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Accountability in Accounting?
The Politics of Private Rule-Making in the Public Interest

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I. Delegation of Public Authority to Private Actors

Why do governments delegate public authority to private actors, and what are the consequences? The phenomenon of delegation to private actors has so far been largely overlooked by the social science literature on delegation, which focuses predominantly on delegation from legislatures to public bureaucracies. Existing literature has examined such delegation mostly in the United States (e.g. Hammond and Knott 1996; McCubbins, Noll, and Weingast 1987; cf. also Moe 1985), but recently also comparatively across parliamentary democracies as well as from domestic elected officials to international governmental organizations. In many issue areas, however, public authority and regulatory functions have been delegated to (or effectively been acquired by) highly specialized private actors, creating new forms of public-private governance (Mattli 2003; Salter 1999). Indeed, spurred by globalization, some observers have recommended such private or public-private governance as a way to improve the speed and effectiveness of policymaking when the activity requiring governance crosses national boundaries (e.g., Reinicke 1997). We present a theoretical and empirical analysis focusing on delegation of regulatory functions from public to private actors. Specifically, we examine how private regulatory agents operate in the aftermath of the initial delegation.

One of the economically and politically most important areas where governance functions have been delegated to the private sector is the setting of standards (e.g., Büthe and Witte 2004; Mattli and Büthe 2003). We focus in this article on accounting or "financial reporting" standards for publicly traded companies, which have gained increasing prominence across the advanced industrialized countries. Accounting standards play an important role in both the domestic and the international political economy. At the international level, the growth of stock ownership, transnational stock market listings, and more generally the increasing integration of financial markets, have intensified demands from firms and investors for international harmonization of accounting standards. This has led to the explicit delegation of standards setting authority to the non-governmental (private) International Accounting Standards Board (IASB). It has been in operation only for a few years, though, and data is currently too scarce for an analysis of the IASB. We therefore examine accounting standards setting post-
delegation in the United States, where these governance functions have a long history of being delegated to a private agent. This U.S. private agent is today called the Financial Accounting Standards Board (FASB), whose immediate principal is a public agency, the Securities and Exchange Commission (SEC), which renders FASB accounting standards binding based on the regulatory authority delegated to the SEC by Congress.3

Why Accounting Standards?

What are accounting standards and why should we study them? Accounting standards specify how particular types of transaction and other events should be reflected in the financial statements issued by firms. In other words, they are rules that firms must follow in calculating and disclosing information like profits, costs, assets, liabilities, and revenues to their shareholders and the general public; they are supposed to result in accurate and truthful descriptions of firms’ value and financial position, which are easily comparable across firms.

Seemingly technical, accounting standards and related regulations create incentives and disincentives through which they shape the behavior of firms and consequently important aspects of a country's political economy; they are overdue for social science analysis.4 Accounting standards determine, for instance, how publicly traded companies report research and development (R&D) expenses in their financial reports, making R&D more or less attractive to firms; they influence firms' decision whether to use stock options as performance incentives for managers or other incentives; and they affect how firms structure their employee pension funds. In many European countries, they also affect how corporations are taxed. Poor accounting standards—and their lax enforcement—are also considered major causes of events that imposed great costs on society, from the stock market crash of 1929 to the spectacular bankruptcies of Enron and WorldCom in the US and Parmalat and Ahold in Europe (e.g., 2002b; U.S. House of Representatives 2001; 2002c).

Given the economic and policy relevance of accounting standards, it is as important for public policy as it is interesting theoretically to gain a better understanding of how regulatory functions are exercised by these non-governmental (private-sector) agencies to which the task of drawing up accounting standards is delegated. We draw on principal-agent theory to analyze this
issue, identifying both strengths and limits of this approach for analyzing regulation after delegation to private actors.

2. Public Principals, Private Agents, Transaction Costs and Macro-Political Context

In this section, we seek to advance the theoretical understanding of the post-delegation incentives and behavior when governance functions are delegated to private actors. We view such delegation as a special case of one actor (the "principal") conditionally granting authority to another actor (the "agent") to act on the principal's behalf in a specified domain. Since such situations are the central focus of the social choice analytical framework that has become known as "principal-agent theory" (P-A), we start from P-A. It adopts the core assumptions of rational choice (RC) theory (Weingast 1996), but differs from most RC approaches in that its starting assumption is that information is neither complete nor perfect, because transactions, including information gathering, are costly (though the costs are sometimes downplayed in P-A). This central insight of the early, Nobel-prize-winning work of Ronald Coase—who sought to explain why economic actors sometimes prefer to organize the division of labor through hierarchies like firms rather than markets (Coase 1937)—inspired the view of delegation as an inherently incomplete and imperfectly enforced contract (see Williamson 1975; 1985; 2000). Delegation is an incomplete contract not just because it is impossible to foresee every contingency but because the costliness of drawing up ever more detailed contracts undercuts the benefits from delegation; it is an imperfectly enforceable contract because monitoring is costly. Delegation therefore inevitably creates some discretion for the agent, which gives rise to the "agency problem" of "shirking" when the principal's and the agent's interests do not coincide, and the agent therefore acts contrary to the principal's interests after authority has been delegated to the agent.

The delegation of policymaking authority to regulatory agencies has been a central focus of the principal-agent literature (for a recent review, see Bendor, Glazer, and Hammond 2001), but few scholars have provided thorough analyses of the post-delegation operation of such regulators (for exceptions, see Balla 1998; Balla and Wright 2001; Eisner and Meier 1990; Hamilton 1996; Moe 1985; Wood 1988). We go beyond much of the P-A literature by asking not only why public principals delegate to private agents in the first place, but also: Do the agency losses that should be expected in such cases differ from the agency losses expected when
regulatory functions are delegated to public bureaucracies? We also go beyond P-A by emphasizing the macro-political context in which any particular principal-agent relationship is embedded.

2.1. Why Grant Public Authority to Private Actors?

The P-A literature has identified several reasons for political principals to delegate policymaking in certain issue areas to agents. Most generally, when delegating policymaking authority, political actors trade off the costs "of internal policy production … against the external costs of delegation" (Epstein and O'Halloran 1999:7), which is attractive to the political principal if the economic and/or political costs of developing policy him/herself are high relative to the costs of delegation. Under which conditions, then, should we expect public officials to consider delegating governance functions to private actors?

Of the main reasons for delegation, some—such as enhancing efficiency through (new) specialization (e.g., Epstein and O'Halloran 1999:48) or creating policy commitments or biases (e.g., Blinder 1997; Moe 1990:esp. 220, 227f)—generate no particular incentives for delegating public authority to private agents. Another important reason for delegating authority, however, is that it allows the principal to benefit from existing expertise since "delegation to an expert can be an effective substitute for the acquisition of expertise" (Alt and Alesina 1996:658). This presumes prior specialization. Expertise-based delegation is particularly common in highly technical and complex issues areas, where a political principal's willingness tends to be high "to trade uncertainty about policy consequences [which is a function of the principal's own lack of expertise] for uncertainty about agency behavior" (Bawn 1995), such as in the fields of science policy and space technology (e.g., Epstein and O'Halloran 1999:5f, 196ff), as well as arguably monetary policy (e.g., Blinder 1997:120; Persson and Tabellini 2000:441ff). In such highly technical, complex issue areas, governments are more likely to find the requisite expertise more costly to acquire and maintain—especially if maintaining expertise requires keeping up with the latest developments in a fast-changing technology, which pays off for private actors who can also use that expertise to improve products, production, etc., but is very costly for public authorities. We would therefore expect to see delegation to private actors especially in seemingly technical, not overtly politicized issue areas.
A second reason for delegating policymaking functions, which create particular incentives for delegation to private agents, is "blame avoidance" or "shifting responsibility." (Fiorina 1982:esp.46ff). Delegation here is especially attractive if regulatory activity is more palatable for the regulated when carried out by an agent who has some separation from the principal, rather than being carried out directly by the principal him-/herself.

Accounting standards exhibit both of these characteristics. Complex and technical, accounting standards have been fast-changing in recent years, as new financial instruments were invented and their accounting treatment needed to be clarified. Second, accounting standards are often issued where governments have found it hard to find solutions that fully resolve the conflict of interest between the private groups and individuals with a stake in the regulatory matter (see below), which creates an incentive to delegate in order to avoid the blame for inevitably leaving some groups and individuals dissatisfied with the outcome.

2.2. Private Agents after Delegation

Legislatures, in the US and Europe alike, have delegated some of the details of formulating rules and enforcing regulations to executive departments or independent public agencies for almost as long as they have taken on extensive regulatory functions. Public agents have therefore been the predominant focus of the P-A literature on regulation so far.

Over recent decades, however, states have increasingly delegated domestic and international governance functions to private (non-governmental) actors, as novel forms of economic activities arose (e.g., internet commerce), increasing technical complexity required technical expertise that states found too costly to acquire and maintain (e.g., new financial instruments, bond ratings), and neoliberal ideas undercut the presumption of, and normative justification for, public provision of governance (e.g., Cutler, Haufler, and Porter 1999). Do such private regulators differ from public ones in how they operate post-delegation?

Drawing on the P-A literature in economics, which was motivated by the desire to understand the establishment of employee relationships and subsidiaries, much of the political science literature presents an ideal type of the regulatory agent as created by the principal for the purpose of performing specified governance functions on the principal's behalf (e.g., Thatcher and Sweet 2002:3f). Private agents to whom regulatory authority is granted by a government
principal would seem to differ from such public agents in that they exist prior to the act of
delegation, and to the extent that the issue requires technical expertise, delegation to a private
agent is attractive precisely because s/he has a prior interest in the matter and therefore has
already acquired the requisite expertise. But many acts of delegation of public authority to
public agents in fact also involve choosing an agent from among a finite set of already existing
government bureaucracies (see Volden, in Bendor, Glazer, and Hammond 2001:255). And some
game theorists have modeled principal-agent relationships as just such a choice (Bendor and
Meirowitz 2004). Prior existence as such therefore is not the issue.

Rather, we submit, the key difference vis-à-vis cases of delegation to public agents is that
delegation to private agents creates a multiple principals problem of a different quality from
those usually considered in the literature. Here it is useful to consider the distinction between
"leisure-shirking" and "dissent-shirking" (Müller 2000:320f). Leisure-shirking occurs when
principal and agent differ over the amount of agent effort. It should benefit those who would
prefer to have less effort made (so presumably such shirking by the enforcement unit of the
regulator will benefit those who violate the rules by reducing the chance of getting caught), but
without additional information or assumptions its policy effects are indeterminate. Dissent-
shirking occurs when principal and agent differ over substantive policy; its policy effects are
therefore systematic. And dissent-shirking by the agent appears to be inherently more likely in
the case of private agents.

Potential private agents are almost always collective actors—firms, private associations,
maybe the science and technology advisory committees of unions or environmental groups—
which have an immediate and prior principal in their owners, members, or funders. When public
regulatory authority is delegated to such a private actor, then this agent has at least two
principals, one public and one private—and the private principal inherently pursues the interests
of only one segment of the general public and only one group of stakeholders. Under these
conditions, principal-agent analysis leads us to expect that the agent's behavior will diverge from
the public principal's preference as a function of the relative tightness of the P-A relationships
between each of the principals and the agent.

This qualitative difference between delegation to public vs. private agents may be
brought out most clearly in a very simple spatial model. Assume that the public principal (P)
seeks to balance the interests of two groups of stakeholders (SH1 and SH2), so P's ideal point is between the ideal points of the stakeholders on any particular regulatory issue (see Figure 1). Unless we assume uneven distribution of political lobbying resources between the two stakeholders, we have no reason to expect a public agent to take a position on either side of the principal. But with a private agent, which has one of the stakeholders as a principal (e.g., SH1), we would expect regulatory policy decisions by the agent systematically to favor this stakeholder and thus tend to fall between P and SH1—a specific implication that should be empirically observable whenever the stakeholders' ideal points are on opposite sides of the public principal's ideal point. This model of delegation to a private agent therefore implies, in contrast to traditional multi-principals models, that one group of stakeholders will inherently benefit from delegation at another group's expense.\textsuperscript{11}

[FIGURE 1 ABOUT HERE]

But where should we expect the outcome to fall between P and SH1? What is the relative influence of the two principals when their preferences diverge? We hypothesize that this is a function of the relative importance of the principals for the agent's financial and operational viability as well as effectiveness in rule-making: To the extent that the private agent depends upon voluntary contributions from one of its principals to fund its operations, it has strong incentives to take the interests of this funder into account—at the expense of other interests. The more the agent thus depends upon its private principal for its financial viability, the tighter should be the P-A relationship between the agent and the private principal \textit{(ceteris paribus)}, at the expense of the general public interest. In terms of Figure 1, we would expect the outcome to be closer to SH1. Conversely, the more the agent depends upon a periodic discretionary allocation of resources from the public principal for its financial viability, the tighter should be the P-A relationship between the agent and the public principal, \textit{ceteris paribus}.

The viability of private regulatory agents, however, is not just a function of financial resources. It also involves \textit{operational} viability, for which the agent needs specialized expertise. In the realm of food safety regulation, for instance, operational viability refers to the existence (or lack) of the bio-chemical and related scientific expertise to carry out tests of, for instance, a proposed medication and to critically assess tests performed by others. In the realm of setting accounting standards, the regulatory agent needs general accounting expertise, familiarity with
existing financial instruments, and knowledge of current practices, in order to be able to write an accounting standard that is feasible in implementation as well as effective in achieving the goals of completeness and comparability of financial reporting. How do regulatory agents acquire the needed expertise and technical support? As we suggested above, the prior existence of the requisite expertise among private actors is likely to be a key reason for having delegated to a private agent in the first place. If private provision of such expertise is crucial to the agent's operational effectiveness, we would expect outcomes to favor those providing this crucial resource. Specifically, the more the agent depends upon the private principal for the provision of such expertise, the closer should the outcome be to SH1.

While ensuring its viability may be the agent's first concern, effectiveness as a regulator—i.e. gaining acceptance for and compliance with the standards it issues—also needs to be a centrally important concern for the agent (not least since it otherwise is of little use to its funders). The agent may for this reason develop an interest (separate from any principal) in maintaining a notable distance from the ideal point of any one group, especially if neutrality and independence from the short-term interests of any group of stakeholders (or at least the appearance thereof) is crucial to the effectiveness of the regulatory agent. To what extent this is a central concern for the agent should be a function of the macro-political context.

We go beyond traditional P-A by recognizing explicitly that any particular principal-agent relationship is "embedded" in a broader context of norms and ideas (Blyth 2002; McNamara 2002; Polanyi 1957 (1944); Ruggie 1983), which inter alia define the "proper" relationship between public authority and private actors. David Vogel (1989; 1996; 2003) has documented several cycles of broad public attitudes toward regulatory matters in the course of the 20th century, which we may call the "macro-political" climate or "mood" (Erikson, MacKuen, and Stimson 2002:esp. 325ff). In the case of the United States, for instance, the macro-political climate of the 1920s, when the "prevailing ideological consensus… effectively limited any expansion of government controls over the private sector" (Vogel 1989:292), was followed in the 1930s and '40s by a much more pro-regulatory attitude in response to the perceived failure of the self-governing market (and later the war needs), which in turn was followed in the 1950s and early 1960s by a return of the prior macro-political consensus that the U.S. public should keep its impositions on business to a minimum on regulatory matters and pro-actively ensure that public policy was agreeable to business leaders. But the very economic success of that period, Vogel
argues, increased public attention to health and safety externalities and spurred demands on firms for improving consumer and environmental protection, contributing to a macro-political context from the mid-1960s to the mid-late 1970s, where it was no longer seen as acceptable to leave it to business to regulate itself, though this public demand for regulation dropped off quickly in the later 1970s and early 1980s (Vogel 1989). It appears to have stayed low throughout most of the 1990s, when innovating, highly profitable, and fast-growing firms became public heroes in the U.S., albeit in the context of a still active environmental protection sentiment. Spectacular corporate wrong-doing, such as at Enron, a stagnating stock market, and some highly visible cases of manufacturing firms re-locating plants abroad seem to have led to another swing in the public mood beginning in 2001, creating demands to address perceived problems through targeted regulation.

A clear divergence of the regulatory agent from the macro-political climate makes it more vulnerable to challenges since it increases the benefits that the public principal can attain from forcing a change in the principal-agent relationship. Regulatory agents therefore have an incentive to be at least somewhat responsive to the broader climate, lest their unresponsiveness counteract the trend toward agent autonomy. Substantial rather than merely cosmetic institutional or behavioral change in response to changes in the macro-climate, however, should not be expected to be automatic. As Wood and Waterman note, when signals from principals or the political environment conflict with the interests of a bureaucracy, "it is natural for bureaucracies to react slowly" (1993:504). This expectation should apply to private as well as public bureaucracies. Regulatory agents may react to such changes in the political macro-climate in recognition that it changes their constraints, but we should expect to see changes in the formal institutions or regularized behavior of regulatory agents most clearly when public principals translate the change in the macro climate into specific incentives for agent adaptation.

3. From Theory to Empirical Analysis

We now turn to an empirical examination of the plausibility of our hypotheses about the effects of delegating to a private agent. The setting of accounting standards in the U.S. provides us with an opportunity to analyze empirically the explicit delegation of governance functions to private actors in one of the few cases where such delegation has a long history. Focusing on the
period after the reforms of U.S. accounting standards setting of 1972 (thus holding the institutional context broadly constant), we find that the operation of the institutions for setting accounting standards exhibits many of the principal-agent issues and problems highlighted above. Cognizant of the problem of observational equivalence for establishing shirking in the analysis of many individual regulatory decisions (Huber and Shipan 2000), we focus on episodes in which divergent interests of the stakeholders and the agents can be well established based on original documents, prior analyses, and a series of interviews that we have conducted with current and former participants and close observers of accounting standards setting in American corporations, at the FASB, and at the SEC.

4. Principals and Agents in U.S. Accounting

4.1. From the Initial Delegation to the Wheat Committee Report of 1972

Federal regulation of financial reporting did not begin until after the onset of the Great Depression and the Stock Market Crash of 1929, which was blamed in part on "deceptive and misleading financial reporting practices" (Ripley 1927). The Securities Act of 1933 mandated "full and fair disclosure" in the flotation of securities and was followed in 1934 by the landmark Securities Exchange Act, which required the filing of periodic reports by all companies whose financial securities were listed on the national securities exchanges. It also created the Securities and Exchange Commission (SEC), and delegated to it the tasks of specifying and enforcing all obligations arising from these two acts. Congress thus initially delegated regulatory authority to an independent but public agency, including the authority "to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed … to assure that investors are furnished with information necessary for informed investment decision" and to enforce compliance with these methods (SEC 1973).

Almost from the beginning, the SEC was divided on whether such accounting standards should be produced in-house or delegated to a private-sector organization. Proponents of private-sector standardization argued that the establishment of a highly specialized and technical standard-setting apparatus within the SEC would be overly costly and impractical. The quality and timeliness of SEC-led standardization would suffer due to limited resources, bureaucratic rigidity, and political uncertainties. Opponents countered that financial reporting rules were in
the "public interest," their formulation should therefore not be entrusted to the private sector. They regarded any delegation of rule-making authority to the private-sector as a failure by the SEC to pursue its mission of safeguarding the public interest in financial securities regulation. After months of stalemate, the SEC decided the issue in 1938, by a majority of three to two commissioners, in favour of delegation to the private sector. Henceforth the accounting profession took the lead in developing standards while the SEC retained an oversight function and final authority (Van Riper 1994:7).

The first private-sector body entrusted with the task of producing financial reporting standards was the Committee on Accounting Procedure (CAP) founded in 1936 within the American Institute of Accountants (now the American Institute of Certified Public Accountants, or AICPA, Carey 1969:esp. 199ff; 1970:12-16). After some scandals and intense criticisms by the SEC and others, CAP was replaced in 1959 by the Accounting Principles Board (APB, also a part of the AICPA)—which some saw as actually having too little independence from the SEC (Schuetze 1978:6). Dissatisfaction with the functioning of this all-volunteer and part-time body, as business transactions and practices became more complex (Miller, Redding, and Bahnson 1998:55-58), led to the appointment of a committee headed by Francis Wheat, an attorney and former SEC commissioner, to consider ways of improving the process of setting financial reporting standards in U.S. In March 1972, the “Wheat Committee” submitted a report that recommended a radically new structure for standard setting. It proposed to establish three institutional bodies: the Financial Accounting Foundation (FAF), the Financial Accounting Standards Board (FASB or simply the Board), and the Financial Accounting Standards Advisory Council (FASAC). The Wheat Committee’s recommendations were accepted by the Governing Council of the AICPA and put in place in the summer 1972. With minor modification, they remain in place to this day (SEC 2003).

4.2. A Novel Structure of Private-Sector Standardization

The FAF is composed of trustees whose task it is to appoint the members of FASB and exercise general oversight. They are also responsible for raising funds—initially primarily from business—to pay for FASB salaries and expenditures. Trustees are elected for three-year terms and eligible for re-election to one additional term.
The central operating body of the new standard-setting system is the FASB. Its seven members are all salaried and serve full-time for five year terms with possible reappointment for a second term.\textsuperscript{18} The Wheat report called for the Board to be made up of four certified public accountants and three experts from other relevant disciplines “who in the judgment of the trustees are well versed in problems of financial reporting.”\textsuperscript{19} Board members work with FASB task forces to draft standards. FASB is subject to rules of procedure that are supposed to guarantee due process and provide opportunities for the public to consider and comment on issues (Mezias and Chung 1989). "Final draft" proposals are submitted to the Board for final approval; their adoption as standards required originally a supermajority of five Board members.\textsuperscript{20}

The third institutional pillar of the new standard-setting scheme is the FASAC, designed to be broadly representative of groups interested in or affected by accounting standards.\textsuperscript{21} Meeting on a quarterly basis, its members—also selected by the FAF—liaise with the FASB on technical issues. The FASAC has to be heard, but its requests and recommendations need not be taken into account, and—in contrast to many public agencies today—FASB need not explain any decision not to take them into account.

In sum, what emerged was a novel structure of private-sector standardization that represented a bold experiment in self-regulation, with both legislative and judicial qualities.\textsuperscript{22} The key body of the new scheme, the FAS Board, is nominally an independent agent overseen by two principals: on the one hand the FAF which funds the Board and selects its members, and on the other hand the SEC, a public regulator whose endorsement confers upon FASB standards the weight of federal law. In the process of rulemaking, the Board must heed the concerns of various constituencies – chiefly business, accountants, and investors (Kirk 1979). Each constituency group is bound to be divided over some issues, but on many other aspects of accounting standards the members of each group have a coherent ordering of preferences (Miller, Redding, and Bahnson 1998), which enables each of them as a collective actor (Frey 1985). The hypotheses derived in our theoretical section should be most apparent when the three major groups have diametrically opposed preferences over a particular issue in accounting standards and standardization, leading to tensions and sometimes open conflicts over the control of private-sector rulemaking. To the extent that they are able to overcome their collective action problems, we should see any group use their available means to put pressure on the Board as well as the
principals to push their agendas. Yet, when they agree amongst themselves, we should see the business constituency in particular benefitting from providing financial and operational viability to the agent, FASB, via its private principal, FAF.

How do FASB’s dual loyalties affect its operation, and who are the winners and losers in these battles over accounting rules and rulemaking post delegation? The following section will address these questions by explaining the competing pressures on the Board and the principals, including changes in the specific preferences of the Board and its principals, and the relationship between agent and principals.

5. Politics Post Delegation: Private Rule-Making in Accounting

FASB and Business Groups

The viability of FASB depends foremost on continuing support from business groups, and especially large companies with the requisite resources and expertise available within the firm. These groups willingly support the Board as long as FASB is effective in keeping government regulation at bay, and as long as they feel that their preferences are understood by the agent and acted upon (Miller, Redding, and Bahnson 1998; Minard 1978).

When business feels that FASB is out of step with its preferences, it criticizes the Board for allegedly being overly committed to theory at the expense of practicality and ease of implementation, working too slowly and on the wrong projects, producing rules that are too complex, and being insufficiently sensitive to the cost to business of new standards (Miller, Redding, and Bahnson 1998; Van Riper 1994).

Business can resort to a variety of strategies to push its demands. For thirty years, the funding of the Board was raised by the FAF from voluntary donations. The bulk of this funding for FASB came from business groups. When dissatisfied with FASB decisions, business often reminded the agent on whom the Board’s continuing existence depended. However, this has now changed. In the wake of recent accounting scandals, questions were raised in Congress and beyond about the impact of the funding structure on the independence of FASB as a regulatory agent. In August 2003, a new funding structure, initiated under the Sarbanes-Oxley Act, was implemented.23 Under the new scheme, FASB’s budget is paid by mandatory contributions of
some 7,500 publicly listed companies. This change from voluntary to mandated funding has removed one important means of pressure from business.\textsuperscript{24}

The business constituency also relies, for example, on the services of the Business Roundtable, an influential and by-invitation-only lobby group whose members are about 150 (current and some former) chief executives of the largest U.S. companies across industries and geographic regions. The Roundtable, founded in 1972, established in the late 1970s an Accounting Principles Task Force (APTF, today part of the Roundtable's Corporate Governance Task Force), made up of heads of major companies with a special interest in accounting matters. APTF has sought to influence the work of the FASB through the business representatives among the trustees of the FAF—the Board’s private principal. In theory, the bylaws of FAF prohibit trustee interference in technical and agenda decisions of the standards setters; in practice, however, such influence attempt do happen and tend to be successful (Van Riper 1994:169f). APTF may also air its views in meetings with the SEC or push its agenda on Capitol Hill in the hope that concerted political action may sway reluctant Board members (Miller, Redding, and Bahnson 1998).

Finally, besides lobbying and threat strategies, business can seek to influence the making of standards via the normal due process, that is, by participating in the public consultation phase of the standardization process. In fact, the FASB relies on expert input for its operational viability at that stage. Large corporations have the necessary resources, including technical expertise and organizational structure to be actively involved. Indeed, industry groups contribute an average of 60 to 65 percent of responses to FASB discussion memoranda and exposure drafts; on certain projects more than 80 percent of the submissions at the consultation phase come from large firms and industry associations. Their representation at public hearings is also in the 60 to 70 percent range (see Sampson 1991).

Considering the extensive resources and expertise as well as the privileged access of business to the Board, it is not surprising that it has been quite successful over the years in influencing FASB. Industry groups have succeeded, for example, in having standards cancelled or restated. A case in point is a FASB accounting rule for the translation of foreign currency transactions and foreign currency financial statements, which came into effect in 1976. Siding with the clearly stated preferences of investors and financial analysts, the new FASB standard
required that exchange gains and losses resulting from translation be taken into income in the current period and not be deferred. Monetary assets and liabilities such as cash, receivables, and payables would be translated at the foreign exchange rate in effect when balance sheets were prepared, and other assets and liabilities would be translated at the rate in effect when the assets were acquired or the liabilities incurred (Van Riper 1994:32). Firms with high levels of foreign market exposure strongly opposed this standard because it introduced what they considered excessive earnings volatility. Large firms were united in their position on this issue, and smaller listed firms with no foreign exchange exposure were indifferent, allowing business opponents of the new standards to forge a unified 'business' position on this issue. Working through FAF and through lobbying groups, they put pressure on FASB to withdraw or change the standard until FASB announced in 1979 that it was working on a new standard that later replaced the 1976 rule.

Another telling, albeit somewhat different case is FASB’s standard on financial accounting and reporting by oil and gas production companies. The Energy Policy and Conservation Act of 1975 called on the SEC (or at its discretion the FASB) to develop a set of accounting practices that would allow the compilation of a comprehensive database on the domestic production of crude oil and natural gas for public policy purposes. Such a database required comparable data generated by a single method of accounting. The problem was that two methods existed: the "successful efforts" method and "full-cost" accounting. Under the first method, only the costs of oil and gas exploration and development that lead to proven reserves can be counted as amortizable assets, whereas costs associated with unsuccessful exploration must be counted as expenses, adversely affecting a firm’s income statement. Under full-cost accounting, by contrast, the costs of unsuccessful efforts, too, become amortizable assets, improving both balance sheet and income statement of firms whose efforts have been unsuccessful.

In July 1977, the FASB produced a draft that stipulated that "successful efforts" accounting be mandated as the only method for oil and gas exploration and development costs (FASB 1977). In the Board’s view expenditures that produced no measurable economic benefits should not be called assets. Full cost companies strongly opposed the proposal and rallied to defeat it. They argued that conversion to 'successful efforts’ would depress net capitalized costs in their oil and gas properties, adversely affecting retained earnings, shareholder equity, and annual reported net income. In this case, however, business as a whole was divided, with
companies that were already using "full cost" accounting quite content with the proposal, which made FAF a less effective means for influence and made it easier for FASB to refuse to change its position. Insisting that only one accounting method will eliminate inconsistencies, lack of comparability, and misunderstandings in capital markets, the Board adopted in December 1977 the standard based on "successful efforts" only. Full cost companies, however, had also formed a lobbying group, the Ad Hoc Committee on Full Costing, comprising representatives of 33 large firms with important political connections, particularly to members of Congress from oil-producing states and to heads of federal administrative agencies. High-level calls were made to the SEC urging rejection of a standard based only on the `successful efforts’ accounting. Some of our interviewees described this lobbying campaign as the most aggressive they have seen in their Washington careers (see also Miller, Redding, and Bahnson 1998:117ff; Van Riper 1994:64). A few months later, the SEC in effect overruled the standard by adopting a set of principles that accommodated different methods of accounting. The intense lobbying campaign by the Ad Hoc Committee on Full Costing had fully paid off (see Garton 1991).

Business groups have not only been successful in shaping the content of accounting rules; they also have left their imprint on the institutional structure and mode of operation of standard-setting in accounting, where business has held a common preference in many cases. Several examples are noteworthy: 1) In response to business’ complaints that the FASB was working on the wrong projects, the Board established in 1984, at the urging of FAF, the Emerging Issues Task Force (EITF) to help it identify new trends and address new problems, providing firms greater influence on FASB’s agenda. 2) Under pressure from business for more "pragmatism" and "practicality" on the part of FASB, the trustees agreed in the 1990s to increase from one to two the number of Board representatives from the corporate world. Business also secured an additional place among the Foundation trustees.26 3) Similarly, in 1990 a Board member was up for re-election. Business lobbied successfully to prevent the reappointment; the Board member was dumped.27 4) The bylaws of the FAF explicitly prohibited interference with FASB technical or agenda decisions. A 1991 revision, however, opened the possibility that the trustees may “provide advice and counsel” to the Board on specific items. The trustees exercised this provision, for example, in a 1992 meeting, in response to fierce opposition by the Business Roundtable and other business organizations to FASB’s proposal for the expensing of stock options. In view of a unified position of the business community, the trustees urged the Board to
drop their proposal—successfully: The FASB abandoned its proposal for expensing stock options. Finally, in the mid-1980s, a period of general deregulation, corporate America felt that it was high time to curb what it viewed as rampant standard setting (interview with former FASB official; Miller, Redding, and Bahnson 1998) by changing the voting rule in FASB from simple majority back to supermajority to make it more difficult to adopt new standards. The trustees complied and voted by 11-5 to change the voting requirement.

Notwithstanding all of these episodes where business succeeded in getting its way at FASB, it would be wrong to jump to the conclusion that accounting standards setting post delegation simply boils down to business capture of a private-sector regulator. The delegation relationship is embedded in a broader political and economic context that affects and shapes this relationship. Changes in this macro-political context may change perceptions of the proper balance of interest representation and thus the urgency of weighing competing interests differentially in the process of rulemaking. This logic is illustrated in the following section.

**FASB and SEC**

As noted above, the SEC is the public-sector principal of the FASB. It is charged with overseeing private-sector standards-setting activity, and legally has the power to revoke the Board’s mandate or override FASB standards and replace them by its own rules. The SEC also monitors compliance with FASB standards and is responsible for their enforcement. There is a close working relationship between the SEC (primarily the office of its Chief Accountant) and the FASB. This relationship has been described by a long-time staff member of the Board as follows:

> [A] close liaison was maintained between the two organizations...[T]heir staffs were in almost daily contact by telephone on a wide range of matters...[T]he [SEC] chief accountant participated in meetings of the Advisory Council...and the Board and the Commission held periodic joint meetings...to discuss matters of mutual concern. In addition, the respective chairmen met informally as circumstances required (Van Riper 1994:144).

Operationally, however, FASB depends little on the SEC. The FASB staff has grown from a mere eight in 1973 to about 85 by the mid-1990s; over the same period—a period of greatly increased complexity of accounting matters—the staff in the Office of the SEC’s Chief Accountant remained more or less steady, fluctuating around 25. The staff of FASB is thus more
than three times as large as that of the SEC Chief Accountant’s Office, making any suggestion by the SEC that it might re-appropriate standards setting (beyond the details of a particular measure) an empty threat. At current levels of Congressional funding for the SEC, it has neither the expertise nor the capacity to take on standards setting, as it is hardly able to fulfil its monitoring and enforcement mission (interviews with current and former SEC staff).

Further, FASB pays (private-sector) salaries that are much higher than those offered to SEC staff. The considerably better pay has tended to attract more accounting talent to the FASB than the SEC. As Miller, Redding, and Bahnson put it:

Although working at the SEC may provide an intangible benefit from performing a public service, it seems unlikely that the [SEC] would be able to consistently locate, hire, train, and retain people whose talents and backgrounds are equal to those of the people at the FASB and who are also willing to make a long-term commitment.

The higher level of expertise at FASB should objectively improve performance and thus agent discretion, as we argued in section 2. It also has the effect that SEC employees at the highest level have on occasion encountered their superiors from former private-sector jobs as the FASB Board members or senior staff whose work they were now supposed to oversee (interviews at SEC and FASB).

Arguably the most important role performed by the SEC staff is to feed back to FASB systematic data on enforcement problems with existing accounting standards or report difficulties that SEC registrants may experience implementing specific FASB rules. Such information assists the agent in revising and improving its standards. The SEC, however, rarely tells FASB what items to work on. For the most part, the flow of information is from FASB to the SEC. FASB keeps the SEC informed of new projects, but it depends on the SEC neither for guidance nor expertise.

Consistent with our theoretical conjecture about specialization, it thus appears that FASB’s considerable accounting expertise has helped the agent over time increase its level of autonomy and discretion, thus begetting further specialization. The early and untested FASB still had to fight turf battles with the SEC. For example, in the mid-1970s a variety of accounting initiatives by the SEC gave rise to fears in the private-sector that the SEC might preempt major portions of the standard-setting function of FASB (see Schuetze 1978). FASB eventually
prevailed, and turf battles became a thing of the past. The agent established itself as the focal institution for rule-making in accounting.

Our account of the relationship between FASB and the SEC would be incomplete, however, without considering the role of exogenous analytical factors, chiefly the macro-political context.

The SEC is a politicized regulatory agent. The President appoints the five Commissioners (subject to Senate confirmation and the restriction that no more than three of them may be of the same political party). At least a majority of the Commissioners therefore tend to share the policy views of the current administration, and Congress oversees the SEC, holding it accountable as it sees fit (e.g., Khademian 1992:35f; Schwartz 1973:2679ff). The SEC's approach to regulatory matters, including accounting standards setting, is therefore very much a function of the mood of a period reflected in specific political and economic realities. As a result, SEC demands and expectations of FASB are likely to vary over time. The election of President Ronald Reagan, for instance, institutionalized a change in the macro-political climate in favor of deregulation and economic laissez-faire. Among Reagan's first appointments was a new SEC chairman, John Shad, who had a far less activist attitude than his predecessor Harold Williams. Shad, in turn, filled the chief accountant's position with Clarence Sampson, who largely left FASB to its own devices (Miller, Redding, and Bahnson 1998:102f). Unsurprisingly, it was especially during the Reagan and Bush (Sr.) presidencies that business solidified its control over FASB. Such influence is not undisputed: Dennis Beresford, FASB chairman from 1987 until 1997, steadfastly denied that the corporate community had gained influence over the FASB’s deliberations on technical issues. An FASB insider, however, commented in 1994: “In a literal sense, in terms of the Board’s painstaking consideration of the details of any given issue, [Beresford] is right. But in terms of the overall balance of power in the standard-setting structure, the atmosphere in which the standard setters work, and the trend lines and fault lines that are developing, he is overlooking some stark realities” (Van Riper 1994:170; see also Gerboth 1973).

Occasionally, individual members of Congress have criticized what they perceived as excessive business influence in private rule-making. Representative John Dingel (D-MI), for example, former chairman of both the House committee on energy and commerce and its
subcommittee on oversight and investigations, wrote in the mid-1980s to the SEC chairman advising him of the subcommittee’s expectation that the SEC use its power to shield FASB from what he called “improper influence” by the business community. A few years later, during the (first) battle over how to account for stock options, the chairman of the House Subcommittee on Telecommunications and Finance, Representative Edward Markey (D-MA), deplored business’ “ferocious hardball tactics and not-so-subtle threats” to FASB and went on to note:

The federal government allows the accounting profession to establish its own rules and standards, with limited federal oversight, because it has been promised that the profession can do so objectively and responsibly…The…reported threats raise serious doubts about the wisdom of delegating such broad and important responsibilities to the accounting profession in the first place.\textsuperscript{33}

More generally, Dingel, Markey, and a few others felt that the interests of users of financial information (investors, creditors, and others) were being overlooked. Such users typically want a maximum of disaggregate, detailed, reliable, and relevant information. From their perspective, standards should achieve maximum disclosure of firms’ assets and liabilities and present them in a consistent, easily accessible format. Users also favour a transparent and broadly-inclusive process of standardization. Investors and other users, however, are disadvantaged vis-à-vis reporting business firms not only because they have fewer resources and tend to be less well organized as a group, but also because the delegation to a private agent put them in a less favourable position to influence the process of standardization.

A third group with a stake in standardization are accountants responsible for auditing the books of firms. Generally, they are inclined to want more standards, and more specific ones, which will defuse differences of opinion with clients. At the same time, however, accountants depend on firms for audit engagements, until recently increasingly also for various forms of consulting work.\textsuperscript{34} Though they pride themselves on their analytical abilities and professional objectivity, they may be tempted to take on a less stringent and more compromising approach, especially in a highly competitive environment. And there is little doubt that the environment for consulting became markedly more competitive in the second half of the 1980s and throughout the 1990s, thus making auditors much more pliant to the wishes and demands of business firms (see Stevens 1981; 1985; 1991).
For all these reasons, politicians such as Dingel and Markey demanded that standardization be taken over by the SEC or by a congressionally mandated “self-regulatory organization” under the control of the SEC, for example, along the lines of the municipal Securities Rulemaking Board whose rules covering municipal bond trading are subject to formal approval by the SEC and official review by the three federal bank regulatory agencies prior to becoming effective.

These demands, however, fell on deaf ears in a macro-political climate of deregulation and unbridled faith in market forces—until a series of major corporate accounting scandals, coupled with a marked cooling of the economy, dramatically changed the mood of the time, invigorating the SEC to take on a more activist role (e.g., Stiglitz 2003:esp. 115ff, 241ff). In a speech notable for its directness and forceful tone, SEC Chief Accountant Robert Herdman noted in 2002:

> [E]ven before Enron’s collapse, we called upon the FASB to work with us to address concerns about timeliness, transparency, and complexity…Going forward, we plan to make some changes to the historical way in which we have delegated our authority to oversee the standard-setting process…We plan to 1) broaden funding sources and make the funding involuntary, 2) meaningfully participate in selecting of the members of FASB and setting the FASB agenda, 3) exercise our authority to review standards actually adopted, and 4) ensure that the FASB promulgates principle-based standards, which adapt faster to changing business environment and emphasize overall accuracy and completeness (Herdman 2002, emphasis added).35

The SEC’s first new objective has been attained. As mentioned above, under the Sarbanes Oxley legislation, FASB now receives mandated funding from public companies. Commenting on the funding change, Robert Herz, new FASB chairman since 2002, spoke words that in the pre-Enron era would have struck many within the private-sector standards community as pure heresy: “[W]e need the support, understanding, and partnership of politicians and government officials in helping ensure that accounting standard setting is not subject to inappropriate constituent influence…[A] clear aim of Sarbanes-Oxley in trying to bolster the financial security of the FASB through the mandated funding was to help ensure that our standard setting is carried out in an independent, objective, and neutral way. That’s a tough one for some people to understand and even tougher for some to accept” (Herz 2003).

Progress on Herdman’s other objectives is less certain. In particular, it is unlikely that much will change in the scope and intensity of SEC oversight given the continuing asymmetry in
resources and staff between FASB and the Office of the SEC Chief Accountant. While the staff of latter has increased since the passage of the Sarbanes-Oxley Act, so have the tasks that the Office is asked to tackle. They include not only keeping an eye on private-sector standards setting, but also working to improve the implementation, auditing, and enforcement of accounting standards.

In closing, however, it is worth noting that FASB (and the FAF) have been responding to renewed SEC pressure by launching a series of institutional changes, most notably a return to majority decision rule to more speedily adopt standards and the creation of a new User Advisory Council to improve access for investors, financial analysts, credit rating agencies, and other consumers of financial information.

6. Conclusion

This study has sought to advance the theoretical discussion of delegation by focusing on the much-neglected delegation of regulatory authority from a public principal to a private agent. We have asked: How do private agents differ from public ones and what are the implications of these differences for the relationship between principal and agent after the initial delegation of public authority to the private agent—and consequently for the content of the rules adopted by the agent?

Private-sector delegation tends to occur in highly technical and complex issue areas where the creation of specialized public bureaucracies to deal with such technical issues is either overly costly or simply impractical. Private agents to whom regulatory authority has been delegated, however, are rarely self-reliant bodies. Instead, they almost always are collective actors relying on a prior principal in their owners, funders, or members. In other words, when public regulatory authority is delegated to a private actor, the agent ends up with at least two principals: one public and one private. We have stipulated that this arrangement will advantage those who constitute the private principal over other groups with a stake in the regulatory matter whenever those who constitute the private principal are cohesive amongst themselves yet differ in their preferences from the other groups.

We have argued that the agent’s actions under these conditions will be determined by the relative tightness of the competing P-A relationships. This depends, in turn, on the extent to
which the agent's financial and operational viability is dependent upon each of the principals as well as the principals’ monitoring capabilities, which might be expected to decline over time for the public principal as both the public principal and the private agent specialize further to reap the benefits of delegation. However, this endogenous logic is not alone in shaping the relationship between agent and principals over time. It must be complemented by consideration of exogenous analytical factors, in particular what we have called the macro-political climate. Changes in this broader context can deeply affect the nature of a PA relationship.

We have examined the plausibility of our hypotheses about the politics of regulation in the post-delegation period through a case study of accounting standards setting in the United States, a case of delegation to a private agent—the FASB—with an exceptionally long history, going back to the New Deal era.\textsuperscript{36} We identified three main domestic groups as having a stake in the content of U.S. accounting standards and hence the process of standards setting: business firms that are required by the SEC to report their results according to FASB standards; accountants that audit those firms; and investors who rely upon the information in the reported results to make decisions about buying and selling shares, supporting management or calling for changes, etc. Of these three groups, business tends to have superior resources and, along with accountants, is well organized for collective action. Yet, business is also at times divided over the specifics of accounting—just as in other issue areas (Smith 2000)—such as in the case of "full cost" versus "successful efforts" accounting for oil exploration. In that case, we observed the particular group of firms with the greatest persistence and skill in traditional political lobbying to have the greatest influence on public policy. When business held uniform preferences, however, this group was able to take advantage of the dual-principal institutional arrangement created by the delegation of public authority to a private agent, which granted to business a privileged position through FASB's private principal (the FAF). This allowed business to get FASB to revise its accounting standards regarding the treatment of foreign exchange transactions, reconsider personnel decisions, change its voting rules, and drop plans for the expensing of stock options. Business influence in accounting standards, however, is not static. It is also a function of the macro-political context. Thus, in the changed "post-Enron" climate, business is not only divided on the issue of options expensing, it is also far from clear whether the intensive lobbying efforts of those opposed to expensing are going to pay off in a context of considerable skepticism to business self-regulation.
The principal-agent framework has proven useful for understanding the delegation to a private actor—a type of delegation so far almost entirely overlooked in that literature. As previously formulated, however, it pays little attention to the macro-political context within which a P-A relationship occurs and evolves. We have suggested a way of integrating P-A with a systematic analysis of the macro-political context to push forward the theoretical debate and advance our understanding of accounting standards setting in the U.S.

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\‡ We are grateful to David Cohen, Tonya Putnam, Rachel Rubinstein, Mark Thatcher, and two anonymous reviewers for comments on previous drafts.
1 There is also, of course, an extensive literature on delegation within legislatures (e.g., Shepsle and Weingast 1988; 1994) as well as on representative democracy as delegation from citizens to legislators and governments (e.g., Bergman, Müller, and Strøm 2000).
3 Other examples of delegation of public authority to private actors include the delegation of governance functions regarding publicly mandated social insurance to labor unions in some European countries.
4 So far, accounting standards have received little attention outside accounting and legal scholarship.
5 This delegation of authority is conditional on the agent's performance, i.e. the implicit or explicit grant of authority to the agent can be revised and revoked by the principal; as Giandomenico Majone has pointed out (2001:112ff), a comprehensive or (nearly) irreversible grant of authority may need to be analyzed as a trusteeship relationship rather than an agency relationship.
6 Matthew McCubbins and Talbot Page distinguish a second type of agency problem, which they call "slippage," where instabilities in the agent's decisionmaking process or other "institutionally induced biases" lead a collective agent to make choices that diverge from those preferred by the principal, even if each individual/unit within the agent "earnestly attempt[s] to choose policies that comply with the preferences of" the principal (McCubbins and Page 1987:411). This valid concern, however, is not P-A specific, but is a general issue of institutional design (see, e.g. Koremenos, Lipson, and Snidal 2001).
8 Delegation to independent regulatory agencies has a longer tradition in the U.S. but by now also has a tradition of several decades in many European countries (Pollack 2002:200f; Thatcher and Sweet 2002:9f). Some regulatory functions also were implicitly delegated to the courts—arguably a rather inefficient solution (Glaser and Shleifer 2003), though private arbitration may provide an efficient alternative, at least in transnational economic disputes (Mattli 2001)—but delegation to courts and arbitrators is beyond the scope of this analysis.
9 We thank Jonathon Bendor for fruitful discussions of this issue.
10 Again reflecting its roots in economics, and as implied by the terminology of "shirking" and "slack," much of P-A has traditionally been concerned with agents seeking such "leisure-shirking" or the pursuit of extraneous objectives, such as maximizing the agent's prestige, budget, etc.
11 We do not mean to make too much of this difference: In the real world, regulatory agencies can get captured by those whom they are supposed to regulate and, as Epstein and O'Halloran point out, legislators (as the public principals of the regulatory agencies) themselves may also be very receptive to special interest lobbying when making regulatory decisions on the same matter as a specialized agency (1999:10; see also Moe 1990). When any one group has privileged access, we would expect the regulatory activity to favor the interests of that group regardless of whether this was the intention of the institutional arrangement (McCubbins, Noll, and Weingast 1987:261; 1989) or an unintentional by-product (Robinson 1989). At the same time, the influence of the principal-
stakeholders may be institutionally balanced by ensuring effective input for other stakeholders. Note also that we do not argue that the involvement of non-governmental principals in principle diminishes the effectiveness or efficiency of regulation. Not all public policy decisions significantly affect everyone. If the private principals reflect without bias the balance of interests among those who have a stake in the regulatory matter, public and private benefits should coincide (though there should be less if any need for regulation under these circumstances). Without such a balance, however, the presence of multiple principals is likely to skew regulatory policy away the socially optimal outcome. We also note that institutional incentives may mitigate the risk of bias, as arguably occurs when highly institutionalized professional norms provide effective incentives for former senior partners in corporate law firms to become quite independent judges after appointment, or national policy experts largely disregard their own countries' policy preference after joining the European Commission bureaucracy.

12 This may be borne out more in rhetoric than in regulatory policy. Courts, for instance, put a premium on presentation of all rulings as non-partisan, neutral/professional decisions (e.g., Burley and Mattli 1993). We would therefore expect agents to try to avoid statements and actions that overtly favor one side over another, though we would still expect the agent to favor the stakeholder who is the agent's prior principal.

13 In future research, we will examine the temporal dynamics of institutional change (Büthe 2002; Pierson 2004; Thelen 2003).

14 For a history of rudimentary reporting requirements previously put in place by individual U.S. states and by local exchanges, see Banner (1998:esp. 161ff, 222ff, 250ff). Assessments like those of Harvard economist William Ripley gained prominence only well after the crash of 1929.

15 The 1934 Act also stipulated inter alia that the financial statement of most publicly traded companies be audited by independent public accountants.

16 A fourth institutional body, the Governmental Accounting Standards Board (GASB), was added in 1984. GASB sets standards of financial accounting and reporting for state and local governmental units.

17 Each of the five original sponsoring organizations of the new standard-setting structure nominated one or more of the 9 trustees of the Foundation. Besides the AICPA, these organizations included the American Accounting Association (AAA), the professional organization of accounting educators; the Financial Executives Institute (FEI); the Financial Analysts Federation (FAF, now the Association for Investment Management and Research, or AIMR), and the National Association of Accountants (NAA, now the Institute of Management Accountants, IMA). In 1976, the Securities Industry Association (SIP) joined this group of sponsoring organizations. Latest additions are the National Association of State Auditors, Comptrollers and Treasurers as well as the Government Finance Officers Associations. The Foundation’s original trustees were the heads of three large national public accounting firms, two regional accounting firms, an investment banker, an accounting professor, and two executives from large US corporations. By the mid-1990, the number of trustees had risen to sixteen. Trustees tended to represent and promote the interests of their sponsors.

18 Each member has to sever all connections with prior employers and to divest him/herself of all investments or other financial arrangements that might create conflicts of interest.

19 Bylaws of the Financial Accounting Foundation, chapter A, Article II-A, section 2, 1973. The members of the first Board included the president of AICPA and three senior accountants from Haskins&Sells (now part of Deloitte&Touche), Price Waterhouse, and Peat, Marwick, Mitchell&Co. The other three members were a former chief of the office of Accounting and Finance or the Federal Power Commission, a comptroller of Exxon Corporation, and an accounting professor. The requirement of four practicing CPAs was dropped in 1977. The current board consists of five accountants (including on with past positions in investment banking and as a business school professor of accounting), one former comptroller of a major oil corporation, and one accounting professor (see http://www.fasb.org/facts/bd_members_staff.shtml, accessed 26 August 2004).

20 FASB’s mission, structure, operations, and relations with external groups are reviewed by the FAF every three to five years, typically generating recommendations for institutional and procedural changes. For example, as a result of the first review of FASB in 1977, so-called "sunshine" reforms were implemented, including greater public access to deliberations and records of the Board and its task forces, as well as regular publication of various plans for technical projects. Other changes included changing the voting rule for adoption of FASB standards from supermajority of 5-2 to a simple majority of 4-3 (requirements for passing proposals changed several times over the last three decades; see below), placing a limit on annual contributions from any given firm, doubling the technical staff and consolidating the staff in a single Research and Technical Activities Division.

21 It was originally comprised, in 1973, of some 20 experts from the fields of finance, accounting, industry, education, banking, and the legal profession. By the 1990s, the Council counted about 30 members (see...
http://www.fasb.org/fasac/fasacmem.shtml), with representatives of "preparers," i.e., publicly listed companies, accounting for half of the FASAC members (Miller, Redding, and Bahnson 1998:43).

22 The accounting standards setting process is legislative in that it establishes authoritative rules, consistent with a legislative mandate, and it is judicial because it interprets its own rules (Van Riper 1994:178).


24 Several private-sector players interviewed have expressed concern that the new funding structure may move FASB closer to government and make it more susceptible to political interference.

25 The Board felt that full-cost accounting obscured risks and concealed failures by treating the costs of abandoned properties and exploratory dry holes as assets. More generally, its view was that accounting standards should not be designed to take the peaks and valleys out of the periodic earnings of high-risk business.

26 The new chairman was Dennis Beresford. Art Wyatt resigned one year later from the Standards Board charging that the trustees were giving undue prominence to the views of preparers of financial information at the expense of users.

27 The name of the Board member was Arthur Northrop. Miller, Redding, and Bahnson (1998:183) sum up the episode as follows: “Northrop’s reappointment was not supported by the Financial Executives Institute because he had gravely disappointed leaders of the preparer constituency by not always taking positions on the issues that they expected, despite the fact that he had spent more than 40 years with IBM. This decision is significant because it shows that the trustees were again willing to use their appointment powers to try to shape the outcome of the Board’s process to meet their own needs.”

28 Ten years later, after the Enron debacle, FASB felt time was right for resuscitating its stock option project. This time business was less unanimous in opposing the project. Nevertheless, IT firms, in particular, have mounted a strong lobbying campaign against the project. As a result, the House of Representatives passed a bill in June 2004 overriding the standard setters. It remains to be seen whether the Senate will approve the bill.

29 As noted above, the rule had been changed in the late 1970s from supermajority to simple majority. The supermajority requirement had been recommended by the Wheat Committee, which was at the origin of the new scheme of standard-setting in accounting, on grounds that it would reduce the likelihood of controversial rulings which may not enjoy wide support. The change to simple majority in 1977 was justified in terms of speeding up the process of establishing standards and creating less scope for compromising on the substance of a standard (seeFinancial Accounting Foundation 1989:8). Revealingly, in the wake of the Enron scandal of 2001 the FAF decided to move back to simple majority. The FASB had come under heavy criticism for being slow to act and failing to adopt rules that would have tightened the criteria for keeping so-called special purpose entities off corporate financial statements.

30 Van Riper worked for the FASB from 1973 to 1991.

31 For example, in 1997, the SEC chief accountant earned $123,000 while Board members or FASB’s director of research and technical activities earned $345,000. The salaries of the SEC Chief Accountant’s professional staff ranged from $47,180 to $99,250, whereas FASB project managers earned between $80,000 and $125,000 (Miller, Redding, and Bahnson 1998:158).

32 Note, however, that FASB staff may learn of enforcement and implementation problems also directly from interactions with its constituents.


34 The Sarbanes-Oxley Act restricted the kinds and amounts of non-audit work that can be done by the same accountants who work as auditors for a given firm.

35 Herdman reiterated the main points in a Congressional testimony, see (U.S. House of Representatives 2002a; also online at www.sec.gov/news/testimony/021402tsrkh.htm (accessed 16 July 2004)).

36 To be sure, this is not the only example of private-sector delegation. A prominent but more recent case is the EU’s so-called "New Approach," introduced in the mid-1980s. Its cornerstone was the retreat of EU legislation from the field of technical specification and the delegation of regulatory functions to private sector bodies, namely European standardization organizations. Consistent with our theoretical framework, we observe a transformation of what was initially a case of purely private standards governance into joint private-public governance as a result of growing operational and funding dependencies of private-sector agents on the EU Commission and improved monitoring of regional standardization processes by the principal (see Mattli 2003:esp. 212-220).
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