due process, and also discusses the institutional arrangements that have given wide acceptability and authority to the IASB. The latter provides the framework to understand the current position of the IASB as the global standard-setter. As Fogarty (1992) sustains the due process, a balanced background of members, and the public relations efforts are three elements that provide legitimacy to a standard-setter; our analysis of the IASB structure and *modus operandi* suggest that they are well covered in the current framework.

The IASB's due process relies on wide consultation, including a formal process of inviting public comment letters on DPs and EDs. This chapter is based on the assumption that participation results in the submission of comment letters. In this respect, our investigation provides knowledge about the lobbying activities of the NSS, when their lobbying practices occur, and the arguments employed by them.

We focus on the NSS, as they are a very special and relevant lobbying group. They have a good knowledge about the local institutions and consequently they are in a good position to find out how the standards may be understood and applied locally; they also undertake research, encourage stakeholder input from their jurisdictions, and identify emerging issues, in summary they act as a channel between the IASB and the other stakeholders. An obvious recognition of this important role is the proposal to create an ASAF that the IFRS Foundation has been recently announced.

In this study, we analyze the lobbying activity prior to the adoption of the IFRS 2 in February 2004. To this end we analyze the 27 comment letters submitted to the previous documents, the DP and ED2. It is important to highlight that the DP was issued twice, first by the IASC and later by the IASB, thus the project had three consultation periods. The standard requires an entity to record all share-based payments as expenses, regardless of the form of settlement (shares or cash) and the counterpart involved (employees or others). By the time it was adopted, these transactions were not recognized as expenses anywhere; in fact due to the strong pressure the FASB could not impose recognition in the 1990s.

Our examination of the comment letters consists of a content analysis focusing on three key issues: recognition, valuation criteria, and reference date, and

confirms that most of the respondents dealt with the three issues. Our analysis is further aimed at identifying the underlying conceptual and economic arguments used to justify the position on each of these issues. We find that respondents did not employ normally arguments to show support of the proposals, but mainly used conceptual arguments when disagree. No economic consequences-based arguments were used after the ED 2 was issued, and we argue it could be due to the fact that the economic consequences argument might have lost ground as a consequence of the convergence policy of the IASB and the FASB after the 2002 Norwalk agreement.

As most of the prior literature, this study relies on the rational-choice model of lobbying which explains participation if their expected benefits of the lobbyists exceed the cost of lobbying (Sutton 1984). However, the institutional theory is particularly relevant as well, as lobbying may evidence the perceived importance or viability of the organization being lobbied (Kenny and Larson 1995); the considerable participation of NSS after the ED 2 is consistent with the insights of this theory. Moreover the majority of the respondents only participate at the end to show agreement with the proposal.

In summary, this analysis is consistent with the institutional theory which considers that organizations, such as the IASB, have to be acceptable to their constituency to survive. In our view, the attitudes of NSS in the IFRS 2 due process may be seen as a sign of support for the IASB's role as a global standard-setter.

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