

Sequences of change in financial reporting: the case of fair value.

Julia Morley
Department of Accounting
London School of Economics and Political Science
j.e.morley@lse.ac.uk

August 20th, 2014

Abstract

This study seeks to explain the transnational shift towards fair value accounting after 1985 by analysing six standard-setting projects in the areas of pensions, derivatives and non-financial liabilities. It contributes to accounting scholarship in two ways. First, it supplies rich evidence concerning individual fair value projects through interviews with key actors. In paying attention to the meanings of events and practices for these actors, the study provides thick descriptions (Geertz, 1973) which reveal their motivations for supporting or opposing these fair value projects. Knowledge of these motivations allows for the development of a particular form of causal explanation which makes use of counterfactual conditionals proposed by Lukka and Modell (2010). Second, in extending the analysis to relations *between* the individual projects, the study identifies an intricate web of direct and indirect influences over time, both across jurisdictional boundaries and between distinct technical areas. Although accounting scholars have identified the significance of network effects between entities at a point in time (Richardson, 2009), accounting change has not been analysed as chronological chains of events. This study finds the *sequence* to be an appropriate unit of analysis in explaining regulatory change.

Keywords: Fair value, regulatory change, sequences.

1. Introduction

For the most part, academic research into the emergence of fair value accounting has focused on the potential technical benefits and observed socio-economic effects of this approach to financial reporting.¹ In contrast, this study addresses the *sources* of regulatory change, focusing on the shift towards fair value accounting from the mid-1980s.² The study analyses a set of six standard-setting projects initiated by the FASB, IASC/B and the ASC/B that aimed to extend the use of fair value in the areas of pensions, derivatives and non-financial liabilities.³ It intends to contribute to the existing accounting literature in two ways.

First, it supports work by scholars in the political economy school who have addressed questions concerning regulatory change in accounting in that it attempts to uncover the true motivations of the actors involved in the production of accounting standards. By studying them in context, it generates ‘thick’ descriptions of their actions (Geertz, 1973; Ryle, 1968) which make possible a type of causal explanation described by Lukka and Modell (2010). This form of causal explanation, known as the “difference-making theory of causation,” makes causal claims derivative upon the truth of counterfactuals rather than ‘covering laws’ (Lewis, 1973).⁴

Second, it introduces a new form of dynamic explanation which extends the analysis from a focus on the individual standard-setting project to a *sequential* analysis of networks of projects, thereby revealing cross-jurisdictional and inter-project interdependencies. Such sequential analysis builds on the work of Richardson (2009) and Posner (2010). It provides a dynamic model which specifies the process through which a particular practice evolves, influences the environment in which it operates and is then itself subsequently influenced by this transformed environment, as described by Miller and Napier (1993).

The paper is structured as follows. In Section 2, I provide an account of the rise of fair value accounting internationally and highlight the uneven adoption of fair value standards in the US, UK and IASC/S jurisdiction. In Section 3, I consider existing theories of change in accounting practice. In Section 4, I describe my research methods, in particular highlighting the sources of evidence used. In Section 5, I examine evidence from a set of five standard-setting projects in the areas of pensions and derivatives which resulted in new standards being published between 1985 and 2006. I then analyse a sixth project, the IASB Liabilities Project, which did not result in a published standard and was removed from the IASB’s agenda in 2010. This sixth project represents a failure to extend fair value accounting. It thus acts as a control case, which aids the identification of the factors responsible for the publication of fair value standards. In Section 6, I analyse the factors which have shaped these episodes of accounting change using a sequential analysis. Finally, in Section 7, I draw conclusions and suggest possibilities for future research.

¹Many commentators question the usefulness of particular rules for stakeholders, for example the informational content of accounting information generally (Aboody and Lev, 1998; Barth et al., 2001); considerable research scrutinises the value relevance of particular choices over disclosure or recognition of items such as pension and post-retirement health care obligations (Amir, 1993, 1996; Amir and Ziv, 1997; Amir and Benartzi, 1999; Amir et al., 2007; Barth, 1991; Barth et al., 1992; Gopalakrishnan and Sugrue, 2006; Rees and Stott, 1998) and derivatives and financial instruments (Ahmed et al., 2011; Wang et al., 2005; Barth, 1994; Skinner, 1996).

²The terms ‘financial reporting’ and ‘accounting’ are used synonymously in this paper, but ‘accounting’ refers to the practice of reporting an entity’s activities for external users, in line with generally accepted accounting practice.

³Non-financial liabilities are referred to as ‘contingent liabilities’ in the US.

⁴Philosophical theories of causation often take one of two forms: they either treat causal laws as statements summarising a broad class of true, particular, counterfactual claims, or they use general causal laws to ground the truth of particular counterfactual claims.

2. Revolutions in accounting

Since the 1980s, financial reporting norms have shifted as financial reporting practice has increasingly been influenced by financial economic theory.⁵ This shift in accounting knowledge was manifested in the publication of a cluster of fair value standards which can be characterised in terms of their emphasis on balance sheet recognition (even for uncertain items), the use of financial economic methods for valuation and the reflection of changes in balance sheet values in the income statement. The introduction of these fair value standards may be viewed as the dawning of a new era of reporting norms which demonstrates that accounting is “not a static phenomenon” (Hopwood, 1987, pg.1).

However, this change in accounting norms of best practice did not arise suddenly, nor did it occur uniformly. Furthermore, in some cases, a disparity between prescriptions of generally accepted accounting practice in different jurisdictions persisted for significant periods of time. In the US, the FASB introduced a fair value pension standard (FAS 87) in 1985, fifteen years before a fair value pensions standard, FRS 17 (2000), was published in the UK. It was not until 2006 that the FASB finally published a revised pension standard (FAS 158), which matched the financial economic content of the UK standard. Furthermore, from 1998 a cluster of standards were published, which extended the use of fair value in the the areas of pensions and derivatives (IAS 39, 1998; FAS 133, 1998; IAS 19, 1998; FRS 17, 2000; FAS 158, 2006). Furthermore, given the clear trend towards fair value from the 1990s, there were surprising failures to complete projects to publish fair value standards, such as the IASB’s proposed new standard for non-financial liabilities which was withdrawn from the standard-setting agenda in 2010.

The main objective of this study is to provide an explanation of the specific pattern in which fair value accounting took hold in three jurisdictions over a period of approximately thirty years. In doing this, the study throws light on the mechanism for this change. The transnational analysis of regulatory change provided in this paper is organised across the areas of pensions, derivatives and non-financial liabilities. Figure 1 illustrates the general shift towards fair value accounting in these areas, but also the persistence of inconsistencies and the presence of a cluster of fair value projects.

These projects, with the exception of the Liabilities Project, were completed between 1985 and 2006 and are shown as rounded-rectangle shapes. The shading reflects their financial economic content (their fair value ‘strength’). In order to contextualise the timing of the publication of standards, I have noted along the top of the diagram, events which occurred outside the standard setting institutions and which exerted an influence on the development of the projects. This content is categorised into three types for simplicity: ‘non fair value’ (unshaded), weak fair value (cross-hatch) or strong fair value (shaded grey). The ‘strength’ in terms of the fair value content of the standards is determined by reference to three attributes. The first is the recognition of uncertain future benefits or obligations on the balance sheet, which were

⁵Financial economics applies theories of choice to markets for financial instruments, in which agents “trade on valuations of time, risks and beliefs” (Hens and Rieger, 2010). Such theories have traditionally drawn on theories of rational choice (Muth, 1961), but more recently have started to incorporate elements of behavioural economics to explain, in descriptive terms, the choices agents make (Shleifer, 2000). Financial economics analyses the market prices which result from the aggregation of agents’ individual valuations of financial instruments. It is a discipline which offers an axiomatic approach to normative problems of valuation and portfolio strategies, yet it is informed by rich empirical market-based research. An important development within the field was portfolio and asset pricing theory (see Fama, 1965a, 1970) which were made available for a less technical audience via practitioner publications (Fama, 1965b, 1968). Ultimately the normative strength of financial economic theories derives from assumptions concerning the rationality of economic agents. This assumption has been questioned by those who advocate boundedly rational behaviour in agents Tversky and Kahneman (1986). For a detailed discussion of rational choice theory, see Sugden (1991).

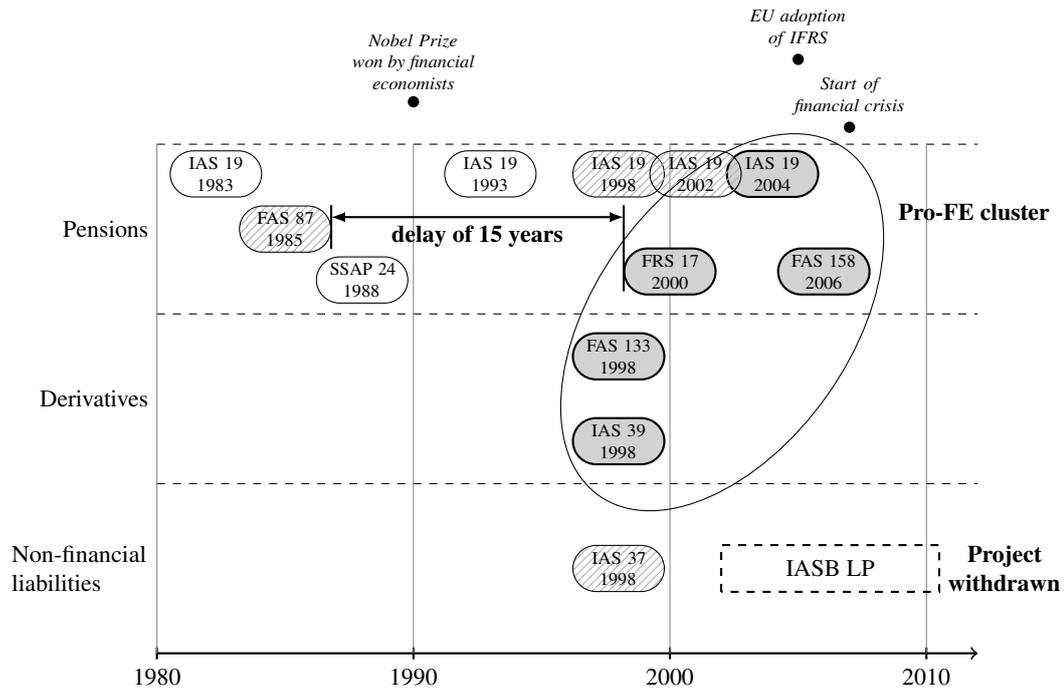


Figure 1: The irregular pattern of publication of fair value standards for pensions, derivatives and non-financial liabilities by FASB, IASB and ASB. The standards are categorised as: ‘non fair value’ (unshaded), weak fair value (cross-hatch) or strong fair value (shaded grey).

not recognised under the historical cost convention for certain types of non-physical item. For instance, before the introduction of fair value accounting standards, pension obligations and derivatives were not recognised on the balance sheet. The second attribute of fair value accounting is the use of financial economic valuation methods, based explicitly on techniques from financial economics.⁶ The third attribute is the use of a financial economic theory of income (Hicks, 1939; Paish, 1940; Bromwich, 1992). While in reality there exists a range of representational forms deserving the label ‘financial economic’ in some sense or other, for purposes of analytical simplicity I use the terms *weak* or *strong* fair value accounting to mark the extent of the financial economic content in a particular set of reporting rules. For these purposes, the weak form of fair value accounting includes, at a minimum, a financial economic approach to valuation. For the strong form of fair value accounting all three components, recognition, valuation and income, must be reported using an economic approach.⁷

Although it can be seen that fair value accounting increasingly took hold as part of generally accepted accounting practice over the period shown, and particularly from 2000, its irregular pattern of adoption presents a puzzle. Explanations of accounting change that identify functional benefits as a key driver do not address such localized irregularities. In what follows, this study addresses the unexplained rhythm of change in accepted financial reporting practice.

⁶This is not to say that financial economic methods are necessarily legitimately applied to the problems of valuation faced by standard setters, nor that standard setters understand them perfectly. Theoretical concerns have been raised about the domain applicability of asset pricing models for the valuation of financial instruments (Bromwich, 2007).

⁷These attributes reflect the commitment by standard setters to the application of *their* interpretation of financial economic theory to financial reporting.

3. Explaining changes in accounting practice

Critical scholars in accounting view explanations which reference perceived functional outcomes alone as simplistic and potentially misleading. Explaining the emergence of a new practice, such as fair value accounting, in purely technical terms is treated with scepticism on grounds that it omits from the explanation important explanatory factors related to the *process* of change. As an alternative approach, some accounting scholars have called attention to the importance of localized meanings of events and actions which can be implicated in the reciprocal influence between accounting practices and the environment in which they operate (Burchell et al., 1985; Hoskin and Macve, 1986, 1988; Miller and Napier, 1993). This approach identifies constellations of factors which make certain outcomes possible. Such explanatory approaches are predicated on the assumption that “accounting facts emerge through a process of change, where this change is institutionally embedded and does not necessarily lead to improvements in practice” (Hopwood, 1987, pg. 226).

The contextual drivers of change in financial reporting are complex, but an obvious starting point is the standard setting organizations themselves as ‘producers of standards’, and thereby as producers of generally accepted accounting practice. Given that standard-setting projects are initiated and voted through by board members at these organizations, some scholars have tried to explain elements of regulatory change through the identification of board members’ preferences and their view of best practice in financial reporting can be used (Allen and Ramanna, 2013). However, the identification of the objective of the standard setting organization alone is not sufficient for explaining regulatory change.

For one thing, standard setters operate within a regulatory space (Young, 1994). As a result, they are not only the product of their backgrounds and training; they are also subject to current institutional influences and tensions which shape their notions of best practice, and thus their objectives. A dynamic mutual influence between standard setters and the environment in which they operate is likely to exist, just as a reflexive relationship is postulated between accounting practice and the environment in which it operates.

Furthermore, even if standard setters’ objectives and ideological commitments were identified, this may not be sufficient for explaining change. They may face a number of obstacles when trying to publish new standards. This is because they operate in a field of competing interests, in which their attempts to publish new standards may be stymied by the actions of particular interest groups. Accounting change may be seen to result from conflict between interest groups, manifested in lobbying behaviour (Watts and Zimmerman, 1978; Sutton, 1984; Zeff, 2002, 2005). However, the Watts and Zimmerman model has been rejected as overly “simplistic” by Lowe et al. (1983). Alternatively, it may reflect the competing aims of different social or economic classes, resulting in the contestation of the valuation schemes which determine distributions of wealth between labour and capital (Tinker et al., 1982), investors and other stakeholders (Bryer, 1995) or the financial and non-financial sectors (Perry and Nölke, 2006).

An even more intricate picture of relations may exist between actors and accounting practice. Some accounting scholars have argued that “the outcomes of accounting policy are essentially political in that they operate for the benefit of some groups in society and to the detriment of others” (Cooper and Sherer, 1984, pg. 208). Political economy approaches have been used to describe how calculative modes of governance or particular practices have emerged and interacted with social forces of change (Bhimani, 1987; Puxty et al., 1987; Arnold and Sikka, 2001; Arnold, 2012). Furthermore, the importance of legitimacy generation is highlighted by Robson et al. (1994) who provide an account of the ideological nature of regulatory discourse expressed by professional accounting associations in the UK in the 1980s.

Scholars outside the field of accounting have also identified the political and economic foundations of the development of particular regulatory practices in accounting. Botzem and Quack (2006) point to transnational features of accounting regulation and argue that contestation and conflict can become driving forces of international standardisation. Richardson and Eberlein (2010) have highlighted the process of legitimacy creation through due process rhetoric at the transnational standard setting bodies such as the IASB. Furthermore, recent work in sociology reveals the influence of contextual factors on the emergence of new practices more generally. In this regard, Padgett and Powell (2013) highlight the role of environmental features and organisational structure in facilitating a “spillover” of practices between different social domains.

Political economy views thus provide a rich description of the environment in which accounting takes place and capture both the endogenous nature of accounting practices and the shaping of the environment by such practices. The findings of this study, which are set out in Section 5, contribute to the political economy literature by highlighting the factors influencing the increasing acceptance of the fair value paradigm from the mid-1980s, by standard setters and by other groups.

However, the political economy approach tends to remain silent on the specific processes which link one practice to its next incarnation, and which determine the timing of the looping effect between environment-and-practice and practice-and-environment. For certain research questions such as, *Why did fair value accounting emerge for pensions under US GAAP at a particular point in time?*, we may want to understand the dynamism of accounting through an understanding of these processes. In order to explain particular cases of regulatory change in accounting, we therefore need explicit assumptions about the underlying processes.

The ability of interpretive research to generate causal explanation has recently been the focus of debate in the accounting literature. In this regard, Lukka and Modell (2010) draw on recent developments in the philosophy of causation in arguing that,

“[b]y focusing on careful analyses of the sequences of actual events and actions in specific, local contexts, it [interpretive research] is in a good position to trace the dependencies (causal linkages) between examined phenomena.” (pg. 463)

In other words, an interpretive approach enables the investigator to uncover the *meaning* the actor attaches to a particular practice, or to events which are relevant to changes in that practice, by considering the context. Interpretive research using ‘thick descriptions’ (Ryle, 1968; Geertz, 1973) can illuminate the true causes of action by taking into account contextual subtleties.⁸ In this study, the interpretation of documentary and interview evidence casts light onto the motivations of different actors in the regulatory space and the constraints they faced. In this way, the reasons *why* an actor supported or opposed a particular standard-setting project become clear.

Nevertheless, a form of causal explanation commonly used within accounting research tends to be viewed with scepticism by interpretive theorists. This form of causal explanation identifies regularities between variables. Lukka and Modell (2010) note two reasons for scepticism of regularity-based models of causation. First, regularities cannot be *sufficient* for causal explanation because spurious correlations exist between many events which are not causally related. Second, regularities cannot be *necessary* for causal explanation because not every cause of an event is part of a regularity (e.g., the cause of a specific historical event such as the first World War). Lukka and Modell (2010) build on Kakkuri-Knuuttila et al. (2008) to address these concerns by using an alternative way to identify the cause of an event. Setting aside certain complexities,

⁸The important interaction between meaning and causation has been noted by sociologists such as Weber (1978), who draws attention to the fact that the interpretation of a person’s experience of an action can reveal the meaning of such an action.

one may say that X causes Y exactly when, if X had not happened, then Y would not have happened either.⁹ Hence, the task is not to identify overarching regularities under which the event falls (using the so-called covering law model of causal explanation), but rather to identify true counterfactuals linking the cause to the event. In short, the investigator needs to have evidence that, had the putative cause not occurred, then neither would the event under discussion have occurred. Developing counterfactuals thus requires an understanding of the causes driving the phenomenon under investigation. The present study intends to identify causal mechanisms by uncovering the motivations of standard setters, preparers and other constituents, which in turn can be revealed through an understanding of the meaning of events or actions to those actors in their localized contexts.

However, while thick descriptions may throw light on an actor's motivations, these motivations can only bring about a particular outcome if the actor has some causal power over this outcome. Thus, knowledge of contextual power relations is important part of the explanation. Recent work in accounting has drawn on social network analysis to describe power relations at a Canadian standard-setter (Richardson, 2009). The author provides measures of the relative influence on regulatory outcomes of closely linked organisations, using clusters of organisations as a starting point for an analysis of regulatory change. He argues that,

“The ability of a regulatory body to act effectively will depend on the network of cognate organizations to which it is linked. These links can take many forms including flows of information, personnel or authority.” (pg. 572)

Richardson (2009) shows that power-brokers who connect different communities by bridging ‘structural holes’ can command significant influence due to their position in the network. Although the present study does not explicitly use network analysis, it does consider the influence of relations *between* entities as being key to understanding regulatory change.

Such a network view can be likened to those styles of historical explanation which highlight sequential effects, in that both stress the importance of the position of an entity within a structure (whether topographical or chronological) as a determinant of its causal influence on the outcome to be explained. Whereas the network analysis of Richardson (2009) addresses the impact of the relative position of entities *at a fixed point in time*, this study focuses on the positioning of events and entities *in a chronological sequence*. Such a sequential analysis offers a causal explanation by invoking structural relations between entities.

Sequences of connected events may be self-reinforcing, reflecting an increasing trend towards the dominance of a particular practice or the strengthening of a particular effect. This occurs if path-dependency narrows the set of possible outcomes after each additional event in the sequence. In the field of political science, Pierson (2000) has highlighted the importance of acknowledging the effects of sequential increasing returns when explaining particular political outcomes. Such sequences may lead to the “formation and long-term reproduction of a given institutional pattern” (Mahoney, 2000, pg. 508). In financial reporting regulation, self-reinforcing sequences might be expected to explain the increasing entrenchment of particular technical reporting schemes which eventually come to be viewed as best practice, such as fair value accounting by the early 2000s. It should be noted that self-reinforcing systems highlight weaknesses in functional forms of explanation which fail to acknowledge the significance of path dependencies that challenge the ability of actors to design optimal solutions at particular points in time (Pierson, 2000).

⁹Causal overdetermination, for example the death of a person shot by a firing squad, so that any one of the multiple shots fired may have been the cause of death, is one such complexity. There is a large philosophical literature devoted to the analysis of causality using counterfactuals which considers these complexities in detail (see, for example Woodward, 2003).

Another type of sequence which stresses the effects of stochastic interactions between events has been labelled 'reactive' (Mahoney, 2000, pg. 509). Posner (2010) has explained the increasing power of the IASB in terms of such a reactive sequence of political and institutional events, identifying specific temporal orderings of actions and reactions as causes of particular outcomes. Building on the work of sociologists and political theorists (Abbott, 1983, 1995; Abbott and Tsay, 2000; Pierson, 2004), he analyses the timing and implications of particular interactions between standard setters and political institutions. In the present paper, and consistent with Posner (2010), I argue that the position of each project within a chronological sequence is important in explaining the outcome of each project, and by extension, in explaining the pattern of adoption of fair value accounting overall. I find elements of self-reinforcement to be in evidence, but also effects brought about by exogenous, stochastic events which derail apparently predictable outcomes. In order to accommodate these two different effects, I develop a hybrid sequential analysis that incorporates both self-reinforcement and reactive elements.

This study responds to Lukka and Modell (2010) in applying a counterfactual form of causal explanation to the observed pattern of publication of fair value accounting standards. In so doing, it reveals the significance of the sequential nature of regulatory change. Section 5 contains a detailed analysis of particular episodes in the shift towards fair value accounting. An important source of evidence included in the analysis is the accounts provided by actors in the regulatory space which reveals the meanings they attached to particular events and thus their motivations with respect to particular standard-setting projects. Furthermore, the study draws on network effects *over time* by considering connected sequences of events.

4. Research methods

In line with the work of Lukka and Modell (2010), who advocate the use of thick description as a means of accessing causal mechanisms, this study focuses on the reasons *why* standard setters and lobbyists acted in particular ways, what constraints they faced and the effects of their actions on project outcomes. A distinguishing feature is the use of evidence obtained through interviews with board members and senior technical staff of accounting standard setting organizations and other senior figures involved in the standard setting process. Access to these key individuals, over and above the use of archival sources, offers important insights into the reasons why standard setters were able to publish standards when they did, and why they were unable to complete other projects. Twenty-two interviews (with twenty-one individuals) were conducted between July 2009 and April 2014. Of these, thirteen interviewees worked for standard-setting organizations and were directly involved with the projects being analysed in this study, either as board members or technical staff at standard setting institutions (see Appendix A for details). Other interviewees included Big Four accounting partners, representatives of US and European analyst associations and senior actuaries. Interviews lasted between half an hour and two hours. All interviewees were guaranteed anonymity in order to encourage them to speak freely and to avoid them simply expressing an agreed view endorsed by their organization. These interviews serve to highlight important factors which might otherwise be passed over if buried within a lengthy or complex document or which would be excluded from organisational documentation in order to preserve the official organisational view on certain issues.

The analysis of regulatory change in this study focuses on three areas of accounting: pensions, derivatives and non-financial liabilities. I have chosen to analyse these areas for three reasons. First, the area of pensions offers useful insights into the influence of financial economics because fair value was introduced relatively early in this area. The US pensions standard FAS 87, which was published in 1985, used the term *fair value* and required the use of some elements of

financial economic representation. As a result of this early adoption, and also the complex nature of pension accounting, the introduction of financial economic methods in this area generated significant debate and yielded rich documentary evidence. Many of these documents were produced by standard setting institutions, and included position papers, exposure drafts, notes of meetings and so on. It is also still possible to gain access to interview some of the participants in the standard setting process. Second, the two derivatives standards published in 1998 (IAS 39, 1998; FAS 133, 1998) marked a watershed in accounting norms with respect to the use of financial economic methods. In this case, the methods used for valuing derivatives were the same as those used in pricing these instruments in the market. This made derivatives the perfect candidate for financial economic representation. Third, the IASB Liabilities Project offers a glimpse into the world of regulatory failure. In spite of a strong fair value world view at the IASB, and with little reason to believe interest groups would align against the proposed standard, the IASB found that it had to remove the project from its agenda in 2010 without publishing a revised standard.

Analytical work in the social sciences inevitably faces problems concerning the objectivity of variables. In this project such difficulties relate to the possibility of misinterpreting evidence or failing to categorise data in a consistent way. In particular, drawing inferences from one type of source, such as practitioner documentation, may result in a failure to identify those factors which *actually* influenced the timing and outcome of particular projects. For example, the relative power of different interest groups cannot easily be identified from a comment letter analysis alone. The use of interview evidence was an important supplement to the documentary analysis. In the case of the Liabilities Project (discussed in Section 5), for instance, interview evidence revealed that the American Bar Association was particularly powerful because of the IASB's desire to avoid actions which would risk derailing the convergence project between IFRS and US GAAP. Furthermore, the use of 'due process criticisms' was described by one opponent of fair value as a tactical move to block the IASB, rather than a true reflection of the concerns of constituents over due process. It was only by listening to the accounts of the interviewees that the true motivations for action became clear and that relevant causal processes revealed.

Three further issues relate to the reliability of reports given by interviewees. First, accuracy of reports can be problematic, as some interviewees were recounting events which had taken place over two decades previously. Second, selection bias might result if evidence from this sample of interviewees was unrepresentative of the population of potential interviewees. I was able to alleviate these concerns about reliability, to a great extent, by selecting a broad spectrum of interviewees from different interest groups and triangulating the multiple oral and textual reports of events. Third, employees or ex-employees of a particular institution might have felt duty-bound to present the 'organizational line' when responding to questions. I have taken steps to reduce this risk by providing assurances of anonymity as well as checking the consistency of answers with other sources.

5. Case studies

Changes in generally accepted accounting practice (US GAAP, IFRS and UK GAAP) come about through the publication of accounting standards. Thus it is the factors that drive the publication of particular accounting standards that shape accounting change. A major factor driving change is thus the aims of standard setters. For the case of US GAAP, FASB's conceptual framework states that standard setters aim to "provide information that is useful in making business and economic decisions" (FASB Concept Statement No. 1, 1978, ¶9). Thus, standard setters claim to respond to user demands and deliver benefits to users, including enhanced relevance and

comparability of financial statements.¹⁰ As a result, a first step in attempting to explain the introduction of fair value standards is to consider the aims of the standard setting organizations and the way in which the standard setting boards believed that these aims could best be achieved. After all, a necessary condition for the publication of fair value standards is the commitment of the standard setting organizations themselves to this new accounting paradigm.

Between the early 1930s and the mid 1970s, US GAAP was firmly rooted in historical cost. This conceptual approach stemmed from the attitude and influence of the Securities and Exchange Commission (SEC) on US financial reporting (Zeff, 2007, pg. 59). A gradual shift towards a belief in the importance of providing relevant information for decision-making was formalised in 1973 when the Trueblood committee invoked a forward-looking approach to financial reporting, which moved away from the traditional emphasis on stewardship. This marked the beginning of the conceptual framework project, which was seen as a test of the success of the FASB as a private sector standard setter (Macve, 1997, pg. 105-107). This shift in attitude at standard setting organizations was associated with a gradual permeation of accounting academia by financial economic theory after the 1970s. At this time, the capital markets research stream emerged with its focus on the value relevance of accounting information (Ball and Brown, 1968) and the efficient markets hypothesis (Fama, 1970).

The new aims of financial reporting were codified in the conceptual framework projects in the US and UK. In the US, FASB Concept Statement No. 3 (1980) provided a definition of a liability in terms of the probable future sacrifices of benefits arising from present obligations, which were to include non-contractual obligations. Given the shifting aims of financial reporting towards the provision of decision-useful information, standard setters turned to financial economics as a measurement tool when faced with new types of uncertain items, particularly when traditional historical cost accounting failed to offer a solution. This is not to say that financial economic methods were necessarily legitimately applied to the problems of valuation faced by standard setters, nor that standard setters understood them perfectly. Moreover, the possibility of intentionally simplistic interpretations and cherry-picking of theories by standard setters has been suggested (Bromwich et al., 2010). Issues of domain inapplicability and other theoretical concerns did not prevent the adoption by standard setters of financial economics based models for valuation in financial reporting. What is important to note is that the normative merit of applying financial economics models to financial reporting practice is less relevant than the belief by the standard setters at that time, that it was conceptually appropriate. Such issues relating to the translation of theory to practice suggests that financial reporting should not be viewed as a stable object, but rather one which regulators attempted to construct in situ.

However, the following transnational analysis of six pro-fair value standard setting projects in the areas of pensions, derivatives and non-financial liabilities, shows that standard setters' aims may be thwarted by localised constraints. These constraints may result in the standard setters finding themselves offering "the best pragmatic solution" (FAS 87, 1985, ¶178) rather than the solution they viewed as best. Thus obstacles faced by standard setters lead to "pragmatic" regulatory outcomes observed in practice. These localised constraints may help explain the uneven publication of fair value standards.

5.1. Case study 1: Pensions

The area of pension accounting is complex and controversial, not only because pension obligations are long-term and uncertain, but also because of the "changing nature of pension

¹⁰Such 'functional' explanations which focus on standard setters' attempts to optimise financial reporting under constraints, may also offer the advantage of parsimony (Walker, 2004).

arrangements and the legal and social contexts in which they operate” (Napier, 2009, pg. 231). Pensions have been subject to a variety of interpretations by practitioners, academics and standard setters over time. Furthermore, demographic trends have caused pension liabilities to increase significantly in recent decades, largely because post-retirement life expectancy has increased. The growth in the size of pension obligations and the requirements of accounting standards have exerted a significant impact on the net assets of many companies which operate defined-benefit schemes.

The US and UK standards pioneered the introduction of fair value for pension obligations while the equivalent IASC introduced its fair value pension standard in advance of mandatory adoption by EU listed companies.¹¹ Before the introduction of these fair value standards, pension obligations were not included on the balance sheet and pension accounting was cost-focused. According to the requirements of the pre-fair value standards (APB Opinion No. 8, 1966; IAS 19, 1983; SSAP 24, 1988), pensions were accounted for either on a cash- or an accruals-basis. In the US, a weak form of fair value was first introduced to US GAAP by the publication of FAS 87 (1985). For the first time, US GAAP required the recognition of a liability on the balance sheet, although this was a somewhat opaque “minimum liability”. Nevertheless, it did require sufficient disclosure in the notes to enable users to calculate the financial economic value of the pension liability. It was not until 2000, fifteen years after the publication of FAS 87, that the UK standard, FRS 17 (2000), introduced a stronger form of fair value. Although FAS 87 was limited in its application of fair value, it was nevertheless viewed as providing a significant shift in best practice towards fair value and was described by an IASB technical staff member as “a very advanced standard.” (Interview with Y)

The sources of change in pension accounting had their roots in changing legal and social understandings of the concept of the defined-benefit final salary pension. Up until the mid-twentieth century, pension payments were generally discretionary with the result that financial statements showed the contributions paid into a scheme as a periodic cost only. Benefits to employees would be expensed only at the time of payment (Napier, 2009, pg. 232) and no pension liability was recognised under the implicit assumption that the employee had no legal recourse. In the 1960s and 1970s concern grew among various groups, including regulators, about the size and uncertainty of the pension obligations faced by companies with defined benefit schemes. Stock market collapses depleted the value of fund assets, while increased longevity and the impact of inflation increased the levels of future payments expected for post-retirement payments per employee (Napier, 2009). At the same time, social dissatisfaction with pension arrangements increased as these came to be perceived by workers as unenforceable promises made by employers (McGill et al., 2004). In 1974, pensions legislation in the US, *The Employee Retirement Income Security Act of 1974* (ERISA) clarified the employers’ obligation for pensions, placing constraints on funding and establishing minimum disclosure requirements. In the UK, following the high-profile collapse of the Mirror Group Pensions Scheme in 1991, legislation to protect employees was introduced in the form of the 1995 Pension Act. Just as in the US, pensions obligations became legally enforceable and were subject to stringent funding requirements, which ultimately led the accounting profession to respond by recognising a liability on the balance sheet.

According to the FASB Concept Statement No. 3: “although most liabilities stem from legally enforceable obligations, some liabilities rest on equitable or constructive obligations...” (¶39). In particular, this included responsibilities such as to “pay pensions, deferred compensation and taxes and to honor warranties and guarantees also create liabilities under the definition”(ibid

¹¹Consequently, the publication of IAS 19 (1998) was less controversial as preparers in Europe were not obliged to comply, and were not aware that they would be required to comply after 2005.

¶128). It was against this backdrop that some of the FASB board members argued in FAS 87 (1985) for the representation of the pension liability in the financial statements as a reflection of a constructive, rather than legal, obligation. Such an interpretation would have meant valuing the pension liability on the basis that expected future payments should extend beyond contracted benefits to include constructive or equitable factors such as pay increases. As it turned out, valuing the balance sheet liability in this way was resisted by many of the board members, who felt that it was simply a step too far and that it would not be acceptable to preparers and institutional interest groups. As a result, the balance sheet item did not reflect the fair value of the pension obligation, which was instead shown as a note to the accounts.

5.1.1. Consistency with existing accounting norms

The conceptual framework project provided a theoretical basis for the development of accounting treatments, aiming to promote adherence to the agreed aims of financial accounting in all new standards and minimise deviations from these aims due to changes in the composition of the standard setting board (interview with C of the FASB). However, on its own, the conceptual framework was not sufficient to bring about financial economic valuations for pensions. A technical staff member of the FASB pensions project in the 1980s noted that, “pensions accounting tells us about the limitations of the conceptual approach rather than its power” (Interview with FASB staff member, C). The conceptual framework may have provided guidance for standard setters, and no doubt some legitimacy through its invoking of a consistent conceptual approach to financial representation, but it did not, on its own, provide standard setters with any particular power to introduce change. The shift in the aims of financial reporting advocated by standard setters, from the 1970s onwards, offers a partial explanation for why standard setters tried to introduce financial economic valuation for pension liabilities. However, it fails, on its own, to explain why they were successful in this, since they faced resistance from preparers and other institutional groups.

5.1.2. Legitimacy of fair value measures.

In order for standard setters to introduce fair value as a solution to the problem of reporting defined benefit pensions, it was necessary that the financial economic measurement techniques underpinning fair value accounting were considered legitimate. For pensions, this meant acceptance by the standard setting community, as well as constituents, of the use of discounted cash flow techniques for the calculation of present values, and the treatment of certain long term obligations as having ‘bond-like’ features. By the time the issue of valuing pension liabilities came to prominence within financial reporting practice in the US in the early 1980s, the use of financial economic methods was emerging as a common tool in management accounting. Economic ideas relating to decision theory appeared in business journals by this time and were included in training courses for management accountants and university accounting and business degrees. Increasingly, management accountants in business were becoming familiar with techniques such as investment appraisal using discounted cash flows, even if they did not necessarily understand the fundamentals of the economic theory on which they were based.¹²

Over the period from 1960 to 1980, there was a significant shift in the types of calculations businesses regularly employed when making investment decisions. In the early 1960s, the use of discounting procedures for investment decisions was relatively uncommon, but had become

¹²For example, Bromwich (1977) notes the fact that much of the accounting literature at the time supported the use of net present value, and suggests that its use might have represented part of the search for the “best practical surrogate” for existing subjective measures of value used as part of financial reporting for external users.

much more prevalent in some of the largest industrial companies by the 1980s (Miller, 1991). The results of a survey carried out in 1980 by Scapens and Sale (1981) suggest that discounted cash flows were adopted by 50% of *Times 1000* UK companies and 84% of the *Fortune 500* US companies.

This increasing legitimacy was a necessary condition for the introduction of the use of financial economic methods for reporting pension obligations. In the case of FAS 87, the FASB were not able to go as far as they wanted, in part because they faced constituent groups, many of whom were unfamiliar with and potentially hostile to the introduction of stronger fair value approaches. In the *Basis for Conclusions* section of the standard, we learn that:

“[t]he Board believes that it would be conceptually appropriate and preferable to recognize a net pension liability or asset measured as the difference between the projected benefit obligation and plan assets, either with no delay in recognition of gains and losses, or perhaps with gains and losses reported currently in comprehensive income but not in earnings. However, it concluded that those approaches would be too great a change from past practice to be adopted at the present time.” (FAS 87, 1985, ¶107)

For the US standard, the legitimacy of financial economic theory was not as well developed as was the case a decade later when the ASB were developing FRS 17. Had preparers and the interest groups accepted financial economics as a legitimate approach to the valuation of long term pension obligations, the FASB might have been able to introduce stronger economic reporting in FAS 87.

In the case of FRS 17, the ASB were able to introduce strong fair value accounting in an environment immediately. An interview with an ASB technical staff member involved with the development of the UK standard provides evidence to suggest that the increasing acceptance by the business community of applications of financial economic theory was a necessary condition for the introduction of such methods to financial reporting valuation:

“We firmed up ideas on FRS 17 and then went to the 100 Group of Finance Directors Meeting, but they were split. Douglas Flint (HSBC) recognised it was right [not to smooth] possibly because he was a new breed of FD who understood the ideas of financial economics. If we’d tried to do this ten years earlier it would have been very different.” (Interview with former technical staff member of the ASB, E)

Thus, changes in the legitimacy of financial economic methods, or the agreed view of best practice, in the business community enabled standard setters to introduce financial economic methods for representing pensions. The increase in economic legitimacy was a worldwide phenomenon and would have been expected to apply also in the IASC jurisdiction, relevant for the introduction of IAS 19 (1998).

5.1.3. *Economic climate.*

Given that the pension liability on the balance sheet was calculated as the net of the fair value of the pension fund assets and the net present value of pension obligation cash outflows, falling asset values would be likely to result in the recognition of a net liability. According to one of the FAS87 project leaders, Interviewee C,

“Timing is very important – for pensions especially. When the process started the market was down and liabilities were huge but by the end, when [statement] 87 was nearing the end, the market was up and people had net assets to show.”

Here we see that economic conditions constrain standard setters attempting to introduce market-based items onto the balance sheet.

A commentary on the effects of the introduction of FAS 87, in the *Journal of Corporate Accountancy and Finance* states that, “[i]n general, the recognition of a minimum liability results in a deterioration of ratios involving the long-term balance sheet accounts” and that, “return on assets . . . would often deteriorate because of the increase in the denominator due to intangible asset recognition” (Bline and Skekel, 1990, pg.211).¹³

At the time the due process for FAS 87 was coming to its close in early 1985, conditions were conducive to the implementation of fair value accounting for pensions. Stock market buoyancy (and hence rising pension asset valuations), falling inflation and increasing employee turnover led to the development of pension surpluses.¹⁴ As a result, the introduction of fair value for pensions was not expected to result in the requirement to disclose large net pension liabilities immediately. Had the economic conditions been unfavourable, it is likely that preparers would have mounted greater pressure to block the projects to introduce FAS 87 and FRS 17.

In the UK, the same pattern of increasing share prices can be seen to have preceded the publication of FRS 17. In spite of the volatility in the index from 1999 to 2000, the minimum value of the index during those two years was almost double the level at 1995.¹⁵ After the publication of FRS 17, market conditions deteriorated, causing the value of pension assets to decrease, and hence the value of the pension liabilities to be recognised on the balance sheet to increase. The negative reaction to the requirement to show a pension liability, given the weak market conditions, can be seen to result from the fact that, “it came into force as the dotcom bubble burst, meaning that tumbling stock markets savaged the value of pension holdings, making deficits look even larger” (Financial Times, Jennifer Hughes, 5th October, 2008). As it was, the standard was introduced just before economic conditions deteriorated. Despite the volatility in the index from 1999 to 2000, the minimum value of the index during those two years was almost double the level at 1995.

Since compliance with IAS 19 (1998) was not required by European public companies until 2005, the economic climate at the time of its introduction in 1998 were of less importance than those for FAS 87 and FRS 17. Nevertheless, similarly rising stock prices existed in period immediately before its approval and publication.

5.1.4. *Interest groups.*

Political economy approaches to explaining regulatory change stress the important role played by interest groups in shaping accounting practice and techniques (Watts and Zimmerman, 1978, 1979; Cooper and Sherer, 1984; Puxty et al., 1987; Robson et al., 1994; Willmott et al., 1992; Arnold, 2012). In particular, standard-setters’ decisions can be affected by lobbying (Zeff, 1999; Beresford, 2001). Empirical evidence supports this view for the case of FAS 87 (Francis, 1987). For the case of pension standards, standard setters were subject to the influence of various groups, including preparers, the actuarial profession and standard-setting organizations in different jurisdictions, which I consider in turn.

¹³The impact of economic conditions has been discussed as a factor affecting the introduction of other types of valuation in financial reporting, such as replacement cost (Boer, 1966) foreign currency (Cook, 1989) and inflation accounting (Pong and Whittington, 1996).

¹⁴In fact, Napier argues that the thinking of UK standard setters was driven by the assumption that the reporting of pensions would result in deficits and they did not address the issues of surpluses in any depth.

¹⁵Since compliance with IAS 19 (1998) was not required by European public companies until 2005, the economic conditions at the time of its introduction in 1998 were of less importance than those for FAS 87 and FRS 17.

Preparers initially put up significant opposition to FAS 87 (1985). In the published standard, the FASB acknowledged the objections of respondents to the proposals. In particular,

“Some argued that the uncertainties inherent in predicting future interest rates and salary levels are sufficiently great that available measures of the projected benefit obligation fail to achieve the level of reliability needed for recognition in financial statements. They would prefer to disclose rather than recognize the obligation.” (SFAS 87, ¶100)

and

“Some respondents described that volatility as meaningless or even misleading, particularly in view of the long-run nature of the pension commitment and the fact that pension investments are often held for long periods, thus providing the opportunity for some gains or losses to reverse.” (SFAS 87, ¶120)

In addition, the costliness of reporting pensions according to the new proposals was raised (¶116). However, the oppositions became much attenuated before the final vote on the standard. One possible reason for the reduced opposition, suggested by an interviewee, is that preparers became persuaded of the huge obligations they faced and realised that the requirement to recognise a pension liability would justify the closure of their defined-benefit pension schemes. (Interviewee F) In other words, they sought a way of exiting such schemes without incurring moral castigation by stakeholders.

The second group which influenced the pension projects of FASB, IASB and ASB was the actuarial profession. In both the US and the UK, standard setting institutions had a significant level of interaction with the actuarial profession during the development of pensions standards (Interview with FASB staff member, C and interview with former ASB technical staff member, E). The IASC also worked closely with actuaries when developing its standards for pensions (Camfferman and Zeff, 2007, pg. 129). However, actuaries traditionally produced funding rather than financial economic valuations for fair value reporting purposes.¹⁶ An important factor in the development of the pensions standards in the US and subsequently the UK, was a knowledge shift within the actuarial profession, resulting in the acceptance of financial economic methods. In 1997 a paper presented at the Institute of Actuaries acted as a catalyst for change (Exley et al., 1997). It recast actuarial valuations in terms of financial economics and set in motion a move towards an acceptance of a financial economics perspective on pension fund valuation. Initial resistance by UK actuaries to economic methods gave way partly as a response to a threat to the survival of the profession in the context of the increasing legitimacy of financial economics. According to a senior actuary,

“Financial economics is quite hard to argue against. It’s really annoying for actuaries. When the financial economists came along and argued that a pension obligation was like a bond, it was quite difficult to argue against it. It was difficult to argue against the sound theoretical underpinning of a calculation. . . . From then on we were doomed.” (Interview with pensions actuary, P)

This statement reflects the despondency felt by many actuaries at the prospect of the impending loss of their expert status in the area of pensions.

¹⁶Their interest was in the production of a valuation which would guide decisions about how to ensure funding was sufficient to cover future cash payments due (discounted at the return on investment), rather than as a representation of an unavoidable future liability (discounted at something close to the risk-free rate).

In contrast to the UK experience, financial economic theory did not penetrate the US actuarial practice until shortly after the turn of the millennium (Bader and Gold, 2003, pg. 2). The fact that the US actuarial profession adopted financial economics almost a decade later than their counterparts in the UK no doubt shaped the development of pension accounting. The adoption of the market based FAS 87 was acceptable, even in the 1980s, because of its large actuarial component and the use of the “minimum liability.” The adoption of this quasi-actuarial standard, however, appears to have facilitated the institutional entrenchment of actuarial and non-financial-economic approaches to pension valuation. By contrast, in the UK, the move away from an accruals approach to the financial reporting of pensions occurred shortly *after* the actuarial profession had started to yield to financial economic influence. This may explain the ability of the ASB to introduce a relatively strong form of fair value accounting so quickly. In the US, it was not until 2006 that FAS 158 introduced a comparable reporting approach. Thus we see that interactions between interest groups were important in shaping the outcome and timing of fair value standards.

The third category of organization which influenced the pension projects was standard setting organizations operating in other jurisdictions. Standard setters often followed the example of other standard setters when developing a new standard. In most cases, for national standard setters and for the IASC, this meant looking to the United States. As an example of this, in the early 1990s, the IASC applied pressure on the ASB to introduce a new pension standard by making it clear that the IASC would be publishing a standard along the lines of FAS87 (Interview with former ASB staff member, E).

Once the original US standard, FAS 87, was introduced, other standard setters used it as a blueprint from which to build their own pensions standard. A current IASB board member who was also involved with the IASC development of IAS 39 argued that:

“There was influence from the US on the development of standards by the International Accounting Standards Committee (IASC). Although the US representatives and observers kept a relatively low profile, they provided an important guiding hand. At the time, national standard setters from a number of countries were leveraging off one another and, in the process, providing significant support to the IASC. The iterative nature of standard setting was clearly evident. One standard setter filled a gap. This was then picked up and improved on by others. The Americans were the first serious national standard setter and typically the first to develop new standards and concepts, so they set the ground rules.” (Interview with IASB board member, H, March 2010)

This illustrates that interactions between standard setters were an important part of the standard setting process.

5.1.5. Board composition

To counter the initial opposition from interest groups, the presence of powerful, individual advocates on the board was necessary as they were able to persuade powerful opponents to accept the new standard. They remained committed to pushing through the standard in spite of the hostility they faced and were potentially prepared to use up political capital in ensuring the success of the project. Moreover, where the board was split, as was the case with FAS 87 (1985), the presence of powerful and persuasive advocates on the board, would presumably have put some pressure on less confident board members, potentially persuading them to vote in favour of the standard.

These individuals had often learnt about financial economic theory as a result of studying economics, either as their main degree or as part of an accounting degree. Early in their careers, they had often been influenced by charismatic teachers or mentors who advocated a move towards fair value accounting. They believed that in order to provide useful information, financial reporting needed to have its foundations in financial economic theory.

In summarising the case of pension accounting in the US, UK and IASC/B jurisdictions, an important point to note is that the timing and economic content of the standards published appear to have been contingent on a set of contextual factors. While the actions of interest groups constrained standard setters, other factors were also influential. These factors included the existence of fair value norms (in the form of the conceptual framework), the economic conditions (that is, the stability and relative level of stock markets), the legitimacy among constituents of the fair value measurement techniques being proposed and the presence of forceful advocates of fair value accounting on the boards of standard setting organizations. The publication of FAS 87 (1985) was an important test case for the advancement of fair value accounting. Although it was a relatively weak fair value standard (with limited recognition of the liability on the balance sheet and smoothing in the income statement), it marked an important step towards the dominance of the fair value paradigm. It also served as a signal to standard setters in other jurisdictions that it was indeed possible to include a value for a pension liability in the financial statements. Pension accounting marked a starting point for the uptake of fair value accounting, but it was fair value standards in another area of accounting, addressed in Case Study 2, which drove a more dramatic and rapid change to this representational norm.

5.2. Case study 2: Derivatives

Derivatives standards exerted a significant effect on financial reporting norms. It has been reported that "...it was the use of financial derivatives that signalled the end of pure cost accounting" (Butler, 2009, pg. 30). During the last two decades of the twentieth century, capital markets were transformed by the rapid growth in the use of derivatives. In 1977, only 3% of futures traded on the Chicago Exchange were financial instruments, compared with almost two thirds of the volume of futures trading on American exchanges by the mid-1980s (FASB Research Report, 1991, pg. 4). Derivatives are financial instruments whose value is dependent on, or derived from, the value of other financial instruments, events or conditions, known as underlying assets (or 'underlyings'), such as shares, bonds, interest rates or currencies. Financial derivatives, such as futures, forward, swap and options contracts, are often highly leveraged, with the result that small movements in the value of underlyings can lead to a disproportionate change in the value of the instrument overall.¹⁷

In 1973, the publication of a new option pricing model (Black and Scholes, 1973) provided the necessary platform for an explosion in the use of derivatives. It provided a valuation method which traders were able to use as a guide to pricing derivative instruments which were traded at exchanges such as the International Monetary Market (IMM) in Chicago, the Chicago Board Options Exchange, the London International Futures Exchange (LIFFE) and the Deutsche Terminbörse (now Eurex). By the 1980s, swaps and other over-the-counter (OTC) derivatives began to be traded to a significant degree and, by the 1990s, most large businesses were using derivatives as a means of hedging against interest rate, foreign exchange and commodity price

¹⁷An option is a contract offering one party the right to purchase (call) or sell (put) an underlying (an instrument, asset or liability) at a pre-determined strike price at the expiration date of the option. In some cases, the underlying instrument may itself be a derivative, in which case it is termed a *financial* derivative. For example an option over an interest rate swap, is known as a 'swaption'. *Exchange-traded* options have standardised characteristics, whereas *over-the-counter* options are traded privately, normally by financial institutions.

fluctuations (Chance, 1995). Finance theorists, mathematicians and physicists were recruited by financial institutions and large corporates to develop financial instruments using variants on the new Black-Scholes option pricing model. Increases in computing capability, and hence speed, removed a critical constraint on the development of the market. According to *Swaps Monitor* (1993), the notional amount of outstanding interest-rate swaps at the end of 1992 was \$6.0 trillion and the outstanding notional amount of currency swaps was \$1.1 trillion. US commercial banks held \$1.2 billion of interest rate swaps and \$279 billion of foreign exchange swaps (quoted in Gorton and Rosen, 1995, pg. 300). By June 2000, the notional value of outstanding derivatives contracts amounted to \$108 trillion (Millo and Mackenzie, 2003). In the mid-1990s, the increasing use of technically complex derivative instruments known as ‘exotics’ marked a shift away from the simpler derivatives of the 1980’s.

The FASB launched its financial instruments project in 1986. In the introduction to the disclosure-based financial instruments standard, FAS 105 (1990), the project team stated that, “The dynamic state of financial markets suggests the need to develop broad, general disclosure requirements about financial instruments” (FAS 105, 1990, ¶4). Before the implementation of FAS 133 and IAS 39, financial reporting regulation in the US, UK and IASC jurisdictions did not require any recognition of derivative contracts on the balance sheet. By the mid-1990s, investors, regulators and standard setters were becoming acutely aware that an off-balance sheet treatment of derivatives was leading to “problems and abuses” (Butler, 2009, pg. 41). The FASB and IASB found themselves wrestling with the problem of how to report derivatives, specifically rules for recognition, valuation and the reporting of changes in value. It turned out that the solution they identified and which was promulgated by FAS 133 in the US and IAS 39 in the IFRS-jurisdiction, invoked financial economics.¹⁸

As with pensions, the historical cost convention offered little scope for providing a useful representation of derivatives, since the initial cost of a derivative contract could be negligible compared with the benefit or exposure created (Hague, 2004, pg 24). As a result, standard setters were forced to look beyond historical cost approaches to find a measurement solution. The two new standards, FAS 133 and IAS 39, aimed to ensure the recognition of all derivatives on the balance sheet and to introduce the use of fair values for all such instruments after initial recognition. The standards required that the fair value of a traded derivative be ascertained from the observed market price. For a non-traded derivative, fair value should be ascertained by reference to a similar class of instruments. If no similar class of instruments could be identified, the valuation would be calculated using a financial economic model such as an options pricing model (a valuation type known as “mark-to-model”). In addition, both standards required immediate recognition in the profit and loss account for periodic changes in the fair value of derivatives unless hedging rules applied.

Although the creation of a standard using fair value accounting originated from the work of the FASB, the IASB also played an important role in the introduction of fair value for derivatives through IAS 39 because of their increasing jurisdictional reach, particularly after the mandatory adoption by EU listed companies of IFRS after 2005. In certain respects, we see that the case of derivatives was similar to that of pensions, as interest groups and preparers were strongly opposed initially. However, an interesting feature of the case of derivatives reporting, which distinguishes it from that of pensions reporting, is the speed with which fair value accounting was introduced across different reporting jurisdictions.

¹⁸I do not consider evidence from the development of the standard for financial derivatives in UK GAAP. In the run-up to EU adoption of IFRS in 2005, the ASB decided to adopt the requirements of international GAAP rather than developing their own standard (see ASB Discussion paper for FRED 23, 2002).

5.2.1. Consistency with existing accounting norms.

Normative approaches to the representation of derivatives under FAS 133 (1998) drew on the FASB concept statements, much as had been the case for pension reporting in the US. In explaining its rationale for recognising derivatives, the FASB argues that such instruments should be understood as assets or liabilities in accordance with FASB Concept Statement No. 6 (1985), *Elements of Financial Statements*. An interview with a member of the project team for FAS 133 reveals that:

“... [t]he thought that these things were assets and liabilities was based on the work we’d done in the Conceptual Framework. In principle, the conceptual idea was: assets and liabilities ought to be on the balance sheet. And the only measurement scheme we could come up with for derivatives that made any sense at all was fair value. Because they started out at zero. Putting something on the balance sheet valued at zero was not considered a good compromise.” (Interview with FASB staff member C)

This statement demonstrates the influence of the conceptual framework on the FASB’s choices for the representation of derivatives.

IAS 39 was very closely modelled on FAS 133 for reasons discussed below in Section 5.2.4. Nevertheless, “the principles proposed in this paper are reasoned within the IASC Framework for the Preparation and Presentation of Financial Statements (the IASC Framework), interpreted in the context of how financial instruments are used in modern capital markets” (IASC, 1997, ¶1.5). From this, we can still see the influence of the conceptual framework on the *earlier* stages of the financial instruments project, before the IASC was subject to IOSCO pressure (IASC, 1997, ¶1.5).

5.2.2. Legitimacy of fair value measures.

Financial economic methods for the valuation of derivatives, specifically option-pricing models, such as Black-Scholes, were becoming increasingly accepted by the business community towards the end of the twentieth century. In 1990, three financial economists won the Nobel prize for economics for their work on financial economics, and the business press referred with increasing frequency to financial economic models. For certain types of accounting item, such as derivatives, the notion of ‘reliability’ began to give way to a notion of ‘being consistent with an economic model’ rather than being testable by reference to a contract or physical item (Power, 2010).

During the 1960s, economics and finance courses became part of business school curricula. Whereas previously the place of economics had been squarely within social science faculties at liberal arts universities, now the business schools, such as Wharton, Harvard and the University of Chicago, were becoming a locus of economics teaching. The inclusion of economic theory on business school courses, and the publication of the new-style economics ideas in practitioner journals such as the *Harvard Business Review* and the general financial press such as the *Wall Street Journal*, *The Financial Times*, *Institutional Investor*, *Fortune Magazine* and *The Economist* disseminated them into the business community, with the result that economic methods became acceptable for application to a variety of business problems, particularly those concerning investment strategy. Scholars have noted the penetration of financial economics into business, at this time as, “... the mastery of the language and techniques of financial economics soon became an indispensable credentialing device not only for finance professors but also for practitioners in the financial market” (Fourcade and Khurana, 2011, pg. 26). Before the 1980s, financial economics was not part of the assumed knowledge of business, or even possibly of finance. An

informal analysis of the Economist magazine from 1965 to 2005 reveals an increasing number of references to the term “financial economics” after 1980 which gives an indication of the increasing legitimacy of financial economics (see Appendix B). The term “derivative” showed a similar pattern of increased use. In December 1990, an article about the Miller-Modigliani theorem, refers to Robert Merton’s view as marking a “watershed between old and new finance”. The article notes that “New finance is mathematically rigorous” (The Economist, December 8th, 1990, pg. 117) which presumably reflects the increasing legitimacy from the 1980s of financial economics as a finance and business tool.

The evidence provided in this section suggests that by the time FAS 133 and IAS 39 were in development in the mid-1990s, financial economic techniques used for valuing derivatives had gained acceptance, both in the accounting profession and in the preparer community.

5.2.3. *Economic climate.*

If economic conditions had not been favourable, the recognition of derivatives on the balance sheet at fair value would have been almost impossible for standard setters to achieve. Resistance to any requirement for financial institutions to take on further liabilities would be likely given concerns about liquidity issues, for instance the risk of breaching debt covenants or a failure to satisfy capital adequacy rules.¹⁹ A former IASB board member, reflected on the IASB experience of fair value during the credit crisis, saying:

“The crisis was a real crunch for us. What we found was that it’s great going upwards, but when it comes downwards they don’t want to know about it.” (Interview with former IASB board member, T)

The interviewee makes clear that, in the case of a significant economic downturn, regulators (such as banking regulators) and quasi-political institutions are more likely to scrutinize standard setters for due process issues and argue for modifications to standards which were viewed as being potentially pro-cyclical. Such a view is reflected in Laux and Leuz (2009) who highlight the “intense lobbying and political interference with the standard setting process during the current crisis”. Thus, the existence of stable economic conditions appears to have been an important factor influencing the ability of standard setters to publish the fair value derivatives standards in 1998. In the run up to the publication of the projects to introduce FAS 133 and IAS 39, economic conditions were indeed favourable in both the US and in Europe, with an overall trend increase in stock market levels.

In the EU, the adoption of IASB standards, including IAS 39, became mandatory in 2005 and it is the economic climate which prevailed during the period before European-wide adoption which is most relevant in explaining the success of the project. Market conditions were buoyant in the pre-publication period for IAS 39 in 1998 and also during the two years before mandatory adoption for EU listed companies in 2005. However, between 2000 and 2003, before the adoption of IAS 39 by the EC, the UK FTSE 100 index and the S&P 500 Index²⁰ exhibited a downward trend. It was during this period that many financial institutions raised concerns about the effect on volatility of the standard. However, the year before mandatory adoption in Europe, the UK and US stock markets recovered from their 2000-2003 positions.

¹⁹See for example (Financial Times, Asia Edition, Jennifer Hughes, 24th September, 2008).

²⁰Given the size of the US stock market, I refer to both the UK and US stock market indices as proxies for the buoyancy of the European market.

5.2.4. Interest groups.

Accounting academics have described accounting for derivatives as “one of the most controversial public policy issues for many years” (Shin, 2004, pg. xiv). The FASB received more than 250 comment letters on the June 1996 exposure draft, *Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities*. An analysis of these letters in an article by Boyd et al. (1996) in the *Journal of Financial Management and Accounting*, reveals that 49% came from financial firms, mostly banks, which were least likely to agree with the exposure draft, with 77% being categorised as ‘disagree’ (*ibid*, pg. 249). In its July 1998 edition, *Journal of Accountancy* carried a piece which claimed that: “[t]he FASB derivatives project has caused so much controversy that many observers doubted it would be issued at all” (pg.4).

A number of different interest groups were influential in the development of IAS 39 and FAS 133. These included the Basel Committee, the Joint Working Group on Accounting Standards (JWG), the Securities and Exchange Commission (SEC), the International Organization of Securities Commissions (IOSCO) and the European Union. In addition, the standard-setting agencies were mutually influential. An important feature of the derivatives standards was the delay between publication and subsequent *implementation*. The periods between 1998 and 2000 for FAS 133, and between 1998 and 2005 for IAS 39, provided an opportunity for further lobbying by institutions opposing the new requirements for derivatives and for post-publication amendments to be made. The observed influence of interest groups is consistent with the political economy literature. Echoes of the work of Willmott et al. (1992) are evident as they note that accounting practice is shaped by a “*structural* complex of institutional arrangements within which to regulate accounting, accounts and accountants” (pg. 49). In what follows, I review the influence of commercial and political interest groups.

In the US, powerful interest groups in the banking and insurance industries lobbied the FASB to curtail the introduction of the derivatives standards and it was only when the lobbying activity weakened, that the FASB was able to publish FAS 133. The banking (and to some extent insurance) industries were anxious that the forced recognition of previously off-balance sheet derivatives would reduce demand for the products which they developed and marketed. Press coverage at the time described the introduction of FAS 133 as prompting a “barrage of criticism” (Financial Times, June 20th 1996, pg. 28, Laurie Morse). All interviewees questioned about FAS 133 stated that banks were opposed to it for operational reasons. For instance, one interviewee, a leading US analyst²¹, contrasted FAS 133 with the earlier opposition to the FASB accounting standard for stock options (Interview with S, 2010). In the case of the derivatives project, the de facto political spokesperson for the banking lobby was Alan Greenspan of the Federal Reserve, who entered the fray in July 1997. In a letter to the FASB, which was viewed as, “an uncompromising attack on its plans for a new standard” (Financial Times, Jim Kelly, August 15th, 1997) he argued that:

“The treatment of cash flow hedges will report an increase in the volatility of comprehensive income and stockholders’ equity where no comparable increase in risk has occurred.” (Greenspan, 1997, quoted in Sapra and Shin, 2004).

Greenspan opposed the increase in regulation which, he claimed, encouraged unnecessary and unrepresentative accounting volatility.²² An ex-FASB board member involved in the development of FAS 133, noted the strength of the banking groups and the fact that at certain points, they appeared to be capable of blocking the project:

²¹This interviewee was a member of the Accounting Policy Committee of the Association for Investment Management and Research (now the CFA institute).

²²See also an article in the Wall Street Journal, August 7th, 1998.

“They lobbied Congress and the Federal Reserve. There were some indications that the Fed was not going to be as supportive as they ended up being. We had direct conversations with [Alan] Greenspan and I think he became more insightful as to what the issues were so it was a pretty open discussion between the Chairman of the Federal Reserve and the FASB . . . While legislation and everything else was ‘sponsored’ to stop the accounting for derivatives, that didn’t happen and we didn’t allow it to happen . . . It’s not unusual to have that kind of activity going on. It was more intense over derivatives in a sense because banks are very good at getting organised. Their lobbying efforts are very coordinated and they were vociferously opposed [to the standard].” (Interview with former FASB Board member Q)

This interviewee highlights the efficiency and power of the banking lobby. Other sources of evidence for this view include press reports by the International Swaps and Derivatives Association (Financial Times, Vincent Boland, 3rd May, 2001) and an interview with Ed Jenkins, Chairman of the FASB at the time of the development of FAS 133, (Journal of Accountancy, 1998). The confident stance of the banking institutions may be explained, at least in part, by the recent history of FASB standard setting. The FASB had been viewed as having granted concessions to preparers, particularly those in Silicon Valley, on the hotly debated issue of stock compensation in 1995.²³

FAS 133 was a complex standard, dealing as it did with hedge accounting and derivative valuations. When asked if this complexity was a problem for constituents, one of the project leaders responded that in fact some constituents had wanted *more* complexity in the standard. Others however, preferred less:

“Many times the staff have seen people argue against what we’re doing citing complexity but only in the areas that they don’t like. So there’s good complexity and bad complexity. They’re inconsistent in their arguments but nevertheless that’s the way they choose to argue.” (Interview with FASB technical staff member, R)

This suggests that some arguments levelled against the standard were instrumental in the sense that they were intended to slow or block the project, rather than reflecting the true position of the constituent with regard to the technical proposals contained within the standard. We will see in Section 5.3 below, that similar instrumental or ‘proxy’ objections were employed by those who wanted to block the proposed revisions to IAS 37 (1998).

A board member of the FASB at the time also suggested that the concerns raised by constituents were instrumental:

“You see, what you never know – and *I* don’t know – about that era in terms of the politics is: were they really opposed to accounting for derivatives or were they just afraid of the Bogie man called ‘fair value’? So you don’t know if they wanted to oppose fair value just for the sake of it, which they still do to this day. Or whether, intellectually, they really, really thought you shouldn’t account for derivatives. I don’t know what their strategies were. I guess it was a bit of both.” (Interviewee Q)

This demonstrates the belief by some board members that criticisms of particular standards may have had more to do with a general opposition to fair value than any specific technical objections relating to the proposals contained within this standard. Although it falls outside of the scope of

²³Corporate lobbying over FAS 133 led to congressional hearings in 1997 (S1560) and 1998 (HR 3165), which aimed to restrict the power of the FASB. In 1997, HR 1560, known as *Accurate Accounting Standards Certification Act of 1997* required that federal banking agencies confirm to Congress that any new FASB standard was acceptable.

this paper, it should be noted that the demarcation of technical and political objections can be interpreted in terms of the perceived “purity” of the arguments levelled against the proposals. It has been argued that such notions of purity may be useful for standard setters who want to close down discussion about the unavoidable value-ladenness of standard setting choices (Young, 2014).

Given the intense lobbying the FASB encountered, it is somewhat surprising that the board were able to push through the publication of FAS 133 (1998). Practitioner publications and self-reports by board members suggest that the FASB mounted a strong defence to the intervention by the Federal Reserve. Articles in the press support the view that the FASB fought hard to challenge the attacks from the Federal Reserve (see for example Financial Times, Jim Kelly, 17th July, 1998, pg. 4). Ultimately the FASB emerged triumphant from this debacle, having seen off the intervention from the Federal Reserve and with the standard on-track for publication. It appears that contingent factors played a part in this victory. Following the Asian crisis in 1997, regulators became committed to enforcing standards which would enhance transparency (World Bank, 1998). This led them to position themselves on the side of the FASB.

The influence of FASB on the IASC’s project to develop IAS 39 was significant. In fact, the derivatives element of the standards produced by the IASC was a virtual copy of the US standard. Right from the early stages of the project, US influence was evident.²⁴ The influence of FASB resulted from the IASC’s need to publish a standard quickly for political reasons. The development of IAS 39 formed part of a greater project by the IASC to develop a set of core standards for the International Organisation of Securities Commissions (IOSCO) (Camfferman and Zeff, 2007, pg. 374). The IASC had been given a tight deadline by IOSCO to produce a set of core standards, which would enable companies to list on US stock markets without the need to provide a reconciliation between their financial statements and those prepared under US GAAP. This would make IASC compliance attractive to many European companies wishing to list on a US stock exchange. Without IOSCO endorsement of its standards, the IASC would have little authority. According to a former IASC board member,

“We had to pass IAS 39 before anything could happen ... And who’s the most important member of IOSCO? The SEC!” (Interview with former IASC and ASC board member, V)

Given the international importance of US capital markets, the SEC represented one of the dominant members of IOSCO and so developing a US-style standard was considered the best way to maximise the likelihood of endorsement (Camfferman and Zeff, 2007, pg. 10).²⁵ According to the same interviewee, the obvious solution to finding a standard which was acceptable to the SEC was to copy US GAAP.

“Once you’ve decided to copy US GAAP, you might as well get an American to write it!” (Interviewee V)

In the end, the IASC negotiated with the FASB to bring over an FASB staff member, Paul Pacter, to draft the standard under the guidance of FASB board member Jim Leisenring (Camfferman and Zeff, 2007). This first stage of the project was completed with the publication of IAS 39 by the IASC in 1998. At this time, the European Commission (EC) was merely an observer to the IASC’s activities.

²⁴The Canadian CICA was also heavily involved in the project at the outset. In addition, arguments in favour of using fair value for measurement came from the Australian delegation (Camfferman and Zeff, 2007, pg. 364).

²⁵For further corroboration of this view, see the discussion in McGregor (1999, 159-160). McGregor, a former IASC board member, supports the view that the endorsement sought by the IASC from IOSCO meant indirect influence from the US regulators as “... the linchpin to IOSCO endorsement is endorsement by the SEC”.

Another factor which led to influence between standard setters was the existence of joint working groups. In particular, the emergence of the G4+1 during the 1990s provided a forum for standard setters from a number of accounting jurisdictions to share views and develop particular approaches to accounting issues, particularly the issue of financial instruments during the development of FAS 133 and IAS 39. What is more, the G4+1 provided more than just scope for intellectual interaction by its members. By offering opportunities for social interactions, the working group may have encouraged the breaking down of barriers between representatives of different accounting jurisdictions, the sharing of ideological commitments and norm-building. The development and sharing of theories to underpin regulatory activity is consistent with Robson et al. (1994), in that the regulators can be seen to, “draw upon such theories in making sense of their world, and changes to it” (pg. 530). However more importantly, such shared theory plays a role in enabling the standard setters to navigate and even to shape the “discursive terrain” of regulation, representing themselves as credible to the different constituencies with which they interact. It is noticeable that the individuals who are often identified as members of the group which favours of the use of fair values at the IASB (Jim Leisenring, Patricia O’Malley, David Tweedie and Warren McGregor), were all members of the G4+1. As a transnational group, the G4+1 may have nurtured or intensified the pro-fair value beliefs of its members. In this sense, it can be seen as an example of a “transnational community” (Djelic and Quack, 2003). Such communities appear likely to have contributed to the ultimate harmonisation of accounting rules by enabling members to share “common cognitive frames through parallel socialization” (*ibid*, pg. 319).

The second phase of the project started in 2000 when the EC announced that it would require mandatory compliance with IASB standards for all listed companies within the EU from 2005. Just as the IASC had needed to focus on gaining endorsement from IOSCO, now the IASB faced a similar hurdle in obtaining approval by the EC.²⁶ Lobbying of the EC was fierce in the period between the announcement and implementation of mandatory adoption of IASB standards, with reports that the “banks are seemingly willing to use any means open to them to avoid being made to follow IAS 39” (Walton, 2004, pgs. 5–6). In 2004, arguably as a result of intense lobbying by certain national governments and concerns raised by the Basel Committee for Banking Supervision²⁷, the European Central Bank and prudential supervisors (EFRAG Press Release, 2004, ¶2.2), the EC announced that it could not adopt IAS 39 in full and would endorse the standard only if certain elements were ‘carved out’. The carve-outs included the ‘fair value option’ as well as several sections of IAS 39 relating to hedge accounting.²⁸ Regulatory organizations were appalled by the carve-out and saw it as a disgraceful climb-down by the IASB (see, for example Bank of England Press Office, 2004). Although the carve-out certainly weakened the reputation of the IASB by signalling its lack of political independence, it did facilitate the adoption of the pared down standard across the EU, thus mandating the use of fair value accounting, at least for derivatives, across the EU jurisdiction for listed companies.

²⁶An added complication was the fact that the scope of IAS 39 included financial instruments generally, whereas FAS 133 set out the reporting requirements for derivative instruments alone. Objections to the required treatment of *non-derivative* financial instruments risked impeding the progress of the whole standard.

²⁷See Basel Committee on Banking Supervision (2000), pg. 1.

²⁸The hedge accounting carve-out affected paragraphs in the standard relating to allowing hedging of core deposits on a portfolio basis, amending those items which could be designated for hedging and reducing effectiveness testing for certain hedges (EFRAG Press Release, 2004).

5.2.5. Board composition.

The board members who figured heavily in the development and implementation of FAS 133 were Edmund Jenkins and Jim Leisenring.²⁹ In particular, Leisenring has been described independently by several interviewees as being a strong advocate of fair value reporting for derivatives. These interviewees were T (former ASB and IASB board member), V (former IASC board member) and W (IASB technical staff member).

Following the attack on the new proposals for derivatives by Alan Greenspan in July 1997, Edmund Jenkins did not offer to weaken the requirement to recognise derivatives at fair value (Financial Times, Jim Kelly, August 15th, 1997). At a Senate Hearing in October 1997, Edmund Jenkins argued firmly for the FASB's position on derivatives accounting (Senate Banking Committee, October 9th, 1997). This provides evidence of the determination of the standard setting board to achieve the publication and implementation of the standard. When asked in an interview how important it was to have strong board members at the FASB when dealing with the Federal Reserve, a former FASB board member at the time of FAS 133 answered:

“Absolutely! It's very easy to cave in to the pressure but we didn't! . . . You have to decide if you are going to stand up to the pressure and argue and fight and more importantly stick to the intellectual arguments you have for why it's the right accounting. . . There were two bills in Congress against accounting for derivatives – you know, but they didn't pass. Ed Jenkins was not going to back down as chairman.” (Interview with former FASB board member, Q)

The Leisenring and Jenkins pairing appears to have been an effective one. However, an important factor which contributed to their success was the willingness of the SEC to support the FASB in this project. In part, this support was driven by the SEC's experience of the Asian financial crisis.

At the IASC, the main supporters of fair value for derivatives were Mary Barth, Jim Leisenring, David Tweedie, Warren McGregor and John Smith. Tweedie joined the IASB from the UK ASB where he had supported projects such as FRS 17 (2000) which introduced fair value accounting for pensions. Leisenring was appointed in 2001 immediately after leaving the FASB, where he had played a significant role in developing FAS 133. Although the IASB board compromised on the carve-out, this compromise made possible the diffusion of the fair value approach to the reporting of derivative across the EU and brought derivatives onto the balance sheet at economic values.

For both the FASB and IASB standards, expert standard setters with a knowledge of derivatives appear to have driven the process. It seems that familiarity with financial economics constituted expertise in this sense. It is also a view which is supported by interview evidence. A member of the IASB technical staff stated that:

“ . . . when you talk about stochastic models, some people's eyes glaze over because that's just not their background. So they rely on a few individuals to help them . . . And with hedge accounting, people can have difficulty understanding. You know, maybe three people in the room understand it [laughs]. And so personalities can be very important as well. If someone has a strong background *and* a strong personality, they can dominate a conversation — and they can dominate accounting. ” (Interview with W)

In this we see how the ideological commitments of a small group of board members can dominate, and indeed have dominated, the development of technically complex standards, such as the

²⁹Dennis R Beresford, was the FASB Chairman during the early stages of the project, but he retired in 1996 before its publication .

financial instruments projects. If this is true for the IASB, which has a board of fifteen, we might expect technical discussions to be dominated to an even greater extent by certain individuals at the FASB, which had a board of only seven. Once a group of ‘experts’ emerges on the board, they may be able to drive the discussion. The same interviewee, W, referred to an unofficial analysis of contributions to discussions by particular individuals during board meetings. This research revealed that most of the contributions were made by Jim Leisenring, Mary Barth and Trish O’Malley. According to this interviewee, “When Jim left, the whole dynamic changed” (Interview with W). This corroborates the hypothesis that dominant individuals play an important role in driving the technical development of reporting standards and that their ideological commitments may be reflected in the standards produced by the boards.

Another important factor was experience of standard setting in this area. The American members of the new IASB board were influential, partly because several of them brought with them experience of working on the US financial instruments project. According to an IASB board member at the time:

“The major issues were IAS39 – that was like the American standard – and they [the Americans] had been all over it . . . all of the voices in our boardroom were American. Gradually, as the rest of the team got involved in it, the American voices subsided – well except for Jim [Leisenring]. . . [laughs]” (Interview with T)

This suggests that individuals on the board derived authority from prior experience of successfully setting derivatives standards in other jurisdictions. Consequently, we see that board members’ experience acts as a link between projects. Thus, Leisenring and Pacter embodied the influence of the FASB on the IASC for the case of derivatives.

To summarise, the two derivatives projects analysed above resulted in the publication of new fair value standards, thereby shifting the existing form of accounting knowledge further towards fair value. This observed dynamic is consistent with political economy explanations of regulatory change, in that the regulatory environment in which standard setters were operating was shaped by developments in practice such as the publication of fair value standards (Miller and Napier, 1993). Contextual documentary and interview evidence was used to identify factors which were necessary and sufficient *in that context* for the publication of the new standards. These were broadly similar to those factors necessary for the publication of fair value pension standards earlier. Had the actors in the regulatory space at that time not accepted financial economic valuation techniques (such as Black-Scholes) as being both legitimate and appropriate for valuing derivatives, fair value derivatives standards of the form of FAS 133 and IAS 39 would not have been capable of being published. Had interest groups been able to exert more pressure on the standard-setting organizations, by raising technical or political concerns, the standards would not have been published. Had strong advocates of the standards, such as Jim Leisenring, not been present on the board and willing to expend political capital on project, the project might well not have resulted in a fair value standard.

However, in addition, a path dependency is in evidence. Had the notion of fair value not been ‘tested’ earlier by the publication of the fair value standards for *pensions*, the board may have struggled to publish standards which would potentially result in the reporting of large liabilities measured using financial economic techniques. Similarly, had IOSCO not applied pressure to the IASC to publish its core standards, IAS 39 would not necessarily have been a near-direct copy of FAS 133. Thus, we see that interactions between different standard-setting projects appear to have shaped possibilities for later standards. Having required the disclosure of a liability for pensions (and required that part of it be recognised on the balance sheet), FAS 87 (1985)

began to shift notions of what constituted ‘good’ reporting. The publication of the standards for derivatives (which were the most suitable item for valuation using financial economic methods) cemented the view that financial reporting was done best when its representation methods were consistent with financial economic theory. However, the dominance of fair value was to be challenged within a few years as the next case study demonstrates.

5.3. Case study 3: Non-financial Liabilities

The IASB Liabilities Project (“LP”) was initiated in 2003 with the aim of extending the use of expected values for non-financial liabilities (often referred to as ‘contingencies’) by amending IAS 37 (1998). However, in contrast to the cases discussed so far, it did not result in the publication of a revised standard but instead was withdrawn in 2010. The LP originally arose out of a desire to achieve convergence with US GAAP in 2002, but the IASB soon became concerned about inconsistencies in the treatment of liabilities between IAS 37 (1998) and other International Financial Reporting Standards (IFRSs), as well as inconsistencies between IAS 37 and US standards.³⁰ In particular, the IASB wanted to remove the unclear requirement to use a “best estimate” of the expenditure required to settle an obligation, which is open to a variety of interpretations such as, “the most likely outcome, the weighted average of all possible outcomes or even the minimum or maximum amount in the range of possible outcomes”(IASB, 2010, pg. 2).

A group of IASB board members, who advocated fair value soon argued that the *probable outflow* test in IAS 37 resulted in poor quality reporting. In the view of a former IASB Board member:

“IAS37 gives weird results in practice in some circumstances, for example warranties. The accounting treatment is dependent on an assessment of the probability of future cash outflows arising. If an entity assesses that it is not probable that cash outflows will arise, a provision is not recognised, even if there is a greater than zero probability that they *could* arise.” (Interview with IASB board member H)

The LP proposed two major changes to the rules for representing uncertain obligations. First, it aimed to introduce the notion of an unconditional ‘stand-ready’ obligation in place of a liability passing the ‘probability-of-outflow’ test. Under IAS 37, a liability would be recorded only if two tests had been satisfied. First, an event had incurred which brought about a potential obligation for the entity and, second, a more than likely probability of an outflow of economic benefits associated with that obligation existed. By contrast, a ‘stand ready obligation’ would arise whenever an obligation had been triggered as a result of the entity’s actions, irrespective of the likelihood of an associate outflow of resources. A typical example would be a potential obligation for a pending litigation following negligent behaviour by the entity, but the example of such a stand-ready obligation which is often cited in IASB literature is that of a burger vendor who negligently sells potentially poisonous burgers to customers or an ongoing responsibility to service warranty obligations. The important point to note is that a stand ready obligation exists *even if the probability of economic outflows is low* and a liability will be recorded. Second, it amended the rules for measurement of the liability, in part to take into account the fact that low probability events might be recognised. All stand ready obligations would be measured at the expected value, thereby removing the distinction perceived by many preparers between the

³⁰In an IASB meeting in July 2002, the IASB board identified inconsistencies between FASB Statement 146, *Accounting for Costs Associated with Exit or Disposal Activities* and the IASB approach formalised in IAS 37 (1998) and IAS 19 (1998).

measurement requirements for large populations of items (such as warranties) and one-off items (such as an individual law suit against a company).

The IASB published two exposure drafts, the first in June 2005 on recognition and the second in January 2010 on measurement. The second exposure draft attracted significant technical and due-process criticism, with the result that the IASB decided it was necessary to release a further exposure draft to address some of the concerns raised. However, before the new exposure draft was issued, the project was removed from the IASB project agenda and as such can be considered unsuccessful. Since the IASB meeting to discuss comment letters in November 2010, work on the LP appears to have ceased. The last minuted comment from the board meeting concerning these revisions states: “The Board will schedule future deliberations based on priorities with other projects, but expect to further deliberate in 2011.” However, no specific timetable exists with respect to the production of any further consultation documents and statements made by board members of standard setting institutions, including the IASB, acknowledge that the LP has been indefinitely postponed, if not cancelled. According to a an interviewee who was an IASB board member during the LP:

“It’s been shelved now though. That’s not to say that the exposure draft wasn’t going in the right direction, but we only had 9 votes and then we lost one. That stopped it and frankly while we’re trying to get this stuff done for the US, we haven’t the time. And so it’s been postponed . . . people don’t like just this part being exposed. It’s been five years since we exposed the last one and that’s really because of pressure with the financial crisis and everything else.” (Interview with former IASB board member, T)

As we will see in what follows, the decision to ‘shelve’ the LP effectively has been attributed to three main factors: the volatile economic climate, the opposition of interest groups and the lack of strong advocates on the IASB board.

5.3.1. *Economic climate.*

The financial crisis of 2007-2009 created a new obstacle to the introduction of fair value accounting, and impacted negatively on the progress of the LP. Two main mechanisms were at work. First, many firms were hostile towards the use of fair values, because they believed it might result in the recognition of additional liabilities. This concern was raised in comment letters, and subsequently the IASB staff responded in a staff paper that the LP would not in fact lead to an increase in liabilities recognised (IASB Staff Paper, April, 2010, ¶6 and ¶7). Second, this general anxiety about the pro-cyclicality attributed to fair value accounting led to the start of a period of increased focus on due process at standard setting bodies and regulators. Accusations that poorly conceived fair value standards had exacerbated the crisis forced standard setters to defend not only their reasoning over the technical benefits of the new recognition criteria and valuation methods, but also the appropriateness of, and compliance with, the *processes* by which such methods were introduced. The increased concern with due process offered ammunition to those interest groups opposed to the LP, who were able to hamper its progress more successfully by bringing up due process concerns than by raising technical criticisms with the LP. An IASB staff member revealed that fair value was a dominant aspirational norm at the IASB initially:

“And of course during that time – up until 2005 and slightly beyond 2005 it was definitely the case that the prevailing mood at the IASB was for fair value and recognition of everything. That everything could be measured . . . But at some point, probably coinciding with the financial crisis, but possibly starting a bit before,

board members and I suppose staff, became increasingly worried about that as an overriding objective - and fair value started to fall out of favour.”

This demonstrates that the financial crisis was associated with the waning support for fair value accounting at the IASB.

The volume of projects on the convergence agenda was too great to be processed within the convergence deadline set by the G20 without compromising quality. The G20 demands used IASB resources, which would otherwise have been available for work on existing projects, led to a focus on those projects on the IASB-FASB convergence agenda. The LP was not one of these.

5.3.2. *Interest groups.*

Almost all preparers strongly opposed the proposals in the exposure drafts, particularly those on measurement. In addition, professional accounting groups, financial analysts, quasi-political groups such as the European Financial Reporting Advisory Group (EFRAG) raised technical and due-process objections during the consultation process. The main technical criticisms of the LP common to almost all the comment letters to the IASB, related to the extension of expected values to single events. Specifically the fact that an apparently precise probability for a single event may be misleading. This view is summarised by a senior technical staff member of the ICAEW who argued:

“Don’t put something ‘apparently’ precise in the balance sheet when the probability judgments are probably unreliable. Single case probabilities are *not* precise. . . Anybody can say: ‘we think there’s a 1% probability or there’s a 5% probability.’ It’s very difficult to challenge. It’s virtually un-auditable.” (Interview with ICAEW staff member, L)

This argument refers to the deficiencies of probabilistic valuations in cases where limited evidence exists and also highlights the belief of many constituents that the aim of providing *useful* information is simply not met by the proposed measurement rules. Many comment letters also highlighted the problem that by disclosing the ‘economic’ value of a pending litigation the entity would signal to litigators their expectation of being found liable.

Another very important category of complaint related to weaknesses in the IASB’s due process. After the financial crisis and the consequent backlash against the IASB’s introduction of fair value accounting, the IASB was subject to greater monitoring regarding its due process. The One Hundred Group, representing the finance directors of the UK’s largest companies (mostly represented on the FTSE100 Index) highlighted such process concerns in their comment letter, stating:

“At a time when the Board’s due process is under scrutiny, we believe that it was ill-advised not to have sought comments from constituents on revised proposals that are likely to affect all of them.” (Comment letter, CL 202, 19th May 2010)

The decision not to produce a full second exposure draft led to disapproval from different stakeholders. The comment letter from Pfizer used extremely negative language, for example, using the word “disappointed” to describe the company’s reaction to the LP. The Accounting Standards Board in the UK (ASB) was also unsupportive of the LP, arguing that it should be delayed and advising the IASB to undertake a “fundamental rethink of its proposals” (Comment letter CL12). The evidence from comment letters and interviews I have conducted shows that accounting institutions were generally strongly opposed to the LP.

One interest group which opposed the LP was that of professional accounting groups, several of which became antagonistic towards the IASB over the LP. In particular, the Institute of Chartered Accountants in England and Wales (ICAEW) saw the contents of the second Exposure Draft as a direct rejection of their advice. In an interview, a senior technical partner of an international accounting firm and member of several advisory groups to standard-setters (Interviewee J) described the IASB as “utterly pig-headed”, suggesting that they did not listen to advice which contradicted their desired approach. The frustration felt by accounting institutions at having their technical advice ignored by the IASB may have contributed to a desire to use any means necessary to halt the LP. According to the same source:

“This [the decision to make due process objections] was tactics. Within the IASB there were six dissenting opinions - and there were going to be two major changes to the board [at the end of June] . . . So we thought if we could get it deferred till after June, we might get another dissenting vote and get it defeated . . . By claiming due process, in essence, we were going above their heads to the trustees and the supervisory body . . . It was the most effective way of putting pressure on them.”
(Interview with technical partner, J)

Thus, some interest groups realised that the most effective means of halting the progress of the LP, and possibly preventing it from being voted in, was by making complaints about due process rather than raising specific technical concerns they believed to be legitimate.

Another group, the professional financial analysts association, which would normally be expected to favour financial economic valuations,³¹ also objected that the exposure draft was given insufficient re-exposure (Comment letter CL207) and described the aim of the standard as being, “a bit confusing”. Although they support the use of probability weighted measurement, they make an exception for circumstances where: “the outcome is binary, or where there is too much uncertainty to make the production of a single ‘answer’ meaningful.” Moreover, they highlight a lack of clarity in some elements of the recognition criteria. These comments and the language used may be interpreted as particularly negative given that they are made by a group which generally supports a move towards financial economic valuation.

The EFRAG was influential as it advised the EC on endorsement of IASB standards. The views expressed on the LP by the EFRAG were negative. At a meeting on Wednesday March 17th 2010 between the IASB and representatives of the EFRAG on convergence-related issues, the unofficial observer minutes expressed “grave concerns about the IAS 37 proposals”, particularly the “probability-of-outflow recognition criterion”. They urged the IASB to extend the comment period. The EFRAG comment letter in response to the second exposure draft states that the proposed changes in the exposure draft “fail to satisfy the IASB’s objective to improve the quality of financial reporting” (Comment Letter from the EFRAG, CL184). Such a negative response to the exposure draft could only signal the likelihood that the EC would refuse to endorse the standard if it were to be voted in by the IASB Board. This in turn would no doubt impact on the voting behaviour of the Board, since there would be little point in pushing through a standard if it was unlikely to be endorsed.³² The project staff were aware that EFRAG were negatively disposed towards the project, and identified the IASB’s focus on convergence with US GAAP as a possible explanation. According to a member of the IASB technical staff,

³¹ See letter by Jane Fuller, Chair of the Accounting Advocacy Committee, CFA Society of the UK, Letters to the Editor, Financial Times, October 8th 2008.

³² Moreover, the perceived risk that the standard might fail to be endorsed may have increased as a result of the decision by the EU not to endorse the new standard on financial instruments, IFRS 9, in November 2009.

“EFRAG were very sensitive to the fact that IASB spent a lot more time working with and listening to the FASB than EFRAG even though Europe uses IFRSs and the US didn’t. So EFRAG sort of felt that the IASB had not paid them proper attention generally.” (Interviewee Y)

This statement reveals a potential motivation for the EFRAG’s response which reflects institutional or even personal factors rather than technical ones. More generally, we see that it is by understanding the relationship between these organizations and their motivations for action, that we can piece together the constellation of factors which influenced particular regulatory outcomes.

So far I have highlighted two main points of opposition to the LP, which were the lack of reliability of probabilities for single events, and complaints about the IASB’s failure to follow due process. However, these criticisms do not explain the vociferous opposition to the LP from constituents. The implications of adopting the IASB’s proposed amendments to IAS 37 would not have been particularly onerous to most companies, particularly when compared to other projects such as those for pensions (IAS 19) and financial derivatives (IAS 39). Nor would the use of expected values be especially difficult or costly to apply. Moreover, the effects on the income statement would be insufficiently large in most cases to justify such a negative reaction. Many financial reporting numbers incorporate allocations based on unreliable assumptions (for example, inventory and the allocation of fair values for business combinations) and preparers’ discomfort with the kind of subjective measurement included within IAS 37 is hard to explain in terms of technical issues alone. What can then explain such strong opposition?

Most important in explaining this reaction to the LP is that constituents viewed the requirements of the LP as an unnecessary and unreliable substitution for an existing technique which preparers believed was satisfactory. In other words, the ‘problems’ in IAS 37 as perceived by the IASB and addressed in the exposure drafts were, in the eyes of preparers, not really problems at all. Most interest groups did not agree with the IASB that viewed a unified approach to financial reporting incorporating elements of financial economics as superior to a mixed approach. Furthermore, some of the hostility towards the LP may be explained by the fact that many more preparers were likely to be affected than was the case with the derivatives standards. As Andy Simmonds (a former technical partner of Deloitte) argued in his weblog: “Unlike financial instruments, which affects a relatively small group of preparers, this change affects just about everyone”³³. Thus, a unifying factor for preparers who opposed the project was the universal scope of the LP. An interview with a senior IASB Board Member, T, corroborates this view.

5.3.3. Board composition

The timing of changes in board composition was a key factor driving the outcome of the LP. Several board members who were committed to fair value retired between the publication of the 2005 exposure draft and the vote on the second exposure draft in June 2010, as illustrated in Figure 1. According to Interviewee J, the champions of the project on the IASB Board were Warren McGregor and Jim Leisenring. In addition, Tom Jones and Mary Barth who had been board members since the inception of the IASB in 2001, were influential and had expressed a commitment to fair value accounting (see Barth, 2006; Barth et al., 2001). Furthermore, Jim Leisenring, a key advocate of the project, was due to step down in June 2010.

Compared with the 2005 exposure draft, which only one board member had voted against,

³³Simmonds, Andy. ICAEW weblog. <http://www.ion.icaew.com/FinancialReporting/19258> (2010).

the 2010 exposure draft proved more controversial. Six members voted against it and nine voted in favour, leaving a majority of only three members.

Date retired	Name	Vote: ED 2005	Vote: ED 2010
June 2010	R. Garnett	For	For
June 2010	G. Gélard	For	For
June 2010	J. Leisenring	For	For
June 2009	T. Jones	For	–
June 2009	M. Barth	For	–
June 2007	H. Bruns	For	–
June 2007	A. Cope	For	–
June 2007	P. O'Malley	For	–

Table 1: Retirement of board members who supported the LP between 2007 – 2010

Soon after the vote, in June 2010, three of the fifteen board members who had voted in favour of the 2010 exposure draft were due to retire, thus eliminating the definite majority altogether. One of those stepping down was Jim Leisenring, who has been described as a particularly outspoken advocate of fair value accounting. Leisenring's absence might have reduced the pressure on other members who had previously voted in favour of the exposure draft previously to do so again. This offered opponents of the LP an opportunity to undermine it by delaying the vote until after June 2010, by which time three of the pro-votes would be replaced. This would leave the outcome of the vote hanging in the balance. The LP history displays some tell-tale signs of rushed preparation. A partner of a Big Four auditing firm, Interviewee J, argued that the project team's decision to re-expose only part of the proposed standard, in 2010, reflected a desire to speed the project through. Given these board changes, the remaining advocates of the project became less inclined to throw their weight behind what was rapidly becoming an unpopular project. An influential IASB board member argued that, "the board was divided anyway . . . and it wasn't worth using all the political capital" (Interview with IASB board member T). In other words, with limited time and resources, the fair value advocates judged it a poor choice of project to support.

Unlike the earlier projects studied in the areas of pensions and derivatives, the LP did not result in a standard which extended the use of fair value accounting. In spite of the fact that there had been a general shift in accounting knowledge towards fair value reporting norms, the IASB board was unable to gain acceptance for what they perceived to be a relatively innocuous standard. It is this project which throws up a serious objection to functional explanations of this period of accounting change. If fair value accounting was beneficial and had been accepted in previous standards, it is not clear why this project stalled. It seems that the Liabilities Project became a victim of various factors, including the opportunistic due process objections raised by certain interest groups along with changes in board composition.

6. Analysis

The study of the six projects contributes to an understanding of regulatory change in financial reporting and takes the political economy approach as its theoretical basis. A fundamental

methodological premise of this approach is the need to “examine accountancy as outcome, as an historically and geographically localized result of the composition of various lines of force” (Miller and Napier, 1993, pg. 644). I have found that the particular “lines of force” operating during the shift towards fair value accounting were: the impact of economic conditions, the legitimacy of the specific economic technique being introduced, the influence of interest groups and the presence on standard setting boards of strong advocates of fair value accounting. The relative impact of these factors is unclear and, in fact, a notion of joint sufficiency may be more useful as a means of understanding the influence of this constellation of factors rather than any attempt to identify the relative strength of different factors at particular points in time.³⁴ The analysis of each individual project demonstrates the effects of the factors identified in driving project outcomes and the standard-setting organisation’s ability to publish a pro-fair value standard, even though the projects differed in terms of jurisdiction and the type of accounting item concerned.

This paper responds to the call for the use of thick descriptions as a means of generating knowledge about causal processes. Specifically, Lukka and Modell (2010) argue that what is required for an explanation of a phenomenon is,

“a context-specific, meticulous analysis of sequences of events and actions, to trace the *dependency relations* between things in the world.” (pg. 465)

In the three case studies presented in Section 5, an analysis of the meanings of events and actions for the actors involved in the standard-setting process provides evidence for such dependency relations which drove the norm of fair value accounting. These actors were board members and technical staff at the standard setting organizations as well as constituents and related professional groups, such as actuaries. The ostensible reasons for their actions are brought into question as a result of interview evidence, throwing light on their true motivations. In the case of pensions, the role of the actuaries was shown to be important, and it can be seen that the ‘fair value revolution’ in accounting was connected to the ‘financial economics revolution’ in the actuarial profession. In the case of derivatives, the support of the SEC in defending the FASB against the aggressive stance taken by the Federal Reserve was in part due to the recent memory of the Asian Financial Crisis, and no doubt in part due to the forceful combination of Ed Jenkins and Jim Leisenring. In the case of the Liabilities Project, the use of proxy criticisms such as those concerning due process proved to be tactical and successful in slowing the project until its key supporters had retired from the board. The analysis picks out the subtleties of the process of change and demonstrates that perceived technical benefits alone fail to explain the specific pattern of the adoption of fair value accounting.

Although the project-by-project analysis usefully highlights the constellation of causal factors shaping financial reporting, it misses an important explanatory feature. It fails to pay attention to the evidence of interactions and feedback loops between projects in the overall process of change. It does not help us answer questions such as, ‘Why were environmental conditions more conducive to the introduction of fair value accounting after 1998 across all jurisdictions?’ A closer investigation of the relationships between projects suggests that the account of change is significantly enriched by moving beyond an atomistic view of standard-setting events by considering *sequences* of change in accounting knowledge. Thus, early project outcomes carve out possibilities for change in future projects through their effect on the background conditions against which future standard-setting projects play out.

³⁴In this regard, the work of Mackie (1974), who proposes a solution to the problem of apportioning weightings to multiple causal factors, is of relevance and may offer a fruitful line of research in the future.

Viewed in this way, the completion of the first weak fair value pensions project in the US (culminating in the publication of FAS 87) constitutes more than an isolated breakthrough of fair value accounting. Instead, it deserves credit as a critical experiment for the development of a new accounting paradigm. Its success at introducing elements of fair value accounting for pension liabilities, demonstrated to standard setters and preparers that the use of fair value was not just *possible*, but was to be viewed as best practice. The legacy of FAS 87 thus included not just the later pensions standards, which moved increasingly towards strong versions of fair value (with full recognition, economic valuation and economic performance reporting), but also, in part, it shifted perceived best practice in the standard setting community towards the use of fair value accounting in *other* areas. In this way, it shaped the environment in a way that laid the ground for the FASB and IASC derivatives standards which would be published over a decade later. What emerges is an explanation of regulatory change in accounting, in terms which may not have been obvious before. The apparent simplicity of the explanation of individual projects gives way to more complex and dynamic structures of change. Rather than viewing regulatory change simply in terms of unrelated episodes, this analysis highlights their connected and sequential nature.

My analysis shares certain features with the sequential analysis provided by Posner (2010), in that I emphasise the importance of the timing of projects and the potential impact of contingent events on their development. However, the sequential analysis I introduce differs from Posner's in one important respect. That is, when attempting to explain the shift in financial reporting norms, this study makes explicit the importance of *self-reinforcing* elements in the sequence of change, whereas Posner's focus is more on the *reactive* elements. In Posner's analysis, the events which punctuate the sequence are causal factors which interact to cause a particular outcome. They are not themselves constitutive of the overall shift in practice to be explained: they are causes of change but not *constitutive* of the change. By contrast, the individual standard setting projects which I analyse are themselves constitutive of the increasing influence of fair value accounting. Thus, the projects are both *indicators* of change and *causes* of subsequent change.

My findings suggest that the shift towards a fair value reporting norm results not only from the interplay of reactive elements but also from the effects of self-reinforcement. This is not to say that a self-reinforcing sequence alone is capable of explaining the increasing influence of financial economics. Reactive elements are also necessary, and what we see is that a self-reinforcing sequence interacts with stochastic (or "reactive") events to yield the observed regulatory pattern. Such stochastic events may cause a project outcome to deviate from what would be predicted by an analysis using self-reinforcing sequences alone. For example, if self-reinforcement alone explained the rise of fair value accounting, the IASB Liabilities Project might have been expected to build on the success of the fair value standards which preceded it. However, we see that it was driven off course by unexpected, 'reactive' events.

Thus we see that both reactive and self-reinforcing elements are needed to explain the sequential shift towards fair value accounting. In this case, the sequence itself is made up of standard-setting projects where these projects are connected by causal influences, either from earlier projects (self-reinforcing elements) or from exogenous factors (reactive elements). To explain why a certain sequence of events unfolded in one way rather than another, it is necessary to identify the influences between projects. In the six projects analysed above, we can group the various kinds of influences into two broad categories, which I will call *direct* and *indirect* influences.

For the six projects analysed, direct and indirect inter-project influences can be identified. Figure 2 shows interactions between all the projects analysed. I argue that direct influence arises when technical requirements or definitions contained in one standard are incorporated almost verbatim into another standard, as was seen with FAS 133 (1998) and IAS 39 (1998).

Direct influence results in self-reinforcing characteristics of the sequence as technical rules are adopted by different standard setters and become increasingly embedded as financial reporting norms. Such direct influence is, and has been, facilitated by the structure of the standard setting institutions and the tendency towards imitative behaviour by particular standard setters which has an important effect on the landscape of reporting regulation. In this regard, conceptual framework projects have formalised particular representational norms. Furthermore, joint projects and movements of staff between standard setting institutions facilitated direct influence. This can be seen in the case of the derivatives standards on which Jim Leisenring and Paul Pacter worked, both at the FASB and at the IASC. Similarly, transnational organisations such as the G4+1 allowed for the development of a unified view of standard setting, thus blurring the boundaries between the individual institutions. This is consistent with the argument made by Power (2009) that financial accounting norms are fundamentally transnational.

However, this is not to say that successful projects create deterministic paths of success. Not all the factors identified were affected by the outcomes of earlier projects. For instance, economic conditions at the time of the project would have been causally independent of previous project outcomes. Although more predictable, the retirement timing of individual members of the standard setting board would also be independent of earlier projects, although their presence on the board would be no doubt be influenced by their experience. Moreover, other factors are probabilistically dependent as they may be affected by earlier outcomes. These include the influence of interest groups, which are themselves subject to unpredictable external influences.

Indirect effects appear to occur through two mechanisms. First, success in earlier projects may serve to increase the *confidence* of the individual members of standard setting boards that a project is capable of being adopted and therefore worth supporting. Past successes in the introduction of a particular standard may act as a signal to institutions that their objections are unlikely to succeed in blocking a project. Second, a successful project may exert an effect on the outcome of future projects by changing the general notion of best practice in the regulatory space.

Gauging the *confidence* of standard setters is problematic because this is hard to distinguish from changes in standard setters' perceptions resulting from changes in the *understanding of best practice*. They are certainly closely related. However, we can see that when FAS 87 was published, the FASB Board acknowledged that they had wanted the standard to include balance sheet recognition rather than disclosure in the notes but admitted that, "...those approaches would be too great a change from past practice to be adopted at the present time" (FAS 87, 1985, ¶107).

Standard setters appear to have viewed the successful publication of earlier projects as evidence that future projects of the same type might also have a high chance of being published and implemented. In the case of FAS 87, standard setters were aware that they were constrained in terms of the elements of fair value accounting they could introduce because of objections from constituents to new techniques which diverged from the 'accepted way' of doing accounting. In other words, the existence of a norm acts as a constraint on the introduction of practices which do not conform.

Following the publication of the derivatives standards, standard setters would have felt increasingly confident about the chances of successful publication of projects such as FRS 17 (2000) just *because* the preparers and interest groups had accepted the legitimacy of fair value accounting. When asked in an interview whether the experience of introducing FRS 17 (2000) made standard setters at the IASB more confident about bringing in fair value for derivatives, Interviewee T agreed that it probably did, although the interviewee claimed to be unaware of specific technical links between the standards. While the influence of confidence

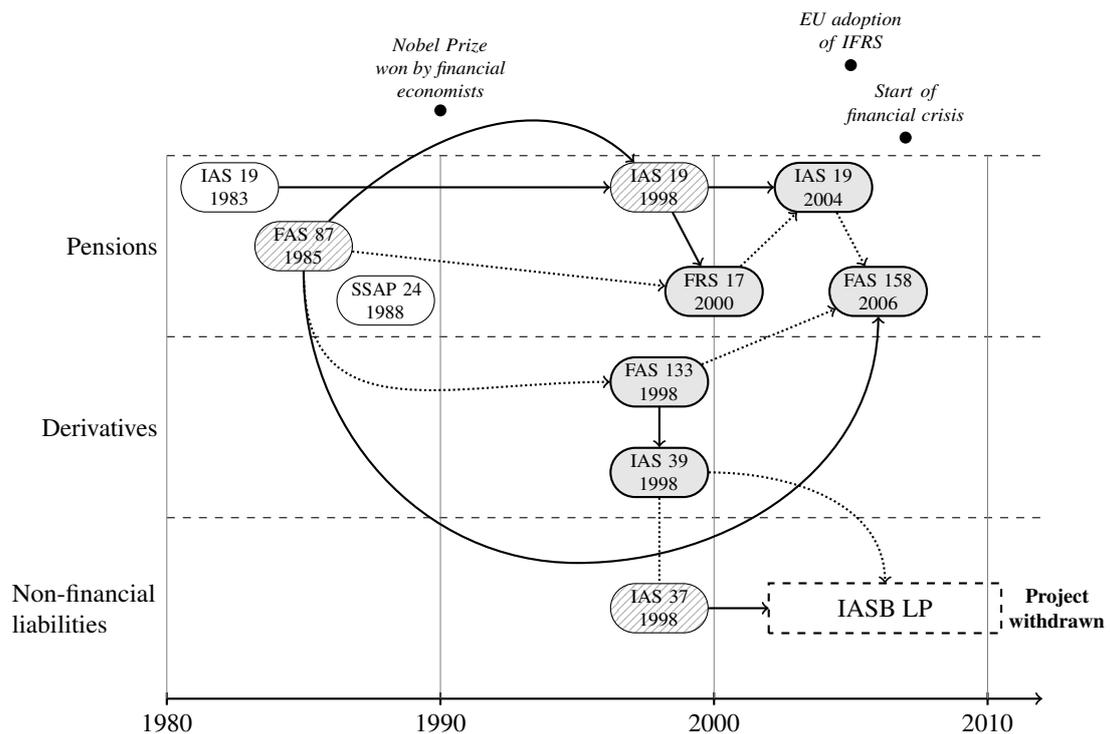


Figure 2: Interactions between projects. Interactions between projects can be categorised as direct or indirect. Direct influence between projects is represented by bold lines and indirect influence by dotted lines between project icons. (The 1992 and 2002 amendments to IAS 19 included in figure 1 have been omitted here for purposes of clarity.)

on standard setters is extremely difficult to establish, especially ex-post, this response from the interviewee provides evidence that it was in fact a relevant factor linking certain fair value projects (specifically FRS 17 and IAS 39 (1998)).

The effect of standard setters' confidence is apparent in the case of the IASB Liabilities Project, which was initiated as a way of dealing with the perceived inconsistency of treatment rather than as a response to external pressure for change. The IASB decision to embark on the LP thus reflects the board's confidence in their ability to issue a standard. A former IASC and ASC board member described as "amazing" and "weird" the fact that many constituencies did not understand the notion of expected values as a means of valuing non-financial liabilities (Interviewee V). The fact that this interviewee was surprised by the negative reactions to the Exposure Draft suggests that the project advocates were initially confident in their ability to deliver a positive outcome. This confidence was likely to have developed as a result of previous successful projects in pensions and derivatives.

Second, the publication of new fair value standards served to shift the *notion of best practice*, both for standard setters and for other organizations in the regulatory space. It thereby carved out possibilities for future projects by changing the perceptions of these actors about what constituted a legitimate 'problem' in financial reporting and what methods were capable of providing technically and socially appropriate solutions. In this way, the *notion of best practice* constrained the initiation and development of projects by determining what merited attention, what constituted an appropriate solution and what constituted good financial reporting (consistent with Young, 1996).

For standard setters, self-reinforcement effects result from experience in setting fair value standards. According to a technical staff member of the IASB, staff and board members are heavily influenced by the first projects they work on:

"The first big issue you get into colours your view and your understanding of what can be achieved and what a good result is." (Interview with Y)

Speaking about pension accounting, the same interviewee argued that,

If you come from that background, you think – well I certainly think – that people who try to account for financial instruments are very 'backwards' ... If you are introduced to pensions as the first thing you think about in accounting, it actually means you are pushed into current values – very far – and you cannot then understand why other areas of accounting don't do this."

Here, the environment of professional and intellectual development of a standard setter is described as having moulded their view of best practice. Given this, it seems likely that the publication of the fair value pensions standards shifted the notion of best practice within the standard setting organizations towards fair value. This may explain why the reporting of non-financial liabilities in IAS 37 (1998) was viewed as deficient and selected for revision by IASB board members who had been involved in fair value standard, first for pensions and then for derivatives. This leads us to question the assumption that standard setting organizations, such as FASB and IASB, are homogeneous entities which provide a rational best response to user needs. The evidence in this study suggests they are more complex structures composed of individuals with unique experiences and attitudes to financial reporting practice, who form alliances, act to promote their own careers and respond differentially to the actions of lobbyists.

The publication of fair value standards also exerted a significant effect on the view of best practice held by preparers and other interest groups. Beyond the effect on the technical views of standard setters, the case of pensions also offers a good example of the impact of an earlier

successful project on the attitudes of interest groups. First, after significant contact with the FASB, the actuarial profession in the US did not perceive FAS 87 to be a threat to their professional expertise in pension fund valuations (Interview with FASB staff member C). As a result, the actuarial profession accepted FAS 87 as its leadership did not sense any particular threat from the new standard. By contrast, actuarial dispositions to later standards in the US and the UK, were hostile as the jump from FAS 87 to FAS 158, and from SSAP 24 to FRS 17 marked a challenge to the importance of actuarial judgement, and hence expertise, in this professional domain (Todisco, 2005, pg.1). While the FAS 87 first introduced fair value accounting and smoothed the way for further fair value standards, it was the publication of the derivatives standards, FAS 133 and IAS 39, which effected a rapid shift in agreed-upon best practice. After the adoption of IAS 39 became mandatory across the EU in 2005, the practice of using financial economic methods for reporting derivatives became commonplace for a large number of preparers. As a result of the derivatives projects, financial reporting practice experienced a move towards an era of fair value accounting.

Given all of these considerations, I tentatively propose that the pattern of publications of fair value standards observed is best explained using both elements of self-reinforcement and reactive or stochastic elements, such as the timing of the financial crisis and standard-setting board changes (discussed in the case studies in Section 4). This combination of elements generates sequences of connected project outcomes which follow a cumulative and relatively predictable trajectory at a higher level of analysis, but a more erratic and unpredictable trajectory at the local, fine-grain level.

7. Conclusion

The focus of this work has been to explain when and how particular techniques permeated accounting practice. The original puzzle it sought to solve was how a particular pattern of change in accounting knowledge occurred from the 1980s onwards. The standard setters themselves have described the *overall* shift in reporting norms associated with the publication of fair value standards as a best response to the challenge posed by the emergence of growing pension obligations and new financial instruments. However, this type of functional explanation fails to explain the variation in adoption of fair value across jurisdictions and across technical areas of accounting *within* jurisdictions. In the area of pensions, the FASB introduced an accounting standard that required the use of fair value accounting in 1985 (SFAS 87), but it was more than a decade later that the IASC and ASB first introduced fair value pension standards (IAS19; FRS17). Examples of differential treatment within a jurisdiction for different types of accounting item can also be observed. In the US, the pension standard (SFAS 87) remained in place for over a decade after the publication of a derivatives standard (SFAS 133), which required more extensive elements of fair value accounting. In addition, functional styles of explanation fail to explain unexpected failures to advance fair value accounting, such as the case of the IASB Liabilities Project. To explain these inconsistencies, this study has analysed evidence from six standard setting projects by FASB, IASC/B and ASB/C in the areas of pensions, derivatives and non-financial liabilities. It found that the standard setters' ability to publish fair value standards was constrained by the set of environmental conditions they faced.

This work has made a contribution to the accounting literature on regulatory change in two ways. First, it has contributed to the political economy literature by explaining the pattern of adoption of fair value accounting transnationally as the result of the interplay of different interest groups and the emergence of localised practices (Cooper and Sherer, 1984; Robson et al., 1994; Young, 1996; Perry and Nölke, 2006; Arnold, 2012). In so doing, the study has

responded to the call by Lukka and Modell (2010) for a particular form of counterfactual causal explanation in accounting scholarship which uses thick descriptions as a means of identifying actors' motivations and thus actions. In this study, the self-reported accounts by board members and project staff at the standard setting organizations of the important factors driving the different projects offered thick descriptions. By revealing the meanings that these actors attached to particular events and actions in the regulatory space, their motivations, and hence actions, could be explained.

Second, the study has raised the question of what is the appropriate unit of analysis for explaining regulatory change. It found evidence of direct and indirect 'lines of influence' (Miller and Napier, 1993) linking projects, across jurisdictional boundaries and different areas of accounting. Given these connections, it is proposed that the interconnected projects which were constitutive of the rise of fair value, might more effectively be analysed at the level of a sequence rather than at the level of the individual project. Although some accounting scholars have identified the significance such connections for networked entities (Richardson, 2009), the idea that patterns of accounting change are best understood as the product of chronological sequences has gone unnoticed in the accounting literature. This study introduced a hybrid sequential analysis, building on the work of Posner (2010), combining elements of reactive and self-reinforcing sequences. It proposed that a sequential analysis is capable of explaining both the gradual trend over time and also the unexpected local deviations from that trend. The identification of these cascading interactions may yield a template for analysing other instances of change in financial reporting practice, although this would require significantly more evidence and incorporate other episodes of regulatory change. Such sequential analysis could lead to an improved understanding of changes in accounting practice.

A. Appendix: Interviews conducted

No.	Name*	Area**	Position	Interview date
1	B	P	Former IASC staff member	December 2009
2	C	P, D	Project manager, FAS 87	January 2010
3	D	P	Big 4 partner (pensions specialist)	January 2010
4	E	P	Former ASB technical staff and IASC staff	January 2010
5	F	P, D	Former IASB and ASB board member	February 2010
6	G	P, D, C	ASB technical staff	February 2010
7	H	P, D, C	IASB board member	March & May 2010
8	J	C	Financial Reporting Committee (ASB) and Big 4 partner	August 2010
9	K	C	CFA analyst	August 2010
10	L	C	ICAEW technical staff	August 2010
11	M	C	CRUF (European analysts group)	August 2010
12	N	P	Former president, Institute of Actuaries	November 2010
13	P	P	Managing Principal (pensions), international actuarial firm	November 2010
14	Q	D	FASB board member, worked on FAS 133	November 2010
15	R	D	FASB technical staff, worked on FAS 133	November 2010
16	S	D	Financial analyst	November 2010
17	T	P, D, C	Former ASB and IASB Board Member	January 2011
18	V	P, D, C	Former IASC and ASC board member	May 2011
19	W	P, D, C	Technical staff IASB	August 2011
20	X	C	Technical staff IASB	June 2013
21	Y	P, C	Technical staff IASB	April 2014

*Interviewee names have been replaced with codes to preserve anonymity

** Areas: P = pensions, D = derivatives and C = contingencies

B. Charting the increasing legitimacy of financial economic methods

Figure 3 shows the number of references to specific terms included in the Economist Magazine, for every fifth year between 1970 and 2005 inclusive, using The Economist Historical Archive online resource. Each entry was viewed in order to remove references to ‘derivatives’ of a non-financial kind. Until the 1990s, there are few inclusions of the terms “financial economics” and “derivative”. From 1990, the number of references increases significantly in relative terms (although not in absolute terms given the low starting level). To control for the possibility that the increase in references to the two terms reflects merely an increase in the number of finance or banking articles from 1980, I obtained frequency data for the number of articles containing the terms ‘banking’ or ‘finance’ and found that these did not show a similar increase from 1980.

Year	“financial economics”	“derivative”	“banking”	“finance”
1970	2	0	806	890
1975	0	0	828	1243
1980	5	0	935	1315
1985	11	0	747	1104
1990	21	12	753	1227
1995	17	58	825	1365
2000	34	30	715	1493
2005	25	9	539	1145

Figure 3: Annual frequency of specific terms used in the Economist between 1970 and 2005 (every 5th year).

In 1990, there were 21 results for ‘financial economics’, 18 of which were recruitment advertisements for positions requiring a knowledge of financial economics. The remaining three references to ‘financial economics’ were in articles, one of which reported the award of the Nobel Prize in economic sciences to three financial economists (Harry Markowitz, William Sharpe and Merton Miller). The article states that, “None of the laureates is a household name; unlike some recent winners, all three deserve to be. Between them, they have had a profound effect not only on the way economists think about financial markets, but also on the way financial market practitioners think about themselves” (The Economist, October 20th, 1990, pg. 145).

References

- Abbott, Andrew (1983). “Sequences of Social Events”. *Historical Methods* 16: 129–147.
- (1995). “Sequence Analysis: New Methods for Old Ideas”. *Annual Review of Sociology* 21: 93–113.
- Abbott, Andrew and Angela Tsay (2000). “Sequence Analysis and Optimal Matching Methods in Sociology”. *Sociological Methods and Research* 29, 1: 2–33.
- Abodiy, D and B Lev (1998). “The Value Relevance of Intangibles: The Case of Software Capitalization”. *Journal of Accounting Research* .
- Accounting Standards Board (2006). *Discounting in Financial Reporting — Working Paper*, Accounting Standards Board, volume Discussion and Consultation Papers in Issue, pp. 3102–3114.
- Ahmed, Anwer S, Emre Kilic, and Gerald J Lobo (2011). “Effects of SFAS 133 on the Risk Relevance of Accounting Measures of Banks’ Derivative Exposures”. *Accounting Review, forthcoming* .
- Allen, Abigail and Karthik Ramanna (2013). “Towards an understanding of the role of standard setters in standard setting”. *Journal of Accounting and Economics* 55: 66–90.
- Amir, E (1993). “The market valuation of accounting information: the case of postretirement benefits other than pensions.” *Accounting Review* 68, 4: 703–724.
- (1996). “The effect of accounting aggregation on the value relevance of financial disclosures: The case of postretirement benefits other than pensions”. *Accounting Review* 71: 573–590.
- Amir, E and S Benartzi (1999). “Accounting recognition and the determinants of pension asset allocation”. *Journal of Accounting, Auditing and Finance* 14, 3: 321–343.
- Amir, Eli, Yanling Guan, and Dennis Oswald (2007). “The Effect of Pension Accounting on Corporate Pension Asset Allocation: A Comparative Study of UK and US”. Technical Report Discussion Paper PI-0623, Pensions Institute.
- Amir, Eli and Amir Ziv (1997). “Economic Consequences of Alternative Adoption Rules for New Accounting Standards”. *Contemporary Accounting Research* 14, 3: 543–568.
- APB Opinion No. 8 (1966). *Opinion No. 8, Accounting for the Cost of Pension Plans*. American Institute of Certified Public Accountants.
- Arnold, Patricia J (2012). “The political economy of financial harmonization: The East Asian financial crisis and the rise of international accounting standards”. *Accounting, Organizations and Society* 37: 361–381.
- Arnold, Patricia J and Prem Sikka (2001). “Globalization and the state-profession relationship: the case of the Bank of Credit and Commerce International”. *Accounting Organizations and Society* 26, 6: 475–499.
- ASB Discussion paper for FRED 23 (2002). “Financial Instruments”.

- Bader, Lawrence N and Jeremy Gold (2003). “Reinventing Pension Actuarial Science”. *The Pension Forum (Society of Actuaries)* 14, 2: 1–13.
- Ball, R and P Brown (1968). “An empirical evaluation of accounting income numbers”. *Journal of Accounting Research* 6: 159–177.
- Bank of England Press Office (2004). *Bank of England News Release*. Bank of England Press Office.
- Barth, M E, W H Beaver, and W Landsman (1992). “The market valuation implications of net periodic pension cost components”. *Journal of Accounting and Economics* 15: 27–62.
- Barth, Mary E (1991). “Measurement Errors among Alternative Pension Asset and Liability Measures”. *The Accounting Review* 66: 433–463.
- (1994). “Fair value accounting: Evidence from investment securities and the market valuation of banks”. *Accounting Review* 69: 1–25.
- (2006). “Including estimates of the future in today’s financial statements”. *Accounting Horizons* 20, 3: 271–285.
- Barth, Mary E, William H Beaver, and Wayne R Landsman (2001). “The relevance of the value relevance literature for financial accounting standard setting: another view”. *Journal of Accounting and Economics* 31, 1-3: 77–104.
- Basel Committee on Banking Supervision (2000). “Report to G7 Ministers and Central Bank Governors on International Accounting Standards”. Technical report, Basel Committee on Banking Supervision.
- Beresford, Dennis R (2001). “Congress Looks at Accounting for Business Combinations”. *Accounting Horizons* 15, 1: 73–86.
- Bhimani, Alnoor (1987). “Accounting and the emergence of “economic man””. *Accounting Organizations and Society* 19, 8: 637–674.
- Black, Fischer and Myron Scholes (1973). “The Pricing of Options and Corporate Liabilities”. *Journal of Political Economy* 81, 3: 637.
- Bline, Dennis M and Ted D Skekel (1990). “Interpreting the FAS 87 Minimum Liability Adjustment”. *Journal of Corporate Accounting and Finance* Spring.
- Boer (1966). “Replacement Cost - A historical look”. *Accounting Review* 41, 1: 92–97.
- Botzem, S and S Quack (2006). “Contested Rules and Shifting Boundaries: International Standard Setting in Accounting”. In M Djelic and K Sahlin-Andersson, eds., *Transnational Governance*, Cambridge University Press.
- Boyd, Jeffrey F, Gregory S Hayt, Richard C Reynolds, and Charles W Smithson (1996). “A review of Industry Reaction to Proposed Changes in Derivatives Accounting”. *Journal of International Financial Management and Accounting* 7, 3: 243–258.
- Bromwich, Michael (1977). “The Use of Present Value Valuation Models in Published Accounting Reports”. *The Accounting Review* .

- (1992). *Financial Reporting, Information and Capital Markets*. Pitman.
- (2007). “Fair Values: Imaginary Prices and Mystical Markets: A Clarificatory Review”. In P Walton, ed., *The Routledge Companion to Fair Value in Financial Reporting*, Routledge, pp. 46–68.
- Bromwich, Michael, Richard Macve, and Shyam Sunder (2010). “Hicksian Income in the Conceptual Framework”. *Abacus* 46, 3: 348–375.
- Bryer, R A (1995). “A political economy of SSAP22: Accounting for goodwill”. *British Accounting Review* 27: 283–310.
- Burchell, S, C Clubb, and A G Hopwood (1985). “Accounting in its Social Context: Towards a History of Value Added in the United Kingdom”. *Accounting, Organizations and Society* pp. 381–413.
- Butler, Cormac (2009). *Accounting for financial instruments*. John Wiley & Sons Ltd.
- Camfferman, Kees and Stephen A Zeff (2007). *Financial Reporting and Global Capital Markets*. Oxford University Press.
- Chance, Don M (1995). “A Chronology of Derivatives”. *Derivatives Quarterly* 2: 53–60.
- Cook, Allan (1989). “International Business: A Channel for Change in United Kingdom Accounting”. In Anthony G Hopwood, ed., *International Pressures for accounting change*, ICAEW, chapter 3.
- Cooper, David J and Michael J Sherer (1984). “The value of corporate accounting reports: Argumens for a political economy of accounting”. *Accounting, Organizations and Society* 9, 3–4: 207–232.
- Djelic, Marie-Laure and Sigrid Quack (2003). “Globalization as a double process of institutional change and institution building”. In Marie-Laure Djelic and Sigrid Quack, eds., *Globalization and institutions: redefining the rules of the economic game*, Edward Elgar Publishing, Inc.
- EFRAG Press Release (2004). *Adoption of the amended IAS 39 Financial Instruments: Recognition and Measurement*. EFRAG.
- ERISA (1974). “The Employee Retirement Income Security Act of 1974”. September 2, 1974 Pub.L. 93-406, 88 Stat. 829,, Federal State Law.
- Exley, C J, S J Mehta, and A D Smith (1997). “The financial theory of defined benefit pension schemes.” *British Actuarial Journal* 3: 835–966.
- Fama, Eugene (1965a). “The Behavior of Stock Market Prices”. *Journal of Business* 38: 34–105.
- (1965b). “Random Walks in Stock Market Prices”. *Financial Analysts Journal* pp. 55–59.
- (1968). “Random Walks in Stock Market Prices”. *Institutional Investor* .
- (1970). “Efficient Capital Markets: A Review of Theory and Empirical Work”. *The Journal of Finance* 25, 2: 383–417.

- FAS 105 (1990). *Disclosure of Information about Financial Instruments with Off-balance-Sheet Risk and financial Instruments with Concentration of Credit Risk*. Financial Accounting Standards Board.
- FAS 133 (1998). *Statement No. 133: Accounting for Derivative Instruments and Hedging Activities*. Financial Accounting Standards Board.
- FAS 158 (2006). *Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Financial Accounting Standards Board.
- FAS 87 (1985). *Employers' Accounting for Pensions*. Financial Accounting Standards Board.
- FASB Concept Statement No. 1 (1978). *Statement of Financial Accounting Concepts No.1: Objectives of Financial Reporting by Business Enterprises*. Financial Accounting Standards Board.
- FASB Concept Statement No. 3 (1980). *FASB Concept Statement No. 3*. Financial Accounting Standards Board.
- FASB Concept Statement No. 6 (1985). *Concept Statement 6*. Financial Accounting Standards Board.
- FASB Research Report (1991). *Hedge Accounting: An exploratory Study of the underlying issues*. FASB.
- Financial Times, Asia Edition, Jennifer Hughes, 24th September (2008). *IASB calls credit crunch meeting*.
- Financial Times, Jennifer Hughes, 5th October (2008). *Drive for clearer accounting continues*.
- Financial Times, Jim Kelly, 17th July (1998). *Standard Procedures*.
- Financial Times, Jim Kelly, August 15th (1997). *Greenspan goes on attack over derivatives*.
- Financial Times, Laurie Morse, 20th June, (1996). *The Americas: FASB draft standards face a frosty reception*.
- Financial Times, Vincent Boland, 3rd May (2001). *ISDA lobbies FASB on swaps*.
- Fourcade, Marion and Rakesh Khurana (2011). *From Social Control to Financial Economics: The Linked Ecologies of Economics and Business in Twentieth Century America*. Harvard Business School.
- Francis, Jere R (1987). "Lobbying against proposed accounting standards: The case of employers' pension accounting". *Journal of Accounting and Public Policy* 6, 1: 35–57.
- FRS 17 (2000). *Financial Reporting Standard 17, Retirement Benefits*. Accounting Standards Board.
- Geertz, Clifford (1973). *Thick description: Towards an Interpretive Theory of Culture*, Basic Books, New York.

- Gopalakrishnan, V and Timothy F Sugrue (2006). “An empirical investigation of stock market valuation of corporate projected pension liabilities”. *Journal of Business Finance and Accounting* 20, 5: 711–724.
- Gorton, Gary and Richard Rosen (1995). “Banks and Derivatives”. In Ben S Bernanke and Julio J Rotemberg, eds., *National Bureau of Economics Research (NBER) Macroeconomics Annual*, MIT Press, volume 10, pp. 299–349. [Http://www.nber.org/chapters/c11023](http://www.nber.org/chapters/c11023).
- Greenspan, Alan (1997). *Letter to FASB from the Federal Reserve*.
- Hague, Ian P N (2004). “IAS 39: Underlying Principles”. *Accounting in Europe* 1: 21–26.
- Hens, Thorsten and Marc Oliver Rieger (2010). *Financial economics: A concise introduction to classical and behavioral finance*. Springer.
- Hicks, J (1939). *Value and Capital*. Clarendon Press, Oxford.
- Hopwood, Anthony G (1983). “On trying to study accounting in the contexts in which it operates”. *Accounting, Organizations and Society* 8, 2/3: 287–305.
- (1987). “The archaeology of accounting systems”. *Accounting Organizations and Society* 12, 3: 207–234.
- Hoskin, K W and R H Macve (1986). “Accounting and the examination: A genealogy of disciplinary power”. *Accounting Organizations and Society* 11: 105–136.
- (1988). “The genesis of accountability: The West Point connections”. *Accounting Organizations and Society* 13: 37–74.
- IAS 19 (1983). *Accounting for Retirement Benefits in the Financial Statements of Employers*. International Accounting Standards Committee.
- (1998). *Employee Benefit Costs*. International Accounting Standards Committee.
- IAS 37 (1998). *Provisions, Contingent Liabilities and Contingent Assets*. International Accounting Standards Board.
- IAS 39 (1998). *IAS 39, Financial Instruments: Recognition and Measurement*. International Accounting Standards Board.
- IASB (2010). “Exposure Draft Snapshot: IAS 37 Replacement”. Technical report, IASB.
- IASB Round-Table Discussions (2006). *IAS 37 Round-table Discussions: Summary of outcomes*. International Accounting Standards Board.
- IASB Staff Paper, April (2010). *Recognising liabilities arising from lawsuits*. IASB Project Team.
- IASB (1997). *Accounting for Financial Assets and Financial Liabilities*. International Accounting Standards Committee. Staff discussion paper, Steering Committee on Financial Instruments.
- IFRS 9 (2009). *Financial Instruments (replacement of IAS 39)*. International Accounting Standards Board.
- Journal of Accountancy (1998). *Damn the Torpedoes — Full Speed Ahead on Derivatives*.

- Kakkuri-Knuuttila, M, K Lukka, and J Kuorikoski (2008). “Straddling between paradigms: A naturalistic philosophical case study on interpretive research in management accounting.” *Accounting Organizations and Society* 33, 2–3: 267–291.
- Laux, C and C Leuz (2009). “The Crisis of Fair Value Accounting: Making Sense of the Recent Debate”. *Accounting Organizations and Society* 34, 6–7: 826–834.
- Lewis, David (1973). *Philosophical Papers*, Oxford, Blackwell.
- Lowe, E A, A G Puxty, and R C Laughlin (1983). “Simple theories for complex processes: accounting policy and the market for myopia”. *Journal of Accounting and Public Policy* 2: 19–42.
- Lukka, Karri and Sven Modell (2010). “Validation in interpretive management accounting research”. *Accounting, Organizations and Society* 35: 462–477.
- Mackie, John (1974). *The Cement of the Universe*. Oxford: Clarendon Press.
- Macve, Richard (1997). *A conceptual framework for financial accounting and reporting: Vision, tool or threat?* Garland Publishing Inc.
- Mahoney, J (2000). “Path Dependence in Historical Sociology”. *Theory and Society* 29, 4: 507–548.
- McGill, D M, K M Brown, J J Haley, and S J Schieber (2004). *Fundamentals of Private Pensions*. Oxford University Press.
- McGregor, Warren (1999). “An Insider’s View of the Current State and Future Direction of International Accounting Standard Setting”. *Accounting Horizons* 13, 2: 159–168.
- Miller, P and C Napier (1993). “Genealogies of Calculation”. *Accounting, Organizations and Society* 18, 7-8: 631–48.
- Miller, Peter (1991). “Accounting Innovation beyond the enterprise: problematizing investment decisions and programming economic growth in the U.K. in the 1960s”. *Accounting, Organizations and Society* 16, 8: 733–762.
- Millo, Yuval and Donald Mackenzie (2003). “Constructing a Market, Performing Theory: The Historical Sociology of a Financial Derivatives Market”. *American Journal of Sociology* 109: 107–145.
- Morgan, Mary (1990). *The History of Econometric Ideas*. Cambridge University Press.
- Muth, J F (1961). “Rational expectations and the theory of price movements”. *Econometrica* .
- Napier, Christopher J (2009). “The Logic of Pension Accounting, Institute of Chartered Accountants in England and Wales: Information for Better Markets Conference, London, 15-16 December 2008”. *Accounting and Business Research* 39, 3: 231–249.
- Padgett, John F and Walter W Powell (2013). *The Problem of Emergence*. Princeton University Press.
- Paish, F (1940). “Capital Value and Income”. *Economica* 17, 28: 416–418.

- Perry, James and Andreas Nölke (2006). “The political economy of International Accounting Standards”. *Review of International Political Economy* 13, 4: 559–586.
- Pierson, Paul (2000). “Increasing returns, path dependence and the study of politics”. *The American Political Science Review* 94, 2: 251–266.
- (2004). *Politics in time: history, institutions, and social analysis*. Princeton University Press.
- Pong, Christopher and Geoffrey Whittington (1996). “The Withdrawal of Current Cost Accounting in the United Kingdom: A Study of the Accounting Standards Committee”. *Abacus* 32, 1: 30–53.
- Posner, Elliot (2010). “Sequence as explanation: The international politics of accounting standards”. *Review of International Political Economy* 17, 4: 639–664.
- Power, M (1992). “The politics of brand accounting”. *European Accounting Review* 1, 1: 36–53.
- Power, Michael (2009). “Financial Accounting without a State”. In David Cooper Christopher Chapman and Peter Miller, eds., *Accounting, Organizations, and Institutions: Essays in Honour of Anthony Hopwood*, Oxford University Press.
- (2010). “Fair value accounting, financial economics and the transformation of reliability”. *Accounting and Business Research* 40, 3: 197–210. P D Leake Lecture, Institute of Chartered Accountants in England and Wales.
- Puxty, A G, Hugh C Willmott, David J Cooper, and Tony Lowe (1987). “Modes of regulation in advanced capitalism: locating accountancy in four countries”. *Accounting Organizations and Society* 12, 3: 273–291.
- Rees, Henry (2006). “The IASB’s Proposed Amendments to IAS 37”. *Accounting in Europe* 3: 28–34.
- Rees, Lynn L and David Stott (1998). “The Value-Relevance of Stock-Based Employee Compensation Disclosures”. *Unpublished working paper, SSRN* .
- Richardson, Alan J (2009). “Regulatory networks for accounting and auditing standards: A social network analysis of Canadian and international standard-setting”. *Accounting Organizations and Society* 34: 571–588.
- Richardson, Alan J and Burkard Eberlein (2010). “Legitimizing transnational standard-setting: The case of the International Accounting Standards Board”. *Journal of Business Ethics* 98: 217–245.
- Robson, Keith, Hugh Willmott, David Cooper, and Tony Puxty (1994). “The ideology of professional regulation and the markets for accounting labour: three episodes in the recent history of the U.K. accountancy profession”. *Accounting Organizations and Society* 19, 6: 527–553.
- Ryle, Gilbert (1968). “Thinking and Reflecting”. In *Royal Institute Philosophy Lectures*. Cambridge Journals, volume 1, pp. 210–226.
- Sapra, Haresh and Hyun Song Shin (2004). “How will derivatives reporting standards affect risk management practices?” Unpublished research paper.

- Scapens, Robert W and J Timothy Sale (1981). "Performance measurement and formal capital expenditure controls in dividionalised companies". *Journal of Business Finance and Accounting* 8, 3: 389–419.
- Senate Banking Committee, October 9th (1997). *Oversight Hearing on the Financial Accounting Standards Board and its Proposed Derivatives Accounting Standard*. US Senate Banking, Housing and Urban Affairs Committee.
- Shin, Hyun Song, ed. (2004). *Derivatives Accounting and Risk Management*. Risk Books.
- Shleifer, Andrei (2000). *Inefficient Markets: An Introduction to Behavioral Finance (Clarendon Lectures in Economics)*. Oxford University Press.
- Simmonds, Andy. ICAEW weblog. <http://www.ion.icaew.com/FinancialReporting/19258> (2010). *Has IASB attempted a bridge too far?*
- Skinner, Douglas J (1996). "Are disclosures about bank derivatives and employee stock options 'value-relevant'?" *Journal of Accounting and Economics* 22, 1–3: 393–405.
- SSAP 24 (1988). *Statement of Standard Accounting Practice 24: Accounting for Pension Costs*. Accounting Standards Committee.
- Sugden, Robert (1991). "A survey of contributions from economics and philosophy". *Economic Journal* 101, 407: 751–785.
- Sutton, Timothy G (1984). "Lobbying of accounting standard-setting bodies in the U.K. and the U.S.A.: A downsian analysis". *Accounting Organizations and Society* 9, 1: 88–95.
- The Economist, December 8th (1990). *Schools Brief: Unlocking corporate finance*.
- The Economist, Historical Archive: 1843–2009 (2013). Technical report.
- The Economist, October 20th (1990). *Three pioneers of finance*. The Economist.
- Tinker, Anthony M, Barbara D Merino, and Marilyn Neimark (1982). "The normative origins of positive theories: Ideology and accounting thought". *Accounting, Organizations and Society* 7: 167–200.
- Todisco, Frank (2005). "A Reevaluation of ASOP 27, Post-Enron: Is It an Adequate Standard of Professionalism?" *The Pension Forum (Society of Actuaries)* 16, 1: 1–18.
- Tversky, A and D Kahneman (1986). "Rational choice and the framing of decisions". *Journal of Business* 59: S251–78.
- Van Fraassen, Bas C (1980). *The Scientific Image*. Clarendon Press, Oxford.
- Walker, Martin (2004). "Recovering accounting: an economic perspective". *Critical Perspectives on Accounting* 15: 519–527.
- Wall Street Journal, Elizabeth MacDonald, August 7th (1998). *U.S. Firms to Report Value of Derivatives*.
- Walton, Peter (2004). "IAS 39: Where Different Accounting Models Collide". *Accounting in Europe* 1: 5–16.

- Wang, Li, Pervaiz Alam, and Stephen Makar (2005). “The Value-Relevance of Derivative Disclosures by Commercial Banks” A Comprehensive Study of Information Content Under SFAS Nos. 119 and 133”. *Review of Quantitative Finance and Accounting* 25, 4: 413–427.
- Watts, R L and J L Zimmerman (1978). “Towards a positive theory of the determination of accounting standards”. *The Accounting Review* 53: 112–134.
- Watts, Ross L and Jerold L Zimmerman (1979). “The Demand for and Supply of Accounting Theories: The Market for Excuses”. *The Accounting Review* 54, 2: 273–305.
- Weber, Max (1978). *Economy and Society: an outline interpretive sociology*, Berkeley: University of California Press, chapter The Nature of Social Action, pp. 7–32. Number 1.
- Willmott, Hugh C, Anthony G Puxty, Keith Robson, David J Cooper, and E Anthony Lowe (1992). “Regulation of Accountancy and Accountants: A comparative analysis of accounting for research and development in four advanced capitalist countries”. *Accounting, Auditing and Accountability Journal* 5, 2: 32–56.
- Woodward, J (2003). *Making things happen*. Oxford/New York: Oxford University Press.
- World Bank (1998). “East Asia: the road to recovery”. Technical report, Washington DC.
- Young, Joni J (1994). “Outling regulatory space: Agenda issues and the FASB”. *Accounting Organizations and Society* 19, 1: 83–109.
- (1996). “Institutional thinking: the case of financial instruments”. *Accounting Organizations and Society* 21, 5: 487–512.
- (2014). “Separating the Political and Technical: Accounting Standard-Setting and Purification”. *Contemporary Accounting Research* online.
- Zeff, Stephen A (1999). “The Evolution of the Conceptual Framework for Business Enterprises in the United States”. *Accounting Historians Journal* 26, 2.
- (2002). ““Political” lobbying on proposed standards: a challenge to the IASB”. *Accounting Horizons* 16, 1: 43–54.
- (2005). “The Evolution of US GAAP: The Political Forces Behind Professional Standards”. *CPA Journal* .
- (2007). “The SEC rules historical cost accounting: 1934 to the 1970s”. *Accounting and Business Research* Special Issue: International Accounting Policy Forum: 49–62.