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Jannis Bischof & Holger Daske

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Interpreting the European Union's IFRS Endorsement Criteria: The Case of IFRS 9

JANNIS BISCHOF and HOLGER DASKE

Area of Accounting & Taxation, University of Mannheim, Mannheim, Germany

ABSTRACT EU Regulation requires that any international accounting standards (International Financial Reporting Standards, IFRS) and interpretations (IFRIC) pronounced by the International Accounting Standards Board (IASB) meet three sets of criteria before they become binding for EU-based companies: a 'true and fair view' criterion, a list of qualitative criteria, and a 'European public good' criterion. During the endorsement process, EU institutions evaluate each standard or interpretation's compliance with these three criteria. Nevertheless, despite plenty of past endorsement decisions, there is still disagreement about a unanimous interpretation of the criteria in the literature. In this study, we interpret all three criteria against the background of European accounting law and academic accounting research. Then, the paper illustrates for the case of the new IFRS 9 standard on accounting for financial instruments how these criteria can be applied in the endorsement practice. We conclude that the standard cannot reasonably be rejected on grounds of the IAS Regulation. We also explain that the vagueness of the endorsement criteria and the inherent discretion in the eventual endorsement decision help maintain the EU's political influence on the IASB's standard-setting *ex ante*.

Keywords: European Union, IFRS, endorsement, true and fair view, European public good, bank accounting

JEL classification: K22, M41, M48

1. Introduction

In the European Union (EU), international accounting standards (International Financial Reporting Standards, IFRS) and interpretations (IFRIC) that the International Accounting Standards Board (IASB) has officially pronounced must await an additional endorsement procedure before they become binding for EU-based companies. The endorsement procedure involves a formal examination of the standard or interpretation. IAS Regulation 1606/2002 introduces a set of three criteria for this examination: (1) a 'true and fair view' (TFV) criterion, (2) a list of qualitative criteria, and (3) a 'European public good' (EPG) criterion. Perhaps surprisingly, almost 15 years after introduction of the endorsement criteria and after many, at times controversial, endorsement decisions by the EU, a comprehensive interpretation of these criteria is still missing, and there is considerable disagreement about such an interpretation in prior

Correspondence Address: Jannis Bischof, University of Mannheim, 68131 Mannheim, Germany. E-mail: jbischof@uni-mannheim.de

literature (e.g. Alexander & Eberhartinger, 2010; Nobes, 2006, 2015; Wüstemann & Kierzek, 2006). In this study, we attempt to provide such a comprehensive interpretation of the criteria against the background of European accounting law and academic research. In a second step, the paper illustrates how these criteria can be applied in the endorsement practice for the case of the new IFRS 9 standard on financial instruments accounting.

While we attempt to provide a comprehensive interpretation of the endorsement criteria, we acknowledge that some degree of vagueness in these criteria is part of the EU's strategy to maintain its influence over financial accounting rules that are binding for publicly traded EU firms. This vagueness ensures maximum political influence of the EU on the IASB's standard-setting *ex ante*, that is, during the due process, by keeping discretion in the political endorsement process *ex post*. The discretion in the endorsement decision avoids an unconditional delegation of standard setting to a private body. A mechanical 'tick-the-box' approach would substantially reduce such discretion and, accordingly, dampen the influence beforehand. In the case of IFRS 9, we observe that several EU institutions (European Financial Reporting Advisory Group (EFRAG), European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), European Securities and Markets Authority (ESMA)) made use of their power and intervened in the IASB's development of the new standard (see also Walton, 2015). Consistent with the vague endorsement criteria ensuring maximum influence, the IASB was responsive to these interventions and changed the standard multiple times before its final pronouncement.

It is against this background that we address the interpretation of the endorsement criteria. We do so in separate chapters for each of the criteria and, thus, contribute to different debates in financial accounting. First, we add to the discussion about the interpretation of the *TFV principle* introduced by European accounting regulation (e.g. Alexander, 1993, 2006; Nobes, 2006; Ordelheide, 1993; Wüstemann & Kierzek, 2006). On the one hand, the TFV is viewed as a dynamic criterion that largely refers to common accounting practice accepted by market participants. On the other hand, the TFV can be understood as being reflective of the general spirit and individual norms of the Accounting Directives. Most notably, a 1996 European Court of Justice (ECJ) verdict named the *prudence principle* as the core of the European TFV principle. Nevertheless, even when great emphasis is placed on the Accounting Directive's prudence principle, the use of fair value accounting per se is not harmful to the TFV criterion (Nobes, 2015, comes to a similar conclusion). We conclude that this is especially true when the use of fair value accounting is as limited as in IFRS 9 and that the conditional conservatism of reported earnings is likely to increase as a result of the new expected credit loss model for loan impairments.

Second, we argue that the four *qualitative criteria* ('*understandability*, *relevance*, *reliability*, and *comparability* required of the financial information needed for making economic decisions and assessing the stewardship of management') are of a technical nature. Their definitions are well established in the accounting literature (e.g. Barth, 2007; Barth, Beaver, & Landsman, 2001; Maines & Wahlen, 2006), as is their operationalisation in accounting research. Still, many criteria conflict with each other, with the most prominent trade-off probably being that between relevance and reliability. Therefore, an overall assessment of the criteria requires individual judgement and weighting of different interests (e.g. of shareholders and lenders). In our analysis at least some aspects of IFRS 9 score high on many of the four criteria. We conclude that the qualitative criteria do not provide convincing grounds for rejecting the endorsement of IFRS 9.

Third, we discuss the *EPG* criterion, which is unique to the IAS Regulation but at the same time fails to provide a clear-cut definition (e.g. Alexander & Eberhartinger, 2010; Camfferman & Zeff, 2015; Van Hulle, 2004). Economics and political sciences offer different definitions of the public good and these definitions are partially incompatible. The recent Maystadt Report (2013) proposes that the criterion be interpreted in light of a standard's effect on *financial* *stability* and the EU's *economic development*. However, the operationalisation of these additional criteria is at least as vague as for the EPG per se. In our view, the only feasible way to assess the EPG is by means of a comprehensive *cost–benefit analysis* that considers the reactions of different stakeholders to the proposed standard. Nevertheless, no cost–benefit analysis will lead to a unanimous conclusion, because, by definition, the costs and benefits will be borne by different parties affected by the final standard. Ultimately, it is thus a purely political decision of how to weight these different costs and benefits of different parties. At this stage, the EU completely maintains the intended discretion about the eventual endorsement decision. We still conclude that, with the exception of perhaps the insurance industry, we do not see any one party that, in the long run, will have to bear too significant of a cost as a result of IFRS 9 implementation.

Our paper proceeds as follows. Section 2 outlines the three endorsement criteria and the political process leading to the endorsement decision. Sections 3–5 provide an individual assessment of each of the three endorsement criteria for a new IFRS/IFRIC in the EU. In Section 6, we conclude by discussing the implications of our interpretation of the endorsement criteria for the political decision in the case of IFRS 9.

2. The EU Endorsement of IFRS 9

2.1. Endorsement Criteria

Regulation (EU) 1606/2002 (IAS Regulation) introduced the endorsement of IAS/IFRS and related Standard Interpretations Committee/International Financial Reporting Interpretations Committee interpretations (SIC/IFRIC) in the EU. Because IFRS are prepared by a private body, that is, the London-based IASB, the Regulation established an EU endorsement process for all IFRS pronounced by the IASB. The process requires, inter alia, the evaluation of each accounting standard or interpretation against a set of pre-defined criteria before they can become effective for European firms. The endorsement process[1] ensures that the EU maintains its influence over financial accounting rules that are binding for listed EU firms and avoids an unconditional delegation of standard setting to a private body over which the EU has no formal influence (Wüstemann, Bischof, & Wüstemann, 2012).

Under Article 3(2) IAS Regulation, an international accounting standard can only be endorsed if

- it is not contrary to the principle set out in ex-Article 2(3) of Directive 78/660/EEC and in ex-Article 16(3) of Directive 83/349/EEC (the 'TFV' principle),[2]
- it is *conducive to the EPG*, *and*
- it meets the criteria of *understandability*, *relevance*, *reliability*, and *comparability* required of the financial information needed for making economic decisions and assessing the stewardship of management.

The IAS Regulation does not offer a more precise definition for any of the three criteria, nor do the Accounting Directives. Concepts such as the TFV or the relevance and reliability of accounting numbers are controversial in the accounting literature, with different definitions of each concept being used simultaneously. Therefore, a clear-cut application of the endorsement criteria is not possible, and involved EU institutions[3] at each stage of the endorsement process are left with considerable discretion regarding their decisions on the endorsement of IFRS.

This paper aims to develop a framework against which to judge a new IFRS standard or IFRIC interpretation. In particular, the paper outlines the different dimensions by which an endorsement criterion can be interpreted and examines for the case of IFRS 9 how the new standard fares in relation to these different dimensions.

2.2. Key Endorsement Decisions

The application of the endorsement criteria in previous decisions provides some evidence of how the criteria were interpreted in the practice of EU law-making. The European Commission makes these decisions publicly available on its website.[4] Until today, all standards and all interpretations except one that were originally pronounced by the IASB were eventually endorsed by the EU and thus became binding accounting law for EU firms. In the case of IFRIC 3 on emission rights accounting, EFRAG advised against endorsement, and the IASB eventually withdrew the Interpretation, that is, there was no formal vote by any EU institution. These observations highlight that the endorsement process plays a more proactive role by making the EU a credible threat towards the IASB and thereby giving the EU greater power to intervene *ex ante* in the process of standard setting. The reclassification amendments to IAS 39 and IFRS 7 at the peak of the financial crisis in October 2008 are one illustrative example of the significant influence the EU has over the IASB (see André, Cazavan-Jeny, Dick, Richard, & Walton, 2009; Bischof, Brüggemann, & Daske, 2014). However, there are three (two) notable exceptions where a new standard (interpretation) was at least controversial in the endorsement process and where, in two cases, the endorsed standard differed from the original standard pronounced by the IASB (see Table 1 for an overview).

The history of endorsement decisions demonstrates that all three criteria are binding in the assessment of an accounting standard (or interpretation):

- The first controversy about the IAS 39 full fair value option for liabilities is related to the TFV principle (criterion (1)). The EU decision highlights that the TFV was interpreted in light of the two European Accounting Directives that did not permit a complete fair value balance sheet in achieving the TFV (Wüstemann & Bischof, 2007).
- The second controversy about hedge accounting in IAS 39 is related, at least indirectly, to the EPG (criterion (2)). The reasons presented to justify the carve-out were related to economic outcomes, such as artificial market volatility, that are potentially harmful for the European economy. In this decision, the EU also referred to the potential implementation costs for the financial industry, suggesting that a cost–benefit analysis is one means of operationalising the assessment of the EPG. Similar reasoning applies to the controversy about IFRIC 12, in which case the European Commission delayed its endorsement decision for two years, mainly in response to objections from Spain that were implicitly related to the EPG.
- The third controversy concerned the decision usefulness of the management approach underlying IFRS 8 for financial statement users such as analysts. This concern is what the relevance criterion (criterion (3)) typically captures in accounting research.
- The fourth controversy about IFRIC 3 led to the IASB eventually withdrawing the standard after EFRAG issued a negative recommendation. EFRAG's recommendation referred to both violations of the TFV criterion (1) and the qualitative criteria (3).

The history of enforcement actions also shows that carve-outs place an additional burden on firms that have equity shares cross-listed on the US capital market (approx. 80 major European firms as of 2014). The Securities and Exchange Commission (SEC) only accepts a firm's IFRS reports as being equivalent to financial statements based on US Generally Accepted Accounting Principles (GAAP) if the firms make no use of any EU carve-out. Therefore, cross-listed firms

Table 1. History of controversial endorsement decisions.

Accounting standard/ interpretation	Issue/ controversy	Endorsement concern
IAS 39	Fair value option for liabilities	'Article 42a of the Fourth Company Law Directive (Directive 78/660/EEC[a]) does not allow full fair valuation of all liabilities; the main category of liabilities excluded from fair valuation is companies fair valuing their own debt. Companies are therefore not allowed to use the full fair value option.' European Commission (2004).
IAS 39	Hedge accounting	'[The carve-out] reflects criticism by the majority of European banks, which argued that IAS 39 in its current form would force them into disproportionate and costly changes both to their asset/liability management and to their accounting systems and would produce unwarranted volatility.' European Commission (2004).
IFRS 8	Segment reporting	'The impact assessment carried out by the Commission did not sufficiently take into account the interests of users.' European Parliament (2007).
IFRIC 3 (withdrawn)	Emission rights	'EFRAG believes that application of IFRIC 3 will not always result in relevant financial information because in certain cases it does not faithfully represent the economic reality'. 'EFRAG also believes that the disadvantages that would arise from endorsing the interpretation outweigh the advantages of guidance on the accounting on the emission right schemes.' (EFRAG, 2005).
IFRIC 12	Service concession arrangements	'It has been argued that IFRIC 12 would make service concession activities economically less attractive and thereby make private sector financed infrastructure projects more difficult. During the [cost-benefit] analysis, Commission Services have found no evidence that IFRIC 12 would have such consequences.' European Commission (2008b).

Source: Authors' research.
[a]The directive has been replaced by Directive 2013/34/EU. The new Directive continues to prohibit the full fair value accounting for liabilities (see Article 8), that is, the endorsement concern is still valid.

tend to emphasise in the footnotes to their financial statements that their IFRS application is consistent with both EU regulations and the original IFRS as pronounced by the IASB. The more an EU version of the IFRS deviates from the original IFRS, the higher will be the costs of achieving simultaneous consistency through firms' accounting choices.

2.3. Public Perception of the Endorsement Process

From its inception, the endorsement process itself has been subject to public debate among researchers, practitioners, and regulators. To consider potential implications of an endorsement decision *ex ante*, it is important to be aware of these perceptions.

At its core, the endorsement process seems to conflict with the underlying objective of European IFRS adoption and the EU's financial reporting strategy because the EU's financial reporting strategy seeks to establish greater comparability of financial statements worldwide and to ease the acceptance of EU firms' financial statements on capital markets outside the EU (most notably in the US).[5] However, the comparability of financial statements of firms domiciled in different IFRS adopting countries and the acceptance of European financial statements by the

SEC are both at risk when the endorsement decision leads to carve-outs or other deviations of the EU version of IFRS from the original IASB-issued standards. That is, the decision not to endorse a standard is economically costly; prior evidence has shown that equity shares of EU firms had abnormal decreases in value when the decision about the IAS 39 carve-outs became publicly known in 2004 (see Armstrong, Barth, Jagolinzer, & Riedl, 2010). The literature views this conflict as a strategic dilemma that the EU faces in its decisions.

An alternative to the current endorsement criteria would be a formal process resulting in the mechanical endorsement of all IASB pronouncements when a pre-defined set of precise criteria is met ('check-list' or 'tick-box' approach).[6] Nevertheless, we argue that if the process were indeed mechanical, the EU would lose much of its political power over the IASB, which has steadily increased over the last decade (e.g. Walton, 2015). The reason is that the IASB could exactly predict at which point the pre-defined set of criteria would be technically met, and from that point onwards, the EU would lose any further influence. Therefore, in the current equilibrium, the endorsement criteria must provide EU institutions with at least some flexibility to deny the endorsement, which, at the same time, should lead to the IASB changing the standards beforehand in response to feedback from EU institutions, rather than those changes being implemented throughout the endorsement process.

Against this background, it is important to note that the IASB's development in the case of IFRS 9 was a six-year process of extensive consultation and debate starting in 2009 where several EU institutions became involved at different stages; this involvement did have an impact on the eventual standard. For example, institutions such as EFRAG, EBA, EIOPA, and ESMA frequently participated in the IASB's due process,[7] during which the IASB changed the standard significantly multiple times. When conducting our background research for this paper, we also examined the participation of EU institutions in the IFRS 9 due process and the IASB's responsiveness to comment letters. Based on these observations, we conclude that the IASB has taken positions brought forward by EU institutions seriously (see also Walton, 2015).[8] In fact, we argue that the IASB's behaviour is purely rational, as the private body itself struggles to gain legitimacy and funding (e.g. Danjou & Walton, 2012; Sunder, 2009), which are both severely threatened by a standard's failure in the EU endorsement process. Consistent with our view, observers of the SEC's role in the convergence project claim that the IASB's responsiveness to EU interests explains why the project is currently put on hold by the SEC (see Katz, 2014; Zeff, 2012).

There is wide consensus in the accounting literature that the present endorsement criteria lack precision, and there is a considerable unresolved debate about the correct interpretation of these criteria (see Alexander, 2006; Alexander & Eberhartinger, 2010; Wüstemann & Kierzek, 2005, 2006). However, while many commentators view the broad endorsement criteria as being too vague to establish legal certainty (see Schmidt, Berg, & Schmidt, 2011; Wüstemann & Kierzek, 2005, 2006), it is the vagueness of the criteria that largely establishes the political discretion necessary for the EU to have influence over the IASB *ex ante*. Uncertainty about the criteria impedes the IASB's ability to exactly anticipate the outcome of the process and, thus, gives EFRAG and other EU institutions more leverage in negotiations.

At the same time, the vagueness of the criteria makes the endorsement process susceptible to firms lobbying for special interests. For example, some call the application of the endorsement criteria in regards to IAS 39 of 'dubious merit' (Nobes & Parker, 2008, p. 226). Former French President Jacques Chirac's famous letter to then-President of the European Commission, Romano Prodi, on the subject of hedge accounting provides evidence that there needs to be political support at the highest level for an accounting standard to be put on hold during the endorsement process (see Walton, 2004; Whittington, 2008).[9] Thus, it is probably fair to emphasise that the EU's previous endorsement decisions led to the public impression that the process provides solely a means for national politicians to become involved *ex post*, that is, after the IASB's due process, and allows them to cater to vested interests.

Overall, and at the most general level, we caution against a premature decision not to endorse any standard, as such a decision would almost certainly lead to substantial economic costs and potentially hamper the EU's influence over the IASB in the future.[10] In light of this evidence, the endorsement criteria need to be regarded with great care, and the following chapters aim to provide a framework for such an assessment.

3. The TFV Criterion

The first endorsement criterion states that IFRS shall not be contrary to the principle set out in ex-Article 2(3) of Directive 78/660/EEC (4th Company Law Directive) and in ex-Article 16(3) of Directive 83/349/EEC (7th Company Law Directive), that is: 'The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss'. When these Directives were repealed by the Accounting Directive 2013/34/EC, the wording was taken up in Article 4(3) but framed within a broader and more descriptive context; see Appendix 1. In the accounting literature, this principle is known as the *TFV principle*. In this chapter, we (a) review the understanding of the TFV under the 4th and 7th Company Law Directives, (b) evaluate the interpretation of the TFV criterion in the endorsement process against this historical background, and (c) assess whether and, if so, to what extent the TFV comprises the prudence principle, as is frequently argued in the academic literature and in political debates.

3.1. The Lack of a Common TFV Interpretation under the EU's Accounting Directives

In line with the EU's objective to establish a common market (ex-Article 2 EC Treaty, now internal market in Article 3(3) Treaty on EU, Article 26 Treaty on the Functioning of the EU), the Commission started a process of *harmonising* national European accounting law. The effort resulted in the 4th and 7th Company Law Directives. The goal of these Directives was to create a 'level playing field' in a single market while still accepting differences in national implementation. It was the 4th Directive in 1978 that initially introduced the requirement for company accounts to provide a TFV.

While its historical origins lie in UK case law (see Alexander, 1993, p. 61), the principle is undefined and without a clear predecessor. Its great importance comes from the fact that first, through the Accounting Directives, it has become, from a legal point of view, one of the leading accounting principles for EU Member States (see Ordelheide, 1993, p. 81). Second, the different perceptions of its meaning and significance ever since its introduction into law 'are symptomatic of different cultural, legal and accounting attributes' (Alexander, 1993, p. 72) in the EU. Even today, after almost 40 years in existence, these different perceptions on what constitutes TFV remain significant.

These different perceptions are aggravated by different terminology and different legal standing that national legislators used in the integration of the TFV principle into national law (see Aisbitt & Nobes, 2001). Given that EU institutions accept largely heterogeneous and, in part, even contradictory measurement options into national accounting laws (see Ordelheide, 1993, p. 85), it seems clear that the EU had a broad understanding of the TFV principle. In addition, there is no ECJ decision that has pronounced an opinion on the *consistency* of different national interpretations of TFV in regard to the Accounting Directives.

Germany and the UK represent the extreme ends of the opposite approaches to TFV. In the UK interpretation, which is based on accounting practice under British case-law tradition with an emphasis on professional judgement of the accounting profession, the 4th Company

Law Directive of 1978 gives TFV 'an overriding importance, over and above "the provisions of this Directive"' (Alexander, 1993, p. 61). For British lawyers, TFV is a 'dynamic concept' (Arden, 1993, para. 14), and 'legislators or standard setters can affect its meaning by constraining practice, as can companies by making policy choices' (Nobes, 2006, p. 85). Thus, the UK interpretation attaches an importance to TFV that justifies deviations from other accounting rules (i.e. a TFV 'override'). These deviations occur frequently in UK accounting practice, with 1141 observations noted just for the five-year period from 1998 to 2002 (see Livne & McNichols, 2009, Table 1).

In contrast, in the German Roman law-based tradition, the methodology of legal interpretation requires gaps and ambiguities in the law to be closed in the context of the law itself. Thus, the more-specific ex-Article 31 on valuation principles (such as prudence) and the individual legal accounting rules of ex-Articles 34-42 of the 4th Company Law Directive 78/660/EEC were used to interpret the TFV.[11] Hence, by definition, a TFV is achieved if an account fully complies with all the individual rules stated in the Directive and, thus, allows no room for any override. Informational shortcomings that might arise from a too-prudent application of measurement rules shall rather be addressed in qualitative footnote disclosures (see Moxter, 1979; Ordelheide, 1993). These different approaches have implications for the role of prudence in the interpretation of the TFV principle, as it is only under the latter view that the TFV explicitly comprises the prudence principle.[12]

The two different approaches to TFV involve different risks of 'misreporting'. The UK position risks excessive violations of rules and earnings management based on TFV overrides, while the German position risks that a strict application of the rules may fail, in abnormal circumstances, to provide an adequate picture of the firm. We note, however, that empirical evidence indicates that there is a sufficient degree of flexibility in preparing financial statements under either approach, as any accounting rule offers some leeway for managers (e.g. Ball, 2006; Ball, Robin, & Wu, 2003; Burgstahler, Hail, & Leuz, 2006). Under the 'incentives-based view' that is now broadly established in the accounting literature (see Burgstahler et al., 2006; Christensen, Hail, & Leuz, 2013; Daske, Hail, Leuz, & Verdi, 2008, 2013; Leuz, Nanda, & Wysocki, 2003), it is clear that even a restrictive accounting system leaves considerable room for judgements. In particular, a number of large sample-based empirical studies have consistently documented that the less flexible Germanic accounting systems have significantly more earnings management in reporting practice than the more flexible British system (e.g. Daske, Gebhardt, & McLeay, 2006; Leuz et al., 2003). The robust findings illustrate that the TFV override that was fiercely discussed at the time of introduction has *not* been shown to be of first-order importance for actual financial reporting outcomes in more than 20 years of application.

We finally comment that the European Commission, through statements of its Contact Committee on Accounting Directives and its former Head of Unit for Accounting Standards, Karel Van Hulle, took two notable stands in the debate. First, it became clear that the TFV principle must be applied to the specific company (see European Commission, 1998), and 'Member States cannot introduce rules or standards which would be contrary to the rules in the Directive, otherwise the harmonisation objective would be seriously impaired' (Van Hulle, 1997, p. 714).[13] The statement puts at least some limit to the 'dynamic concept' of TFV interpretation and to the view that 'in short: true and fair is what British accountants declare it to be' (Ordelheide, 1993, p. 82). Second, Van Hulle (1997, p. 719) commented that the introduction of TFV is an 'admission of modesty on behalf of the regulator', because 'no regulator is perfect and the accounting rules and standards which have been designed for the majority of cases can never take account for all cases which may arise in practice'.

3.2. The Role of the TFV Interpretation in the IFRS Endorsement Process

The IAS Regulation's direct reference to the Accounting Directives' TFV principle sheds a different light on the problem of the TFV interpretation. While practical implementation of the Accounting Directives resulted in some equilibrium over the years, with different Member States following different interpretations under national accounting principles, the endorsement process of IFRS/IFRIC requires a *uniform* 'European' interpretation of the TFV criterion. In short, the question in this context is whether the criterion fails whenever a new IFRS is inconsistent with any part of the Accounting Directives or whether the criterion is a dynamic, albeit less precise, one.

Evidence from prior EU legislation is inconclusive: On the one hand, the EU endorsed IFRS 3 'Business Combinations' early in the process, and the standard became binding European accounting law in 2005. The standard does not allow for the systematic amortisation of purchased goodwill, which was, and still is, incompatible with the wording of Articles 34 and 37 of the 4th Company Law Directive. The EU's assessment that the standard still meets the TFV criterion clearly implies that IFRS do not need to map one-to-one into the Accounting Directives in order to be able to establish a TFV.

On the other hand, the amending Directive 2003/51/EC aligned with a narrower view. The Directive amended the original Accounting Directives in 2003 by permitting the broader use of fair values in national accounting laws. The change was explicitly motivated by the need to facilitate the endorsement of IFRS. It was argued that the change in the fair value rules was necessary for the spirit of the Directives to be in general accordance with IFRS so that a TFV could be reasonably achieved through IFRS application (see Directive 2003/51/EC, Recitals 6-8). Directive 2003/51/EC thus suggests that individual accounting rules outlined in the EU's Accounting Directives do matter for the interpretation of the TFV principle.

The only ECJ ruling on the *interpretation* of TFV[14] (declared years before the IAS Regulation) also supports the narrower view. In the context of the Tomberger/Wettern Case in 1996 (Case C-234/94), the ECJ clarified that the 'Application of that [i.e. the TFV] principle must, as far as possible, be guided by the general principles contained in Article 31 of the Fourth Directive' (European Court of Justice, 1996, para. 18). That understanding follows a more restrictive interpretation of Article 2(5), which would mean that TFV 'cannot act as the basis for the establishment of fundamentally different accounting principles and rules contradictory to the explicitly stated principles and rules of the EC Directive' (Ordelheide, 1993, p. 83).[15] Following the ruling, consistency with at least Article 31 must be necessary for a TFV to be achieved. This is one key reason commentators emphasise the importance of Article 31's prudence principle for the endorsement process (e.g. Wüstemann & Kierzek, 2005, 2006).

However, the Tomberger/Wettern case was a highly specific one. The court even noted that 'it should be emphasised at the outset that [. . .] the question arises in the context of highly specific circumstances'.[16] Even though the Court referred to the principles in Article 31 of the 4th Company Law Directive (such as prudence), the Court's *actual verdict* resulted in *earlier* recognition of dividends (which goes against prudence). The ECJ also seems to accept that there can be different national meanings and not only one binding interpretation of TFV. The Court did not conclude that the unapproved dividends should be treated as revenue (para. 25) but rather that it is not contrary to TFV for a national court to consider that the profits in question must be entered in the parent company's balance sheet (see Nobes, 2006). Nobes (2006) interprets this statement as evidence that there can be multiple TFVs, consistent with the view that there is no 'the' TFV, but rather 'a' TFV. Accordingly, 'endorsement of an IFRS can be quite proper even if a non-IFRS treatment could also give a TFV' (Nobes, 2006, p. 82).

3.3. The Role of the Prudence Principle for the Application of the TFV Criterion

For the endorsement of a new IFRS/IFRIC (such as IFRS 9), the most controversial issue with the TFV criterion is the new standard's potential failure to comply with the *prudence principle*. As discussed above, compliance with the prudence principle outlined in Article 31 of the 4th Company Law Directive (and Article 6 of the new Accounting Directive 2013/34/EU) is viewed by some as a pre-condition for a standard to comply with the TFV principle. Our discussion of prior endorsement decisions and evidence on TFV interpretation in individual Member States shows that this link can be challenged on very reasonable grounds. In particular, the link hinges on whether the TFV principle itself embodies the prudence principle, as the IAS Regulation does not directly require the latter principle to be tested in the endorsement process. Yet, the following discussion is based on the *assumption* that a new IFRS/IFRIC will need to follow the prudence principle for meeting the TFV criterion. Also, as a matter of practical fact, EFRAG consider prudence in their (Draft) Endorsement Advice to be a component of TFV, and they test whether a new IFRS/IFIC leads to prudent accounting.[17]

Against the background of IFRS 9, an obvious reason for placing importance on prudence is the dissatisfaction with the role of accounting standards (and, most notably, IFRS) in the financial crisis. The G20 in its 2009 London Summit explicitly urged the standard setters to improve the standards on valuation and provisioning (see G20, 2009, para. 15). The perception was that a lack of prudence in IFRS helped create the over-expansion of credit, unrealised profits, and, therefore, unjustified bonuses and dividends.[18] The role of fair value accounting in the crisis was heavily debated even by the highest ranks of political leaders (see André et al., 2009). However, empirical findings in the academic literature that have emerged in the years following the crisis paint a more balanced picture. Based on this evidence, the Basel Committee concluded in a recent report that there is (still) no evidence that would support the notion that fair value accounting triggered or even exaggerated the crisis.[19]

One should also note that fair value accounting is not only about the recognition of unrealised gains, but also requires the early recognition of expected losses. Overwhelming evidence in the accounting literature suggests that early anticipation of future losses is key to oversight bodies (board of directors or prudential regulators) being able to implement corrective measures in time (e.g. Beatty & Liao, 2011; Bushman, inpress; Bushman & Williams, 2015). However, there are significant delays in taking impairments and write-downs of assets measured in other ways than fair value in times of crisis (e.g. Vyas, 2011). Recent research also provides evidence that the public fair value debate in the media and by US congresspersons was rather fostered by the vested interests of the banking industry to avoid the reporting of losses (see Bischof, Daske, & Sextroh, 2016; Becker, Daske, & Sextroh, 2016). More generally, when analysing banks' lobbying activities against fair value accounting, it has been shown that it was the opaque banks that were most actively calling for more-prudent accounting practices (see Hodder & Hopkins, 2014). Overall, this collective evidence convincingly suggests that the objectives behind the prudence principle outlined in the Accounting Directives (e.g. financial stability) may instead be mainly achieved through fair value reporting. Vice versa, too strict of a historical cost regime potentially endangers these objectives to an even greater extent.

Consistent with this view, there is no other EU legislation or ECJ judgement that would directly link the prudence principle to pure historical cost accounting. In fact, the EU seems to accept that different Member States have different interpretations of prudence (e.g. Evans, 2004).

We note that there are different understandings of 'prudence'. The concept is often used interchangeably with the concept of 'conservatism' that is rooted in the US literature.[20] While not necessarily identical, it is still useful for the assessment of IFRS 9 to consult the empirical accounting literature that tests the economic effects of ‘conservatism’ in two different forms (see Watts, 2003):

- unconditional conservatism (*ex ante* and unrelated to news), which mechanically measures assets at an amount lower, and liabilities at an amount higher, than their current value, and
- conditional conservatism (*ex post* and driven by news on asset values), which incorporates bad news into asset and liability valuation in a more timely fashion than good news.

Robust *evidence* indicates that it is conditional conservatism that fosters lower cost of capital, increases investments, and supports economic growth (e.g. Bushman & Piotroski, 2006; Kim & Zhang, 2016; Lara, Osma, & Penalva, 2011). Nevertheless, the Continental European countries whose accounting systems were most restricted to historical cost measurement show empirically low levels of conditional conservatism in actual reporting outcomes (Bushman & Piotroski, 2006; Raonic, McLeay, & Asimakopoulos, 2004). Again, these insights from the empirical literature suggest that viewing prudence in light of a stale application of historical cost measurement does not necessarily lead to ‘prudent’ reporting outcomes in practice.[21]

Apart from academic evidence, the Accounting Directives do not limit asset and liability measurement to historical or amortised cost. Article 7a of the 4th Company Law Directive and Article 8 of the new Accounting Directive 2013/34/EU provide a number of options for Member States to permit the use of fair values even beyond the scope of financial instruments. If strict compliance with individual rules of the Accounting Directives leads to prudent reporting and ultimately establishes a TFV, fair value measurement per se cannot contradict the TFV principle. The new Accounting Directive’s Recital 9 is more explicit:

> systems of fair value accounting provide information that can be of more relevance to the users of financial statements than purchase price or production cost-based information. Accordingly, Member States should permit the adoption of a fair value system of accounting by all undertakings or classes of undertaking.

Ultimately, the question comes down to whether the scope of fair value accounting required by a new standard such as IFRS 9 is compatible with the EU Accounting Directives. To address this question, it is helpful to begin by considering the existing reporting practice of European banks under a previous standard (here, IAS 39) and to gauge the extent to which measurement is likely

Table 2. Use of IAS 39 measurement categories by European banks.

	Assets			
Measurement category	Mean (%)	Median (%)	Min (%)	Max (%)
Loans and Receivables	71.9	75.7	4.5	98.9
Held to Maturity	1.7	<.01	0	33.6
$\sum$ ***Amortised Cost***	***73.6***	***77.7***	***4.5***	***98.9***
Trading Securities	7.8	3.1	0	79.4
Derivatives	2.7	1.2	0	29.6
Fair Value Option	4.7	0.9	0	88.6
$\sum$ ***Fair Value***	***15.3***	***8.9***	***0***	***94.3***
Available-for-sale Assets	8.0	5.4	0	54.8

Source: Own data (320 firms, 2006–2010), % of total assets.

to change. The evidence is summarised in Table 2. The data indicate that the two amortised cost categories still account for approximately 75% of bank assets and that the use of the fair value option is actually quite limited (less than 1% of total assets for the median bank).

If we apply this evidence to IFRS 9, most IAS 39 Loans and Receivables and Held to Maturity assets will likely meet the requirements for amortised cost accounting,[22] while IAS 39 fair value assets will generally continue to be reported at fair value. IFRS 9 adoption will, therefore, increase fair value usage only modestly, with the average level of fair value usage being substantially lower than the level of amortised cost. Accounting rules for liabilities will cause even less change to the measurement bases. It is also important to note that the largest class of fair value assets are trading securities and derivatives. It is this class of instruments for which many Member States, including Germany, already prescribe fair value accounting under national accounting law at least for financial institutions (i.e. in accordance with the Accounting Directives).

Overall, if we benchmark IFRS 9 against the rules embodied in the Accounting Directives, it is not possible to argue that the new standard systematically deviates from either the general spirit of the Directives or the individual rules on asset and liability measurement. We can only apply the prudence principle in the context of these Directives. There are extremely restrictive interpretations of the prudence principle that seem to suggest that fair value accounting per se is an imprudent reporting practice. However, not only are these interpretations purely theoretical, but they are also inconsistent with the general consensus in the accounting literature of what meaningfully constitutes a prudent (or 'conservative') accounting system. Therefore, these interpretations cannot play a role in the assessment of an IFRS endorsement (Nobes, 2015, comes to a similar conclusion). Thus, IFRS 9 meets the prudence principle as it exists under the present Accounting Directive 2013/34/EU.

3.4. The Role of Footnote Disclosures for the Application of the TFV Criterion

The Accounting Directives frame the TFV concept within a broader context (see also Appendix 1), and they place additional emphasis on notes disclosures:

> Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, *such additional information* as is necessary to comply with that requirement *shall be given in the notes to the financial statements*. (Italics added by the author)

Taken literally, the framing suggests that any potential violation of TFV in recognition and measurement could be outweighed by adequate disclosures in the footnotes.[23] This interpretation potentially softens the TFV requirement and makes non-endorsement of IFRS/IFRIC less likely because alternative accounting treatments are often required to be disclosed in the footnotes. For example, in the case of financial instruments and IFRS 9, corresponding IFRS 7 disclosures provide additional information on alternative measurement bases for the different categories in the footnotes to the financial statements. EFRAG, in a response letter to the European Commission, already recognised accompanying footnote disclosures required by IFRS 7 in their evaluation of IFRS 9's compliance with the TFV principle (see EFRAG, 2015a, p. 2).

However, we caution against overstating the role of note disclosures because, in a strict sense, the reference to additional footnote disclosures simply confirms that the Accounting Directives leave little room for compromising fundamental principles of recognition and measurement. Thus, if the rigorous application of recognition and measurement principles (such as the prudence principle) were to result in a violation of the TFV principle, the solution would not be to adjust the measurement base but rather to provide complementary footnote disclosures (Najderek, 2010).

3.5. Conclusions

We conclude that the endorsement of IFRS 9 cannot reasonably be rejected on the grounds of the TFV criterion (of Article 3(2) IAS Regulation). Overall, we are not convinced that current EU legislation or available ECJ jurisprudence require annual accounts to comply with the prudence principle to achieve a TFV. Still, there are prominent views in the literature and strong voices in the political debate that make this point. However, even if the TFV criterion embodies the prudence principle, this principle can only be interpreted in light of the current Accounting Directive. In terms of asset and liability measurement, IFRS 9 will not lead to significant deviations from the accounting rules included in the Accounting Directive (at least in the form of Member State options). When prudence is interpreted while taking into account the Accounting Directive, IFRS 9 cannot be judged to result in a violation of this principle.

We still acknowledge that there is an obvious need to limit managerial discretion in accounting valuation. The recent financial crises have demonstrated that accounting valuation, among other actions, can lead to excessive dividend pay-outs, bonus payments or risk-taking. Nevertheless, empirical evidence consistently shows that such excessive behaviour is not successfully prevented through a purely cost-based accounting regime. To the contrary, such a regime most likely has the most adverse consequences for the stability of financial markets. It also makes us suspicious, in light of the past crises, that it has been the financial industry and their associations that have persistently been lobbying for cost-based accounting regimes. Therefore, we recommend that regulators consult other institutions, such as the enforcement authorities or prudential supervisors, when aiming to restrict excessive manipulation of accounting figures. The suspension of fair value accounting, for example, through the rejection of IFRS 9, would not help achieve this goal.

4. The Qualitative Criteria

The second set of endorsement criteria refers to ‘the technical criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management’. In this chapter, we (a) present available definitions for the ‘technical’ criteria – or in the language of standard setting, ‘qualitative characteristics’ – as well as their operationalisations in the scientific literature; (b) outline possible conflicts among these criteria when drafting accounting standards; and (c) offer conclusions on the implications of this analysis for an IFRS endorsement advice based on these technical criteria, using IFRS 9 as an application case.

4.1. Understandability

All available definitions of the criterion ‘understandability’ require assessing whether the information resulting from the application of a standard will be understandable by a knowledgeable user and not unduly complex.[24]

The scientific literature has only operationalised the criterion ‘understandability’ in the context of controlled laboratory experiments. Under laboratory conditions, one is able to analyse whether different types of *presentations* of accounting information make a difference in users’ understanding of that piece of information. On the downside, it remains questionable how generalisable those insights from the lab are to a real world setting, that is, their external validity (see Koonce, Lipe, and McAnally (2005) for a fair value-related example). At the same time, empirically disentangling the form and style of the presentation of a specific piece of information from its content, the reasons for the presentation choice (e.g. the underlying transaction or business model), and other influences such as simultaneous disclosure events, is almost impossible when using real world settings, that is, the internal validity is a concern (e.g. Gassen, 2014). Accordingly, we note that the scientific literature does not offer any guidance on how one can judge whether a new IFRS standard will lead to understandable and less-complex information.[25] We can therefore only provide a subjective judgement based on our own perception of the standard's understandability and complexity.

4.2. Relevance

All available definitions of the 'relevance' criterion require relevant information to have an impact on the economic decisions of users through predictive values (i.e. by helping users to evaluate past, present or future transactions and other events that impact the firm's future cash flows) or through confirmatory values (i.e. by helping users confirm or correct their prior expectations about the firm).[26]

The definition assumes that we understand how users incorporate accounting information into their decision-making and that we can judge what impact an accounting standard will have on users' economic decisions. Another challenge is the co-existence of many different user groups (e.g. equity vs. debt investors, compensation committees, labour representatives, prudential supervisors), when each group follows a distinct approach on how to formalise expectations and assess financial reporting information.

The accounting literature has tried to operationalise 'relevance' through a number of empirical proxies and in the context of different research designs, primarily with 'value relevance' and 'earnings quality' designs. In the value relevance literature, 'an accounting amount is defined as value relevant if it has a predicted association with equity market values' (Barth et al., 2001, p. 79). Researchers use the level of stock prices or changes in stock returns as valuation benchmarks against which to assess how well a specific piece of accounting information reflects information potentially used by investors (see Barth et al., 2001). Under this design, it remains unclear what is the mechanism behind the association observed.[27] This is one key reason why the relevance of 'value relevance' studies for standard setting purposes is highly controversial (see Barth et al., 2001; Holthausen & Watts, 2001), despite the voluminous evidence documented in the literature (for IFRS-related studies see Harris & Muller, 1999; Song, Thomas, & Yi, 2010).

In the earnings quality literature, which also attempts to capture the 'relevance' of accounting information (e.g. Dechow, Ge, & Schrand, 2010), researchers use three categories of earnings quality proxies: (a) the magnitude of earnings management, (b) investor responsiveness to earnings, and (c) external indicators of earnings misstatements. Nevertheless, all of these approaches share the limitation of needing actual available data for application in practice, and the evaluation is at a very high aggregation level.

4.3. Reliability

Despite its central role, the 'reliability' criterion is a 'complex and elusive construct of accounting information', where '[e]ven expert accountants do not necessarily agree on the nature of reliability characteristics' (Maines & Wahlen, 2006, p. 400). In addition, '[r]eliability is difficult to specify precisely in accounting standards and practice, and it is difficult to examine directly with research' (Maines & Wahlen, 2006, p. 399). Many of these differences stem from different national backgrounds, with some jurisdictions viewing reliability as comprising the prudence principle. There still seems to be a minimum consensus that the following characteristics should be considered when judging the 'reliability' of accounting information:

- completeness,
- free from material error and bias, and
- faithful representation.

Traditionally, the Conceptual Frameworks of the Financial Accounting Standards Board (FASB) and IASB have stated that reliability, in combination with relevance, determines the usefulness of accounting information and that there must be the right balance between relevance and reliability (see FASB, 1980; IASB, 2010, para. 4.64). The IFRS Conceptual Framework no longer refers to reliability by name, but rather emphasises two characteristics of reliability, that is, *representational faithfulness*, and *verifiability*,[28] where information must be complete, neutral, and free from error. The IASB argues that the term 'faithful representation' describes those latter aspects better than the term 'reliability'. This is largely consistent with the view of the US-based accounting literature on reliability (see Barth et al., 2001; Linsmeier, 2013),[29] but it means that the IASB effectively removed one of the IAS Regulation's qualitative criteria from its Conceptual Framework (at least in wording). EFRAG, while using different terminology, uses a similar list of characteristics in their assessment of IFRS 9.[30]

Reliability concerns regarding accounting information arise because the managers preparing financial statements respond to reporting incentives by 'interpreting or applying standards in a non-neutral fashion' (Maines & Wahlen, 2006, p. 400). In other words, a voluminous academic literature and common experience of regulators and market participants show that managers use the inherent discretion in all accounting systems to their advantage. Conservative accounting standards are supposed to counterbalance this potential bias (see, e.g. Watts & Zimmerman, 1986). The difficulty, however, is that the extent of reliability issues, and the way managers use their discretion (e.g. through opportunistic accounting choices or through the structuring of transactions), 'depend[s] on the interaction between preparers' specific incentives (including auditing and enforcement) and the accounting standards' (Maines & Wahlen, 2006, p. 400). In addition, different reliability concerns frequently arise under different accounting alternatives, and there is a trade-off in how one judges the relative importance of these reliability concerns under each alternative. For example, in accounting for financial instruments during economic downturns under amortised cost, there is discretion in determining whether an impairment should be taken, and under fair value accounting, there is discretion in determining the lower market value when the instrument is not traded. In economic upturns, there is the same discretion in determining market values under fair value accounting, while under amortised cost there is discretion in selling and realising only those instruments that have accumulated positive value changes, while continuing to hold those assets with negative value changes ('cherry-picking'). Therefore, both valuation principles, ceteris paribus, potentially lead to overvaluation of assets in the balance sheet under both economic scenarios. Therefore, we not only need to identify potential reliability concerns that arise from IFRS 9 adoption, but we also need to balance those concerns with simultaneous concerns under alternative accounting solutions.

4.4. Comparability

There are two conceptual levels at which the 'comparability' criterion can be defined. Traditionally, comparability requires preparers to account for similar economic transactions in the same way (across firms or over time) and for different economic transactions in different ways (preparer perspective).[31] More recent definitions instead define the former requirements as 'consistency', and regard consistency as a component of comparability that helps achieve comparability.[32] 'Comparability' tends to be more broadly defined as enabling users to identify similarities and differences between two sets of economic phenomena (user perspective) (see Barth, 2007; Barth, Landsman, Lang, & Williams, 2012; De Franco, Kothari, & Verdi, 2011; IASB, 2015a, para. 2.24). Thus, this definition adds the requirement for accounting rules not only to depict similar economic transactions in a similar way and different economic transactions in different ways but also to enable users to externally identify similarities and differences from the highly aggregated information that is presented in the annual reports. Overall, the new definition places significant additional weight on information presentation and disclosure in financial statements.[33]

Scientific studies that research comparability typically judge the extent of comparability by relating aggregate summary measures of the accounts (such as earnings or book values) to aggregate proxies for economic outcomes (such as stock returns).[34] However, this approach is not suitable for judging a standard *ex ante*, because the necessary data only becomes available after adoption of the standard, and the empirical proxies for comparability are at too high of an aggregation level to judge the effect of an individual standard.

Threats to comparability due to inconsistent accounting practices reflecting identical economic transactions could conceptually emerge primarily from

- the availability of explicit accounting choices and options,
- the usage of managerial discretion inherent in standards, and
- inadequate presentation and disclosure of the actual usage of these options.

Therefore, we base our analysis of whether IFRS 9 meets the requirement of 'comparability' on these conceptual sub-criteria.[35]

4.5. Trade-offs in Technical Criteria and in Decision Usefulness vs. Stewardship

Information produced under the technical criteria should be useful for making economic decisions and assessing the stewardship of management. The general definition of the criteria shows that there exist inherent trade-offs in the four criteria. Moreover, there are sub-characteristics that need to be considered and balanced in any standard, and there may be additional trade-offs when these criteria are applied for the intended purpose of a standard.

Table 3 summarises the most important trade-offs that arise in the assessment of the technical criteria. Additional trade-offs emerge because accounting is a multi-purpose concept that is designed to address the needs of different user groups.[36] For example, the EU endorsement criteria describe the two main purposes as being 'decision usefulness' and 'stewardship'. While, in short, the former is asking for information to predict *future* cash flows (i.e. to improve *price efficiency*) (see Gebhardt, Mora, & Wagenhofer, 2014), the latter provides information that is useful in assessing management's *past* actions (i.e. to improve *economic efficiency*) (see O'Connell, 2007; Whittington, 2008). Thus, the objectives of decision usefulness and stewardship are potentially achieved through different accounting rules (see Drymiotes & Hemmer, 2013), with the two different types of efficiencies frequently placing different weight on individual criteria. Table 4 summarises the most critical of these conflicts (see Gebhardt et al., 2014, p. 110).

4.6. Conclusions

These deliberations demonstrate the great challenges involved in testing an accounting standard for the four technical criteria prescribed by the IAS Regulation. While the definition of each individual criterion is generally accepted among academics (with the exception perhaps of reliability)

Table 3. Trade-offs in the IAS regulation's technical criteria.

Trade-off	Description
Relevance vs. reliability	Some information may be conceptually highly relevant for economic decisions, but so unreliable to measure that its relevance may get greatly impaired in practice and it is subject to manipulation.
Neutrality vs. prudence/ conservatism	Faithful representation requires information to be presented neutrally in an unbiased manner, yet strict definitions of prudence require asymmetric treatment of good vs. bad news.
Relevance vs. comparability	To adequately portray a variety of economic transactions, a range of reporting options may be necessary, but allowing reporting options will potentially impair comparability across firms.
Completeness (reliability) vs. understandability	Completeness requires extensive reports with high levels of disaggregation, while understandability requires less complexity and more focused reports.

and each one has been operationalised in research, several of the criteria conflict with each other and involve significant trade-offs. Thus, any endorsement advice based on these criteria is necessarily subjective and based on individual perceptions of how well a standard reflects and balances the different criteria. Overall, we can conclude that IFRS 9 does not clearly contradict any one of these principles. Most importantly, the less-complex structure of the standard (compared with its predecessor IAS 39) will likely improve understandability. Apart from this, there are many accounting issues for which the verdict goes in both directions. Table 5 summarises the most important of these issues, which leads us to conclude that the endorsement of IFRS 9 as a whole cannot reasonably be rejected on the grounds of the technical criteria.

5. The Criterion of the EPG

The third endorsement criterion states that IFRS can only be endorsed if 'they are conducive to the European public good'. In this chapter, (a) we outline the elusiveness of this criterion and offer an interpretation of how it entered the endorsement requirements; (b) we summarise approaches in the literature and from other EU public policy areas that attempt to capture the concept; (c) we review the accounting standard setters' approach of cost–benefit analyses when drafting and evaluating a new accounting standard and the criteria suggested by Philippe

Table 4. Trade-offs between decision usefulness and stewardship.

Trade-off	Description
Level of verifiability	While investors can discount less verifiable information *ex post*, contracts define the use of information *ex ante* thereby causing verifiability issues which eliminate its usefulness in contracting and stewardship.
Transactions vs. expectations	Past transactions are relevant for decision usefulness to update own prior expectations; for stewardship, past transactions assess whether management fulfilled its goals; hence, accounting information that is built on past transactions is more important for stewardship.
Transitory items	Transitory items are probably not well suited for decision usefulness because they make forecasting more difficult, but for stewardship, transitory items can provide information about how management handled its responsibilities.
Timeliness	Decision usefulness benefits more from timely information than stewardship since the latter puts more weight on the confirmatory function than on timely provision of information.

Table 5. Expected effects of IFRS 9 adoption on the technical criteria.

IFRS 9 Accounting rule	Expected effect on: Understandability	Relevance	Reliability	Comparability
Financial asset classification	+[a]	o[b]	o	−[c]
Fair value option	+	+	o	−
Compound instruments	+	+	o	+
Own credit risk changes in liability fair values	+	−	o	−
Recycling of OCI gains/losses from equity instruments	−	−	+	+
Expected loss model	−	+	−	o
Hedge accounting	+	o	+	−

[a]positive expected effect.
[b]neutral expected effect.
[c]negative expected effect.

Maystadt, Special Adviser to Commissioner Barnier; and (d) we summarise the implications for our endorsement advice in the case of IFRS 9.

5.1. *Definition and Intended Use*

The IAS Regulation does not explain what is meant by stating that an accounting standard should be 'conducive to the European public good' (EPG). It is therefore open to interpretation. The EU Commission seems to acknowledge that this criterion is of a 'political nature' (Van Hulle, 2004, p. 369). Critics go further in arguing that this criterion is 'inherently incapable of interpretation in an objective or operationally effective way' (Alexander, 2006, p. 71)[37] in endorsement decisions. Proponents counter-argue that one benefit of the criterion could be to grant a 'more flexible approach taking into account the specifiers of each standard' (Expert Group on the IAS Regulation, 2014, p. 3).

When analysing how the EPG criterion became an endorsement criterion, we observe a shift in semantics in the process, which has implications on the feasibility of capturing this criterion in endorsement advice. The precise wording in Recital 9 of the IAS Regulation reads

> To adopt *an* international accounting standard for application in the Community, it is necessary [. . .] that, *in accordance with the conclusions of the Council of 17 July 2000*, it is conducive to the European public good. (Italics added by the author)

Thus, the motivation to include this endorsement criterion seems to date back to these intentions of the Council. However, in the minutes to the 2283rd Council meeting referenced above, the EU's Economic and Financial Affairs Council (ECOFIN) states in Recital 3 to their new European accounting strategy that

> In recognising these international accounting standards, the European Community will ensure that *they* are *in fact* conducive to the European public good and that they can be used by European undertakings with full legal certainty. (Council of the EU, 2000, p. 8, Italics added by the author)

We infer from the words 'they' and 'in fact', from the content of the surrounding Recitals, and from the shift in the Council's strategy to move from local GAAP to supporting IFRS that the

Council may have had different intentions at the time. First, the term 'in fact' indicates that the Commission should make sure to monitor that adopting IAS/IFRS as a reporting system really delivers (*ex post*) the net benefits to the EU that proponents expected. We think that this statement has to be interpreted against the background of national resistance, at the time, to move away from local GAAP (see as an example Hoarau, 1995). Second, the term 'they' is consistent with our interpretation that IAS/IFRS as a reporting system (rather than an individual standard) should deliver measurable benefits.

In sum, individual IAS/IFRS standards should be evaluated *ex ante* regarding whether they are likely to be conducive to the 'European public good'. We note that it is already challenging, even when using 10 years of data, to present robust evidence on whether IFRS as a reporting system delivered net benefits relative to local GAAP *ex post* and, thus, were so far 'conducive to the European public good'.[38] Judgement of the effects of *individual* standards (where one has to disentangle the effects of the new standard from the effects of all the other standards) and *ex ante* – without any empirical data – is even more difficult.

5.2. A Public Interest Perspective

When trying to answer the question of what the EPG stands for, the consensus from many different fields of public policy research is that although the references to the EPG in EU politics are very frequent (see Sapir, 2003, p. 89), 'there is a lack of clarity in setting out what exactly is meant by a EPG' (Zuleeg, 2009, p. 7). We make the following observations:

First, the reference clearly signifies the *European* public good. The EU-level of interest is distinct from a reference to a single national interest (e.g. relevant in case of adverse feedback in endorsement mainly coming from one Member State) and from the global level of the IASB (see Effects Analysis Consultative Group, 2014, para. 32–33; e.g. relevant when US interests inappropriately affect IFRS in the due process).

Second, we find that the component 'public good' is reflected in many official EU languages as 'public interest'.[39] This distinction is relevant when operationalising the EPG as an endorsement criterion because 'public good' is a concept rooted in public economics, while 'public interest' is a concept from the political sciences. They differ in their definition and operationalisation. The majority of EU languages, as we understand, rather follow the concept of 'public interest' in the IAS Directive.

Third, political philosophy does not deliver a consensus on whether there exists, and what would constitute, a 'public interest'. Political scientists are split on whether they follow normative theories, abolitionist theories, process theories, or consensualist theories, each of which has different implications on what constitutes 'public interest'. While for some, public interest in policy-making activities is nothing more than a rhetorical costume for special interests (abolitionist), others consider public interest a valuable term that refers to policy debate in which protagonists do consider morals, principles, and community values in their reasoning over and above their own special interests (consensualists; see Cochran, 1974).

Fourth, references to other EU policy areas do not provide much guidance. The literature discusses whether the EPG can be formed based on EU values and goals or (from the rationales of EU policy) based on political, social, and environmental reasons. Accounting standards fall under the EU's strategy to create a Single Market. In general (see Van Mourik, 2013, p. 195), accounting standards serve this interest by preventing capital markets from breaking down due to uninformed investors withdrawing from capital markets (see Lev, 1988) or due to informed investors having insufficient incentives to invest because of low-value information sources (see Grossman & Stiglitz, 1980). However, any proposed changes to the existing

IFRS (such as replacing IAS 39 with IFRS 9) are unlikely to have such massive effects. Their contribution will be more subtle.

Fifth, due to the elusiveness of the criterion, the vast majority of independent accounting scholars understand any 'political' intervention into the standard setting of experts and into the content of technical accounting issues to be purely driven by the vested interests catering to the needs of powerful industries resisting transparency (in abolitionist thinking).[40] Based on such concern, the Institute of Chartered Accountants in England and Wales (ICAEW) has developed a framework of issues to consider when justifying or challenging the justification of an action as being in the public interest (see ICAEW, 2012, pp. 5–8). This ICAEW framework is an honest attempt by the profession to help regulators and politicians in critically judging suggestions put forward by vocal, vested interest groups on the grounds of being in the public interest. We also observe a small number of an emerging type of politicians who focus on 'transparency' issues (many being affiliated with the European Greens), who are likely to be less affected by *corporate* lobbying (because they use their independence as a commitment device) and, thus, should be better advocates for transparency issues.[41] The downside for standard setting is that they often try to use the umbrella of 'accountability' to push topics such as consumer protection, gender issues, or carbon disclosures on the agenda, which are, at best, loosely related to *financial* reporting standard-setting. Nevertheless, 'the public interest and the requirement to serve the public, has one meaning for members of the profession and another meaning for members of the public' (Dellaportas & Davenport, 2008, p. 1089).

5.3. Concepts of Serving the Public Interest

Private standard setters, such as the IASB, also claim to serve the 'public interest' primarily through bringing 'transparency, accountability and efficiency to financial markets'.[42] Although the IASB outlines in its recently published mission statement that their work serves the public interest by 'fostering trust, growth and long-term financial stability in the global economy', their working credo is nevertheless that those objectives will be automatically achieved in the long run by making financial markets better, that is, they have no direct relevance to their standard-setting process. Furthermore, the IASB does not recognise any social responsibilities in its constitution beyond those of establishing a set of high-quality accounting standards that will 'help investors and other participants in the world's capital markets and other users of financial information make economic decisions'.[43]

When operationalising the public interest in setting accounting standards, the standard setters' approach towards this issue has traditionally been to focus on the stated objectives of standard setting, assuming that a standard should be in the public interest if it scores high on the technical qualitative characteristics of the framework. More recently, standard setters have tried to conduct a cost–benefit (or 'economic' or 'effects') analysis of individual standards.

5.3.1. Standard Setters' Cost–benefit Analysis

Cost–benefit analysis is conceptually rooted in economics and is a widely used tool in public sector decision-making, in particular in the infrastructure, transport, energy, and telecommunications sectors. For example, the EU has its own guide, comprising more than 250 pages, for the cost–benefit analysis of investment projects (see European Commission, 2008a). Cost–benefit analysis is a variant of classical capital budgeting that aims to start only those projects that deliver a positive net present value. Implementing a cost–benefit analysis requires (a) identifying and quantifying (i.e. assigning monetary value) to all expected benefits and costs, (b) allocating those components to the relevant periods during which they are expected to be realised, and (c) selecting the appropriate discount rate(s) (adjusted for risk and time value of money).

Cost–benefit analysis can be further complicated by potential deadweight losses (might cause excess burden or inefficient allocation of resources), distributional effects (might introduce winners and losers into society), and behavioural effects (might have adverse effects on the behaviour of some constituents in society).[44] Cost–benefit considerations have also been included in the mission statements and conceptual frameworks of private accounting standard setters.

The introduction of these considerations into accounting standard setting historically originated from the SEC, a US governmental supervisory organisation where cost–benefit analysis, or economic analysis, is an essential part of its rule-making. The SEC deferred the development of accounting standards, along with its cost–benefit concept, to the private-sector standard setter, the FASB, looking for leadership in setting accounting principles (Zeff, 2010).[45] The IASB, influenced by the US FASB, recently (re-)established a consultative group that published in 2014 an extensive report on effects analysis[46] in standard setting.[47] That report responds to the IFRS Foundation's Trustees *Strategy Review* calling for more (economic) effects analysis (and field testing) in the IASB's due process (see IFRS Foundation, 2012, C3). Cost–benefit analysis has since been embedded in the IASB's due process at every major stage; a new IFRS standard or change to an existing standard should only be mandated if its net benefits under the IASB's objectives outweigh its costs.

The core challenge in application is exactly *how* to conceptualise the benefits and costs of a standard. The existing approaches differ in their ambition on how far such analysis could extend. The FASB acknowledges that it is difficult or even impossible to make this assessment quantitatively (see FASB, 1980, para. 144).[48] The IASB should be more ambitious. First, they need to explain how the suggested changes would improve the quality of financial statements, and why these changes are justifiable. Second, they should verify that stakeholders fully understand the decisions and the trade-offs of these decisions. Third, they should collect information and undertake sufficient background analyses to anchor these decisions. That information should be collected from outreach activities and fieldwork at different stages. The instruments to be used should be primarily surveys, case studies and, where possible, simulations.

Overall, the IASB is attempting to conceptualise the benefits and costs without incurring the cost of estimating each component quantitatively. For that purpose, they have developed a substantial repertoire of application guidance (see Effects Analysis Consultative Group, 2014, pp. 33–64). Experts estimate that attempts to go any further than that by trying to fully quantify each benefit or cost component would be extremely costly and would still be imprecise and incomplete (see Schipper, 2010, p. 314).[49]

Nevertheless, expectations on the breadth and depth of a comprehensive cost–benefit analysis by the IASB must take into consideration its standard-setting *milieu* in terms of both its resources and operations. First, while the US Financial Accounting Foundation (FAF) governing the FASB has a planned budget of \$58.0 million,[50] the IFRS Foundation governing the IASB has only around £25.0 (~\$36.5 million),[51] despite its global focus. Second, the IASB is composed of 14 members from some 8 or 9 countries around the world, supported by a highly multinational staff. The likelihood of such a large and culturally diverse institution agreeing on a standard without making pragmatic and seemingly arbitrary compromises is not high, when even the FASB struggles to find conceptually sound answers in a single country setting.

As with every new IFRS standard, the IASB published alongside its final IFRS 9 standard, in their Basis for Conclusions, their own cost–benefit analysis of IFRS 9 (see IASB, 2014). This comprehensive, 387-page single-spaced document outlines the core reasons behind the IASB's decisions regarding particular areas of IFRS 9 (e.g. classification and measurement, impairment, hedge accounting), and it provides explanations of why the IASB did not follow alternatives in controversial areas. Nearly 60 pages are dedicated to the analysis of the expected effects of IFRS 9 only. The document outlines the major benefits to be expected from the new standard and assesses, based on IASB's outreach activities, the likely costs at initial recognition and on an ongoing basis for preparers and users. The *Basis for Conclusions* can be considered the accumulation of insights gained over the lengthy due process when developing a standard and should not be overlooked in the endorsement discussion.

5.3.2. A Second Layer of Cost–benefit Analysis in EU Endorsement

There is a need to recognise a degree of incongruency between the assignment of the IASB to serve worldwide capital markets and the EU's assignment to primarily ensure the welfare of its Member States, or put differently, the EPG. Therefore, the criterion that a standard should be 'conducive to the EPG' requires a separate, new cost–benefit analysis for EU endorsement and not just a review of the IASB's analysis (see Schipper, 2010).[52] We still suggest, operationally, that the IASB's effects analysis should be the *starting point* to understand the IASB's rationales and the trade-offs of their decisions. Differences in the cost–benefit analysis of the EU endorsement can emerge from: (a) a disagreement with the *content* of the IASB's cost–benefit analysis, (b) a deviation of the 'European' cost–benefit analysis, and (c) a difference in the *components* of cost–benefit analysis considered by a public entity that is rooted in democratic principles and with legal enforcement responsibilities relative to a private-sector standard setter.

(a) *Disagreement with the content of the IASB's cost–benefit analysis*

With reference to point (a) above, we note that, of course, there can be other issues and costs neglected in the IASB's cost–benefit analysis and disagreement for many justified reasons. However, when criticising the content and outlining suggested alternatives, one *should transparently outline the expected benefits and costs of these alternative conclusions*. To be fair, we often see that IASB decisions are openly criticised, yet these critics too often do not explain or openly discuss the issues that would emerge from proposed alternative options. It is the *incremental costs* relative to the next alternative that matters in decision-making.

We also predict that disagreement about technical issues on the basis of clear articulation of issues and reasons will probably be regarded in the accounting profession and among accounting academics as the most credible approach to challenging IASB decisions, be it in the due process *ex ante* or in endorsement decisions *ex post*.[53] Vague references to the EPG that lack any credible supporting evidence will be criticised almost by definition as catering to vested interests of powerful industries, even if the political intervention is in fact due to the underlying intrinsic belief. This deeply rooted belief is probably reflective of the influential work of Professor Stephen A. Zeff and follow-up studies that have documented that politicians in the US intervening in the standard-setting process of the FASB can be linked, even at a personal level in terms of campaign contributions, to vested interests of powerful industries and their attempts to keep transparency low (e.g. Bischof et al., 2016; Ramanna, 2008; Zeff, 2008, 2012). To date, there are no examples in the scientific literature that document that politicians successfully intervened in the standard-setting process to increase the transparency of financial reports.

We further observe that the IASB is not required to consider any 'broader' economic consequences, because these are beyond its objectives (see Effects Analysis Consultative Group, 2014, para. 13). On that basis, it has been suggested that the EU would benefit from engaging in broader deliberations with more stakeholders, including those who do not frequently engage in the IASB's or EFRAG's consultations, and that the characteristics of the IASB 'make it a challenge for stakeholders from outside the financial industry to engage with the IASB' (Botzem, 2015, p. 35). We would paint a more balanced picture:

First, if those wider stakeholders would in fact be adversely affected by accounting standards, they would certainly have incentives to engage more with standard setters, which they currently do not do.[54]

Second, our informed observation – based on following the process for many years and recently based on our own observation in the IFRS Advisory Council[55] – is that the due process is open to all interested parties and the feedback is collected transparently through the IASB's webpage. All parties that may have interests in accounting are invited to have a word in the process, or are even in a proactive way invited to contribute.[56]

Third, while it sounds certainly persuasive to give 'civil society stakeholders' a more important role in the process (see Botzem, 2015, p. 35), we question what their exact contribution and role could be in a financial accounting standard setting.[57] There is certainly a role for specialisation here, similar to setting norms in other areas of life that require specific expertise and have an important impact on society as a whole (e.g. in technical, environmental, or medical norms).

As a practical matter of fact, in the case of accounting for financial instruments, it is even difficult for (full-time) specialists like us to fully absorb and comprehend all challenges, trade-offs, and details involved with a standard such as IFRS 9. However, an interesting idea could be to grant transparency activists, individuals who have a credible personal trait to fight for transparency issues, an active voice in standard setting.[58] If such individuals are persuaded in the process by the standard setter that its intention is truly to improve transparency (and not caused by the influence of the auditing profession or the financial sector, as often feared), such individuals could more credibly communicate the fight for transparency when the standard setter is challenged by the vested interests of powerful preparers. The challenge, however, would be to find such uncompromised individuals who show an interest in accounting.[59]

(b) *Deviation of the 'European' cost–benefit analysis*

We note, in reference to point (b) above, that the objectives of the EU as a large economic bloc with approximately one quarter of the global GDP[60] should, in general, not deviate much from the global perspective of the IASB. Exceptions could primarily emerge from an observation in the due process where the IASB would give in (too much) to the vested interests of other economic blocs and their particular economic set-up, most notably the US. To increase credibility, objections in endorsement could, in such a case, pinpoint particular changes that the IASB implemented in response to outside pressure.

Another plausible reason for a carve-out from a standard could be the particular economic set-ups of an important industry in the EU that would truly be adversely affected. Carve-outs in other jurisdictions are based on such motivation (see Ramanna, 2013, p. 22). However, we would urge EU institutions involved in endorsement decisions to critically evaluate in detail how different the economic set-up of an industry really is. For example, we do not believe that financial institutions that have traded equity and debt in financial markets in the EU (i.e. that are subject to IFRS standards) have sufficient differences in their set-up or business activities relative to their non-EU peers that would justify such argumentation with regard to IFRS 9.

(c) *Difference in the components of cost–benefit analysis*

We note, in reference to point (c) above, that the EU could be more specific in what it regards as 'constituting the EPG in the case of an accounting standard'. Legislators could specify additions or alternatives when judging endorsements, relative to the IASB's objectives guiding their development of IFRS. We discuss recent contributions to this discussion in the sections below.

5.3.3. The Maystadt Criteria

In response to the financial crises and following the recommendations of the ECOFIN Council, the previous EU Commissioner for Internal Market and Services, Michel Barnier, commissioned a report by Philippe Maystadt, former President of the European Investment Bank, to answer a number of questions regarding the EU's contribution to the development of IFRS (the *Maystadt Report*; see also Walton, 2015). From the beginning, the introduction to this report makes it clear that 'policy choices in the field of accounting involve public interest stakes that should be considered more thoroughly' and that 'EFRAG, which should be Europe's voice in the accounting debate, is a technical committee with views that do not always take appropriate account of these stakes' (Maystadt, 2013, p. 5). The report, therefore, places even greater emphasis on the EPG criterion based on the feedback of certain stakeholders who claim that positions held by EFRAG in its endorsement advice are based on technical analyses of standards that do not adequately assess the economic impact or the contribution of the standards to the public interest (Maystadt, 2013, p. 11).

In his policy recommendations, Mr Maystadt recommends that 'the European Union could revise its IFRS adoption criteria by supplementing and clarifying the current criteria of the IAS Regulation' (Maystadt, 2013, p. 10). In particular, he recommends what he considers to be two components of the public good: standards should not endanger financial stability, and they should not hinder the economic development of the Union (Maystadt, 2013, p. 10). He also asked the Commission to provide guidance for interpreting the EPG criterion (Maystadt, 2013, p. 10). Follow-up work by Commission Services and the newly instituted Expert Group on the IAS Regulation[61] list in their IFRS endorsement report a number of factors that should be considered in determining what constitutes the EPG (see Expert Group on the IAS Regulation, 2014, p. 4):

- Is the standard consistent with EU competition law?
- Has the standard converged with US GAAP to 'level the playing field'?
- Have the needs of different types of investors been considered?
- Have the needs of a broad range of users, including regulators, other stakeholder and creditors, been considered?
- What are the broad economic effects of standards on employment or public policy?
- Do standards improve financial reporting?
- Is there a reference to the cost–benefit analysis?

However, the group acknowledges that these criteria can lead to additional definition issues (Expert Group on the IAS Regulation, 2014, p. 4). We strongly agree with these concerns.

A standard 'should not endanger financial stability'

The only tangible new operationalisation of the EPG criteria is the component that a standard 'should not endanger financial stability'. However, years after the financial crisis, and considering the significant media attention and incentives from regulators and the research community to provide such evidence, there is still no evidence that can actually document that specific accounting standards have played a significant role in, or have fostered the crisis (see, e.g. Bank for International Settlements, 2015). Thus, an evidence-based showcase that would reject IFRS endorsement based on fears of financial instability is an unlikely scenario. A counter-argument that could be made is that prudential regulators, that is, those who do have the mandate to ensure financial stability, should counterbalance any potential adverse effects of accounting they may perceive in/via their own regulation (e.g. through prudential filters; see Committee of European Banking Supervisors, 2004). The IASB, as part of its obligation as a member of the Financial Stability Board (FSB), has to ensure that the FSB (and prudential regulators) have sufficient time to assess and potentially address how any change in accounting standards should be reflected in prudential regulators' own monitoring systems.[62]

We would stress again that introducing this new operationalisation of the EPG criterion in the *Maystadt Report* has increased pressure on the IASB *ex ante* to place more importance on issues put forward by prudential supervisors. That the IASB recently introduced a *long-term financial stability* wording in its mission statement can be considered a reaction to this pressure. We also observe from the comment letters of both EBA and European Central Bank (ECB), both in charge of banking supervision in the EU, to EFRAG that their issues have been reflected in the IASB's due process when developing the new financial instruments standard.[63] Both are supportive of the final wording of IFRS 9.

A standard 'should not hinder the economic development of the Union'

The second new criterion, 'should not hinder the economic development of the Union', is almost tautological and an invitation to industries to foster boilerplate defensive arguments of vested interests trying to protect their own rents.[64] For example, the first argument of the financial industry against every regulatory intervention is that new regulation or certain accounting standards will lead to a credit crunch and, thus, to lower credit availability for small businesses, ultimately hindering economic growth (see, e.g. Beresford, 1993; Zeff, 2008). Another current example is the leasing industry, which strongly opposes a new leasing standard because they are trying to protect their business model of enabling firms to show lower levels of debt than they economically possess.

5.3.4. *Inferring Stakeholders' Cost–benefit Assessments from Observable Reactions*

One market-based approach to derive stakeholders' net benefits or costs of a new standard is to analyse interest groups' response to EFRAG's call for comments on their draft endorsement advice. These responses can expose, although biasedly, how stakeholders evaluate whether IFRS meet the EU's endorsement criteria.

The likelihood of participation in and feedback on the endorsement advice will be driven by stakeholders' relative expected benefits and costs of providing their feedback. Sutton's (1984) classical cost–benefit framework of stakeholder participation in standard setting can also be applied to feedback on EFRAG's draft endorsement advice. In particular, stakeholders who have significant net costs from the new standard have greater incentives to file adverse endorsement recommendations in response to positive EFRAG endorsement advice. Therefore, one can infer from the type of respondent (e.g. preparer, auditor, user), the magnitude of letters from organisations of a stakeholder group, and the distribution of concerns among different stakeholder groups to what extent stakeholders in the EU perceive themselves to be negatively affected.[65]

It is important to note, however, that stakeholders who expect net benefits from the new standards do not have similar incentives to respond to positive EFRAG endorsement advice. Therefore, potential supportive feedback regarding positive EFRAG endorsement advice will primarily come from commentators who always provide feedback as part of their job responsibilities (e.g. active national standard setters; important EU institutions such as ESMA, EBA, and ECB; and global organisations actively participating in standard-setting issues, such as Association of Chartered Certified Accountants (ACCA), ICAEW, International Federation of Accountants (IFAC), the Chartered Financial Analyst (CFA) Institute, or Financial Executives International (FEI)).

Overall, in the case of IFRS 9, we observe from the feedback on EFRAG's draft endorsement advice[66] that the vast majority of stakeholders consider the new standard as contributing to the EPG. There are only three notable exceptions:

- the insurance industry because of the pending IFRS 4 adoption,
- some commentators from France,[67] and
- the UK-based LAPFF.[68]

Another market-based approach to derive shareholders' perceptions of the net benefits or costs of a new accounting standard is to study the stock market reactions to events that increase or decrease the likelihood of the standard being published. With regard to the IFRS 9 due process, research provides at least weak evidence for, on average, small positive share price reactions to the IASB announcements.[69]

5.4. Conclusions

The criterion of the EPG is even vaguer than the first two endorsement criteria. As discussed in Section 1, the vagueness is not necessarily harmful as it potentially increases the power that EU institutions have *ex ante* over the IASB's standard-setting process. Nevertheless, the vagueness complicates a clear-cut *ex post* endorsement recommendation.

In our view, the only feasible way to assess the EPG criterion is by means of a comprehensive cost–benefit analysis that considers the reactions of different stakeholders to the proposed standard. However, any cost–benefit analysis will, by definition, not lead to a unanimous conclusion, as the costs and benefits will be borne by different parties affected by the final standard. Ultimately, it is a political decision of how to weight the different costs and benefits of different parties.

In the case of IFRS 9, for example, implementation costs seem to be the greatest for the insurance industry, where IFRS 4 is still under revision by the IASB, with significant changes to some of the IFRS 9 policies to be expected in the relatively short term. However, the key benefits of IFRS 9, for example, from its greater understandability, will be obtained by other parties. Therefore, there is probably a net cost for preparers in the insurance industry, while there is a net benefit for some users of accounting information.

Overall, we still tend to conclude that, at least, many features of IFRS 9 are an improvement over IAS 39, which would be the alternative if the EU voted against the endorsement of IFRS 9. Therefore, we argue that IFRS 9 is likely to be conducive to the EPG.

6. Overall Assessment

Sections 3–5 provide an individual assessment of each of the three endorsement criteria for a new IFRS/IFRIC in the EU. For none of the three criteria do we find sufficient evidence that could support the rejection in the case of IFRS 9 endorsement. As such, our assessment based on the academic literature confirms the conclusions of EFRAG's IFRS 9 endorsement advice.

However, our discussion has also shown that the IAS Regulation 1606/2002 deliberately provides European legislators with substantial leeway in the endorsement decision and that endorsement is ultimately a political decision of weighting costs and benefits. Our discussion also shows that IFRS 9 provides at least some reasons for concern. In our overall assessment below, we summarise these concerns and discuss the implications for the political decision.

6.1. *IFRS 9 as an 'Equilibrium Outcome'*

IFRS 9 has been preceded by a decades-long controversy about the accounting for financial instruments, especially in the banking sector. The IASB's work programme on financial instruments dates back to at least 1988 when the then-International Accounting Standards Committee (IASC) set-up a work project. Despite intense efforts, the *Joint Working Group of Standard Setters* failed in 1999 to provide a set of accounting rules that standard setters worldwide could unanimously implement. While the original version of IAS 39 was adopted in 1998, it underwent significant revision already in 2005.

The work on the new IFRS 9 started in 2009 right after the EU and the G20 called for a major reform of bank accounting rules. The revision of specific parts of IAS 39 (on issues surrounding portfolio hedges of interest rate risk) is still under discussion. It is thus fair to say that accounting standards on financial instruments are among the most complex and the most controversial. The reasons for the intensity of the debate are obvious:

First, the underlying cash flow structures of the instruments are inherently complex, as are many of the transactions that the instruments are used for, where the same transaction can have different economic substance in the different divisions of a universal bank (e.g. asset-liability management vs. trading).

Second, reliability issues are of particular importance for many financial instruments that are infrequently traded and thus lack evidence on current values. Any valuation framework (both cost-based and current value-based frameworks) faces enormous difficulties in providing reliable estimates of valuation benchmarks that sufficiently limit managerial discretion over valuation inputs.

Third, accounting research shows that a potential solution is not clear-cut. The benefits of key stakeholders in the debate (e.g. preparers from investment banking vs. preparers from commercial banking, debt investors vs. equity investors, depositors vs. money market investors) vary between the extremes of the debate (i.e. a full fair value-based system vs. a strict cost-based system), so that no accounting solution can, by its very nature, be entirely neutral.

The involvement of the specific actors/stakeholders in the debate illustrates that accounting standards have the potential to re-allocate economic resources (see Watts & Zimmerman, 1986). In fact, accounting research can trace the struggle to find an appropriate accounting measurement basis back to medieval times.[70] Regulators favoured different measurement bases at different points in time.

For example, market-based valuation was viewed favourably right before the *German Gründerkrise* in the 1870's, before the *Wall Street Crash* and *Great Depression* in 1929, and before the 2008/2009 *Subprime Mortgage Crisis*, and it was heavily opposed right after these crises. In contrast, the 1980s saw a debate where the *Savings and Loans Crisis* in the US was attributed to amortised cost accounting (Georgiou & Jack, 2011; Zeff, 2007). Even historically, it is therefore hardly possible to find an appropriate consensus on the debate.

Against this historical background, IFRS 9 provides a current equilibrium outcome (see Watts & Zimmerman, 1979, on the market for accounting theories). The analysis of comment letters, the minutes of IASB meetings, the working papers of the IASB staff and the public discussion surrounding the development of the standard all indicate that the views and concerns of all key stakeholders have been considered in the development of the standard. The outcome is yet another 'mixed accounting model' (see Walton, 2004, for a corresponding characterisation of IAS 39), where fair value-based measurement is combined with amortised cost measurement and where management is still left with substantial accounting choice (e.g. the fair value option, the other comprehensive income (OCI) option, the hedge accounting option). The final standard is therefore balancing largely incompatible interests of different parties and provides a solution that is far from either of the two extremes.

The standard has all the characteristics of a political compromise. While this solution inevitably introduces costs for some of the affected parties, any shift of the standard into one or the other direction would incur additional costs for other parties that would need to be weighed against questionable benefits.

Our view that the standard provides a balanced solution is also supported by the fact that the interests of banking associations, as the most powerful and best-equipped lobbying groups,[71] are not entirely reflected in the new standard. These groups favoured a more radical cut-back on fair value accounting that has not been achieved with the current standard that also reflects the interest of users, for example, of financial analysts in this regard (see Bischof, Daske, & Sextroh, 2014; CFA Institute, 2008).

Overall, IFRS 9 represents an equilibrium outcome, given the current institutional set-up of global accounting standard setting. It reflects the strength of arguments and powers of different parties that participated in the process, most notably:

- the technical expertise, inherent accounting philosophy, and individual incentives of accounting standard setters (IASB) and their staff,
- the conceptual arguments in the market for accounting theories ('accounting philosophies'),
- the insights into actual accounting practice from evidence on IAS 39 implementation (and similar standards worldwide),
- the evidence academic research was able to provide on the benefits and costs of different accounting regimes,
- the economic incentives and lobbying powers of various stakeholders, and
- 'political considerations', particularly anticipating *ex post* endorsement and achieving convergence with the FASB.

During the extensive due process of IFRS 9, many fundamental changes proposed by the IASB (e.g. a nearly complete elimination of the OCI option) were eliminated from the final version of the standard. As a result, IFRS 9 is not very far from the accounting treatment under IAS 39.

The most fundamental change comes from the new expected loss model for loan impairments that will replace the incurred loss model of IAS 39 (see also Camfferman, 2015; Gebhardt, 2016; Hashim, Li, & O'Hanlon, 2016; Novotny-Farkas, 2016). After all, it is only fair to conclude that the standard represents the global accounting community's best effort after six years of debate.

6.2. *Weighing Costs and Benefits*

While it is beyond the scope of this paper to provide a comprehensive cost–benefit assessment of IFRS 9 adoption in Europe, the following section highlights some of the key concerns that stakeholders brought forward during the IASB's due process. For each remaining issue, we summarise in Table 6 the main costs and the key benefits.

The four accounting topics that we summarise in Table 6 have attracted the most comments during the IASB's due process for IFRS 9 (and, to lesser extent, to EFRAG's call for comments on its draft endorsement advise). Our findings indicate that, apart from issues concerning the adoption date for the insurance industry, all decisions that the IASB made on these issues involve both, costs and benefits. Again, it is ultimately a political decision of how to trade-off these costs and benefits against each other.

Table 6. Summary of key concerns from the IASB's due process.

Comment Letter concern	Cost	Benefit
• Restriction of the reclassification option	• Limitation of managerial flexibility during a crisis (limiting potential regulatory benefits of the option) • Potential disadvantage towards US competitors (with potential adverse effects on the EPG)	• Restriction of opportunistic earnings management • Corrective regulatory actions during a crisis are not impeded by the lack of timely write-downs
• Restriction of the recycling of OCI gains/losses from equity instruments	• Violation of the clean-surplus principle • Potential necessity for adjustments of valuation models • Lack of informational usefulness for long-term business models	• Short-term monitoring is crucial (and certainly practised internally) even for a long-term business • Restriction discourages the use of the option (i.e. limits managerial accounting discretion)
• Expected loss model	• Complexity of valuation models • Inconsistency between the IFRS 9 approach and the Basel approach (i.e. costs from parallel systems) • Potential increase in volatility • Arbitrary distinction between 12-months and lifetime losses	• Greater timeliness of loss recognition • Positive association with financial stability • IFRS 9 model closer to regulatory approaches than the former IAS 39 model • Potentially even greater management discretion under an incurred loss model
• Different adoption dates for IFRS 9 and (revised) IFRS 4 in the insurance industry	• Significant implementation costs in the insurance industry • Lack of comparability over multiple years • Accounting inconsistencies in the transition period between IFRS 9 and IFRS 4 adoption (potentially impeding the informational usefulness)	• Not clear

Source: Comment letters from the due process for the IFRS 9 project, www.iasb.org.

The only exception is the divergence in the adoption dates of IFRS 9 and IFRS 4. The timing of the adoption dates will incur significant costs for the insurance industry as well as for investors when the consistency of financial statements over time is adversely affected twice in a row. These costs could, at least in part, be avoided by a simultaneous adoption of both standards. The adoption date (or, more precisely, the industry-specific transition period) is one issue where the EU could use the endorsement criteria to justify a deviation from the original IFRS 9. Because this issue is unrelated to the accounting treatment of financial instruments as such, a carve-out at this point would also likely not harm the acceptance of IFRS financial statements on US capital markets.

There were other, more general concerns that participants in the IASB's due process addressed, for example, the alleged threat to financial stability or the potential increase in volatility. We note that these concerns are not based on any hard evidence from serious academic research but reflect a purely subjective assessment. We are unable to provide a conclusive *ex ante* judgement on the economic consequences of IFRS 9. New accounting standards do not just change the treatment for existing assets and liabilities; they can also change investment behaviour, that is, they affect the composition of the balance sheet per se. It is inherently difficult to predict those behavioural changes, and such a prediction would require significant technical efforts that the assessments in the comment letters are lacking.

6.3. Implications for the EU Endorsement Decision

Like any new accounting standard, IFRS 9 is the result of different forces participating in the IASB's due process. Different participants in the process favour different accounting regimes, with a market-based regime and a cost-based regime representing the extreme positions that were brought forward. The net benefits of the different accounting regimes vary across the different parties.

The final wording of IFRS 9, therefore, is a political compromise and thus a current 'equilibrium outcome'. It reflects a balanced 'mixed measurement' approach that incorporates the different views of the participants in the debate. The new standard will not fundamentally change the accounting treatment for financial instruments. The most significant change most likely comes from the new expected loss approach to the impairment of loans.

Given that the views of the participants in the due process are largely incompatible, IFRS 9 will still result in significant costs for some parties (and in benefits for other parties). Therefore, it is ultimately a political decision to weigh these costs and benefits against each other. The only technical issue where costs tend to outweigh benefits are the different adoption dates of IFRS 9 and the revised IFRS 4 in the insurance industry. The diverging adoption dates will likely result in unusually high implementation costs that are specific to the one industry.

Apart from this latter point, our judgement of IFRS 9 does not indicate that the standard clearly violates one of the three endorsement criteria.

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No potential conflict of interest was reported by the authors.

Notes

[1]For an overview of the EU's endorsement process, see Botzem (2015, p. 27, Figure 5). The latest update on IFRS and interpretations pending endorsement and past endorsement decisions are provided in EFRAG's 'EU endorsement status report' at: http://www.efrag.org/Endorsement.

[2]The two Directives that the IAS Regulation 1606/2002 continues to refer to (Directive 78/660/EEC and Directive 83/349/EEC) have been replaced by the Accounting Directive 2013/34/EU. However, the wording of the TFV principle remained unchanged in Article 4 of the new Accounting Directive 2013/34/EU. In the following, we refer to all three Directives as 'the Accounting Directives' in their respective context. See Appendix 1 for the corresponding legal texts on the endorsement criteria.

[3]These are the EFRAG, the European Commission, the Accounting Regulatory Committee (ARC), the Council, and the European Parliament.

[4]See http://ec.europa.eu/finance/accounting/ias/index_en.htm.

[5]See http://ec.europa.eu/finance/company-reporting/ifrs-financial-statements/index_en.htm for the EU's underlying objectives of IFRS adoption.

[6]See, for example, the discussion and proposal on reforming the current endorsement process in the Maystadt Report (2013).

[7]The Maystadt Report proposes that the activities of EU institutions be bundled and coordinated by one institution alone (e.g. EFRAG) to further enhance the EU's influence over the IASB's standard-setting; see Maystadt (2013).

[8]For details on the steps in the due process, corresponding feedback and board deliberations in the process replacing IAS 39 by IFRS 9, see http://www.ifrs.org/current-projects/iasb-projects/financial-instruments-a-replacement-of-ias-39-financial-instruments-recognitio/Pages/Financial-Instruments-Replacement-of-IAS-39.aspx.

[9]The stakes are likely to be lower in case of an IFRIC interpretation on a specific technical issue.

[10]While some jurisdictions have already endorsed IFRS 9 (e.g. Canada, see http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/adv-prv/Pages/freifrs9.aspx), in others, new IFRS will automatically become legally binding. Our observation is that many jurisdictions are closely following, if not awaiting, the EU's endorsement decision.

[11]See, for example, Ordelheide's (1993) discussion on whether the percentage-of-completion method in long-term production is in accordance with the 4th Company Law Directive.

[12]For example, Ordelheide (1993, p. 83) argues that 'if it is one's opinion that the valuation principles of Art. 31 are characterized by a certain degree of prudent income determination – and this seems conceivable – one has to accept a similar prudent solution in order to reduce open areas and ambiguities'.

[13]See also the European Commission's (1998) Interpretative Communication providing clarification of Article 2(5) of the 4th Company Law Directive: 'In the interest of harmonisation, Member States may not use the last sentence of Article 2(5) in order to introduce an accounting rule of a general nature which is contrary to provisions of the Directive, nor can they use this sentence to create additional options allowing for accounting treatments which are not in conformity with the Directive'.

[14]Note that while there are many ECJ rulings that refer to the Accounting Directive's TFV criterion, it is consensus in the academic literature that it was and still is the Tomberger case that shaped the ECJ's interpretation of the criterion. In fact, more-recent cases, such as *GIMLE SA* (Case C-322/12) or *Texdata Software GmbH* (Case C-418/11), heavily rely on the TFV interpretation in the Tomberger case (see the references in the more-recent verdicts). All related verdicts can be retrieved via *InfoCuria – Case-law of the Court of Justice* at: http://curia.europa.eu/juris/recherche.jsf?cid=238754.

[15]In other words, 'The gateway of Art. 2 (5) seems to narrow for all derivations of British accounting from the accounting principles and rules of the Fourth Directive' (Ordelheide, 1993, pp. 83–84); see also European Commission (1998).

[16]See ECJ, Case C-234/94, p. I-3133, para. 15.

[17]See, for example, their Endorsement Advice on IFRS 9, para. 4, in EFRAG (2015a). This test is likely to be a response to demand from particularly vocal stakeholders who placed specific emphasis on 'prudence' and actively lobbied the EU institutions that were involved in the endorsement process (e.g. the UK Local Authority Pension Fund Forum (LAPFF)). For an example, see the introductory statement by Haaker (2015) in the public hearing on IFRS 9 in the

European Parliament (note that the other three experts in the hearing did not mention 'prudence' in their introductory statements), see: http://www.europarl.europa.eu/committees/en/econ/events-hearings.html?id=20151201CHE00081.

[18]See, for example, different reports on the effects of accounting rules on the financial crisis: International Monetary Fund (2008); De Larosière et al. (2009, para. 73–79); Marteau and Morand (2010); Bieg et al. (2008).

[19]See Bank for International Settlements (2015) for a comprehensive literature review. A 2008 SEC report on 'Mark-to-Market Accounting' commissioned by the US Congress came to a similar conclusion; see SEC (2008) and also https://www.sec.gov/spotlight/fairvalue.htm.

[20]Prudence is often defined as 'caution in conditions of uncertainty' (see, e.g. EFRAG, 2015b, para. 209). Conservatism has historically meant not overstating assets and revenues, and not understating liabilities and expenses.

[21]A reason for this finding could be that the exercise of prudence allows the creation of hidden reserves or excessive provisions by holding back profits in one year that may lead to their release in a subsequent period (either automatically because the accruals reverse (e.g. Dechow, 1994) or by intentional selling of undervalued assets and the reporting of exaggerated results).

[22]However, we predict that under IFRS 9, the 'contractual cash flow characteristics test' will likely lead to more classifications into measurement categories outside cost than the business model test.

[23]In a sense, the wording seems to comply with the conceptual idea of the 'Abkopplungsthese' discussed in the German literature since the 1970s (e.g. Moxter, 1979; Ordelheide, 1993).

[24]Barth (2007, p. 9): 'Understandability is the quality of information that enables users who have a reasonable knowledge of business and economic activities and financial reporting, and who study the information with reasonable diligence, to comprehend its meaning'; see also IASB (2015a, para. 2.33–35) and EFRAG (2015b, para. 191).

[25]In addition, it is unclear how such an evaluation should address the evolution in complexity of the underlying economic transactions over time. For example, in the case of financial instruments and innovations in financial engineering, one can observe an 'Arms Race' between accounting standard setters and preparers over a period of decades; see Dye, Glover, and Sunder (2015).

[26]See Barth (2007, p. 9): 'Relevant information is capable of making a difference to a financial statement user's decisions. Relevant information has predictive value, i.e., it helps users to evaluate the potential effects of past, present, or future transactions or other events on future cash flows, and confirmatory value, i.e., it helps to confirm or correct their previous evaluations'; see also IASB (2015a, para. 2.6–7) and EFRAG (2015b, para. 7).

[27]For example, Gassen (2008, p. 6) points out that value relevance 'targets the alignment between accounting and market information per se, without addressing the question whether accounting information is (potentially) useful to market participants in valuation-related decisions or whether it merely constitutes an echo of information from more timely sources which were already impounded into prices'.

[28]See IASB (2010, QC26): 'Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified'.

[29]Camfferman and Zeff (2015) concluded that it was the Americans, specifically the FASB, who drove the term 'reliability' out of the two boards' Conceptual Frameworks in 2010. The FASB was also responsible for excising the references to prudence and stewardship in the CF. See pp. 361–362, where FASB senior staff member Todd Johnson argued that many had misinterpreted reliability to mean precision, and thus, it stood in the way of the FASB requiring greater use of fair value measurements.

[30]EFRAG (2015b, para. 128): 'Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost'. Para. 129: 'There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness'.

[31]See Schipper (2003, p. 62): 'similar things are accounted for the same way, either across firms or over time'. Her definition includes consistency but does not explicitly state the 'difference' component; see also EFRAG (2015b, para. 152).

[32]See Barth (2007, p. 9): Consistency 'refers to the use of the same accounting policies, either from period to period within an entity or in a single period across entities'; see also IASB (2015a, para. 2.25).

[33]Recent research by Chen, Miao, and Shevlin (2015) has suggested a novel measure of disclosure quality based on the *disaggregation* of accounting data.

[34]See De Franco et al. (2011), Barth et al. (2012), and Yip and Young (2012, p. 1769). The concepts they use to operationalise 'comparability' are 'similarity of accounting functions', 'accounting system comparability', 'value relevance comparability', and the 'degree of information transfer, as measured by the association between the earnings surprise of an announcing firm and the contemporaneous stock price movements of other firms'.

[35]Note that comparability is distinct from uniformity, as there could be circumstances where one accounting option would suit the underlying economics better than the alternative. Similarly, the use of managerial discretion seems unavoidable no matter how narrowly a standard is framed.

[36]Note that the intention behind the IASB's revision of its conceptual framework is to reduce this conflict by exclusively focusing on external users of accounting information. The objective has resulted in the removal of 'stewardship' as a purpose and the verbal downgrade of 'prudence' in the qualitative characteristics of the exposure draft.

[37]Alexander (2006, p. 71) goes further, arguing that 'The phrase was presumably inserted by politicians, for politicians'. This critique is repeated in Alexander and Eberhartinger (2010, p. 57): 'It is particularly noteworthy that the criterion singled out for emphasis [the European public good] is, as stated above, undefinable, completely unmeasurable and nothing to do with accounting'.

[38]On 18 June 2015, the European Commission (2015) issued a staff working document on the evaluation of the IAS Regulation, providing a summary of the process and output. Further extensive reviews have been conducted recently after 10 years of IFRS usage; see, for example, ICAEW (2015) and De George, Li, and Shivakumar (2016) and the empirical evidence in, for example, Barth, Landsman, and Lang (2008), Barth et al. (2012), Daske et al. (2008, 2013), and Christensen et al. (2013).

[39]See the German, French, Italian, and Spanish language versions on EurLex (http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002R1606): 'im europäischen öffentlichen Interesse', 'l'intérêt public européen', 'interesse pubblico europeo', 'el interés público europeo'. For a critical discussion on different language used in national implementations and translations of Directive 2013/34/EU, see Alexander (2015).

[40]See, for example, Alexander's (2006) interpretation of Jacques Chirac's letter to Romano Prodi. See also Ramanna (2013) on IFRS endorsement and carve-outs in other countries around the world. The ICAEW (2012) contemplates in its report on 'Public Interest' that 'there can be a natural suspicion that the phrase may be used as a smokescreen to garner support for something that is actually in the advocate's own interests'. See http://www.icaew.com/en/technical/ethics/the-public-interest.

[41]See, for example, the webpage of Sven Giegold (European Greens and Member of ECON Committee of the European Parliament) and his statements on IFRS, http://www.sven-giegold.de/.

[42]See the IFRS Foundation's Mission Statement: 'Our mission is to develop International Financial Reporting Standards (IFRS) that bring transparency, accountability and efficiency to financial markets around the world. Our work serves the public interest by fostering trust, growth and long-term financial stability in the global economy'. http://www.ifrs.org/About-us/Pages/IFRS-Foundation-and-IASB.aspx; see also IASB (2015b), where the IASB outlines in detail how it proposes to serve the public interest.

[43]See the Objectives of the IFRS Foundation's Constitution, where it states 'to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions' IFRS Foundation (2012).

[44]See Schipper (2010) for an excellent summary.

[45]The FASB discussed the possible application of cost–benefit analyses to accounting standard setting back in 1991 (see FASB, 1991). See also Zeff's (1978) early discussion of 'economic consequences' arguments.

[46]The re-labelling from 'cost-benefit' to 'effects' analysis in accounting standard setting follows the in-depth analysis of Schipper (2010, p. 316), who suggests that '"effects" may result in a better description of the cognitive process actually used by standard setters to weigh the consequences of authoritative guidance'.

[47]See Effects Analysis Consultative Group (2014): The core objectives to consider are to improve the quality of financial information (para. 12). According to its objectives, the IASB is de jure not required to consider the broader economic consequences of its standards (para. 13); de facto, however, broad stakeholder participation, the openness of the process, and the incentives of affected parties ensures that those concerns are heard.

[48]See also FASB (1978, para. 23): '[T]he benefits from financial information are usually difficult or impossible to measure objectively, and the costs often are; different persons will honestly disagree about whether the benefits of the information justify its costs'.

[49]The difficulties of conducting quantitative analysis based on comprehensive real-world data are illustrated in the case of IFRS 9 when even the European Systemic Risk Board (ESRB) openly admitted on request of the European Parliament that 'ESRB has not yet assessed the impact of the new accounting standards on the financial sector as a whole. Draghi explained that this was down to the "poor quality of the data available and uncertainty as to whether – and if so how – capital regulation might change in the light of the new accounting rules"'; see Bouvier (2016).

[50]See http://www.accountingfoundation.org/jsp/Foundation/Page/FAFSectionPage&cid=1351027545591. Note that the FAF contributions also cover the expenses of the GASB.

[51]See http://www.ifrs.org/About-us/IFRS-Foundation/Oversight/Financing/Pages/Financing.aspx. The budget is in British Pounds; approximate conversion in May 2016.

[52]Note that only reviews of upstream cost–benefit analyses are also observable in other public policy areas. See Schipper (2010, fn. 13).

[53]See Giner & Arce (2012). They find that standard setters react primarily to conceptual arguments in standard setting debates.

[54]A reason may be significant barriers to entry based on required technical expertise.

[55]Holger Daske has been representing the International Association of Accounting Educators and Researchers (IAAER) in the IFRS Advisory Council since 2015 (http://www.iaaer.org/). Note that IAAER is a non-profit organization, that is, there is no compensation for Advisory Council members, and academic independence is uncompromised.

[56]For example, various stakeholders in the wider non-financial reporting community have presented their views in the past few years' IFRS Advisory Council Meetings, such as the Global Reporting Initiative (GRI); see http://www.ifrs.org/About-us/IFRS-Advisory-Council/meetings/Pages/IFRS-Advisory-Council-2016.aspx and the meetings of the years before.

[57]We note that there can certainly be a role for wider non-financial socio-economic reporting requirements, such as laid down in the Non-financial Reporting Directive 2014/95/EU (amending Directive 2013/34/EU); see http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm.

[58]Note that Board members who are active academics have fulfilled this role in the past in the FASB and IASB. At the time of writing, IASB Member Dr Chungwoo Suh is a Professor of Accounting at Kookmin University, Seoul.

[59]We further observe that the typical older age of IASB board members (who tend to make the board membership the last step in their career prior to retirement) enhances their independence from vested interest groups (e.g. the auditing sector) and limits 'revolving door' concerns. However, there are more-frequent job transfers from within the organization of the IFRS foundation at the level of staff involved in standard setting.

[60]See Eurostat: http://ec.europa.eu/eurostat/statistics-explained/index.php/The_EU_in_the_world_-_economy_and_finance.

[61]The Commission set up the group to (a) evaluate the impact of IFRS within the EU against its original aims, and (b) take into account the recommendations of the Maystadt Report; see: http://ec.europa.eu/finance/accounting/governance/committees/evaluation/index_en.htm.

[62]See Effects Analysis Consultative Group (2014, para. 20). For example, EBA notes in their feedback to EFRAG that they are aware of several interactions with the prudential regulatory framework; see feedback letters to the EFRAG Draft endorsement advice.

[63]For example, the ECB summarises that 'Furthermore, the ECB is not aware of any objective reason suggesting that IFRS 9 is not conducive to the European Public Good. On the contrary, some aspects of IFRS 9 may be an improvement from a financial stability perspective'; see feedback letters to the EFRAG Draft endorsement advice; http://www.efrag.org/Front/p328-5-272/IFRS-9—Financial-Instruments.aspx.

[64]Similar arguments have been put forward, for instance, in the stock options debate; see, for example, Farber, Johnson, and Petroni (2007).

[65]Note that such feedback may or may not be similar to comment letter participation in the IASB's due process. Current research analysing comment letters to EFRAG illustrates descriptively that the group of respondents is not identical, and therefore, there seem to be idiosyncratic incentives to participate in EFRAG's call re their endorsement advice, for example, Weiss (2015).

[66]See http://www.efrag.org/Front/p328-5-272/IFRS-9—Financial-Instruments.aspx.

[67]The two institutions that have concerns are the French Autorité des Normes Comptables (ANC) and the *Task Force on Long Term Investment* of the Paris Financial Center.

[68]Note that the Local Authority Pension Fund Forum, a private-sector lobbying group, has recently commissioned a series of legal opinions by QC George Bompas questioning the UK Financial Reporting Council's (FRC) working interpretation of TFV; see http://www.lapfforum.org/news/LAPFF-obtains-further-Legal-Opinion-from-George-Bompas-QC. These opinions have been responded to by the legal opinion of QC Martin Moore, commissioned by the FRC; see https://frc.org.uk/News-and-Events/FRC-Press/Press/2013/October/Accounting-standards-are-part-of-legally-binding-c.aspx; see also Nobes (2015).

[69]See Onali and Ginesti (2014). Such tests, by design, focus on the effects of a new standard on shareholders only.

[70]See Richard (2004) for the case of France, Georgiou and Jack (2011) for Great Britain, and Hoffmann and Detzen (2013) for Germany.

[71]See Alexander (2006) for the EU and Zeff (2008) for the US.

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Appendix 1: Legal texts on endorsement criteria

Directive/regulation	Text
Article 3 (2) Accounting Regulation (EU) 1606/2002	*2. The international accounting standards can only be adopted if: they are not contrary to the [TFV] principle set out in ex-Article 2(3) of Directive 78/660/EEC and in ex-Article 16(3) of Directive 83/349/ EEC [now Article 4 (3) of Directive 2013/34/EU] and are conducive to the European public good and, they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.*
Article 2 (3) 78/660/EEC[a]	[4th Company Law Directive; repealed] *3. The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss.*
Article 16 (3)[b] 83/349/EEC	[7th Company Law Directive; repealed] *3. Consolidated accounts shall give a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included therein taken as a whole.*
Article 4 (3) Directive 2013/34/EU	*3. The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.*

Source: EU Official Journal.
[a]See http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31978L0660&from=EN for the text of the repealed Directive.
[b]See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31983L0349:en:HTML for the text of the repealed Directive.