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# The European Union's accounting policy analyzed from an ethical perspective: The case of petroleum resources, prospecting and evaluation

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### ABSTRACT

This article uses Habermasian philosophy as a reading grid to understand the eminently political aspect of international accounting standard-setting. We specifically analyze the accounting regulations specific to the exploration for and the evaluation of mineral resources in the European context. The rise of the IASC and its successor, the IASB, favors the emergence of a new phase in accounting standard-setting, with a shift from a ruling logic to regulations that put the economic and social actors at the forefront of the negotiations. This change is particularly obvious in the notorious exception allowed by IFRS 6 (Exploration for and evaluation of mineral resources) exempting applicants from paragraphs 10–12 of the IAS 8. This example allows us to question the legitimacy of international accounting standardization and the ethical problems it poses.

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## 1. Introduction

Since the mid-1960s, European Union member states have been engaged in complex negotiations in an effort to harmonize their accounting rules because comparable financial statements from companies were viewed as a “cornerstone of a future common market” (Botzem and Quack, 2006). Finally, in 2002, the European Union decided to subcontract the production of accounting standards to a private entity: the IASB (International Accounting Standard Board). European accounting standard-setting constitutes a “unique institutional configuration” that is the result of collaboration between the IASB and the EU (Colasse, 2007). Chiapello and Medjad (2007) point out that this transfer of competencies is puzzling because it is much broader than the usual forms of delegation to the private sector. The European Union accounting policy could be analyzed as an “unprecedented privatization of legal rules” because IASB standards are incorporated in EU law (Chiapello and Medjad, 2007, 2009).

The accounting literature has focused mainly on the content of the International Financial Reporting Standards and their dissemination. Little attention has been paid to the ethical value of international standard-setting in accounting. Nevertheless, rationality, integrity and objectivity in accounting depend primarily on actors entrusted with standard-setting roles (Gerborth, 1987; Shapiro, 1997, 1998). This is why analysis of ethical issues in accounting must consider standard-setting

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procedures. International standard-setting in accounting is based on consultation between experts and interested economic actors, qualified as “due process.” This aims to favor a transparent defense of all stakeholders’ interests by involving them in the definition of the rules to be applied. However, it poses ethical problems, as highlighted in the literature of the 1970s (Armstrong, 1977; Solomons, 1978; Wyatts, 1986).

What are the consequences of the emergence of private or mixed sources of accounting standardization in Europe? Are the procedures at work in international accounting standardization reconcilable with the values of democratic society where the general interest prevails? Do they meet the requirements of financial markets in terms of reliability and accuracy of accounting information? This article aims to evaluate the procedures at work in international accounting standard-setting from an ethical point of view. This type of reflection is all the more crucial given that the accounting standard-setter must research and promote rules that provide stakeholders with the best information possible. However, the aims announced by the international accounting standard-setters, such as transparency of financial information and market efficiency, seem to be somewhat incompatible with the reality of the IASB’s role as an adjudicator of conflicts of interest between pressure groups. This contradiction is all the more evident in sensitive economic areas like energy. For this reason we have chosen to analyze the ethical and political problems at play within international accounting standard-setting based on the specific case of the mineral resources industry, and more specifically, the mechanisms at work in the adoption of IFRS 6 (Exploration for and evaluation of mineral resources) that sets the rules for recording mineral prospecting and evaluation.

On the basis of the accounting regulations specific to prospecting and evaluation of mineral resources, this article highlights a characteristic of international standard-setting in accounting that is often ignored: its eminently political nature. The case of petroleum as a mineral resource is well-suited for this because the accounting, evaluation and recording of exploration costs imply high stakes with regard to the determination of future economic outlook and industrial competition. This specificity exacerbates the ethical questions posed in terms of accounting standard-setting. We use discourse ethics as developed by Jürgen Habermas as a framework because it captures the way actors can reach a common agreement and resolve conflicts about norms and values. Habermas seeks to develop a global system to validate ethical choices. His system is particularly relevant in a pluralistic society wherein values differ. Habermas provides a relevant framework for understanding the legitimacy of international accounting standard-setting and its ethical assumptions. Habermasian theories have been applied to many accounting scenarios in both public and private sector organizations (Davis and Sturt, 2008) but none have investigated international accounting standard-setting. Consequently, this article uses Habermas’ philosophy to analyze the ethical problems raised by international accounting standard-setting.

The paper is organized as follows. The first section describes the international accounting standard-setting procedure. The second section introduces Habermas’ philosophy as a grid for reading ethical problems related to this mode of standard-setting. The third section analyses the genesis of the IFRS 6 regarding the costs of petroleum exploration in order to reveal the ethical problems it raises. The conclusion underlines the relevance of Habermas ethics of discussion for analyzing international accounting standardization.

## 2. International accounting standard-setting: an application of Anglo-Saxon due process

Accounting standard-setting is the establishment of common rules with the “double aim of standardizing and rationalizing the presentation of accounting information likely to satisfy the presumed need of multiple users” (Hoarau, 2003). In Europe, this dual goal of standardizing and rationalizing has been entrusted to an independent private organization, the International Accounting Standard Board (IASB). In a directive issued on 19 July 2002, the EU delegated the mission of elaborating the accounting standards applicable to listed companies within the EU to the IASB, which until then had no public mandate. However, the European Commission reserves a supervisory right over the standards proposed by the IASB, which must be accepted or rejected after soliciting the opinion of an organization made up of representatives from different EU member countries: the Accounting Regulatory Committee (Comité Réglementaire Comptable Européen, CRCE).<sup>1</sup>

We will first describe the composition of IASB, and we will analyze due process as the key principle of the IASB’s functioning.

### 2.1. The composition of the IASB

The IASB is a private, independent British law organization based in London and controlled by the IASC Foundation. This foundation is based in the United States and financed by large industrial and service companies, auditing firms and international and public organizations. Governance of the IASC Foundation rests with 22 trustees, individuals with executive experience from diverse geographical and professional backgrounds from both the private and public sectors. Standards developed by the IASB are interpreted by the International Financial Reporting Interpretations Committee (IFRIC). Their mandate is to review widespread accounting issues that have arisen within the context of current International Financial Reporting Standards (IFRSs). IFRIC aims to reach consensus on the appropriate accounting treatment interpretations and

<sup>1</sup> Such a procedure aims to make up for the absence of the regulatory power’s expertise by nominating experts drawn from regulatory organizations who then submit their proposals to the decision-making bodies (regulatory). Thus decision-making is delegated, while political power is not (Aghion et al., 2006).

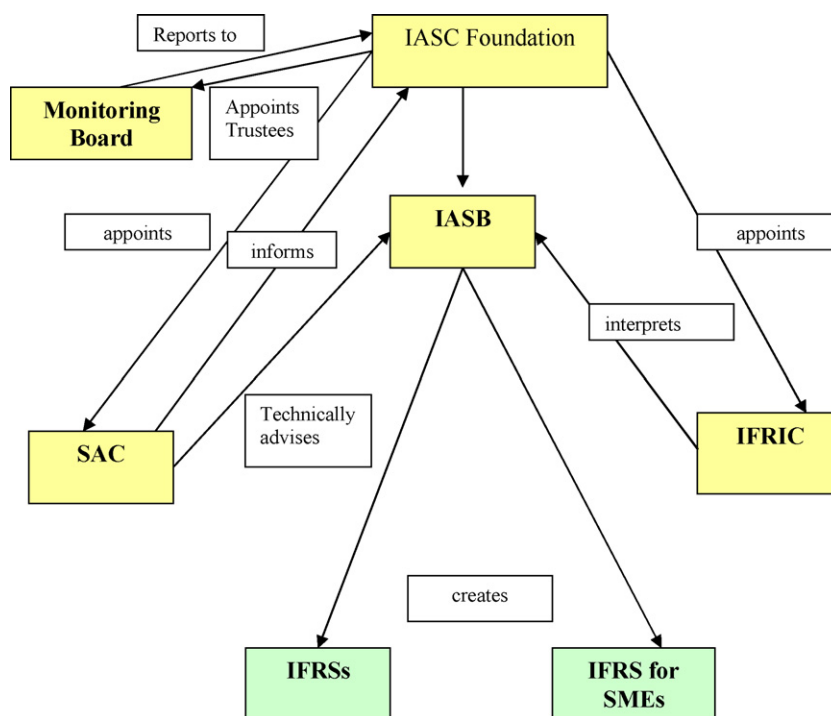


Fig. 1. International standard-setting bodies (IASB website).

provides authoritative guidance on those issues. The IASB is advised by the Standard Advisory Council (SAC), a forum that provides advice on issues of practical application and implementation of accounting standards three times per year. The SAC comprises a wide range of representatives of user groups, financial analysts, academics, auditors, investors, regulators and professional accounting bodies. In January 2009, the trustees of the IASB established a monitoring board to oversee the shaping of international accounting rules. The monitoring board will be made up of representatives from the Emerging Markets and Technical Committees of the International Organization of Securities Commission, the European Commission, the Japanese Financial Services Agency and the US Securities and Exchange Commission. Technically, the trustees have to be approved by the monitoring board.

The IASB is made up of 14 members of nine nationalities, nominated by the IASCF trustees. This number will increase to 16 by 2012. The IASB is responsible for developing a set of accounting standards that are in the public's interest, applicable to the production of financial statements from the perspective of the globalization of economic exchange. The IASB also cooperates with national accounting bodies to favor a convergence of accounting standards worldwide. The members of the IASB are characterized as experts and are often former auditors.

The IASB's structure is presented in Fig. 1.

## 2.2. The key principle of the IASB's functioning: due process

The principles of the IASB's functioning are laid out in a document entitled "IASB Foundation Constitution." The constitution is summarized in a due process manual written in April 2006. The standard-setting procedure is based on the following principles:

- The *principle of transparency and accessibility* assumes that the meetings of the IASB's Standards Advisory Council (SAC) and those of its working groups are open to the public. Reports of these meetings are available on the IASB website.
- The *wide consultation principle* presumes that the IASB regularly organizes vast consultations and working groups that encourage discussion between stakeholders.
- The *principle of responsibility* assumes that the IASB can justify any reasons that could lead it to disregard certain stages in the consultation procedure.

The procedure established by the IASB for elaborating accounting standards includes six stages that are described in Table 1.

The IASB's structure and functioning is actually quite similar to that of the FASB. The procedure for elaborating accounting standards planned by the FASB involves several stages, and each stage is open to public participation or observation. First the

**Table 1**  
The IASB's functioning stages.

Stage	Objective	Comments
1	Set up the schedule	The IASB receives requests to revise existing norms. It then evaluates the pertinence of these requests and their urgency in order to establish a work schedule. Only a simple majority is required at this level.
2	Project planning	The IASB can decide to conduct the elaboration or revision of the norm alone or in collaboration with other organizations. The IASB constitutes a working group. Only a simple majority is required at this level.
3	Elaboration and publication of a pre-project	One of the key stages in the procedure is the publication of a pre-project that is open to stakeholder discussion. Generally, this text includes the approaches that can be considered, the author's preliminary point of view and an invitation to discuss the project. A period of 4 months is generally set aside to allow for a discussion on the pre-project. Comments are collected and summarized by the IASB. Only a simple majority is required at this level.
4	Development and publication of the project	A project that takes into account the comments received is written up and made public. A period of 4 months is again set aside to gather comments from the stakeholders. At this level a 9-vote majority is required.
5	Development and publication of the IFRS norm	The IASB can decide to prolong the procedure by modifying the initial project in order to integrate certain elements. After taking into account the pertinent comments received, the IASB writes up and publishes the IFRS norm. The norm is adopted with a 9-vote majority.
6	Procedures posterior to the adoption of a norm	Regular meetings are held in order to anticipate the foreseeable consequences of the norm and to commence actions that are intended to ensure the efficiency of the published norms.

FASB receives requests and recommendations for standard-setting projects or for the revision of existing standards. These requests and recommendations come from financial professionals or diverse economic actors. The information received is synthesized and discussed, and then the FASB bureau votes to decide whether the project should be added to its work schedule. It is a simple majority decision. The bureau then debates the solutions identified and analyzed by the FASB personnel. A first norm project is elaborated and is sometimes discussed in Public Hearings. The reactions received at the round table are analyzed and can lead to changes in the project. Lobbying phenomena can interfere at this point in the process (Watts and Zimmerman, 1978; Gorton, 2001). Finally, the bureau adopts the text, which may be modified to take into account the reactions obtained at the simple majority vote.

If the different stages of the procedure allow for extensive consultation by the stakeholders and if the stages that underpin the production of accounting standards are transparent, then the composition of the IASB might lead to the development of power relationships that would affect the adoption of accounting standards. The most powerful and influential stakeholders can have a greater impact on the debates. As pointed out earlier, American accounting standard-setting can be defined as a political process, because it is open to common lobbying practices.

Due process can be seen as a chiefly political procedure (Haring, 1979; Newman, 1981; Fogarty et al., 1994; Durocher et al., 2007; Elbannan and Mckinley, 2006) as the adoption of accounting standards becomes more dependent on power relationships between dominant actors than on shareholders' or other stakeholders' expectations. This political aspect of accounting standard-setting is crystallized in the lobbying phenomena that can be identified in accounting institutions (Hussein and Ketz, 1991) with the aim of rejecting a standard or a method, for example, as happened to SFAS 19 (Gorton, 1991). According to Hussein and Ketz (1991), the adoption of accounting standards in the United States results from both the power relationships between the stakeholders represented in the accounting institutions and from anticipating the economic consequences these standards would have on the stakeholders. In this situation, what are the ethical dangers that result from the IASB's manner of functioning? Is due process, which is at the heart of international accounting standard-setting, a threat to the quality of the accounting standards established? The accounting literature points out the ethical value of due process, which refers to the procedures that constrain administrative decision-making (Richardson, 2008). If Belton (2005) shows that due process prevents the abuse of authority because it subjects "the exercise of power to scrutiny and constraint" (Richardson, 2008), then, as Leuz et al. (2004) argue, the legitimacy of the standards depends on the participation of those affected by the process. Thus the ethical value of international accounting standard-setting could be analyzed only through the composition of the different bodies involved. This leads Morley and Newby (2002) to use the lack of stakeholder participation as evidence of the failure of due process in accounting standard-setting.

In order to precisely examine the ethical status of international accounting standard-setting, we apply Habermasian philosophy. Discourse ethics will serve as a reading grid to define the criteria for standard-setting that conforms to a particular ethic.

### 3. Habermas' philosophy, a reading grid for the ethical stakes involved in international accounting standard-setting

Habermas was widely influential in the field of management science (Antoine and Duchamp, 2004). His theory of communicative action has been used to understand decision-making procedures, particularly concerning planning (Forester,

1985), the development of information systems (Myers and Young, 1997; Klein and Myers, 1998; Kwon, 2002) and even the relationship between law and accounting (Arrington and Puxty, 1991; Broadbent and Laughlin, 1994; Power and Laughlin, 1996). His theory of action is of direct interest: it can be seen as an attempt to clarify the links among politics, values and knowledge. McGann (2005, p. 4) asserts that Habermas uses the ideal of consensual agreement achieved through discourse to provide a justification for the concepts of truth and validity to “save them from skeptical, relativistic and postmodern philosophies.” Habermas is constantly guided by one question: how can you create the conditions for democratic participation in daily life (Pusey, 1987)? Accordingly, Habermas’ thought can help us identify the questions emerging from the evolution of accounting standard-setting and the conditions required for negotiation compatible with democratic requirements. After having synthesized Habermas’ theory of action, we use it to explain ethical problems in international accounting standard-setting.

### 3.1. The contribution of Habermas’ theory of action

Habermas’ moral theory is grounded in the principle of discourse ethics, which can be viewed as a principle of argumentation. Habermas’ discourse ethics guarantee that the process of making judgments and producing norms is carried out impartially. Accounting standards are both judicial norms (in some cases) and technical norms. Unlike moral norms, judicial and technical norms are legitimate only if they can be justified from the point of view of the values they incarnate, at a pragmatic level. The convention system must then propose the best possible representation of a constantly changing economic reality. This statement implies that the norm results from a confrontation of the viewpoints of the actors involved. Thus, a judicial norm resulting from a procedure compatible with democracy, i.e. the free expression of the people, is legitimate. On the basis of his distinction between strategic action and communicative action, Habermas defines the characteristics and the conditions of these procedures. He lays the framework for discourse ethics, which he considers the only way to produce legitimate norms.

#### 3.1.1. Categories of action

In the theory of communicative action, Habermas (1987) distinguishes five types of action: teleological, strategic, normative, dramaturgical and communicative. The first two types of action are instrumental; they are oriented towards the success of a group of actors. The latter three are cultural, directed towards the understanding of the actors involved. The specifics of these categories and actions are presented in Table 2.

In Habermas’ typology, the opposition between strategic action and communicative action clarifies the power relations at stake in the elaboration of judicial norms in general and accounting standards in particular.

Strategic action is intended to influence the other in order to fulfill one’s own interest. It is driven by the success of a single viewpoint. This type of achievement is based on clear acts of influence (war, demonstrations of strength) or hidden acts of influence (indoctrination, lobbying). This type of action implies the flattering presentation of a project or a reality, one which enhances its acceptance and minimizes its inconveniences.

Communicative action is intended to create an understanding between participants. This does not imply that communicative action belongs to the realm of altruism, but in a communicative action the participant’s plans have not been coordinated by pure calculation based on egocentric interest. They aim at reaching an agreement or consensus. In Habermas’ vocabulary, consensus is the opposite of compromise. Consensus is based on agreement motivated by epistemic reason and therefore common convictions. “The process of inter-comprehension aims at an agreement which satisfies the conditions of rationally motivated assent, regarding the content of an expression” (Habermas, 1987, p. 297). In contrast with compromise, the notion of consensus assumes wholehearted agreement. Thus, it necessarily implies an extreme idea towards which one should work, while knowing it is impossible to attain in reality.

**Table 2**  
Categories of action in Habermas’ philosophy.

	Type of action	Definition
Instrumental actions	Teleological	Definitive (or instrumental) action: the actor tries to attain a goal efficiently and effectively using appropriate means. The actor draws upon physical or behavioral models, and the world in which they intervene is considered an objective and rational one.
	Strategic	Definitive (or instrumental) action that involves at least two actors. Contrary to a teleological action, a strategic action supposes that the decisions of at least one other actor are taken into account. Aims at individual usefulness. Coordination of actors out of interest.
Understanding actions	Normative	Action regulated by norms and values shared by a social group. The social group elaborates the behavioral norms and expects the actors to respect these norms, making social behavior predictable.
	Dramaturgical	Action that implies the subject has actually experienced the situation personally. The actor can communicate an impression to the audience resulting from a partial revelation of his subjectivity.
	Communicational	An action that consists in engaging an interpersonal relationship by means of language. Aims towards coordination and reaching a consensus. Actor coordination through reciprocal acceptance.



In Habermas' theory, only communicative action is compatible with democracy. This does not imply that all strategic actions should be banned in a democratic regime. Habermas was aware that communicative actions were a purely theoretical construction, and that any interpersonal relationship is partly based on strategic action. Nonetheless, the procedures for establishing judicial norms should tend towards communicative actions and render such actions possible. Consequently, the normative process should be based on discourse ethics.

3.1.2. The conditions for discourse ethics

Habermas (1976) defined discourse as a form of communication in which statements that are problematic in terms of their validity are examined by the actors from the point of view of their justification (1976, p. 279). Discourse ethics is a formal morality concerned with methods of establishing and revising standards but not with the evaluation of their content. It is thus particularly relevant to evaluate the pertinence and the political and ethical value of a procedure.

Discourse ethics can be reduced to two principles: the *Discourse principle* (D principle) and the *Universalization principle* (U principle). The Universalization principle applies to the Discourse principle. According to the D principle, a norm can be valid only if all the stakeholders concerned have been able to take part in its negotiation. "Only those norms can claim validity that could meet with the agreement of all those concerned in their capacity as participants in a practical discourse" (Habermas, 1990, p. 66). This principle implies that each member of the community has the right to participate in the discussion and has an equal right to express himself. Each actor must be able to make suggestions and defend them. Each actor must also be able to refuse proposals put forward by others. The effectiveness of this principle also assumes that the negotiation will not be influenced by any exterior constraint. For this to happen, the total transparency of the discussions must be guaranteed.

According to the U principle, a norm can be valid only if the foreseeable consequences are acceptable to all the people involved and if they are preferable to the consequences that would result from another type of rule. A norm is valid only if "all affected can accept the consequences and the side affects its general observance can be anticipated to have for the satisfaction for everyone's interests (and these consequences are preferred to those of known alternative possibilities)" (Habermas, 1990, p. 65). In this way, the universalization principle formally determines those conditions which must be met if the claim of legitimacy is justified.

The conjunction of these two principles assumes that the interests of all the stakeholders that may be affected by the norm examined must be taken into consideration. The judgments expressed by the stakeholders regarding the norm must also be taken into account. One could criticize Habermas for reasoning within the framework of an ideal community that could not possibly exist. In such a community the actors are not susceptible to bargaining or selfishness. Habermas' discourse ethics would be better read as a model rather than a set of instructions to be directly applied. These principles should be applicable to the critical examination of accounting standards.

Based on this analysis, the questions of whether the IASB's mode of functioning fulfills the criteria of discourse ethics and whether the procedures in use pertain to a strategic or a communicative action arise. We will address these questions below.

3.2. Ethical problems posed by international accounting standard-setting

Discourse ethics assumes that the procedures for developing social and political norms are based on a representation of all the interests at stake and that an open dialogue has been organized among the stakeholders. According to Habermas, a democratic space must integrate marginal voices in the process of developing social and political norms. The due process procedure is based both on consultation with the concerned economic actors and on the competence of technical experts. It should consequently fulfill the requirements of discourse ethics. However, all the participants in the debate that precedes the adoption of a standard by the IASB bureau do not have the same means of action and do not carry the same weight, which implies that the equitable character of the debate could be distorted. Table 3 summarizes the elements of IASB functioning that are compatible or incompatible with discourse ethics.

Analysis of the procedures employed by the IASB shows that overall, the criteria of discourse ethics are met. In the case of the D principle, a discussion between the stakeholders is organized at different stages of the standard development. Are the rights of each actor identical in a discussion of accounting standards? Does each actor carry the same weight in the

**Table 3**  
IASB functioning according to the discussion of ethical criteria.

	Elements related to IASB functioning that satisfy the principle	Elements related to IASB functioning that do not satisfy the principle
D Principle: discussion	All the people affected by the norm can participate in the debate led by the IASB (wide consultation) The procedure for developing the norm is transparent (the different stages are listed, particularly by means of the IASB website). The foreseeable consequences of the norms under discussion are examined by the IASB.	Do all actors have the same right to express themselves? The financial and technical resources employed can be influential. Actions that are of the "strategic action" type (lobbying) can be carried out between the different stages.
U Principle: universalization		The foreseeable consequences of norms under discussion are rarely acceptable to all the stakeholders, if their interests diverge. The consequences of the norm on the most influential economic groups take priority.

negotiations? Does transparency only give the average actor the impression he can intervene at every stage of the procedure while actually serving the interests of pressure groups?

Arbitration by the IASB may be guided by power relationships, particularly at an economic level, and by the opinions of technical experts. In this respect, Habermas lashes out at the expert culture found in vast areas of regulation making. The State tends to disengage itself from the development of judicial norms, leaving the task to expert group entities. The problem of citizen involvement in the regulation of scientific and technical investigation was brought to public attention in the late 70s, with reference to the potential hazards of genetic engineering or recombinant DNA research (Kleinman, 2000). Accounting is an area where the legislator transfers some of his power to elites whose legitimacy is automatically reinforced by the use of technical rhetoric. In this sense, accounting is a good example of the way that the normative process is being transformed into an 'expertocracy.'

An expert can be defined as "an individual with a certain 'know-how' who produces a solution on behalf of others. The resulting solution is usually viewed as a product of an intelligent and a rational approach" (White and Taket, 1994). The expert is seen as capable of arbitrating between different views via his access to reason and science. According to Barthes (1977), experts are not always conscious of the implications of what they propose. Insisting on the impartiality of expertise may be a pretext for imposing a view, making the expert an instrument of power. Habermas thinks experts should not be excluded from normative procedures, but the discussion must be a public one in order to ensure their legitimacy (Broadbent and Laughlin, 1995). If this is not the case, public areas risk being colonized by a technical bureaucracy.

The main ethical danger in the functioning procedures of the IASB lies in the possible influence of lobbying phenomena on the process of defining an accounting standard. International accounting regulations concerning the cost of petroleum exploration provide a particularly convincing example of the major role the standard-setters have conferred on the economic strength of the stakeholders and the use of the resulting influence. We will now concentrate on the determining factors that led to the adoption of the IFRS 6 standard governing the exploration of mineral resources.

#### 4. International accounting regulation specific to exploration for and evaluation of mineral resources: the result of leverage plays?

The analysis of accounting standards specific to mineral resources will show that the accounting standard-setting process is permeable to lobbying between influential actors in this specific economic sector. One could object that the economic role of oil and mining resources or even the geopolitical stakes linked to the localization of the resources give these actors an atypical profile, yet this profile originated from accounting and financial innovation. Indeed, the petroleum sector was the precursor of rules, which later spread to other sectors.<sup>2</sup> First we will introduce the stakes involved in the accounting regulations specific to the oil industry by using the American case. Second, we will present the chronology of the IFRS 6. Lastly, we will analyze the accuracy of the IFRS 6 by comparing it with the American SFAS 69.

##### 4.1. Petroleum-specific accounting regulation and the result of stakeholder influence

Oil is a dominant source of energy (Chevallier, 2004). For example, in 2005, tax and VAT on petroleum products represented almost 12% of the budgetary resources in France. The sale of refined petroleum products represents about \$2 trillion. A quarter of this amount covers the exploration, production, transport and transformation costs. The \$1.5 trillion surplus is shared among the producer states, the companies that operate all along the line and the consumer states. An analysis of the American example illustrates what is at stake in terms of petroleum activity accounting regulations.

The accounting standards used in the United States to record the cost of petroleum exploration are presented, followed by the political debate surrounding the FASB's adoption of these standards.

##### 4.1.1. Accounting standards used in the United States for recording petroleum exploration costs

Until the end of the 1970s, American accounting institutions authorized the recording of petroleum exploration costs by three distinct methods:

- the full expense accounting (FE) method,
- the successful effort accounting (SE) method,
- the full costing (FC) method.

<sup>2</sup> As early as 1978, petroleum companies had to publish supplementary information on the estimated value of natural resources reserves at their current value. This occurred three decades before the International Accounting Standards Committee (IASC), the IASB's ancestor, was created in 1973, the same year as the FASB, by professional accounting organizations from nine countries, including France, the United States and Japan. The primary purpose of the IASC was to develop basic standards that could be rapidly accepted and implemented all over the world. According to Ahre and Brunsson (2006), the IASC was both a standard-setter and a meta-organization with national accounting and financial bodies as members. For instance, the IASC followed a policy of cooptation, offering membership status to organizations such as the Association of Financial Analysts and the Federation of Swiss Holding Companies. The IASC proposed giving observer status to other institutions or states such as the Financial Accounting Standards Board (FASB) or the Republic of China. This status allowed them to participate in the IASC discussion concerning accounting standards but gave them no right to vote on the decision. After the decision by the European Union to adopt international accounting standards, the IASC was reorganized in order to reinforce its independence, particularly with regard to the accounting profession (Botzem and Quack, 2006; Colasse, 2007). These methods were reintroduced by the IASB in 2006.

Only the latter two methods were used in practice. Under the successful effort method, only costs that led to the successful discovery of oil can be capitalized. Under the full costing method, all costs generated by exploration activity could be capitalized. This also includes costs of unsuccessful exploration, creating an “enhancement” effect on earnings. As a result, net income under the successful effort method is less than under the full costing method. Several studies have tried to draw up a typology of companies using the SE or FC methods. According to Antill and Arnott (2000), the SE method is preferred by large organizations. Small organizations or organizations that concentrate on upstream activity (exploration and production) are usually much more indebted (Deakin, 1979; Dhaliwal, 1980). Consequently they show a real preference for the capitalization of all exploration costs, which allows them to maximize their results.

This typology clarifies the arguments used by petroleum companies in debates over the standardization of accounting methods applicable to the cost of petroleum exploration.

#### 4.1.2. Regulation that results from an unstable compromise

The first oil crisis highlighted American dependency on oil and led to a slowdown of economic activity. It became necessary for the US Congress to deal with the unexpectedly volatile barrel prices effectively and to better handle the possibility of permanently high prices. In 1975, Congress set up a global plan called the “Energy Policy and Conservation Act” (EPCA) with the aim of facilitating the reading of accounting information because the “balance sheets were meaningless” (Johnston, 2005). Congress asked the SEC to eliminate heterogeneous accounting practices, forcing the FASB to choose between the SE method and the FC method, “two overly flexible and irrelevant accounting methods” (Gorton, 1991).

In 1977, the publication of SFAS 19 established the SE method as the dominant reference, thus favoring the large petroleum companies and drawing severe criticism. A political battle erupted between Congress and the Departments of Justice and Energy. The former lobbied aggressively (Gorton, 1991) and the latter supported the small petroleum companies that felt that this choice was unfair to them. In 1978, for the second and last time since its creation, FASB due process was overridden when the SEC held a rare Public Hearing on the acceptability of SFAS 19 and the reconsideration of the FC method. The publication of an information supplement entitled *Reserve Recognition Accounting* (RRA) was then required.

The political debate sparked by this new obligation has shown, after four years of exchanges (from 1978 to 1982), that the American normative context has definitively established the political will to adapt accounting and financial issues to the economic context. Indeed, the arguments surrounding the controversy belong to a societal order of preoccupation that has more to do with the need to reduce the volatility of revenues published (Congress’ argument) and the fear of concentration in the sector that would result in a weakening of the smaller entities.

SFAS 69, published by the FASB in 1982, brought an end to the quarrel and maintained a compromise of plurality among the accounting standards regarding the recording of oil exploration costs. It also satisfied the demands of financial analysts and petroleum engineers (Zeff, 2005a,b). In the following decades, research concentrated on evaluating reserves and analyzing methods for recording costs. The subject disappeared from center stage until the appearance of IFRS 6.

The acceptance of two accounting methods to record exploration costs in the United States seems to be a compromise in the Habermasian sense. This compromise is the expression of a failure to reach a consensus due to the divergence of the actors’ interests. The response to the expectations that the IASB take a decisive stand and make a clear choice between the different accounting methods used to record the cost of oil exploration has thus become visible (Asekomeh et al., 2006).

#### 4.2. The development of IFRS 6

IFRS 6 has been registered on the IASB agenda since 1998. It currently upholds an unsatisfactory status quo. Its temporary nature indicates an ongoing dialogue carried out in parallel. A comparison of American and international accounting regulations specific to the exploration for and evaluation of mineral resources illustrates the political aspect of European accounting standard-setting.

##### 4.2.1. The piloting committee’s study

Since 1998 the IASB has been working on a project for accounting regulations specific to the exploration for and evaluation of mineral resources. Table 4 shows the main lines of the IASB’s deliberations.

Discussion regarding the definition of the IFRS 6 standard brought together an advisory panel around a dedicated piloting committee.<sup>3</sup> If one assumes that the actors present have equal time to talk and carry equal weight in the dialogue, an analysis of the origins of the members of the panel (shown in Table 5), reveals a composition that is in conflict with the requirements of discourse ethics. According to the D principle, all the actors involved in the negotiation process must be represented in order to benefit from an identical right to express themselves. This does not seem to be the case.

The IFRS 6 piloting committee rehabilitates the role of industry in the accounting standard-setting procedure. The committee is largely made up of representatives from the accounting profession employed by the companies affected by the application of these standards (67% of the members). Six representatives of the major companies are mentioned amongst the financial professionals, which gives the large companies an 18% stake in the number of representatives. In comparison,

<sup>3</sup> The composition of the panel is described in iasb.org.



**Table 4**

Project regarding the extraction industry, developed by the IASC.

Project regarding the extraction industry developed by the IASC	
<b>Actions carried out</b>	
<b>1998</b>	Creation of a piloting committee responsible for working on the financial information produced by the extraction companies.
November 2000	Publication of the IASC pre-project; 52 comment letters are received in response.
September 2002	The committee rules that it is impossible to carry out an exhaustive project before the IFRS norms are put into application and proposes the adoption of a temporary norm.
16 January 2004	Publication of the ED draft 6 "Exploration for and evaluation of mineral resources" as a temporary solution.
10 December 2004	Publication of IFRS 6.
30 June 2005	Amendment regarding the circulation of comparative information is published. Correction of IFRS 1.36B. Modification proposed in April 2005. Modification proposal formulated on 2 May 2005. Last date for consideration of the comment letters: 3 June 2005.
1 January 2006	Date from which IFRS 6 will be applied.
October 2006	Consultations resume, including a detailed study of the norms in place around the world.
<b>Objectives announced</b>	
<b>Mid-2008</b>	Publication of a pre-project for discussion.
End 2009	Development of an ED (new draft), project modified after public consultation.
End 2010	Finalization of the definitive norm

the shareholders only hold 12%. The United States contributes 50% of the group, and the highest portion of the shareholders group (29%). Two of the four users' representatives belong to regulatory organizations and the two others are a representative from the order of chartered accountants and a mining shares investor, considered here as a professional investor.

The comment letters submitted to the regulatory organization during the period of standard development represent a means of direct lobbying. They reveal the specific interests of the authors (Georgiou, 2004) and increase the likelihood of other forms of lobbying such as calling upon auditors or arranging private meetings with members of the regulatory committees. Assuming the sincerity of the comment letters is greater than the quality of responses obtained through surveys,

Asekomeh et al. (2006) pose a study of the content of 52 comment letters received during the development of IFRS 6. This study shows an overrepresentation of future applicants; 23 of the 52 letters the board received are from industries involved. The correlation between the positions of the mineral resources extraction companies and the authors of comments is important. The method of analogy with an election highlights a major dispersal of positions adopted (0.48) with regard to the choice of method of recording exploration costs. It consists of applying a binary dichotomy (either for or against) to the authors' reactions to the proposed reforms. The dispersal of positions indicates a high level of discord between the actors, for whom the successful effort method obtains a favorable opinion from only 33% of those concerned. Historical cost recording receives greater support (6% of objections with a typical difference of 0.24). Rejection of the idea of adopting a uniform rule for recording costs is also clearly expressed. Such a hypothesis receives only 15% of the votes from the total number of letters, 9% of which are from the companies involved. The cumulative influence of participants from mining or petroleum companies that express themselves either through epistolary lobbying or through the composition of the advisory committee gives the extraction industry a visible representation of 55% of rights to speech (see Table 5).

The positions adopted by the IASB can be interpreted as a reflection of the importance of this influence. In relation to the means of recording exploration costs, directors preserve their discretionary powers because they are allowed to avoid altering the image of their companies by a readjustment of mineral assets during a period of high commodity pricing. History will probably repeat itself. Even though equal weight is given to participants and consensus (in the Habermasian sense) might look like a platonic ideal, the question of "how lobbying alters the views of those assumed to have been influenced by it" (Gorton, 1991) arises. It is worth examining the common factors and the points of divergence between IFRS 6 and SFAS 69.

#### 4.2.2. A comparison of the IFRS 6 and SFAS 69 standards

The European Economic Commission adopted IFRS 6 under rule (CE) 1910/2005 on 8 November 2005. The standard was published on 9 December 2005 by the IASB. In four pages, IFRS 6 defines the aims and areas of application of the accounting standards for the evaluation and depreciation of assets used in prospecting and evaluation. This standard is directed towards any entity related to prospecting and evaluation of mineral resources in a limited time frame. It concerns any activity that occurs before feasibility and viability have been evaluated but after obtaining legal rights to prospect. The resources mentioned also include minerals, gas, oil and any other non-renewable resource.

SFAS 69, 44 pages long, published by FASB in November 1982, deals with a wider range of elements: quantities of proven reserves, capitalization of costs relative to production activities, acquisition, exploration and development costs, results of production operations and the standardized measures of future cash flows to be generated by the quantities of reserves.

The fixed assets acquired within the framework of these activities thus remain subject to the application of IAS 16. SFAS 69 proposes a definition of clearly proven reserves and identifies the acts that could lead to revaluations (revisions, improvement in recoverability, purchases, physical extensions, production and sales). It also specifies the evaluation dates (beginning and end of the accounting period), the consolidation methods, as well as the units of measurement for the quantities. It enforces the identification of uncertain sources and allows disclosure of information relative to reserves other

**Table 5**

Breakdown of members of the advisory panel according to their geographical, functional and sectorial origins. Source: IASB.

	Advisors' roles				Organization they belong to				Total	in %
	Auditor	Accountant	Analyst	User	Belonging to a company		Activity Expert			
					Mining shares	Petroleum and gas	Mining shares	Petroleum and gas		
Continent										
▼ Africa	1	3	2	0	2	1	3	0	6	18%
▼ South-east Asia	1	7	0	1	2	5	2	0	9	27%
▼ Europe	11%	78%	0%	11%	22%	56%	22%	0%	11	33%
▼ USA	2	8	0	1	4	5	0	2	11	33%
	18%	73%	0%	9%	36%	45%	0%	18%	7	21%
	1	4	0	2	2	3	0	0	7	21%
	14%	57%	0%	29%	29%	43%	0%	0%		
▼ Global total	5	22	2	4	10	14	5	2	33	100%
▼ Proportion	15%	67%	6%	12%	30%	42%	15%	6%	100%	

374 than proven ones if authorization has been accorded by the government of origin of the company applying for SFAS 69. For  
375 instance, these limitations allow Canadian companies to disseminate coherent, comparable information on separate capital  
376 markets.

377 For the first time, SFAS 69 distinguishes production costs from prospecting and evaluation costs. IAS 18 (Product of  
378 ordinary production) authorizes a notorious exception to mineral production costs. IFRS 6 precisely defines the elements  
379 included in costs relative to prospecting, acquisition of rights to evaluation activities and prospecting drilling. SFAS 69 is less  
380 precise on this subject and maintains a clear dichotomy between costs associated with proven and unproven reserves.

381 Apart from this distinction, the accounting choices made by the IASB resemble the choices made in the American reg-  
382 ulations. IFRS 5 (Non-current assets, held with a view to sell, and abandoned products) thus uses a dichotomy similar to  
383 the distinction maintained between proven and unproven reserves. For the IASB, an asset is reputed to be highly probable  
384 when it is significantly more probable than improbable (proven reserves versus probable reserves). The IASB's qualification  
385 of probable assets is similar to the notion of possible reserves as opposed to probable reserves, as defined by the Association  
386 of Petroleum Engineers. The precise modes of evaluation of probable assets are not mentioned. The terminology chosen  
387 by the IASB has the advantage of being generalizable to other activities. The IFRS 6 piloting committee was reconvened in  
388 autumn 2006, and it is now studying the subject of reserve<sup>4</sup> evaluation that should be defined before the end of 2010.

389 Fifteen pages of SFAS 69 are dedicated to defining an evaluation methodology and to elucidating the level of precision  
390 of the information required to quantify the reserves and to qualify the economic context. Alternatives are proposed and  
391 rejections are justified. In this sense, the procedures that have led to the formulation of SFAS 69 have respected the U  
392 principle (universalization) in that the 'impact study' has been distributed, allowing the regulatory organization to justify  
393 its choices. The IASB has not yet determined a specific line of action in this regard. The IASB's choices still grant states and  
394 directors sovereignty by allowing, for example, the disclosure of information tabulated according to previously used modes  
395 of calculation (the procedure has a short-term memory: it concerns the fiscal year preceding the application of IFRS 6).  
396 The company Total, for example, describes the quantities of its reserves according to **Rules 4-10** of the SEC S-X regulation.  
397 British Petroleum released an estimate based on the same authoritative accounting literature and a comparison to the  
398 values obtained by applying the British regulations. For the 2006 fiscal year, the multinational stopped releasing two sets of  
399 information in favor of the authoritative American accounting literature.

400 The IASB wishes to consult with all the interested parties rather than hurriedly imposing restrictive and precise rules, but  
401 this position could also betray a real difficulty in establishing globally consistent standards and a desire to let large companies  
402 and governments organize their business as they wish. Although the definitions of prospecting and evaluation assets are  
403 more precise in the IASB publications than in SFAS 69, other points remain unclear. This demonstrates that the international  
404 standard-setter is in a transition period due to the co-existence of several data recording and evaluation methods. There is a  
405 real fear that during this period, pressure groups with diverging interests may clash in an effort to obtain favorable accounting  
406 rules. This conflict of interests could undermine the legitimacy of the IASB, and particularly the piloting committee.

## 407 5. Conclusion

408 The aim of this article was to determine whether the procedures at work in international accounting standard-setting are  
409 compatible with the requirements of a democratic society. We examined whether the actors involved and the procedures at  
410 work really allow for the development of international accounting standards that will favor better information for investors  
411 and other stakeholders.

412 To answer this question, we have focused on the context of the emergence of a temporary standard, IFRS 6, which is  
413 dedicated to the recording of mineral resources exploration costs. Neither the IASB's way of working nor its composition  
414 fulfills the criteria of discourse ethics. While due process logic can apparently establish the conditions for creating discourse  
415 ethics (transparency of debates, consultation with the different actors involved at different levels), we have underlined that  
416 international accounting standard-setting depends largely on the interest relationships between the dominant economic  
417 actors and grants experts too much importance.

418 This definition of accounting standard-setting as an eminently political process is likely to pose problems at an ethical  
419 level. Power plays and diverging interests can only be used to reach a compromise that favors the social order (Ladrière,  
420 2001) if the interests of each party are represented in the same way. We have underlined that all the economic actors do  
421 not carry the same weight in the IASB debates. Thus there exists a real risk of reducing accounting to the level of a mere  
422 instrument serving economic competition between specific sectors or actors. This is clearly in opposition with the stated  
423 aims of international accounting standards: the promotion of transparent financial information that is comparable and  
424 pertinent to the investors. The recent changes in the governance of IASB (i.e. the decision to enhance the organization's  
425 public accountability by establishing a link to a Monitoring **Board of** public authorities and the decision to expand the  
426 IASB to 16 members by 2012) could favor greater control by the public authorities and a better equilibrium between the  
427 trustees. Indeed, the expansion of the IASB to 16 members is presented by the IASC Constitution as a means of guaranteeing  
428 a better geographical representation of the different stakeholders involved in accounting standardization. This remains to  
429 be confirmed by an appropriate choice of new members and the concrete attributions of the monitoring board.

<sup>4</sup> See the notes intended for the IFRS 6 norm observers that list the existing evaluation.

What is the solution? Should accounting standard-setting bodies give more weight to lay citizens? Lay conferees are largely dependent upon information provided to them by certified experts (Kleinman, 2000), particularly concerning technical matters such as accounting. Moreover, modern societies are characterized by their widespread belief in the superior judgment of certified experts (Dutton et al., 1988). In this context, accounting rule-making can hardly reach the standards of discourse ethics elaborated by Habermas, which assumes real cooperation between lay citizens and experts.

Some people may argue that Habermas' discourse of ethics seems to be purely idealistic and that no political institution, including the IASB, could meet this ideal. We are convinced that this argument does not undermine the relevance of Habermas' theory. Pragmatism must not be the guiding principle of political and legal action. The fact that human rights are not respected in many countries and that guaranteeing their enforcement is pure illusion must not lead us to abandon the dream that a day will come when the voice of each individual will have the same value and human dignity will have greater worth than profit. Ideals give rise to action even if they are not or cannot be enforced, because they inspire us to improve our institutions and our behavior. For this reason, Habermas' philosophy may enable us to set the limits of due process and to improve the practice of the IASB.

## Q8 Uncited references

Savoie (1968) and Tandy and Wilburn (1992).

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