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Title	The Politics of Global Governance: Examining the Formation of International Accounting Standards
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Citation	新世代法政策学研究, 2, 207-231
Issue Date	2009-07
Doc URL	<a href="https://hdl.handle.net/2115/43676">https://hdl.handle.net/2115/43676</a>
Type	other
File Information	2_207-231.pdf



## The Politics of Global Governance: Examining the Formation of International Accounting Standards

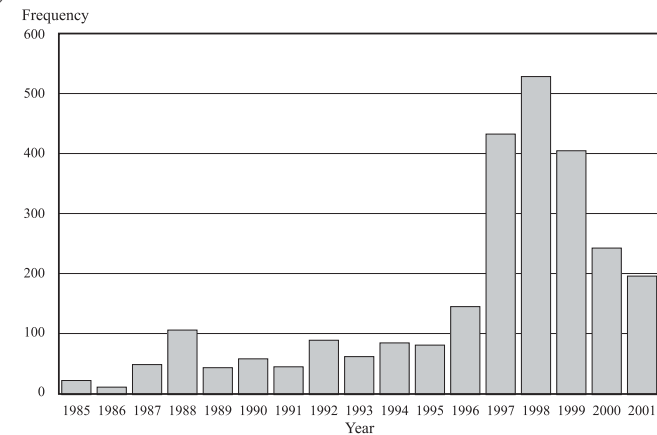
Ken ENDO

### 1. Introduction: The Age of Global Standards

#### The Impact of International Standards

Let us start with Chart 1, which shows that the term “global standard” suddenly came into popular use in Japan towards the end of the 1990s. This development paralleled the acceleration and deepening of the process of globalisation.

**Chart 1:** Frequency of Appearance of “International Standard” and “Global Standard” in Four Major Japanese Newspapers (Asahi, Yomiuri, Mainichi, Nikkei) 1985-2001



Source: Compiled by Nihon University Population Research Institute

We simply cannot take an indifferent stance toward international standards and regulations. The main reason lies elsewhere than the media saga. In fact, standardisation and the regulations have an immense impact. According to an OECD Report published in 1999 (OECD 1999, p. 4), 80 percent of world trade, which is equivalent to approximately \$4 trillion per year, is affected by those standards and related regulations.

Needless to say, this impact reflects the influence that standards have on a wide scope of economic and other human activities. Traditionally, the range of standards has extended from the establishment of standard units of measurement (e.g., the metric system) through units of time (e.g. Greenwich Mean Time) to specifications regulating currencies and tangible goods (e.g., the dimensions and strength of screws) (Spruyt 2000; cf. Quester 1997). In the contemporary world, standards are closely related to the establishment of specifications and regulations that take very diverse forms, such as Internet communication protocols, lists of parts and components that may be used in weapons of mass destruction, and regulatory codes pertaining to genetically-modified agricultural products. In addition to these, there are certain treaties and agreements as to human rights that are widely accepted as norms. Including these, standards virtually cover every aspect of our lives.

With the increasingly unobstructed and speedy transnational movement of goods, people, money and information, standards have also become subject to the pressures of globalisation. This is because national and regional differences in standard units and regulations can be the source of great inconvenience. Trade is obstructed where there is no common understanding on the definitions and standards of quality of goods. Likewise, international investment would be obstructed if financial and equity markets did not satisfy certain standards. The same can be said of electronic and communication equipment for the transmission and receiving of email and facsimile messages. The smooth movement of people is likewise predicated on the mutual acceptance of passport containing a set of standardised information. In other words, globalisation tends to require parallel institutional progress, including the formation of standards.

However, the standard-setting process is neither one-directional nor automatic. The formation of international standards, while backed up by the pressures of globalisation, is made possible when the interests of the principal actors converge. A wide range of actors participates in this formation process: for example, empires and major states, international organisations, civil societies, businesses and experts. The entire process presents itself as a classical case of the management (global governance) of transnational phenomena.

This article is intended to facilitate the understanding of global governance, in particular the formation of global standards. In the following passages, it first will review the formation of international standards and will present an image of global governance by drawing on various real examples and cases. Particular attention will be paid to the following questions: What are international standards? Who creates international standards and how? Then, these questions will be examined using international accounting standards as an example. An examination of this field will provide us with a glimpse of “really existing globalisation” and of process of forming a set of global standards.

## 2. What Are Standards? Definitions and Classifications

### Definitions

How can we define “standard” and “standardisation?” The word “standard” comes from the old French word “estandard,” which was used in reference to a gathering place for military forces or a marker indicating such a place. From this usage the word evolved to denote a clearly perceived goal, then further shifted to mean the rules or basis upon which decisions are made. When denoting “standard” and “standardisation” in modern French, the more commonly used terms are “norm” and “normalisation.” These are terms derived from standards of measurement used by carpenters in past ages (Nara, 2004, pp. 20-21).

For a generally accepted definition of standard, we can turn to the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC), which define standards as a

“document, established by consensus and approved by a recognised body, that provides, for common and repeated use, rules, guidelines or characteristics for activities or their results, aimed at the achievement of the optimum degree of order in a given context” (ISO/IEC 2004, Section 3.1).

There are various factors at play in this definition, including the concepts of “approval,” “commonality” and “repeated use.” In this context, standards serve the purpose of achieving the “optimum degree of order” and constitute meaningful rules that must be conformed to. In many instances, standards go hand-in-hand with “regulations.” International and global standards refer to standards that are endowed with these characteristics, and which are formed, applied and exert their influence across national borders.

### Three Types of Standardisation

The ISO/IEC definition cited above refers to what is called a *de jure* standard, usually a written standard with a normative standing. A *de jure* standard differs from a *de facto* standard that has emerged victorious from the competitive processes of the market. For instance, the international accounting standards that are discussed below are an example of the former, while Microsoft Windows serves as a classic example of the latter.

This differentiation was further refined by W. Mattli (Mattli 2003 and 2006), who proposes the following three models of standardisation:

1. Standardisation via the market
2. Private-sector standardisation and governance
3. Public-sector standardisation and governance

The first category can be viewed to be equivalent to *de facto* standards. The second category refers to standards formed and applied by industry associations, private institutions and networks. ISO and IEC fall in this category of associations and networks, as does the International Accounting Standards Board (IASB) discussed below. While these are private-sector organisations and institutions, in many instances they per-

form a “public” function of forming and establishing standards. As such, they cannot be referred to as purely “private” in character. For instance, ISO contains 186 technical committees, 576 subcommittees and 2057 working groups. Every year, 30,000 to 100,000 experts participate in its functions. ISO reports that, as of the end of 2001, it had established 13,500 standards. Similarly, IEC has established 4,800 standards. It has been estimated that the two organisations account for 58 percent of all international standards (Mattli 2003, pp. 215-216).

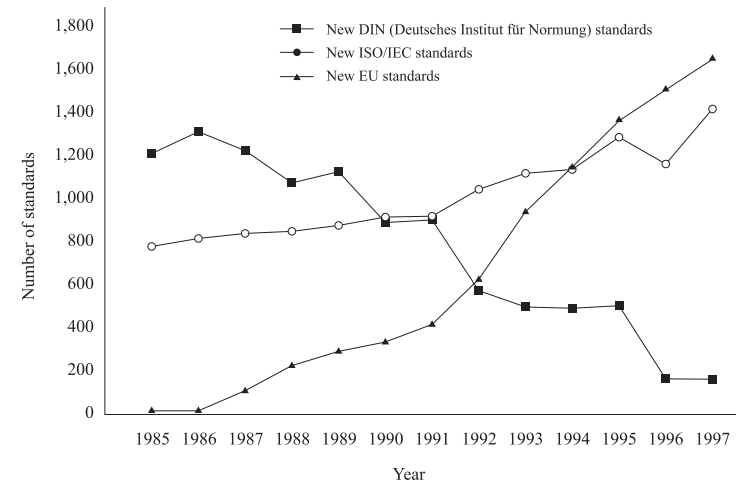
The third category covers the standards established by public and governmental organisations, such as the United Nations, OECD, WTO, the European Union and the governments of individual countries. While the United States exhibits a strong preference for self-regulation by industry associations, of its total of 103,500 standards, approximately one-half or 52,500 are government standards. Among these, the Department of Defence (Pentagon) accounts for 38,000 standards, making it the largest single standards-setting institution (Mattli 2003, p. 209). On an international level, the WTO created in 1995 applies the provisions of the Agreement on Technical Barriers to Trade (TBT) concluded in the GATT Uruguay Round in 1994 to all its member countries. The TBT Agreement mandates the application of international standards by stating, “Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations.” (Article 2-4) Any member state that does not adopt an existing international standard is obligated to explain and justify its course of action. If the explanation is found to be unjustified, the national standard is presumed to constitute an unnecessary obstacle to international trade. In the case of Europe, since the mid-1980s, the EC or later EU has emerged as the regional regulator in parallel to the development of an integrated regional market, resulting in a dramatic increase in the application of EU standards. As this indicates, public and governmental organisations are deeply involved in the formation of standards on the international, regional and national levels.

**Table 1:** Examples of Forums of Governance in Standard-Setting and Regulation

Arena/Actor Level	Private Sector		Public Sector
	Market	Organisations	Government/public organisations
International level	↑ ----- ↓	International Organization for Standardisation (ISO), International Electrotechnical Commission (IEC), International Accounting Standards Board (IASB)	World Trade Organisation (WTO), World Health Organisation (WHO), International Atomic Energy Agency (IAEA)
Regional level		European Committee for Standardisation (CEN), Pacific Area Standards Congress (PASC)	European Commission
National level		American Society of Mechanical Engineers (ASME), Japanese Industrial Standards Committee (JIS)	Government, such as Japan's Ministry of Economy, Trade and Industry (Standards Certification Unit)
Local level		Local markets	State-level U.S. builders associations (self-regulating codes)

Table 1 presents examples of arenas/actors of standardisation and regulation on the global through local levels as classified according to the three models of standardisation. Chart 2, as below, traces the rise of international and EU standards in recent years.

**Chart 2:** Recent Trends in International Standards, EU Standards and German National Standards



Source: Mattli 2003, p. 200

**Governance through the Establishment of International Standards**

Of particular interest in Mattli's exposition is the argument that, in light of the characteristics of standardisation in the contemporary world and the rapid growth in governance by private-sector organisations, joint public-private governance systems can emerge once the necessary institutional framework is in place (Mattli 2003 and 2006). This argument may be summarised as follows.

The first model of standardisation, which involves the formation of standards through competition among companies, has the advantage of being able to create standards that meet market needs in a very swift and timely fashion. On the other hand, this model can result in endless competition in the establishment of standards and the expenditure of vast amounts of money for R&D and other purposes. Consequently, this model carries large risks for companies. This model has various other problems as well: under conditions of imperfect information, the market may

support sub-optimal technologies; the vast amounts of money needed in standards competition may encourage cartel activities; and, the outcome may not reflect the interests of various societal actors, such as consumers and environmental groups.

The third model of *de jure* standards established by governments and international organisations stands in stark contrast to the first model. In comparison to others, the standards created under the third model can generally be characterised as being fair, open and endowed with legitimacy. The second model also has the advantage of being able to regulate the standards proposed by industries from such perspectives as safety and environmental protection. On the other hand, the third model has trouble keeping up with the speed of change in the market. In this age of accelerated technological change and innovation, this represents a major drawback and weakness.

By comparison, the second model, featuring private organisations and networks, can to a certain extent take advantage of the flexibility and speed of the first model, because it is led by the private sector involving experts with specialised knowledge. Moreover, the main actors here are industry associations and networks instead of individual companies. This tends to generate a certain degree of neutrality and facilitate the assembling of supporters. The implication is that market share can be obtained at a relatively low cost. When consensus is reached on a proposed rule, the path to standardisation could be very quick. This tendency is particularly strong in the United States where government intervention in the standardisation process is viewed with scepticism.

On the other hand, standards established under the second model face certain problems of their own. First of all, it is not easy to maintain an adequate level of authority and legitimacy in private-sector standards. Standards that are expensive to implement (e.g., safety standards) must be continuously monitored for compliance and violations. Furthermore, private-sector standards can lead to the distortion of market competition when industry associations are acting in their own self-interest. Finally, the question remains of how to properly reflect the perspective of consumers and the environment in such standards. The public sector is in a

more advantageous position with regard to these specific problems because it is relatively easier for the third model to ensure fairness, openness and legitimacy.

It is in this context that joint public-private governance systems may well be effective and useful. It can provide these advantages of fairness, openness and legitimacy, while also ensuring speed and access to expert knowledge. Typically, governments and international organisations would support the standards established by transnational private-sector organisations and contribute to improving the effectiveness of the standards through surveillance of violations and infringements. Alternatively, by subsuming the perspective of societal actors (e.g., consumers and environmental organisations), governments and international organisations could bolster the legitimacy of such standards.

### **The Intensity of Standards**

As we have seen, the process of standardisation is ongoing on all levels from the local to the global, and standards are being established by a wide variety of entities and forums, which include the market, private organisations and public and governmental organisations.

It should be noted that the standards thus established are not applied at the same level of intensity. At one end of the scale, there are binding standards with penalties for non-compliance. For instance, penal codes, namely a bundle of standards that relate to crimes and punishments, represent the highest level of intensity in standards. These penal codes are predominantly established on a national level and their effectiveness is ensured by the powers of the state. On the other end, some standards are little more than a list of things to keep in mind. Examples of the lower intensity standards can be found in the areas of labour standards, water quality control and, in some cases, bio-ethics. Moreover, there are some standards with very weak binding power. For instance, the EU has established poverty indicators for use in its social programs. These indicators merely provide a common (standardised) metric for the list of data to be monitored, eventually subject to peer reviews amongst the member states (the so-called ‘open method of coordination’).

### 3. The Power to Standardize

#### Who Creates Standards and How?

An examination of the phenomenon of standard-setting must certainly contain the question of who creates standards and how. In other words, the fact that standardisation, though pressurised by certain economic and functional necessities leads us to a series of questions: By whom and where are these necessities evaluated? What criteria are applied in this evaluation? How is the decision made on how far to go? These questions outline a quintessentially *political* arena of debate characterised by both cooperation and conflict.

It is in this context that the power to standardize can be commented on. Should a standard be established or not? If yes, by whom and in what forum? What framework of values should be employed in the process of standardisation? To what degree should the standard be binding? Because all these matters have major economic and social impacts, they often emerge as points of contention and conflict. Hence, decisions on standardisation and access to the decision-making process constitute a form of real power and authority.

The same applies to international standards. There is little doubt that, parallel to the process of globalisation, there is a tendency for standards to be formed and applied across national borders. Nevertheless, there is nothing automatic about this process. Rather, the process starts with the presence of actors (companies, nations, etc.) in the global arena who wish to establish new standards. What results from such initiatives will benefit certain groups while working to the detriment of others. The formation of standards in the global arena is influenced by the power relations among such groups, the size of the market and market shares, normative and conceptual attractiveness of the proposed standards, as well as their economic rationale and perceived necessity.

#### The Power of Empire and Great Powers

Empire, great powers, international organisations, influential companies, and non-governmental organisations will act to promote the for-

mation of an international standard when such a standard conforms to their best interests and ideals, and they will do so in a manner that best fits their interests. Conversely, when a standard runs counter to their interests, such actors will agitate to abrogate the standards and seek out new paths. An international standard is formed when powerful entities cooperate in the promotion of such a standard.

Particularly important is the stance taken by the governments of the United States and Europe. Needless to say, the United States is a leading actor in the formation of international standards. Its position is buttressed by its hard power, consisting of military and economic might, as well as its soft power, as represented by its institutions of higher learning and the English language as *lingua franca*. As for Europe, it has been steadily expanding its influence in the area of standards and regulations through the EU framework. (See Suzuki 2006 for characterisation of the EU as “regulatory empire.”) As of 2003, both the US and the EU boasted GDPs in excess of \$10 trillion, making each of them more than double the size of Japan, which places third in economic size. In combination, the two economies account for roughly 40 percent of global output and trade. Foreign direct investment (FDI) bound for these two economies accounts for 59 percent of total global FDI, while the two economies account for 78 percent of total outgoing FDI. Finally, the United States and the EU account for 88 percent of total global M&A (Drezner 2007, p. 36).

Whenever these two entities are willing to cooperate, rapid progress can be made in the formation of international standards. Conversely, the outcome is very different where the interests of these entities are in conflict. Either the formation of international standards is effectively blocked, or two variant sets of transnational standards come into being. Cooperation between the United States and Europe played a critical role in the globalisation of accounting standards, which will be discussed in detail below. Although not discussed in this paper, an example of conflict can be found in the case of genetically modified organisms where the ways of thinking of the US and the EU were diametrically opposed to each other. This conflict has led to two sets of standards. One originates in the US, which has adopted a tolerant stance, while the EU standard opts for re-

striction.

### **The Power of the Private Sector**

Power does not solely reside in nations and governments. Private organisations, companies and industry associations can also influence the formation of a standard. The participation of such private-sector entities lends its own dynamism to the standard-setting process. As will be seen in the example of accounting standards and environmental regulations for the automobile industry (Shiroyama 2005), private-sector entities play a role that cannot be ignored.

Their influence can take various forms. First of all, private-sector organisations can cooperate with governments in the creation of joint public-private sector governance systems. Secondly, these organisations can oppose and derail government initiatives. There are various other options between cooperation and opposition. For instance, the private sector can support, bypass, or resist government's initiative. In so doing, the response of the private sector will influence the standard-setting process in many cases. Therefore, it is necessary to take into consideration the interests and actions of both the private and public sectors.

### **“Forum Shopping” and Institutionalisation**

The principal actors that are in a position to exert influence over the setting of a standard will carefully consider the choice of forum and intensity of standardisation that matches their own interests. When the forum and intensity of international standardisation match their interests, the principal actors will support the process. Conversely, if these choices conflict with their interests, the principal actors will openly oppose the choices, switch to bilateral negotiations or simply create a different forum for the purpose. This behaviour is referred to as “forum shopping” (Braithwaite and Drahos 2000, Ch. 24; Drezner 2007, Ch. 3).

When endowed with sufficient power, these principal actors will attempt to influence the choice of standardisation format, which includes such options as delegation to market forces or private-sector organisations and direct standardisation by international organisations. Such

choices also extend to the intensity of standards and regulations. Sufficiently powerful entities will attempt to influence these decisions as well, making this an important aspect of the standard-setting process. A very key element in the globalisation of accounting standards was the agreement reached between the United States and Europe to use a joint public-private sector forum for this purpose. An opposite case can be found in the case of establishing the International Criminal Court, where the US and the EU have not been able to agree on the choice of forum and level. In this case, the EU has advocated the use of the ICC as a central forum in the globalisation of criminal trials. However, the Bush Administration opposed the use of international criminal courts that would have a binding impact on domestic procedures. Instead, the US indicated a preference for region-specific ad hoc international courts and “mixed courts” consisting of only slightly internationalised domestic courts (See Kawashima 2008).

However, it would be wrong to conclude that all decisions are made by the United States and Europe. In reality, there is ample room for competition from other leading countries and regional alliances. For instance, given its rapidly growing domestic markets, China starts to realize the importance of international standards (Sakamura 2005, p. 6). Another notable example can be observed in the standardisation of electronic tags, a process that has proceeded under the influence of a global private network (‘EPC Global’) based in the US and Europe. However, the actual electronic tags are manufactured in East Asia. This has apparently encouraged the establishment of manufacturers’ associations in East Asia, which are trying to counteract the dominant position of the US and Europe backed by such major consumers as the military and retail industry complex (e.g. Pentagon and Walmart). Yet another possibility is to control Western dominance through international organisations and their institutional processes. An example of this is seen in the conflict of interest involving public health and intellectual property in coping with HIV/AIDS. To give precedence to the distribution of medication at affordable prices over the protection of intellectual property rights, Brazil and various other developing countries and the NGOs were able to in-

clude the perspective of public health in the WTO Treaty. While Western governments and major pharmaceutical companies have been mounting a counterattack, the fact remains that certain restrictions have been imposed on intellectual property rights (Drezner 2007, Ch. 7).

#### **4. How Are Standards Formed? The Case of International Accounting Standards**

In this section, the process of the formation of international accounting standards is examined as an example of global governance. The picture that emerges from this case of globalisation is one of leadership by the United States and Europe, the utilisation of multiple forums and the emergence of a system for joint public-private sector governance.

##### **Multiple Forums for Accounting Standards**

As a starting point, it is important to realize that multiple forums have been competing against each other in the formation of accounting standards. It may come as a surprise that the United Nations was one of them. Its involvement in this area began in the mid-1970s with meetings of experts to discuss the harmonisation of financial statements. The United Nations has never actually ceded its aspirations in this domain. The OECD provided a second forum when it began to consider guidelines for the regulation of multinational corporations during the 1970s. In 1986, the OECD began the publication of its Accounting Standards Harmonization Series. The EEC and EC (predecessors to the EU) were working to promote harmonisation in accounting standards by the early 1960s. These efforts culminated in Directive No. 4 of 1978 and Directive No. 7 of 1983, which defined certain obligations related to financial statements and financial reporting.

In addition to the forums provided by these public and international organisations, the International Accounting Standards Committee (IASC) was established in 1973 as a private-sector organisation. IASC grew out of accountant associations in the United Kingdom, the United States and Canada and was originally founded by 16 accountant associations in nine

countries (UK, US, Canada, Australia, the Netherlands, Germany, France, Japan, Mexico) for the purpose of the harmonisation of accounting standards and financial statements. In the following year, IASC started formulating the International Accounting Standards (IAS). Thereafter, it gradually grew in membership and international presence, while also accumulating expert knowledge and information. The adoption of any new international accounting standard required the support of three-fourths of the membership. As a result, it took an average of two years to formulate each standard. Moreover, these standards were not compulsory and were subject to numerous exceptions and exemptions. (Mattli 2006)

Two factors were instrumental in changing this situation. The first was the force of globalisation. The second was the course of action taken by the US and the EU in response to globalisation.

##### **Transnational Movement of Capital and the Heightened Need for International Accounting Standards**

Globalisation takes many forms, and one common form presents itself in the rapid increase in the number of companies listing their stocks on overseas exchanges and procuring funds from overseas sources. The New York Stock Exchange provides a good example. The percentage of non-US companies in all companies listed on the New York Stock Exchange has doubled from 8.5 percent in 1994 to 17 percent in 2003. Investment funds are increasingly attracted to companies with promising outlooks and excellent assets regardless of their location. During the early 1970s, foreign exchange transactions for the entire world amounted to about \$18 billion per day. By 1998, this figure had increased dramatically to reach \$1.5 trillion per day. Even assuming that 85 percent of these transactions represented short-term and speculative capital movements, there can be no doubt that investing in foreign countries has become far easier than in the past.

For functional reasons, this form of globalisation will unavoidably generate a need for standardisation in accounting practices and financial statements. Comparability and reliability of financial statements is an

essential requirement in making decisions on whether foreign companies should be listed on domestic exchanges. Moreover, from the perspective of investors, comparability and reliability contribute to the reduction of investment risks.

The Asian currency crisis of 1997 served as a painful reminder of such risks. It was after this crisis that the financial statements of Japanese companies began to bear the disclaimer ('legend') that Japanese accounting standards differed from international standards. In the following year, the currency crisis spread to Russia and subsequently led to the failure of LTCM (Long-Term Capital Management), which very nearly triggered a systemic crisis. This was followed by the collapse of Enron Corporation in 2001 and WorldCom in 2003 when accounting irregularities were uncovered at these giant corporations. This series of events focused renewed attention on the quality and standardisation of accounting practices and financial statements.

However, it should be noted that the integration and convergence of international accounting standards did not come about automatically as a result of functional necessity and these events. The key to standardisation lies in the hands of the principal actors.

### **The Establishment of the "IASB-IOSCO Regime"**

An important first step was taken when the International Organization of Securities Commissions (IOSCO) gradually began to support the formation and adoption of International Accounting Standards (IAS). IOSCO was founded in 1986 under US leadership and originated in the Council of Securities Regulators of the Americas that had been created through the initiative of the US Securities and Exchange Commission (SEC). IOSCO took form when the UK and France joined the earlier initiative. Today, IOSCO stands as a full-fledged international organisation with a membership of 109 national and regional securities regulators (such as the SEC and Japan's Financial Services Agency) and securities exchanges. Its regulations extend to 90 percent of the world financial and securities markets. In 1988, IOSCO began to actively support IAS revisions. By 1993, it was promoting the formulation of the IAS core stan-

dards, which were completed by IASC in 1999. In the following year, IOSCO formally approved the IAS core standards. Thus, what started as an association of accountants (IASC) came effectively to be utilised as a de facto wing of IOSCO dedicated to the forming of accounting standards. Subsequently, with IOSCO's seal of approval, IAS emerged as *the* international standards in the accounting field.

In the next important step, IASC underwent reorganisation culminating in the establishment of the International Accounting Standards Board (IASB) as a transnational private-sector regulatory organisation in 2001. Here again, IOSCO was instrumental in the reorganisation. While IASC was committed to the "harmonisation" of accounting standards, IASB clearly advocates the "development of a single set of international accounting standards." As such, IASB is committed to the convergence of standards through the newly formulated International Financial Reporting Standards (IFRS). At the same time, IASB is an entity that clearly is under US and UK (or Anglo-Saxon) leadership in terms of both organisation and philosophy. In terms of organisation, IASB was founded with a total of 14 trustees, including two external trustees. Of these 14 trustees, ten were from the so-called Anglo-Saxon countries of the US, the UK, Canada, Australia and South Africa. (Note that the adoption of an IFRS required a minimum of eight supporting votes out of 14.) Systems of accounting governance in continental Europe (as well as Japan) tend to be government-centred because of their close relation to the tax system and to existing legal structures. On the other hand, accounting governance in the US and the UK is closely tied to securities investment and is private-sector led. Reflecting this tendency, US and UK accounting standards are formulated in the private sector. IASB conforms to this pattern of private-sector leadership. (IASB was patterned after the Financial Accounting Standards Board [FASB], a US private organisation.) Furthermore, in terms of philosophy, IASB has a tendency to emphasize changes in assets and liabilities, which are of particular interest to investors. This is underscored by its preference for mark-to-market accounting over cost accounting. This preference also reflects contemporary US practices and policies (Murai 2003, p. 35).

As we have seen, IASB emerged as the result of the long-term support of IOSCO. Given the obvious strategic and reciprocal relations that exist between the two organisations, the outcome can be referred to as the “IASB-IOSCO regime” (Oguri 2003, p. 14). The emergence of this framework implies that the previously mentioned forums of the United Nations, OECD and the EU have been effectively bypassed, and that IASB as a transnational private-sector organisation has come to wield the greatest influence over the formation of international accounting standards. Moreover, because IOSCO is centred on the securities regulating authorities of member countries, this framework can be said to be clearly oriented towards a joint public-private system of governance.

### **An EU-Led Big Bang in Accounting Standards**

However, the story does not end here. In the eyes of the European Commission, differences in accounting standards have always constituted an obstacle to economic integration. Consequently, in June 2000, the European Commission formally proposed the enforcement of IAS/IFRS international accounting standards on businesses operating in the EU region. Thereafter, pertinent rules were defined in July 2002 and the standards became applicable in January 2005. As a result of this action, all companies listed on EU stock exchanges were obligated to disclose their financial statements in accordance with the provisions of IAS/IFRS. This again represents a form of joint public-private system of governance in that the EU (a public organisation) has adopted and is monitoring compliance with the standards established by IASB (a private organisation).

The EU decision has far-reaching ramifications because it is applicable regardless of nationality. The decision not only affects the 7,000 companies that are listed in the EU region, but also extends to their subsidiaries. Consequently, some 100,000 companies in total were affected by the decision. It is notable that only 275 companies had adopted IFRS prior to 2005 (Takashi Hashimoto 2007, p. 109).

Following this decision, some Japanese companies actually opted to delist themselves from European exchanges. However, this tactic did not

really allow these companies to avoid the influence of international accounting standards. This is because the United States quickly realigned its strategies in response to EU actions and ultimately decided to cooperate with Europe. This effectively accelerated the global application of IFRS.

In September 2002, IASB and FASB met at FASB headquarters located in Norfolk, Connecticut. The meeting closed with an agreement in principle (Norfolk Agreement) on the convergence of US and international accounting standards (Yamada 2003). Subsequent to this agreement, progress was seen in a number of ongoing formal and informal consultations. Currently, IASB and FASB are engaged in a joint project for harmonizing their conceptual frameworks aimed at promoting the convergence of their standards (Kobori 2007).

During 2003 and 2004, the European Commission issued two directives on accounting (“Prospectus Directive” and “Transparency Directive”). Under these directives, countries were divided into those that have adopted IFRS and others. From the perspective of the protection of investors, countries maintaining their own accounting standards (e.g., Japan, the US, Canada) were made subject to “equivalence assessment.” What this means is that beginning in 2007, any foreign company wishing to conduct business in the EU region had to be domiciled in a country whose accounting standards were equivalent to those of IFRS. Herein lays the reason why the EU has been referred to as the “regulatory empire.” Subsequently, the introduction of this ruling was postponed until 2009 in the interest of avoiding friction with non-EU countries. The postponement will also be used to clarify the interpretation of IFRS and the details of its application. In any case, this postponement does not in any way signify a halt in the movement toward convergence (Kurosawa 2006).

In response to these developments, in August 2007, an agreement in principle was reached between IASB and the Accounting Standards Board of Japan (ASB) for eliminating the differences between IFRS and Japan’s accounting standards before the end of June 2011 (Tokyo Agreement).

## 5. Conclusion – Standardisation, Past and Present

The development of international accounting standards provides a very instructive view of the process of “really existing globalisation.” Japan was by no means a passive onlooker in this process. Rather, it was carefully monitoring related developments from an early stage. Responding to the establishment of IASB, Japan initiated the process of developing its internal systems and mechanisms. During the summer of 2001, the Financial Accounting Standards Foundation (FASF) was formally established, together with ASB, which functions as the standards development department of FASF. During this same time, Tatsumi Yamada (Partner of Chuo-Aoyama Audit Corporation) was appointed a trustee of IASB. In the following years, FASF engaged in regular consultation with IASB, and Japan did not neglect to offer its input on all matters pertaining to the formation of standards, ranging from basic philosophy to technical details. Nevertheless, in reviewing the process of the formation of international accounting standards over the past dozen years or so, it is clear that Japan had little part in setting the arena and agenda of negotiations. From the very start, the arena/agenda was defined and redefined by other entities, and one cannot help but feel that the best Japan could do was to keep up with these changes.

In other areas as well, it is difficult to find cases in which Japan was able to play a central and positive role in the formation of international standards. The standards of the well-known Moving Picture Experts Group (MPEG) represent some very important Japanese technologies in the field of moving picture compression. Yet their adoption as public standards can be attributed in great part to the fact that MPEG (in ITU/IEC) was chaired by an Italian engineer who had earned a doctoral degree at the University of Tokyo (and therefore was sympathetic to Japan). Ken Sakamura, widely known as the creator of TRON, outlines the requirements for establishing international standards as follows. “We need people with ideas and visions who are capable of making a compelling case. They have to be excellent debaters and capable of making strong presentations. Finally, they must be able to do all of the above in Eng-

lish.” The fact is that there is an absolute shortage of such human resources in Japan (Sakamura 2005, pp. 78-79).

A review of ISO standards that have a significant impact on technologies and product systems reveals some important facts. Of the 227 technical committees in existence, Japan is the lead manager or chair of only eleven technical committees. The comparable figure for IEC is 16 out of a total of 110 (Sakamura, p. 88). Considering the human resources needed for leadership in the formation of standards, Japan’s influence is most likely even smaller than what is suggested by these figures.

Companies can only assign relatively limited personnel to tasks related to standardisation, and the same applies to government agencies. “How does your company train personnel in the area of standardisation?” The following commonly received answer to this question sheds light on the Japanese situation. “It is easier to cope with standards that have already been established. This is an area where traditional strength of Japanese companies lies.” Perhaps in the past, this passive approach was successful enough for Japanese companies. However, it is highly questionable whether this approach will continue to serve them well in the future. Because product development cycles are becoming shorter, the fate of a manufacturing company often depends on the speed with which it can bring new products to the market. (A staff member of a company with a strong interest in standardisation quite appropriately explained that the effort and money spent on standardisation is meant for “buying time.”) When standards with fundamental and far-reaching impact (such as accounting standards) are held in the grasp of others, this gives rise to situations in which the cumulative efforts and the carefully nurtured assets of a company can be brought to naught in an instant.

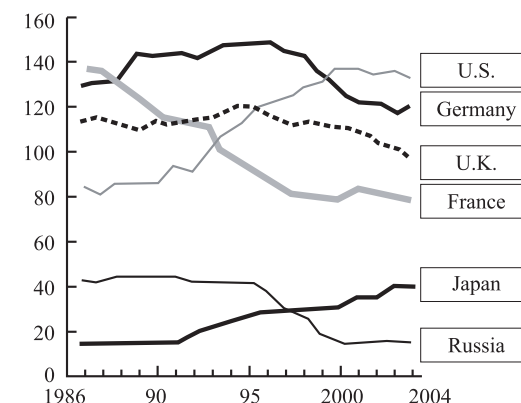
If the tide of globalisation cannot be stopped and if international standards are being adopted to create the foundations of governance, then it is of critical importance to train and develop human resources capable of participating in this process. The point to keep in mind is that the frontlines of the formation of international standards are manned by corporate personnel and government officials who are engaged in highly specific fields of activity that are set apart by industry and by delineations dic-

tated by policy issues. This is a frontier that is expanding outside the confines of traditional diplomacy. In order to exert some degree of influence in this critical frontier, Japan badly needs to develop human resources that have expert knowledge in specific areas. Moreover, these human resources would have to be equipped to work successfully on the international stage.

**Table 2:** Chronological Table of the Formation of International Accounting Standards

1973	IASC (predecessor to IASB) established (work starts on International Accounting Standards).
1994	Daimler-Benz released fiscal 1993 financial statements based on US GAAP (Daimler-Benz became the first German company listed on NYSE in autumn of 1992).
Dec. 1998	IAS core standards completed.
1999	Disclaimer (legend) appended to Japanese accounting standards after the start of fiscal year 1999.
May 2000	IOSCO announced support of IAS.
2001	IASB started its activities (with the work started on new international accounting standards, IFRS).
Jul. 2001	Japan established Financial Accounting Standards Foundation (FASF).
Aug. 2001	Japan established Accounting Standards Board of Japan (ASBJ).
Dec. 2001	Enron Corporation failed.
Jul. 2002	WorldCom failed.
Aug. 2002	Arthur Andersen effectively closed.
Sept. 2002	Norfolk Agreement reached between IASB and FASB.
Jan. 2005	EU applies IFRS to all companies listed in EU market.

**Chart 3:** Number of ISO Chairmanships



Source: Yomiuri Shimbun, July 16, 2005, cited in Sakamura 2005, p. 102.

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