Essays in Financial Accounting Standard Setting

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Abstract

This dissertation consists of three essays that explore the financial accounting standard setting process. In the first, I examine the extent to which the FASB's agenda determination is a function of the contemporaneous preferences of its primary constituents: auditors, preparers, and financial statement users. Using the FASB's consultation with the FASAC as a lens through which to view constituent preferences, I find evidence that from 1982 to 2001 influence on FASB agenda decisions is concentrated among "Big N" audit firms, whereas from 2002 to 2006 the preferences of financial constituents appear to be most significant. Across both periods, I find no evidence of significant preparers' influence in agenda formation, which is in contrast to their documented role in later stages of standard setting.

The second essay, written with Karthik Ramanna and Sugata Roychowdhury, examines how tightening of the U.S. auditing oligopoly—from the Big 8 to the Big 4—has affected incentives of the Big N as manifested in their lobbying preferences on accounting standards. We find, as the oligopoly has tightened, that Big N auditors are more likely to express concerns about decreased "reliability" of FASB-proposed accounting standards

(relative to an independent benchmark). Robust to controls for various alternative explanations, our results are consistent with Big N auditors facing greater political and litigation costs attributable to increased visibility from the tightening oligopoly and decreased competitive pressure to satisfy client preferences. The results are inconsistent with the claim that Big N auditors increasingly consider themselves "too big to fail" as the audit oligopoly tightens.

The third essay, written with Karthik Ramanna, investigates the effect of standard setters in standard setting. We examine how certain professional and political characteristics of FASB members and SEC commissioners predict the accounting "reliability" and "relevance" of proposed standards. Notably, we find FASB members with backgrounds in financial services to be more likely to propose standards that decrease "reliability" and increase "relevance," partly due to their tendency to propose fair-value methods. We find opposite results for FASB members affiliated with the Democratic Party, although only when financial-services background is excluded as an independent variable.

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Acknowledgements

When I entered the doctoral program, 5 years seemed like an eternity, and yet as I graduate I can't believe how fast it's gone by. For the last five years I've woken each morning with the same thought on my mind: "Wow, I am so lucky!" Lucky to be at HBS where I have been afforded the intellectual freedom and institutional resources to pursue the questions I find most compelling. Lucky to be supported by an intensely vested dissertation committee, collaborative department and caring cohort who motivated me to work harder, smarter, and more creatively than I knew I could. Lucky to be married to a man who champions my every endeavor, to have parents who support me unconditionally, and to be the mother of two beautiful children who fill my life with so much joy. To each of these individuals, I owe a significant debt of gratitude.

To my husband, Derek

Chapter 1: Agenda Setting at the FASB – Evidence from the Role of the FASAC

Abstract

I examine the extent to which the FASB's agenda determination is a function of the contemporaneous preferences of its primary constituents: *auditors, preparers*, and *financial statement users*. Using the FASB's consultation with the FASAC as a lens through which to view constituent preferences, I find evidence that from 1982 to 2001 influence on FASB agenda decisions is concentrated among "Big N" audit firms, whereas from 2002 to 2006 the preferences of *financial* constituents appear most significant. Across both periods, I find no evidence of significant *preparer* influence in agenda formation, which is in contrast to their documented role in later stages of standard setting. Collectively, the results contribute to our understanding of the relative influence of constituents in standard setting and highlight a shift in that relative influence over time.

1.1. Introduction

The formation of a regulatory agenda is of critical import to the regulated; determination of the agenda dictates regulatory direction and, ergo, the economic costs and benefits that may accrue to the regulated (Arrow, 1951; Plott, 1976). Self-interested constituents have strong incentives to lobby for agenda admission of regulatory initiatives projected to be net-beneficial and exclusion of projects expected to result in net costs. Within accounting, prior research has demonstrated the influence of constituent lobbying in the determination of US GAAP; however, this literature has focused primarily on the exposure draft to final standard stage due to data availability in the form of constituent comment letters (Watts and Zimmerman, 1978). By contrast, the agenda setting process is largely characterized by archival opacity, severely limiting the development of empirical research, despite recognition by accounting regulators and scholars that agenda setting may be the most aggressively contended phase of standard setting (Miller and Redding 1998).[1] Former FASB chairman Dennis Beresford describes the agenda setting process as "the single most important decision we make at the FASB" yet "one of the least understood and least appreciated" (Beresford, 1993).

In this paper, I utilize hand-collected data to shed light on the political dynamics that surround the FASB's agenda decisions, and provide exploratory empirical evidence on three questions.

1. Are constituent preferences a significant determinant in the FASB's agenda formation?

[1] Leftwich (1995) concludes from a descriptive analysis of FASB agenda decisions between 1990 and 1995 that agenda decisions are difficult to explain ex-post and that future research is needed.

2. Which constituent groups have historically exerted the greatest influence on the FASB's agenda decisions?
3. Are larger constituents (e.g., Big N auditors) more influential than their smaller counterparts in shaping the FASB's agenda?

To obtain an archival perspective on constituent preferences, I leverage a unique institutional feature of the FASB's agenda setting process: formal consultation with an advisory council (FASAC) composed of *auditors*, *preparers*, and *financial statement users* proportionately selected to "represent the Board's constituency in microcosm" (FAF, 1984) and charged to advise the FASB regarding its "agenda of projects and the assigning of priorities thereto" (FASB, 1973). Formally, FASAC opinions are solicited through an annual survey on the "Priorities of the Financial Accounting Standards Board" (hereafter, FASAC Survey), which affords construction of a quantitative measure of contemporaneously expressed constituent agenda preferences.

Although it is not obliged to act on FASAC recommendations, the FASB asserts that, "given its broad membership . . . there is a special significance to the Council's assessment" (FAF, 1986). Accordingly, data on FASAC preferences constitute a unique vantage from which to estimate the broader political dynamics surrounding FASB's agenda decisions. Additionally, for a subset of years, FASAC Surveys also polled FASB members, enabling me to directly control for the Board's ex-ante preferences.

The present study analyzes 323 agenda decisions made by the FASB from 1982 to 2006 for which an explicit numerical priority rating from FASAC members is available from the Summary of Responses to the FASAC Survey. My initial tests regress the FASB's agenda decision for a potential project on the average FASAC member project rating, controlling

for FASB member ex-ante preferences. Due to a change in survey structure in 2002 (detailed in Section 1.3.1), my analysis is split into two panels: 1982-2001 and 2002-2006. Results from both samples provide support for the hypothesis that constituent' preferences, as measured by FASAC member priorities, matter, on average, in determination of the board's agenda.

The second stage of my analysis involves building a biographical database of the professional affiliations of all 242 FASAC members who served between 1982 and 2006. Drawing on prior literature, I classify FASAC members into the three primary groups—*auditors*, *preparers*, and *financial* constituents—viewed as having distinctly different incentives and priorities for accounting standards (Beresford, 1993). Although the FASB expressly commits, in its conceptual framework and elsewhere, to prioritize the needs of investors, creditors, and other *financial statement user*s (broadly termed *financial* constituents), extant literature has illustrated the influence of *auditors* (Haring, 1979; Puro, 1985) and *preparers* (Saemann, 1995; Ramanna, 2008) on standard setting, and there are numerous institutional and political factors that suggest these groups may have significant influence in the FASB's standard setting process. It is thus unclear, ex-ante, which (if any) group's preferences will manifest in FASB agenda decisions.

From 1982 to 2001, I find both *auditor* and *financial* constituents' preferences are significant in the selection of agenda topics but that *preparer* preferences are not. Beresford (1993) asserts that the "scales of justice" demand that the FASB balance the interests of *financial statement users* as primary customers against the needs of other

constituents. Accordingly, sensitivity to *auditor* as well as *financial* constituents' preferences may be indicative of this "balance".

From 2002-2006, significant influence of *financial* users persists but I find no evidence of *auditor* or *preparer* influence. The ascendancy of *financial* (relative to *auditor*) preferences post 2002 is consistent with the increasing influence of the financial industry on standard setting, as documented in Allen and Ramanna (2012). Additionally, the diminished influence of *auditors* post 2002 may be congruous with regulatory and institutional initiatives designed to bolster the FASB's independence from special interests and increase *user* influence in standard setting including, the independent funding provisions of Sarbanes Oxley[2] and establishment of several new *user* advisory committees to the FASB.[3] However, the institutions representing *financial* constituents may, themselves, constitute a special interest rather than pure *user* group (e.g., Young, 2006; Lev, 1986), and there are numerous other factors which may have affected this shift in relative constituent influence. Indeed, supplemental analysis which disaggregates *financial* constituent preferences by industry function suggests that influence post-2002 is concentrated amongst those financial firms expected to have mixed incentives as both *preparers* and *users* of financial reports (e.g., investment banks, commercial banks and financial

[2] Section 109 of Sarbanes Oxley (SOX), which provides for funding the FASB through a mandatory accounting fee imposed on US companies, replaced a voluntary contributions structure that rendered the FASB financially beholden to Big N auditors and large preparers for a significant portion of its annual operating funds.

[3] Between 2003 and 2005, the FASB established the Users Advisory Council, Investors Technical Advisory Committee, and Investors Task Force with the intent to increase *user* participation in its due process.

conglomerates). Disentangling the complex incentives of these firms, or the causal factors that effected their ascendancy is beyond the scope of this paper.

Finally, to the extent that significant influence on the Board's agenda reflects constituent lobbying strength, I expect that influence within each constituent group will be concentrated among the institutions with the greatest political and financial resources (e.g., Becker, 1983). This prediction is tempered by the FASB's espoused mission of balancing the needs of all constituents and, more particularly, consistent with the SEC's mandate of being responsive to the needs of unsophisticated, small investors. Accordingly, the third stage of my analysis explores the distinction between "large" and "small" constituents (see Section 1.3.3).

Analysis of disaggregated preferences from 1982 to 2001 reveals that *auditor* influence is concentrated in the hands of those I expect to wield the most political power, namely, Big N audit firms. Evidence of the influence of *financial* constituents in this period is, however, inconclusive; when disaggregated by size (total assets), *financial* representatives' preferences are no longer significant. By contrast, from 2002 to 2006 the priorities of both large and small *financial* representatives appear significant in FASB agenda decisions while Big N audit firm preferences do not.

Results of my analysis are robust to the inclusion of numerous substantive and econometric controls including, among others, controls for the influence of the Securities and Exchange Commission, concurrent development of International Accounting Standards

and related convergence initiatives, media attention, survey structure changes and year fixed effects.

The rest of the paper is organized as follows. Section 1.2 provides institutional background on the FASAC and on the FASB's agenda decision process and develops related hypotheses. Section 1.3 describes the sample selection and construction of variables. Section 1.4 presents descriptive statistics and multivariate regression design. Section 1.5 presents and interprets multivariate results. Section 1.6 describes robustness tests, and Section 1.7 concludes.

1.2. Institutional background and hypothesis development

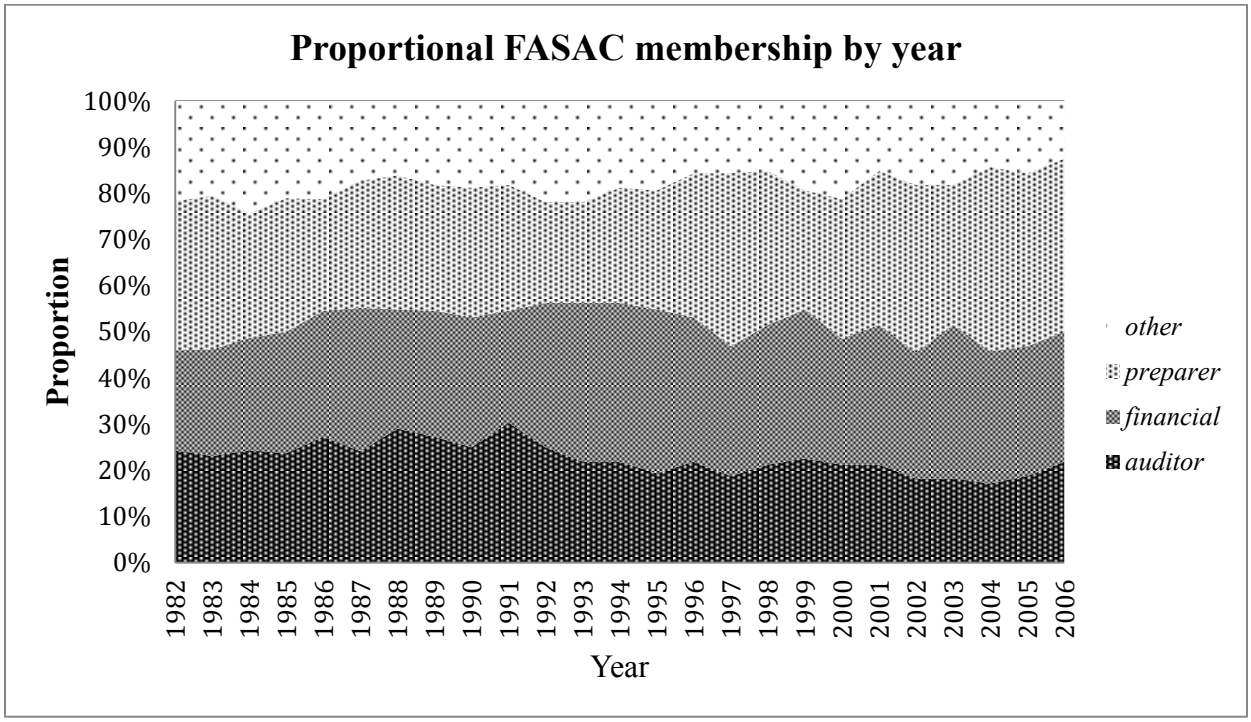
1.2.1 The Financial Accounting Standards Advisory Council

The Financial Accounting Standards Advisory Council (hereafter, FASAC) was established concurrent with the FASB in 1973 as the "FASB's formal liaison with the business and professional world," and is tasked to advise the Board concerning the addition and prioritization of projects to its technical agenda (FASB, 1978a). FASAC members serve part time and, are selected by the FASB's parent organization (the FAF) on the basis of professional affiliation to ensure that the Council remains "broadly representative of *preparers*, *auditors*, and *users* of financial information" in their respective constituencies (FASB, 2007a). Figure 1.1 plots the relative composition of FASAC membership over time. Although variation exists, the general proportion of *auditors*, *preparers*, and *financial* representatives[4] has remained relatively stable. Between 1982 and

[4] Members of FASAC are classified as *auditors*, *preparers*, *financial* and *other*, as detailed in Section 3.3.2. Consistent with the FASB's classification of *financial statement users* in FAF annual reports,

2006, the FASAC averaged 33 members, proportionally distributed as follows: 23% *auditor*s, 30% *preparers*, 29% *financial*, and 18% *others*.

Figure 1.1: FASAC composition by constituent group
auditor is defined as any member currently employed in the public accounting profession, *financial* as any member currently employed in the banking, insurance, or securities industry, *preparer* as any member of business and industry not classified as *auditor* or *user*, and *other* as any member who does not fall into the category of *auditor, financial*, or *preparer*. See Section 1.3.3.2 for details.



Formally, FASAC agenda priorities are solicited at quarterly meetings with the FASB and though an annual survey entitled "Projects and Priorities of the FASB" (hereafter, FASAC Survey). First administered in 1980, from 1982 to 2001 the FASAC Survey solicited both quantitative and qualitative information regarding member priorities with respect to a list of potential projects compiled by FASB staff. The list is intended to be a selective

financial is defined as members associated with the banking, insurance, or securities industries. However, as discussed later in 2.3.2 it is unclear whether the incentives of *financial* constituents will stem from their role as *users* or *preparers*; accordingly the term *financial* rather than *user* is employed in my classification of FASAC members.

amalgamation of topics brought to the FASB's attention throughout the year by the FASAC, the Emerging Issues Task Force (EITF), the Securities Exchange Commission (SEC), and other FASB constituents. From 2002 to 2006, in lieu of a list, FASAC members were asked to identify on a blank sheet of paper the five projects they viewed as most important for the FASB to address. Results of the annual FASAC Survey are tabulated and presented together with council members' comments in a document entitled "Summary of Responses to the FASAC Annual Survey,", which is distributed to Board members and discussed at a subsequent meeting of the FASB. Appendix A provides illustrative excerpts from the 1998 and 2002 FASAC Survey and associated Summaries of Responses.

The shift in survey structure from finite list (pre 2002) to open-ended (post 2002) was intended to better solicit "the accounting and financial reporting issues that were the most challenging" in an environment characterized by "uncertainty and transition" (FASAC, 2002, 2003). Given this deliberate restructuring, the question naturally arises: "Did regulatory/institutional changes alter the relationship between the FASB's agenda decisions and constituent preferences?" Unfortunately, the shift in survey structures precludes pooling of 1982-2001 and 2002-2006 data (see Section 1.3.1) and prevents me from providing direct evidence to this point. Notwithstanding, evidence obtained from *separate* analyses of these two periods can be informative when viewed with the appropriate level of caution.

Although it has no obligation to act on FASAC recommendations, the FASB asserts that "given its broad composition there is a special significance to the Council's assessment" (FAF, 1986) and that the Board "would not add [any] major project to its agenda without

first discussing that project with FASAC" (FAF, 1996). Furthermore, FASAC members are encouraged to share materials with and solicit views from their associates to increase the representativeness of their responses (FASB, 1978a). Accordingly, although FASAC is not the only avenue through which constituents may express agenda preferences to the Board, the opinions of FASAC constitute a meaningful proxy for some of the political dynamics surrounding the FASB's agenda decision.

1.2.2 FASB agenda decisions and constituent influence

In any given year the FASB screens far more topics than there are resources available to address and, consequently, rejects the vast majority of potential agenda items (Beresford, 1993). However, of those items which do make the agenda, a high percentage progress through to completion; of 67 agenda items added between 1982 and 2006 only 4 (6%) are subsequently dropped while the remaining 63 projects have generated over 100 authoritative standards to date[5], highlighting the significance of the FASB's agenda decisions to its constituents.

Historically, the explicit criteria that govern FASB agenda decisions have been articulated as follows:

1. *"Pervasiveness of the problem: the extent to which an issue is troublesome to users, preparers, auditors, or others and the extent to which there is diversity of practice;*

2. *Alternative solutions: the extent to which alternative solutions that will improve financial reporting in terms of relevance, reliability, and comparability are likely to be developed;*

[5] As of 03/13/2013 several projects added to the FASB's agenda between 1982 and 2006 were still ongoing, including major projects on Revenue Recognition, Financial Instruments and Leases.

3. *Technical feasibility: the extent to which a technically sound solution can be developed, or whether the project should await completion of other projects; and*

4. *Practical consequences: the extent to which an improved accounting solution is likely to be acceptable generally, and to which addressing a particular subject or not addressing it might cause others to act (e.g., the SEC or Congress)."* (Miller and Redding, 1998)

Leftwich (1995) notes that evaluation of projects under these criteria is largely subjective; given the diversity of incentives, there is likely little agreement among "*users, preparers,* and *auditors*" about what constitutes a problem, what level of diversity in practice is appropriate, or whether a conceived alternative solution will *improve* financial reporting relevance and reliability. Accordingly, the FASB has asserted that it strives to "weigh carefully the views of its constituents" and undertake only those projects for which the "expected benefits outweigh the costs" (FASB, 2007a). The inherent difficulty of this task is acknowledged in remarks by former FASB member Victor Brown (1983), "[T]here are often," he explains, "differences of opinion as to whether particular items should be added to the Board's agenda. Reaching decisions is rarely a process of discovering truth in any absolute sense. Rather, it is one of reaching on-balance judgments."

Pragmatically, however, "on-balance judgments," are likely to be relative to the eye of the beholder and represent a difficult proposition for the FASB even if one assumes a social welfare maximizing objective. Traditional models of interest group politics suggest that regulators are only partially informed as to the economic and political consequences of policy decisions and, as such, are reliant on outside constituents to provide decision

relevant input (e.g., Austen-Smith, 1993). However, the economic consequences of changes in accounting standards are rarely evenly distributed across the FASB's constituents (e.g., Watts and Zimmerman, 1978, Holthausen and Leftwich, 1983; Fields, Lys, and Vincent, 2001) and it is unlikely, even in theory, that a change in accounting standards will be uniformly preferred by all participants in the economy (Demski, 1973). Accordingly, the information provision by constituents is expected to be strategically self-serving (e.g., Crawford and Sobel, 1982) and it is unclear, ex-ante, what mechanism for aggregating expressed constituent preferences would best facilitate social optimization (e.g., Arrow, 1951; Gibbard, 1973; Satterthwaite, 1975), and ex-post, how FASB agenda decisions could be evaluated for success on this criterion.

Moreover, the FASB does not act in a political vacuum and by its own admission is subject to "practical considerations" when setting its agenda, including the possibility that its decisions may be over-ruled, that its standard setting authority may be revoked, or that financial or institutional viability of the organization may be undermined if a proposed project is not generally acceptable to its constituency and/or government regulators including the SEC and Congress (see agenda criterion #4 above). Accordingly, the FASB's objective function is likely to include pragmatic institutional concerns in addition to ideological social optimization. Specifically, the extent to which constituent lobbying influences the FASB's agenda will depend on the interplay of numerous institutional and political factors including: the technical expertise, incentive alignment (credibility), financial resources, political access and institutional representation of each constituent (for a review of Special Interest Group Theory see Grossman and Helpman, 2002).

1.2.3 Hypothesis development

1.2.3.1 Average constituent preferences and FASB agenda decisions

The general proposition that regulators attempt to optimally balance the demands of competing constituents is well established in both the economics and political science literatures (Becker, 1983; Grossman and Helpman, 2002), but as discussed in the preceding section, the precise mechanism for balancing these demands is difficult to specify ex-ante. Cognizant of the competing economic consequences and political implications of its standards, it is easy to imagine the FASB might attempt to maximize its utility by undertaking only those agenda projects for which it expects criticism will be minimal relative to the accolades it anticipates across its *entire* constituency (Wilson, 1980; Leftwich, 1995). Pragmatically, however, lacking credible information about the preferences its broad constituency the FASB is reliant on the subset of information provided by those constituents willing to engage in its due process. Optimizing its decisions will involve some subjective determination as to the appropriate weighting of this information.

The consultative role and representative composition of FASAC suggest that its existence may have been institutionalized to facilitate such optimization. If this is the case, one might conjecture that the simple average of FASAC member preferences, readily available to Board members in the Summary of Responses to the FASAC Survey, may constitute a pragmatic weighting heuristic for FASB agenda decisions. Accordingly, my first hypothesis, stated in terms of the alternative, is as follows.

[H1] The probability that a topic will be added to the FASB's technical agenda is, ceteris peribus, increasing in the average project priority FASAC members assign to that topic.

Although H1 intuitively resonates, establishing this baseline result is a non-trivial first step in my analysis; no systematic evidence currently exists on constituent preferences at the agenda setting stage. Furthermore, although economic theory postulates the necessity of the Board appearing responsive, this need not translate into agenda decision outcomes. Board members may use FASAC input opportunistically, citing constituent preferences for support when they naturally align with the Board's predetermined selections, and citing its independent jurisdiction or invoking the symbolic overriding public interest of *users* (e.g., Young, 2006) when they do not. Stated otherwise, it is possible that constituent preferences are manifest in the Board's agenda only to the extent that they correlate positively with FASB members' ex-ante preferences. By including a control for FASB member ex-ante preferences (see Section 1.3.4.1) H1 is designed to test for agenda responsiveness in fact rather than just in appearance.

1.2.3.2 Differential influence of auditors, preparers, and financial constituents

Although the average preference expressed by FASAC may constitute a useful starting point for the FASB to internalize constituent preferences in its agenda decision, it likely does not fully capture the host of political and institutional factors likely to shape the balance of constituent influence. Indeed, while an empirical test of [H1] can provide strong evidence as to how the FASB internalizes general consensus opinions, it offers little insight as to how disagreements amongst constituents may be systematically resolved. In particular, accounting research has identified three primary constituencies from whom the

FASB actively seeks input and tries to balance distinctly different preferences: *preparers*, *auditors*, and *financial statement users* (Cyert and Ijiri, 1974; FAF, 1984).

Preparers, bearing the brunt of implementation costs and concerned about a potential reduction in reporting flexibility, rationally exhibit a high propensity to oppose accounting change. Considerable uncertainty at the agenda setting stage regarding the direction, scope, and economic consequences of a potential project may exacerbate this preference for the status quo relative to the FASB's other constituencies. Ceteris paribus, *preparers* prefer greater latitude for management judgment and have argued that *users* are better served by continuity of reporting and flexibility with respect to management "best practices" tailored to a firm's underlying economics than by constantly changing and narrowly proscriptive standards (Beresford, 2012).

Auditors, on the other hand, may exhibit preference *for* accounting change. Proliferation of new standards may increase demand for audit services and professional expertise. Likewise, promulgation of proscriptive standards may curb management opportunities for discretion, and decrease auditors' potential legal liability (Allen, Ramanna, and Roychowdhury, 2012). What *preparers* view as standards overload, *auditors* may see as a profitable opportunity. Consistent with this, Beresford (2012) notes that, during his tenure, pressure to add new issues to its agenda came mainly from *auditors*. On the other hand, *auditor* wealth is eventually dependent on the success of their corporate clients; accordingly, the preferences of *auditors* may, at times, be strategically aligned with those of *preparers* (Watts and Zimmerman, 1981; Puro, 1984).

Financial statement users, too, have incentives to advocate for accounting change. Standards that provide new decision-useful information or increase the reliability of existing information benefit *users*. The construct of a pure *user* group may, however, be idealistic (e.g., Young, 2006) and the FASB itself has historically expressed frustration over the scarcity of user participation in its processes (Beresford, 1993). In practice, *user*s are represented on the FASAC by financial firms in the "banking, securities and insurance industries" (collectively *financial*). Many of these firms are themselves also *preparers* of financial statements and may advocate on certain issues accordingly, potentially obfuscating the link between *financial* constituents and the pure *user* interests the FASB seeks to promote.[6]

Given the diverse incentives and uneven distributional consequences constituents are likely to expound considerable effort to influence the FASB agenda decisions. The relative success of such efforts is predicted to hinge on numerous factors as summarized in Table 1.1, Panel A and discussed in more detail below.

[6] See section 6.4 for more discussion and exploratory analysis on this point.

Table 1.1: Institutional and Political Factors expected to affect the distribution of influence across FASB constituents

Panel A: Factors expected to affect the relative influence of auditors, preparers and financial constituents

	Auditors	***Preparers***	***Financial (Users)***
Informational Factors	***Expertise***: Technical experts in accounting, wide exposure to issues and diversity in practice ***Credibility:*** High if perceived as neutral advisors (technical accounting experts). Diminished by concerns of capture by clients, and self-interest motives.	***Expertise:*** Implementation costs, industry norms, economic consequences ***Credibility:*** Low based on potential incentives to mislead *users*	***Expertise:*** Decision relevance of current and potential accounting information ***Credibility:*** High if perceived as communicating a "pure" user perspective, Diminished if perceived as having conflicting incentives as both users and preparers
Financial Factors	Significant voluntary contributions to FASB operating budget may create financial dependency conditions which can be exploited	Significant voluntary contributions to FASB operating budget may create financial dependency conditions which can be exploited	NA
Institutional Factors	Major supplier of FASB staff, majority holder in FASB member seats, ongoing regulatory collaboration between AICPA and FASB	Represented by powerful lobby groups (FEI and Business Roundtable), adept at mobilizing Congress, public media involvement	Prioritized instrests per SEC mandate and FASB conceptual framework

Table 1.1: (Continued)

Panel B: Factors that changed between 1982-2001 and 2002-2006 samples

	Auditors	***Preparers***	***Financial (Users)***
Post-2001 Factors	Loss of credibility due to accounting scandals, voluntary contributions replaced by mandatory fee structure	Public and congressional backlash due to corporate accounting scandals, voluntary contributions replaced by mandatory fee structure	Formation of ITF, ITAC, and UAC to increase the influence of *users* (*financial* representatives) in standard setting.
Predicted Δ in Influence	Negative	Negative	Positive

Informational factors:

The primary assumption underlying most lobbying models is that interests-groups possess information that is relevant to policy makers' decisions (e.g., Austen-Smith, 1993). As shown in Table 1.1, Panel A, each of the FASB's primary constituents has distinct informational expertise that is relevant to the FASB's agenda decision. *Auditors,* as technical accounting experts, and having wide exposure to issues across multiple industries and firms, may be best suited to provide information regarding the pervasiveness of a problem, and technical feasibility of alternative solutions. *Preparers*, having intimate knowledge their internal transactions and business model, can best speak to the congruence between accounting practices and underlying firm economics, practical implementation issues and economic consequences associated with change. Finally, *financial* firms as investors, creditors and market intermediaries, have expertise regarding the decision-relevance of accounting information.

Although, each constituent may possess policy relevant information, they are expected to communicate it only strategically to further their own self-interest and may have incentives to exaggerate the perceived costs or benefits of a proposed project depending on their preference for its inclusion. Accordingly, the extent to which constituent lobbying is influential will depend on the perceived incentive-alignment (credibility) between the interests of the FASB and the lobbying constituent (Crawford and Sobel, 1982; Farrell, 1995). The FASB's consistent emphasis, in its conceptual framework and elsewhere, on the primacy of the needs of investors, creditors and other *users* of financial statements suggests that the relative influence of *financial* firms should be linked to their ability to convince the FASB their preferences are representative of a *user* (rather than *preparer*) perspective. Likewise, *auditors'* credibility, and hence influence, will be greater when they are viewed as independent accounting experts, who can objectively evaluate decision-relevance and reliability, as opposed to pass-through lobbyists for their clients' interests (e.g., Brown, 1981). Finally, *preparers* have unsuccessfully tried to argue that managers are the primary *users* of financial statements but likely have little credibility given their potentially discordant incentives to mislead providers of capital regarding firm performance.

Financial factors:

Although typically applied to the setting of campaign contributions, there is a wide body of literature suggesting that political donations can influence regulatory outcomes in three ways; indirectly by securing access to policy makers (e.g., Aranson and Hinich, 1979; Austen-Smith, 1998), or directly by influencing regulators' choice of policy (e.g., Austen-

Smith, 1987; Grossman and Helpman, 2002). Accordingly, across constituents, those who expend the greatest financial resources are expected to have greatest influence. FASB members, being appointed rather than elected are not individually the recipients of any political contributions; however, prior to 2002, an average of 39% of the FASB's operational funding came from voluntary contributions made by *auditors* and *preparer*s. Theoretically, this financial dependency may constitute leverage through which these constituents can secure more frequent audience or coerce regulatory action. In particular, Hall and Wayman (1990) argue that the impact of monetary contributions is most likely to manifest in influence at the agenda-setting stage of regulation.

Structural factors:

From its foundation, the FASB has afforded preferential institutional status to *auditors* in the standard setting process (Newman, 1981). Five of the original 9 FAF council members (who are jointly responsible for selecting FASB, FASAC and subsequent FAF members) were appointed by the AICPA. Likewise, *auditors* have historically enjoyed greater representation on the FASB, averaging 3 seats compared to 1-2 for *preparers* and 0-1 for *financial* representatives, and until 2010 all FASB Chairmen were former *auditors*. Finally, AICPA provides significant technical support, standard-setting (including GAAP)[7] and guidelines in conjunctions with the FASB's work generating significant potential for AICPA action/inaction to influence the FASB's selection of projects.

[7] AICPA Industry Audit and Accounting Guides, Statements of Position and AcSEC practice bulletins, are designated as authoritative guidance within GAAP hierarchy (SFAS 162).

A second structural component that may affect constituent influence is the FASB's relationship to the SEC and Congress, each of whom have effectual veto power over FASB agenda decisions.[8] Given the SEC's investor protection mandate, *financial* constituents may garner significant influence over the FASB's agenda by lobbying the SEC. Similarly, *preparers* have, at times, successfully mobilized public media and lobbied Congress to alter regulatory outcomes in later stages of standard setting (Zeff, 1978; Miller and Redding, 1998; Ramanna, 2008). However, it is worth noting that at the agenda setting stage considerable uncertainty at the agenda setting stage regarding the eventual accounting solution may weaken *preparers*' ability to garner influence via congressional or media attention.

Aggregate influence:

As highlighted by the above discussion (and summarized in Table 1.1, Panel A), theoretical examination of informational, financial and structural factors does not yield clear predictions as to which constituencies preferences (if any) may dominate FASB agenda decisions. Each constituent has unique advantages which suggest opportunities for influence on the FASB's agenda, but the relative importance of these factors is unknown, and hence, the relative distribution of influence remains an empirical question. Accordingly, H2 is stated formally below in three separate parts, each in terms of the alternative.

[8] In practice, use of such veto power is rare, potentially reflecting the FASB's reluctance in equilibrium to undertake projects where the perceived threat of regulatory intervention is high. See section 3.4.2.

[H2] The probability that a topic will be added to the FASB's technical agenda is increasing in the average project priority which FASAC members representing **[a]** auditor, **[b]** financial, and **[c]** preparer constituencies assign to that topic.

Although baseline influence is hard to predict, there are, ex-ante, reasons to expect a shift in relative constituent influence between the 1982-2001 and 2002-2006 samples as summarized in Table 1.1, Panel B. In 2002, in the wake of public scrutiny and regulatory reforms motivated by a sequence of large accounting scandals, *auditors* and *preparers* credibility was significantly damaged and a number of institutional changes were effected with the intent of increasing the influence of investors and other *financial* constituents on standard setting. First, to increase the FASB's financial independence from *auditors* and *preparers*, the Sarbanes Oxley Act §109 established a mandatory fee system to fund the FASB's operations. Second, beginning in 2003 the FASB voluntarily undertook structural initiatives intended to increase investor influence including establishment of the Users Advisory Council (UAC), Investors Technical Advisory Committee (ITAC), and Investors Task Force (ITF).[9] To the extent these changes succeeded in their objectives, I am more likely to find evidence in favor of H2[a] & [c] in my 1982-2001 sample and of H2[b] in my 2002-2006 sample.

1.2.3.3 Influence of large constituents

Influencing the agenda likely necessitates the mobilization of resources both to become informed about agenda issues and to successfully lobby for preferred positions (Miller, 1991). It therefore intuitively follows that in the presence of intra-constituent

[9] The UAC includes representatives from individual and institutional investors, equity and debt analysts, lenders and credit rating agencies, the ITAC from the investment community with primary career focus on accounting and financial reporting matters, and the ITF from large institutional asset managers.

disagreement large *auditor*, *preparer* and *financial* firms, leveraging superior financial resources, may have greater influence in the FASB's agenda selections than do their smaller counterparts. Conditional on finding constituent preferences significant in H2, hypothesis three is stated in three parts below in terms of the alternatives.

> **[H3]** The probability that a topic will be added to the FASB's technical agenda is increasing in the average project priority FASAC members representing large **[a]** *auditor*, **[b]** *financial*, and **[c]** *preparer* constituencies assign to that topic, but is not significantly affected by the preferences of small constituents.

Several factors may temper this prediction. First, perhaps in response to large firms' perceived advantage with regard to influencing standards, the SEC's (and by transference, the FASB's) fairness objective aims to protect small and/or unsophisticated *financial statement users*. The FASB's explicitly stated objective of issuing standards that improve decision usefulness may be similarly intended to reduce information asymmetries for small *financial* constituents that are disadvantaged relative to larger *users*. In addition, two of the FASB's founding organizations, the American Institute of Certified Public Accountants (AICPA) and Securities Industry Association (now SIFMA), represent the interests of small *auditors* and small *financial* investors, respectively, and may provide effective channels of influence for these two groups.

The distinction between large and small constituent preferences is important to the FASB's balancing objective. Small *preparers*, bearing disproportionately high implementation costs relative to their larger counterparts, may have a stronger preference for the status quo (Watts and Zimmerman, 1978). Likewise small *auditors*, having higher relative learning costs, may be less likely than large accounting firms to favor accounting

change (Puro, 1984). Finally, small investors will tend to advocate for greater mandated disclosure than their informationally advantaged large *financial* counterparts, which may have strategic incentives to advocate for *un*informative financial reports (Dye and Sridhar, 2008). Lev (1988) suggests that the FASB should prioritize the needs of small investors over those of large financial institutions to avoid the adverse capital market consequences of information inequity.

1.3. Sample construction and variable measurement

1.3.1 Sample construction: FASAC Survey on potential projects

Annual FASAC Surveys solicited member preferences for 323 potential projects considered for inclusion on the FASB's agenda between 1982 and 2006. Individual and aggregate response data from the surveys, presented in annually published "Summaries of Responses", were obtained from the FAF Public Archive in Norwalk, Connecticut. As can be seen in Table 1.2, FASAC members were not surveyed about potential projects in 1988, 1996, and 1997.[10] Additionally, the format of FASAC Survey questions and presentation of results in the Summary of Responses varies across years on three important dimensions, as discussed below.

[10] No FASAC survey was conducted in 1988. The 1996 and 1997 Surveys did not address potential projects due to an "already full agenda." No projects were added to the FASB's agenda in 1997, and in 1998 additions were limited to two "limited scope projects": "Technical Corrections" (SFAS 135) and "Motion Picture Films" (SFAS 139).

Table 1.2: Summary of response data for the FASAC Annual Questionnaire on the Projects and Priorities of the FASB

Panel A: 1982-2001: Priority ratings of prompted topics for future agenda inclusion

Year	FASAC Survey	Question Format	Potential Projects Included	Scale Granularity	# FASAC	FASAC Responding	Unique Project Evaluations	Aggregate Rating Visible	FASB Responding	Visible Individual Ratings
1982	Yes	Prompted Topics	6	[1,3]	37	33 (89%)	198	Yes	No	79 (40%)
1983	Yes	Prompted Topics	6	[1,3]	39	35 (90%)	210	Yes	No	86 (41%)
1984 #	Yes	Prompted Topics	7	[1,3]	37	29 (78%)	203	Yes	No	0 (0%)
1985	Yes	Prompted Topics	6	[1,2]	38	28 (74%)	168	Yes	No	81 (48%)
1986	Yes	Prompted Topics	12	[1,2]	33	28 (85%)	336	Yes	No	123 (37%)
1987	Yes	Prompted Topics	18	[1,2]	29	23 (79%)	414	Yes	No	132 (32%)
1988 ^	No	NA	NA	NA	31	NA	NA	NA	No	NA
1989	Yes	Prompted Topics	20	[1,2]	33	27 (82%)	540	Yes	No	172 (32%)
1990	Yes	Prompted Topics	21	[8,1]	32	27 (84%)	567	Yes	No	275 (49%)
1991	Yes	Prompted Topics	21	[1,8]	33	28 (85%)	588	Yes	No	312 (53%)
1992	Yes	Prompted Topics	23	[1,8]	32	22 (69%)	506	Yes	No	231 (46%)
1993	Yes	Prompted Topics	23	[1,8]	32	26 (81%)	598	Yes	No	394 (66%)
1994	Yes	Prompted Topics	23	[1,8]	32	27 (84%)	621	Yes	No	404 (65%)
1995	Yes	Prompted Topics	20	[1,8]	31	26 (84%)	520	Yes	No	373 (72%)
1996 ^	Yes	NA	NA	NA	32	NA	NA	NA	NA	NA
1997 ^	Yes	NA	NA	NA	32	NA	NA	NA	NA	NA
1998	Yes	Prompted Topics	10	[1,5]	33	18 (55%)	180	Yes	Yes (100%)	161 (89%)
1999	Yes	Prompted Topics	7	[1,5]	31	22 (71%)	154	Yes	Yes (100%)	103 (67%)
2000 ^	Yes	Prompted Topics	NA	Rank	33	NA	NA	NA	NA	NA
2001 #	Yes	Prompted Topics	19	[1,3]	33	22 (67%)	418	Yes	Yes (100%)	0 (0%)
Total			**242**			421 (79%)	6221			2926 (46%)

^ Data with which to construct my variable for aggregate FASAC preferences (*FASAC_pref*) during the 1982-2001 period are unavailable for four years: 1988 (no FASAC survey); 1996 and 1997 (FASAC survey did not address "Potential Agenda Items"); 2000 (survey respondents ranked rather than independently rated projects).

Data with which to construct my variables for disaggregated FASAC preferences by constituent group (*aud_pref*, *fin_pref*, and *ind_pref*) are unavailable for two years: in 1984 and 2001, individual qualitative responses, but not quantitative ratings, are visible in the Summary of FASAC Annual Survey Responses.

Panel B: 2002-2006: Free Response top 5 priorities for future agenda projects

Year	FASAC Survey	Question Format	Potential Projects Mentioned	Scale Granularity	# FASAC	FASAC Responding	Unique Project Evaluations	Aggregate Rating Visible?	FASB Responding	Individual Top 5 Visible
2002	Yes	Open Response	20	Top 5	33	22 (67%)	440	Yes	Yes (100%)	Yes (100%)
2003	Yes	Open Response	16	Top 5	33	27 (82%)	432	Yes	Yes (100%)	Yes (100%)
2004	Yes	Open Response	16	Top 5	35	28 (80%)	448	Yes	Yes (100%)	Yes (100%)
2005	Yes	Open Response	15	Top 5	32	27 (84%)	405	Yes	Yes (100%)	Yes (100%)
2006	Yes	Open Response	14	Top 5	32	31 (97%)	434	Yes	Yes (100%)	Yes (100%)
Total			**81**			135 (82%)	2159			Yes (100%)

Prompted topics versus open response format:

From 1982 to 2001, the FASAC Survey asked respondents to score on a pre-defined Likert scale each of several listed projects the FASB might consider for its agenda.[11] From 2002 to 2006, for reasons discussed in Section 1.2.1, the Survey was switched to an open

[11] In 2000 participants were asked to *rank* rather than *rate* projects; accordingly, this year is excluded from analysis.

response format, with participants asked to list on a blank sheet the five projects they considered most important for the Board to address. Responses elicited using these two survey structures will have systematically different information content (e.g., Schwarz, 1999). Whereas prompted-script FASAC Surveys reveal information about projects constituents *disfavor* as well as those they favor, open-ended, top-5 Surveys capture only positive preferences. Also, prompted-topics format restricts the information set to a subsample of projects that passed initial screening for inclusion on the FASAC Survey, while the open-ended format imposes no such limitation. In aggregate, these disparities in distributional assumptions preclude pooled analysis and each period must be analyzed separately.

Granularity of responses:

As shown in Table 1.2, from 1982 to 2001, the Likert scale used in FASAC Surveys ranges from a binary {"Yes", "No"} at its coarsest to a {1, 8} scale at its finest, affecting the granularity with which participant preferences are captured. Pooling of data across this period is therefore achieved by re-scaling responses to a consistent [0, 1] range, as detailed in Section 1.3.3.3. Because my analyses regress FASB agenda decisions on *mean* constituent preferences rather than individual responses, the noise introduced by rescaling is unlikely to systematically bias results. Nevertheless, in Section 1.6.1 I test the robustness of my results to this choice by restricting analysis to the largest subset of years (1990-1995) for which granularity of responses is constant.

Visibility of individual response:

Copies of individual survey responses are not part of the public record and are protected by the terms of historical disclosure agreements with survey participants. Accordingly, data on individual responses are limited to what is included in the annual Summary of Responses. From 2002 to 2006, individual level response data is reported in entirety in the Summaries. From 1982 to 2001, however, individual level data is unavailable for two years (1984 and 2001),[12] and in the remaining sample is presented only for participants who chose to provide written comments in addition to Likert-score ratings. As illustrated in Table 1.2, 46% (2,926) of individual project evaluations are visible under this restriction.

To understand the effect of missing data on my analysis, Table 1.3 compares the available 2,926 individual responses by constituent group to the overall composition of FASAC. The distribution of comments across my sample is similar to the distribution of total FASAC membership alleviating concern that the subsample composition differs systematically from the actual distribution of responses. Additionally, I manually compute the simple average of FASAC member Likert-ratings for which I have individual level data (*commenting_fasac*) and compare it to the true average Likert-rating reported in the Summary of Responses (*average_fasac*). The correlation between *commenting_fasac* and *average_fasac* is 0.85 (p-value 0.000).

[12] In 1984, individual comments, but not Likert-scale ratings, are presented in the Summary of Responses. In 2001, individual data is truncated to show only the projects to which participants assigned the highest rating.

Table 1.3: Distribution of FASAC Survey commenting members and total FASAC member composition (1982-2001)

Sample is the 2,926 individual survey responses visible in the Summary of Responses to the 1982-2001 FASAC annual surveys (see Section 1.3.1) *auditor* is defined as any member currently employed in the public accounting profession, *financial* as any member currently employed in the banking, insurance, or securities industry, *preparer* as any member of business and industry not classified as *auditor* or *user*, and *other* as any member who does not fall into the category of *auditor, financial*, or *preparer*. See Section 1.3.3.2 for details.

Distribution of Visible Individual Response Data by Constituent Group			Average Annual Distribution of All FASAC Members by Constituent Group		
Auditor	812	28%	*Auditor*	8	24%
Preparer	813	28%	*Preparer*	9	27%
Financial	784	27%	*Financial*	10	30%
Others	517	18%	*Others*	6	18%
Total	2926	100%	Total	33	100%

Table 1.2 summarizes the relevant details of FASAC Survey content and participation between 1982 and 2006. FASAC members were surveyed about 242 potential agenda projects between 1982 and 2001. From 2002 to 2006, 81 potential projects were listed as being in the "Top 5" by FASAC or FASB members. These 323 projects constitute the primary sample for my analysis. Average participation in the survey is 79% and 82% for the 1982-2001 and 2002-2006 periods, respectively, which translates into 6,221 unique Likert-scale project evaluations from 1982 to 2001, and 2,159 unique open-ended binary evaluations (Top 5 or not) from 2002 to 2006. As discussed in the preceding paragraph, average Likert-scores (*reported_fasac*) used to test H1 are available in their entirety for all years from the respective Summary of Responses; individual level data needed to test H2 and H3 are restricted to the subsample of 2,926 responses from 1982 to 2001, but include the full sample of 2,159 responses from 2002 to 2006. From 1998 to 2006, FASB members were also included in the FASAC Survey, and responded with a participation rate of 100%.

1.3.2 Dependent variable: FASB agenda decision

The dependent variable for my analysis is a binary variable ($agenda\_addition_{t+1}$) that takes a value of 1 for each potential agenda project from the year t FASAC Survey that was added to the FASB's technical agenda prior to the publication date of the t+1 FASAC Survey. Information on the timing of new project additions is obtained from the FASB's "Technical Plan," published quarterly as part of the FASB Status Report (later renamed the FASB Report), available through the AICPA library at the University of Michigan.

1.3.3 Independent variables: FASAC member preferences

1.3.3.1. Average FASAC preferences

Average FASAC member project ratings (*average_fasac*) for the 242 projects in my 1982-2001 sample are reported in the respective Summaries of Responses. Standardization of *average_fasac* across years with disparate Likert scales is achieved as follows.

$for\ t \in [1982,2001]$

$$fasac\_pref_{it} = 1 - \frac{average\_fasac_{it} - 1}{LSmax_t - 1} \qquad (Eq\ 1)$$

In Eq (1), $average\_fasac_{it}$ is the un-scaled average rating assigned to project i in year t. $LSmax_t$ is the maximum Likert-scale value used in year t and takes values {2, 3, 5, 8} across my sample, as shown in Table 1.2. In the original Surveys, *higher* Likert-scores indicate *lower* priority; for ease of interpretation Eq (1) transforms $average\_fasac_{it}$ such that $fasac\_pref_{it}$ is *increasing* in the strength of average FASAC preference *for* a project, and is bounded [0,1].

From 2002 to 2006, survey respondents mention 81 potential projects as being of "Top 5" priority. Average FASAC priority ($fasac\_pref_{it}$) is calculated manually from the Summaries of Responses as the proportion of respondents that list project *i* in their "Top 5" for year *t*.[13]

1.3.3.2. Average FASAC preference by constituent type

Tests of H2 require data on FASAC member preferences aggregated by constituent groups, which I calculate manually using individual level response data merged with information about FASAC members' professional affiliations from FAF annual reports (available from the FAF public archive). Using categories outlined in the 1988 FAF annual report, I classify each FASAC member as belonging to one of four mutually exclusive groups as follows.

- *auditor* includes members currently employed in the public accounting profession.
- *financial* includes members currently employed in the banking, insurance, or securities industry.
- *preparer* includes members of industry not classified as auditor or financial.
- *other* includes academics, attorneys, non-profit, and government representatives.

Independent variables that measure the average priority assigned to a potential project by each constituent group are defined as follows. First, analogous to the construction of $fasac\_pref_{it}$, individual member priority ratings for the 1982-2001 sample

[13] The Summary of Responses provides a tally of the five issues that appear most frequently in council members' responses. Individual response data are used to manually tally responses for all other issues.

are rescaled to a range of [0, 1], increasing in members' reported priority *for* project addition.

$$mempref_{m,i,t} = 1 - \frac{Reported\ individual\ member\ priority\ rating_{m,i,t} - 1}{LSmax_t - 1} \quad (Eq\ 2)$$

For 2002-2006, $mempref_{mit}$ is constructed as a binary variable that takes a value of 1 if member *m* ranked project *i* among her "Top 5" in year *t*.

Second, for both samples, $mempref_{mit}$ is averaged across each constituent group to generate four independent variables as illustrated below.

$$aud\_pref_{it} = \sum_{m=1}^{n} (1[constit_m = auditor] * mempref_{mit}) \quad (Eq\ 3)$$

aud_pref_{it} is the average preference expressed by *auditors* for the addition of project *i* to the FASB's agenda in year *t*, rescaled to be bounded [0,1] and increasing in *auditors*' expressed priority *for* a project's addition; fin_pref_{it}, $prep\_pref_{it}$, and $other\_pref_{it}$ are constructed analogously to reflect average *financial*, *preparer*, and *other* FASAC member preferences, respectively.

As discussed in Section 1.3.3.2, data on individual preferences are unavailable for 1984 and 2001 (26 projects). Data are also unavailable for an additional 30 projects from 1982 to 2001 on the individual preferences for at least one constituent group (*aud_pref*, *user_pref*, *prep_pref*, *other_pref*). After exclusions, 186 (81) potential projects remain from 1982 to 2001 (2002 to 2006) for testing H2.

1.3.3.3. Large versus small constituents

To test H3, which is concerned with the distinction between large constituents and the smaller counterparts over which they are predicted to have greater political influence, I disaggregate *auditor*, *financial*, and *preparer* preferences along the lines of large and small factions as follows.

- *big_aud* is constructed as the average project priority of members employed by Big N audit firms (Big 8, 6, 5, and 4, respectively, over time).
- *big_fin* is constructed as the average project priority of members employed by commercial banks, investment management firms, investment banks, insurance companies, or private equity firms with total assets greater than or equal to the total assets of the 20th largest bank holding company (BHC), as reported in the Bank Regulatory database, for each year in my sample. The Big 2 rating agencies are also classified as *big_fin*. Appendix B lists the total asset cutoff values used for each year as well as the member organizations represented on FASAC that fall above and below these cutoffs. [14]
- *big_prep* is constructed as the average project priority of members employed by Fortune 500 companies.

[14] There is no standard definition of "big finance" in the literature and, ex-ante, any separating criteria is necessarily arbitrary. Ex-post however, a clear distinction is apparent between large and small firms for each finance industry represented in my sample and is captured appropriately by the total assets cutoff employed herein. See Appendix B.

- *little_aud*, *little_fin*, and *little_prep* are constructed as the complements of *big_aud*, *big_fin*, and *big_prep*, respectively.[15]

From the sample of 186 (81) projects available for testing H2, an additional 100 (0) projects, for which no individual data on the preferences of at least one disaggregated constituent group (usually *little_fin or little_prep*) is visible in the Summary of Responses, must be excluded from my sample. After data limitations, 94 (81) potential projects remain from 1982 to 2001 (2002 to 2006) for testing H3.

1.3.4 Control variables

1.3.4.1 FASB member ex-ante project priorities

An important control variable in my analyses is FASB member ex-ante project priority. Absent this control, constituent preferences could appear significant in determination of the FASB's agenda merely because they are correlated with what the FASB already had in mind. From 1998 to 2006, the FASAC Survey polled FASB members directly and their preferences are reported in the Summaries of Responses. Accordingly, for my 2002-2006 sample, FASB member priorities can be controlled for explicitly. Analogous to the construction of *fasac_pref* for this period (see Eq (1)), *fasb_pref* is constructed as the proportion of FASB members that rated project *i* as a "Top 5" priority in year *t*.

For my 1982-2001 sample, I construct a binary variable (*fasb_proxy)* based on a manual review of FASB Status reports for mention of potential agenda projects. Quarterly,

[15] *little_aud* includes the AICPA member representative, and little_fin includes the SIFMA member representative.

the FASB provides a partial listing of "*other issues*" it has "*received requests to consider*" for its future agenda. The listing is "*not intended to be comprehensive*"; in 1988, for example, the FASB screened nearly 100 potential projects (FAF, 1988), but only eight are mentioned in that year's Status Reports. Accordingly, I interpret the *choice* of which issues to mention as an ex-ante manifestation of which projects were, at an early stage, viewed by the FASB as stronger potential candidates for its agenda. Conversations with prior Board members and staff confirm the reasonableness of this assumption. $fasb\_proxy_{it}$ is coded 1 for each potential project *i* mentioned in the four quarterly Status Reports preceding the year *t* FASAC Survey.

To judge the validity of *fasb_proxy* I compare it to the explicit measures of FASB member preferences available in the Summaries of Responses from 1998 to 2006. The correlation between *fasb_proxy* (binary) and *fasb_pref* (continuous) is 0.47 (p-value 0.004) for 1998 to 2001 and 0.36 (p-value 0.001) for 2002 to 2006. Additionally, to ensure that my construct is meaningful but not mechanical, I examine the univariate relationship between *fasb_proxy* and my dependent variable (*agenda_addition*). The odds of agenda inclusion increase by 24% (p-value <.001) when *fasb_proxy* is equal to 1; 7(29%) of 24 projects for which fasb_proxy is equal to 1 are subsequently added to the Board's agenda versus only 11(5%) of 218 projects when fasb_proxy is equal to 0.

1.3.4.2 SEC project priorities

The SEC holds statutory standard-setting authority from Congress, but has voluntary delegated responsibility for the promulgation of accounting standards to the FASB. Notwithstanding, the SEC retains close review liaison. The SEC Chief Accountant

regularly attends FASAC meetings and may suggest topics for inclusion on the FASB's agenda. Beresford (2012) recalls that SEC suggestions are most often at the level of practice problems, which can be handled by the EITF; however, in the "relatively rare" case the SEC becomes involved with its technical agenda, the FASB considers it "very seriously." To control for this potential influence, I construct a proxy for SEC preferences (*sec_proxy*) based on a review of all quarterly FASAC meeting minutes (during which the SEC Chief Accountant makes a presentation) and the SEC Annual Reports' "Accounting Matters" section. FASAC meeting minutes are available through the FAF public archives, SEC annual reports online at sec.gov. *sec_proxy* is coded 1 for any potential project discussed favorably by the SEC during the 12 months that directly precede or follow the FASAC annual survey.

1.4. Descriptive statistics and multivariate research design

1.4.1 Descriptive statistics

Table 1.4, Panel A provides summary statistics for my dependent variable. Eighteen (7.4%) of the 242 potential projects in my 1982-2001 sample, and seven (8.6%) of the 81 potential projects in my 2002-2006 sample, are subsequently added to the board's agenda. These low proportions are consistent with the FASB's assertion that they screen "far more [proposed agenda topics] than we can possibly accommodate" (FAF, 1988).

Table 1.4: Summary statistics and Pearson correlation coefficients

Sample is 343 potential projects about which FASAC member preferences were collected in the 1982-2006 FASAC annual surveys. *agenda_addition* is a binary variable that takes the value of 1 for potential projects added to the FASB's agenda within one year of the annual FASAC survey on which it was included; *fasac_pref* is the average priority rating given a potential project by all FASAC members participating in the FASAC annual survey; *fasb_pref* is the average priority rating given a potential project by all FASB members participating in the FASAC annual survey; *fasb_proxy* is a binary variable that takes the value of 1 if a potential project was mentioned in FASB status reports in the year preceding the FASAC annual survey; *aud_pref*, *fin_pref*, *prep_pref*, and *other_pref* are the average priority ratings assigned to a potential project by FASAC members classified as *auditor*, *financial*, *preparer*, or *other*, respectively, as defined in Section 1.3.3; *big_aud*, *little_aud*, *big_fin*, *little_fin*, *big_prep*, and *little_prep* are the average preferences assigned to a potential project by *auditor*, *financial*, and *preparer* FASAC members, respectively, and separated by size according to the criteria described in Section 1.3.3.3. See Sections 1.3.2-1.3.4 for details.

Panel A: Summary statistics (dependent variables)

1982-2001	n	Mean	Med	Std	Min	Max
Y= agenda_addition	*242*	0.07	0.00	0.26	0.00	1.00

2002-2006 (n=81)	n	Mean	Med	Std	Min	Max
Y= agenda_addition	*81*	0.09	0.00	0.28	0.00	1.00

Panel B: Summary statistics (independent variables)

H1: 1982-2001	n	Mean	Med	Std	Min	Max
fasac_pref	*242*	0.39	0.38	0.16	0.03	0.85
fasb_proxy	*242*	0.10	0.00	0.30	0.00	1.00
fasb_pref	*36*	0.48	0.50	0.22	0.06	1.00

H1: 2002-2006	n	Mean	Med	Std	Min	Max
fasac_pref	*81*	0.09	0.05	0.11	0.00	0.59
fasb_proxy	*81*	0.20	0.00	0.40	0.00	1.00
fasb_pref	*81*	0.10	0.00	0.14	0.00	0.57

H2: 1982-2001	n	Mean	Med	Std	Min	Max
aud_pref	*186*	0.42	0.39	0.26	0.00	1.00
fin_pref	*186*	0.43	0.43	0.25	0.00	1.00
prep_pref	*186*	0.36	0.33	0.23	0.00	1.00
other_pref	*186*	0.51	0.52	0.31	0.00	1.00

H2: 2002-2006	n	Mean	Med	Std	Min	Max
aud_pref	*81*	0.12	0.00	0.17	0.00	0.83
fin_pref	*81*	0.10	0.00	0.15	0.00	0.75
prep_pref	*81*	0.07	0.00	0.11	0.00	0.50
other_pref	*81*	0.08	0.00	0.13	0.00	0.50

H3: 1982-2001	n	Mean	Med	Std	Min	Max
big_aud	*86*	0.49	0.50	0.29	0.00	1.00
little_aud	*86*	0.40	0.42	0.31	0.00	1.00
big_fin	*86*	0.45	0.45	0.26	0.00	1.00
little_fin	*86*	0.48	0.49	0.33	0.00	1.00
big_prep	*86*	0.39	0.33	0.24	0.00	1.00
little_prep	*86*	0.41	0.43	0.35	0.00	1.00

H3: 2002-2006	n	Mean	Med	Std	Min	Max
big_aud	*81*	0.12	0.00	0.21	0.00	1.00
little_aud	*81*	0.12	0.00	0.26	0.00	1.00
big_fin	*81*	0.12	0.00	0.19	0.00	0.83
little_fin	*81*	0.06	0.00	0.15	0.00	0.67
big_prep	*81*	0.06	0.00	0.13	0.00	0.50
little_prep	*81*	0.08	0.00	0.16	0.00	0.50

Panel C: Pearson correlation coefficients

1982-1999

n=186

	aud_pref	*fin_pref*	*prep_pref*
fin_pref	0.14 *		
prep_pref	0.30 ***	0.28 ***	
other_pref	0.30 ***	0.24 ***	0.25 ***

n=86

	big_aud	*little_aud*	*big_fin*	*little_fin*	*big_prep*
little_aud	0.38 ***				
big_fin	0.24 **	0.13			
little_fin	0.13	0.03	0.29 ***		
big_prep	0.41 ***	0.20 *	0.25 **	0.30 ***	
little_prep	0.24 **	0.08	0.27 **	0.27 ***	0.37 ***

2002-2006

n=81

	aud_pref	*fin_pref*	*prep_pref*
fin_pref	0.45 ***		
prep_pref	0.52 ***	0.67 ***	
other_pref	0.26 **	0.28 **	0.38 ***

n=81

	big_aud	*little_aud*	*big_fin*	*little_fin*	*big_prep*
little_aud	0.33 ***				
big_fin	0.35 ***	0.54 ***			
little_fin	0.13	0.03 *	0.20 **		
big_prep	0.37 ***	0.43 ***	0.60 ***	0.41 ***	
little_prep	0.25 **	0.37 ***	0.45 ***	0.19 **	0.36 ***

Table 1.4, Panel B provides summary statistics for my independent variables. From 1982 to 2001, the mean values for *fasac_pref*, *aud_pref*, *user_pref*, *prep_pref*, *big_aud*, *little_aud*, *big_fin*, *little_fin*, *big_prep*, and *little_prep* are in the range of 0.36-0.50, which suggests that the board's primary constituents favor adding just under half of the projects proposed on the FASAC's annual survey. Differences in means t-tests reveal that higher average priority is assigned to potential projects by *auditor* and *financial* representatives than by *preparers* (t-test p-values <0.01), consistent with the assertion that preparers are more likely to favor the status quo. Panel B also shows that Big N *auditors* (*big_aud*) and *financial* constituents, regardless of size (*big_fin* and *little_fin*), give more favorable assessments to potential projects than do other constituent groups (*little_aud*, *big_prep*, and *little_prep*). This effect may reflect ex-ante Big N auditor and finance industry influence on the selection of potential projects included on the FASAC Survey, *or* simply that, on average, these groups view any change in accounting standards more favorably.

Pearson correlations between the explanatory variables in Table 1.4, Panel B are shown in Table 1.4, Panel C. From 1982 to 2001, correlations between constituent groups' priorities are generally low, consistent with a high degree of variation in constituent incentives regarding financial reporting standards. The highest observed correlation is between *big_aud* and *big_prep* (.408), consistent with the argument that Big N *auditors* may at times strategically represent the interests of large clients (e.g., Puro, 1984). Correlations between all explanatory variables are higher in the 2002-2006 than in the 1982-2001

sample. Table 1.4, Panel C reveals a particularly high correlation (.671) between *preparer* and *financial* industry preferences in this period.[16]

1.4.2 Multivariate research design

Although there exist no formal constraints on the number of projects the FASB can add to its technical agenda, time and resource constraints impose practical limits on the number of potential projects that can be undertaken simultaneously. Thus, agenda decisions in any given year *t* may be jointly determined, and a standard binary decision model that assumes strict independence of observations could result in biased estimates and/or standard errors. The use of cluster-robust standard errors can only partially mitigate this issue. Instead, the literature provides two primary categories of cluster-specific empirical models that can be used to analyze correlated outcome data: conditional fixed effects, and random effects (Pendergast et al., 1996). Both models address intracluster correlation by estimating the conditional probability of y_{it} on other outcomes from the same cluster (i.e., the set of y_{jt}) and a parameter specific to each cluster (t). The difference is in choice of parameter. Whereas a fixed effects model estimates directly differences in the yearly propensity of the FASB to add issues to its agenda, the random effects model assumes these differences to follow some stochastic distribution.

In my setting, the disadvantage of using a conditional fixed effects (as opposed to random effects) model is that it results in the exclusion of eight years of data for which

[16] To assess the impact of high correlations between independent variables on multivariate regression analysis, variance inflation factors (VIFs) are computed for all regressions presented in this paper. Without exception VIF's are <10, alleviating concern regarding potential multicollinearity.

there is no variation in the outcome variable (i.e., no potential projects from the FASAC Survey are subsequently added to the Board's agenda.)[17] Excluding these years from my analysis results in the loss of valuable information concerning *why* this might have been the case, and diminishes the power of my tests. The disadvantage of a random effects model, however, is that it imposes a potentially invalid assumption of orthogonality between the cluster parameter and the explanatory variables. Omitted year trend variables likely to violate this assumption include the FASB's annual budget, the number, scope, and estimated horizon of projects currently on the agenda, and public sentiment regarding the issue of "standards overload." For this reason, a conditional fixed effects model is most appropriate to my setting.

The formal specifications for my regressions are given by Equations (4)-(6) below.

$$\text{logit}[\Pr(Y = agenda\_addition_{it+1} = 1)|X_{it}, W_{it}, FE_t] = \beta_{0t}(FE_t) + \beta_{1t}X_{it}, + \gamma_{1,t}W_{it}$$

where

$$X_{it} = \begin{cases} FASAC\_pref_{it} & (Eq\ 4) \\ aud\_pref_{it}, fin\_pref_{it}, prep\_pref_{it}, other\_pref_{it}, & (Eq\ 5) \\ big\_aud_{it}, little\_aud_{it}, big\_fin_{it}, little\_fin_{it}, big\_prep_{it}, little\_prep_{it}, other\_pref_{it} & (Eq\ 6) \end{cases}$$

$$W_{it} = \{fasb\_pref\ or\ fasb\_proxy, \text{sec}\_proxy\}, \quad FE_t = Year\ fixed\ effect$$

In Eq (4)-(6), *i* is a potential project included on the year *t* annual FASAC Survey and β_{0t} and β_{1t} are the mean intercept and slope parameters, respectively, for cluster *t*. Standard errors are clustered by year. Results are reported both with and without controls for FASB and SEC preferences (W_{it}). For comparison with the conditional fixed effects

[17] No potential projects from the FASAC annual surveys for 1983, 1984, 1986, 1989, 1990, 1992, 1998, and 2006 were added to the FASB's technical agenda during the following year.

model, all results are also presented using a simple logit model with year-cluster robust standard errors. As discussed above, however, due to the joint determination of dependent variable observations, more weight should be placed on the results of conditional logit specification. As explained in previous sections, each regression is estimated separately for the 1982-2001 and 2002-2006 samples.

1.5. Results

1.5.1 Influence of aggregate FASAC preference on the FASB's agenda

Table 1.5, Panels A and B report regression results on the responsiveness of FASB agenda decisions to average FASAC member preferences for my 1982-2001 and 2002-2006 samples, respectively. Of the six columns in each of the panels in Table 1.5, columns (1), (3), and (5) are estimated using a simple logit model with year-cluster robust standard errors, columns (2), (4), and (6) using a conditional year-fixed effect logit model. For both estimation models, regressions are presented first without FASB and SEC controls, then with only FASB controls, and lastly with both FASB and SEC controls. Simple logit coefficients are estimated on the full sample of 242 (81) potential projects from the 1982-2001 (2002-2006) FASAC Surveys. The sample size is reduced to 143 (67) for the conditional fixed effect logit estimates due to the exclusion of seven years (one year) for which there is no variation in the outcome variable.

Table 1.5: FASB agenda decisions on aggregate FASAC preferences

Sample is 242 (Panel A) and 81 (Panel B) potential projects about which FASAC member preferences were collected in the 1982-2001 and 2002-2006 FASAC annual surveys, respectively. *agenda_addition* is a binary variable that takes the value of 1 for potential projects added to the FASB's agenda within one year of the annual FASAC survey on which it was included; *fasac_pref* is the average priority rating given a potential project by all FASAC members participating in the FASAC annual survey; *fasb_pref* is the average priority rating given a potential project by all FASB members participating in the FASAC annual survey; *fasb_proxy* is a binary variable that takes the value of 1 if a potential project was mentioned in FASB status reports in the year preceding the FASAC annual survey; *sec_proxy* is a binary variable that takes the value of 1 for potential projects mentioned favorably by the SEC in its annual report or at quarterly FASAC meetings. See Sections 1.3.2-1.3.4 for details.

Panel A: 1982-2001^

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
fasac_pref	5.439 ***	4.851 ***	3.791 *	3.174 *	3.708 *	3.184 *
fasb_proxy			1.440 **	1.354 **	1.600 **	1.593 **
sec_proxy					1.420 *	2.029 **
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.0981	0.1194	0.1362	0.162	0.153	0.2062
n	242	143	242	143	242	143

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.
^Excludes 1988, when no FASAC survey was conducted; 1996 and 1997, when the FASAC survey did not ask about potential projects; and 2000, due to inconsistent survey structure. See Table 1 for details.

Panel B: 2002-2006

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
fasac_pref	10.031 ***	10.997 ***	8.358 ***	9.972 **	9.694 **	10.351 ***
fasb_pref			3.554 ***	3.670 ***	3.138 ***	3.473 ***
sec_proxy					-0.950	-0.542
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.2601	0.3467	0.2887	0.3927	0.2999	0.3950
n	81	67	81	67	81	67

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

In aggregate, the results from Table 1.5, Panels A and B provide support for the hypothesis that FASB agenda decisions are responsive to constituent preferences, as proxied by FASAC member responses. Across all model specifications and both samples, FASAC priority (*fasac_pref*) is significant with and without the inclusion of FASB and SEC

controls. As expected, *fasb_proxy* is also significant across all specifications in the 1982-2001 regressions as is *fasb_pref* using 2002-2006 data; *sec_proxy* is significant from 1982-2001, but not from 2002-2006. Converting the coefficients from Panel A (B) column (6) to odds ratios indicates that a change of one standard deviation, 0.16 (0.11), in average FASAC priority increases the likelihood of a project's addition to the subsequent year's technical agenda by a factor of 1.66 (3.12).

1.5.2 Influence of auditor, financial, and preparer preferences on the FASB's agenda

Table 1.6, Panels A and B present regression results on the responsiveness of FASB agenda decisions to *auditor*, *financial*, *preparer*, and *other* FASAC member preferences for the 1982-2001 and 2002-2006 periods, respectively. Owing to the limited visibility of individual level data, as discussed in Section 1.3.1, sample size is reduced to 186 for simple logit, and 111 for conditional logit estimation in Panel A. Table 1.6 is otherwise identical in all respects to Table 1.5.

Table 1.6: FASB agenda decisions on auditor, financial, preparer, and other constituent preferences

Sample is 242 (Panel A) and 81 (Panel B) potential projects about which FASAC member preferences were collected in the 1982-2001 and 2002-2006 FASAC annual surveys, respectively. *agenda_addition* is a binary variable that takes the value of 1 for potential projects added to the FASB's agenda within one year of the annual FASAC survey on which it was included; *aud_pref*, *fin_pref*, *prep_pref*, and *other_pref* are the average priority ratings assigned to a potential project by FASAC members classified *as auditor*, *financial*, *preparer*, or *other*, respectively, as defined in Section 1.3.3; *fasb_pref* is the average priority rating given a potential project by all FASB members participating in the FASAC annual survey; *fasb_proxy* is a binary variable that takes the value of 1 if a potential project was mentioned in FASB status reports in the year preceding FASAC annual survey; *sec_proxy* is a binary variable that takes the value of 1 for potential projects mentioned favorably by the SEC in its annual report or at quarterly FASAC meetings. See Sections 1.3.2-1.3.4 for details.

Table 1.6: (Continued)

Panel A: 1982-2001^

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
aud_pref	2.624 **	3.346 *	2.395 *	3.040 *	2.543 **	3.819 **
fin_pref	2.083 *	2.780 **	1.947 *	2.741 **	1.880 *	1.894
prep_pref	0.581	-0.823	0.154	-1.743	0.084	-2.266
other_pref	-1.604	-1.623	-1.544	-1.770	-1.407	-1.307
fasb_proxy			1.194 *	1.427	1.359 *	2.019 *
sec_proxy					1.603 *	2.637 ***
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.0939	0.1615	0.1179	0.1913	0.1431	0.2693
n	186	111	186	111	186	111

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.
^Excludes 1984 and 2001, because individual numerical scores were not provided; 1988, when no survey was conducted; 1996 and 1997, during which years the survey did not discuss potential projects; and 2000, due to inconsistent survey structure. See Table 1 for details.

Panel B: 2002-2006

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
aud_pref	-0.481	-2.005	-1.579	-6.386	-0.933	-6.314
fin_pref	8.875 **	15.799 ***	7.010	21.371 ***	8.691	21.273 ***
prep_pref	1.548	1.709	3.323	5.715	2.813	5.774
other_pref	0.554	2.049	0.382	3.548	1.433	3.493
fasb_pref			3.731	7.985 **	2.824	7.875 **
sec_proxy					-1.723	-0.234
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.3422	0.5473	0.3655	0.6401	0.3892	0.6403
n	81	67	81	67	81	67

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

Table 1.6, Panel A provides evidence that from 1982 to 2001, both *auditor* and *financial* constituent preferences had significant influence on the FASB's agenda; *aud_pref* is positive and statistically significant across all specifications and *fin_pref* is significant positive except under full conditional logit specification (Column 6). Conversion of the

coefficients in Table 1.5, Column (6) to odds ratios suggests that a project's probability of agenda inclusion is increased by 87% by a 0.16 increase in *auditor* priority, but only by 32% by an equivalent increase in *financial* representatives' priority; however, the difference is not statistically significant.

Table 1.6, Panel B presents results of the regression analysis from 2002 to 2006. In contrast to the results reported in Panel A, there is no evidence to suggest that average *auditor* priority (*aud_pref*) is related to the FASB's agenda decisions during this period. Instead, *financial* constituents' preferences alone appear significant; *fin_pref* is significant across all conditional logit specifications, but only under simple logit when *fasb_pref* and *sec_proxy* controls are excluded. Computing the odds ratios for column (6) suggests that an 11% increase in the proportion of *financial* representatives who rank a project in their top 5 increases the likelihood of agenda admission by a factor of 10.8.

Taken together, the results of Table 1.6, Panel A and Panel B are consistent with the premise that prior to 2002 structural and financial advantages may have afforded *auditors* greater influence in FASB agenda decisions. Table 1.6 also suggests that, consistent with the board's stated intent, *financial* representatives' preferences significantly influence FASB project selection, and may have increased post 2001 pursuant to FASB initiatives to increase *user* participation. Notably, I find no evidence of *preparer* (*prep_pref*) influence on the FASB's selection of agenda projects in either Panel A or Panel B, in sharp contrast with research on later stages of standard setting that has documented significant *preparer* influence. A potential explanation for this, as discussed in Section 1.2.3.2, is that a high degree of uncertainty about the eventual accounting solution to a proposed topic may

hinder *preparers*' ability to persuasively lobby on the grounds of economic consequences at the agenda setting stage.

1.5.3 Influence of large and small constituent preferences on the FASB's agenda

Table 1.7, Panel A and Panel B report for the 1982-2001 and 2002-2006 samples, respectively, the results of regression tests using constituent preferences disaggregated into "large" and "small" institutions (*big_aud* and *little_aud*, *big_fin* and *little_fin*, and *big_prep* and *little_prep*). Sample size is reduced by the limited visibility of individual level data, as discussed in Section 1.3.1, to 94 for simple logit and 52 for conditional logit estimation in the 1982-2001 sample. Table 1.7 is otherwise identical to Table 1.6.

Table 1.7: FASB agenda decisions on auditor, financial, preparer, and other constituent preferences disaggregated by size

Sample is 242 (Panel A) and 81 (Panel B) potential projects about which FASAC member preferences were collected in the 1982-2001 and 2002-2006 FASAC annual surveys respectively. *agenda_addition* is a binary variable that takes the value of 1 for potential projects added to the FASB's agenda within one year of the annual FASAC survey on which it was included; *aud_pref*, *fin_pref*, *prep_pref*, and *other_pref* are the average priority ratings assigned to a potential project by FASAC members classified *as auditor*, *financial*, *preparer*, or *other*, respectively, as defined in Section 1.3.3; *fasb_pref* is the average priority rating given a potential project by all FASB members participating in the FASAC annual survey; *fasb_proxy* is a binary variable that takes the value of 1 if a potential project was mentioned in FASB status reports in the year preceding the FASAC annual survey; *sec_proxy* is a binary variable that takes the value of 1 for potential projects mentioned favorably by the SEC in its annual report or at quarterly FASAC meetings. See Sections 1.3.2-1.3.4 for details.

Panel A: 1982-2001

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
big_aud	2.859 **	5.590 ***	3.253 ***	6.573 ***	3.164 ***	6.526 ***
little_aud	0.289	-0.970	0.215	-1.231	0.241	-1.235
big_fin	-0.213	3.805	-0.869	3.449	-0.803	3.410
little_fin	0.355	-1.917	0.605	-1.630	0.579	-1.634
big_ind	-0.779	-4.398	-1.936	-6.645	-2.039	-6.608
little_ind	-0.931	-0.367	-1.312	-0.844	-1.255	-0.825
other_pref	0.323	-1.337	0.972	-0.841	-0.989	-0.820
fasb_proxy			1.671	2.609	1.647	2.594
sec_proxy					1.011	0.985
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.0774	0.174	0.1062	0.2872	0.1033	0.2436
n	86	57	86	57	86	57

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

^Excludes 1984 and 2001, because individual numerical scores were not provided; 1988, when no survey was conducted; 1996 and 1997, during which years the survey did not discuss potential projects; and 2000, due to inconsistent survey structure. See Table 1 for details.

Table 1.7: (Continued)

Panel B: 2002-2006

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
big_aud	0.598	0.490	-0.241	-1.611	-0.564	-1.567
little_aud	-1.266	-1.610	-0.842	-1.046	-0.351	-1.461
big_fin	5.064	7.330 *	4.124	7.614 *	4.974	7.798 **
little_fin	4.303 *	6.270 **	3.567	6.907 **	3.300	7.097 **
big_ind	2.860	1.528	3.497	2.207	3.340	2.237
little_ind	-0.129	0.192	0.092	0.487	-0.486	0.698
other_pref	1.512	1.848	1.117	2.132	1.909	2.225
fasb_pref			2.667	4.998	2.593	5.230
sec_proxy					-1.011	0.540
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.3444	0.5008	0.3526	0.5406	0.3598	0.5653
n	81	67	81	67	81	67

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

As hypothesized, Table 1.7, Panel A reveals that the significant coefficient on *aud_pref* in Table 1.6, Panel A is attributable to the influence of Big N audit firms; *big_aud* is significant and *little_aud* insignificant across all regression specifications. Odds ratios suggest that a 0.16 increase in average Big N *auditor* preferences (*big_aud*) increases the likelihood of agenda addition by a factor of 2.84. When disaggregated, the significant coefficient on *financial* constituents' preferences observed in Table 1.6 is present for neither *big_fin* nor *little_fin*, making it difficult to assess conclusively what impact, if any, *financial* constituents had on the FASB's agenda during this period. As in Table 1.6, preparer priorities (*big_prep* and *little_prep*) are not significant.

Table 1.7, Panel B shows the significant *fin_pref* estimate for 2002-2006, reported in Table 1.6, Panel B, may be driven by *both* the influence of large and small financial constituents, inconsistent with H3[b]. The estimates for *little_fin and big_fin* are of similar magnitude and are significant under all conditional logit specifications. This result is surprising when the financial and political advantages of large financial institutions are considered, but may be consistent with the FASB's fairness objective and espoused prioritization of the needs of those it broadly terms *users* of financial information.

1.6. Robustness Tests

1.6.1 Scaling of data

It is possible that the decision to pool data across surveys from 1982 to 2001 using different Likert scales may bias findings if the true underlying magnitude of disagreement on issues is systematically different across survey structure periods. Consider a scenario in which one constituent group usually prevails in agenda decisions over other constituents with weak preferences, and a second constituent group on the less frequent occasions when the constituents intensely disagree. The second constituent is arguably more powerful, but may not appear so in my empirical analysis if the agenda decisions she wins are concentrated in years in which data granularity is coarsest. To test for this possibility, I re-estimate the results in Table 1.6, Panel A and Table 1.7, Panel A using only data from 1990 to 1995, during which period respondents ranked projects on a constant, highly granular scale [1-8]. Substantive results are unchanged for this subsample, alleviating concerns that my results may be systematically biased as a consequence of data rescaling

or because the intensity of constituent preferences is inadequately captured by Survey responses.

1.6.2 Preparer preference heterogeneity

The preferences of *preparers* are likely to be less homogeneous than those of other constituents given that, for any potential project, only a subset of *preparers* may be affected (Leftwich, 1995). Accordingly, an alternative explanation for the lack of significance of *preparer* preferences across my regressions is that aggregated *preparer* preferences are a poor proxy for the political pressure likely to be exerted by a small subset of influential *preparers* on any given issue. Given the limited visibility of political maneuvering at the agenda setting stage, my analysis cannot comprehensively address this concern; my vantage is limited to the preferences of those *preparers* represented on the FASAC. However, some evidence of this possibility can be obtained by re-estimating each of my Table 1.6 regressions substituting for *prep_pref* the priority ratings of the FASAC representative for the Financial Executives Institute. The FEI, one of the FASB's sponsoring organizations, has been shown, in representing the interests of *preparers*, to have had a strong disruptive influence on other phases of standard setting over the FASB's history (e.g., Van Riper, 1994). FEI preferences are available for a subsample of 117 projects from 1982 to 2001 and 81 projects from 2002 to 2006. Unreported results obtained from these subsamples are consistent with those reported in Table 1.6; the coefficient on FEI remains insignificant across all specifications.

1.6.3 "Pure" user representatives

As discussed in preceding sections, although the FASB has broadly referred to those in the "securities, banking and insurance industries" as financial statement *users*, these *financial* constituents are likely to have blended incentives which reflect both their role as *preparers* and as *users* of financial information. Accordingly, the ascendancy of *financial* sector influence post 2002 might be consistent with an increased focus on *users* as the FASB's target constituency but could also reflect increased political power of a special-interest *preparer* faction. To explore this distinction, I divide *financial* representatives in my 2002-2006 sample across the following lines. FASAC members from venture capital, private equity, pension fund, credit rating agencies and asset management firms are presumed more likely to reflect a *user* perspective (*fin_user*) whilst members from investment banks, commercial banks and financial conglomerates performing both buy and sell side functions are presumed more likely to reflect the blended concerns of preparers and users (*fin_mixed*).

Descriptively, examining the pre-2002 to post-2002 proportional membership of FASAC reveals a dramatic shift in the type of *financial* firms (*fin_user* vs. *fin_mixed*) represented on FASAC as shown in Table 1.8. Pre-2002, FASAC's *financial* constituency is primarily comprised of those firms expected to have mixed *user*/*preparer* incentives; commercial banks, investment banks, insurance companies and financial conglomerates housing multiple of these functions comprise 79% of FASAC's total financial representatives, while those firms expected to have more "pure" user interests (e.g., investment management, private equity, venture capital, pension funds and credit rating

agencies) comprise only 21%. By contrast, post-2002 the average proportions of "pure" *user* and mixed-incentive (*fin_mixed*) type *financial* firms represented on FASAC have risen/fallen to 49% and 51% respectively, suggesting a potential rebalancing aimed at increasing "pure" *user* participation.

Table 1.8: Proportional distribution of financial FASAC members by firm type
Sample is the 59 FASAC members serving between 1982 and 2006 classified as *financial*. Average FASAC membership proportions are calculated on an annual basis and then averaged across the years in each sample period (1982-2001 and 2002-2006). See section 1.6.3.

		1982-2001	2002-2006
fin_mixed			
	Commercial Banking	42%	13%
	Insurance	10%	0%
	Investment Banking	21%	15%
	Financial Conglomerate	6%	23%
	TOTAL	**79%**	**51%**
fin_user			
	Investment Management	9%	21%
	Private Equity, Venture Capital, Pension	5%	13%
	Credit Rating Agency	7%	15%
	TOTAL	**21%**	**49%**

Empirically, Table 1.9, Panels A and B report the results of re-estimation of Table 1.6 and Table 1.7 for the 2002-2006 sample after substituting *fin_user* and *fin_mixed* for *fin_pref* in Table 1.6 and for *big_fin* and *little_fin* in Table 1.7. Panel A of Table 1.9 reveals that the significant coefficient on fin_pref in Table 1.6, Panel B is primarily attributable to the influence of those financial firms whose incentives cannot be classified as purely user oriented; *fin_mixed* is significant and *fin_user* is insignificant across most regression specifications.

Table 1.9: Re-estimation of Tables 1.5 and 1.6 after disaggregating *financial* FASAC member preferences by firm type for the 2002-2006 sample

Sample is 81 potential projects about which FASAC member preferences were collected in the 2002-2006 FASAC annual surveys respectively. *agenda_addition* is a binary variable that takes the value of 1 for potential projects added to the FASB's agenda within one year of the annual FASAC survey on which it was included; *aud_pref*, *big_aud*, *little_aud*, *fin_user*, *fin_mixed*, *prep*_pref, *big_prep*, *little_prep*, and *other_pref* are the average priority ratings assigned to a potential project by FASAC members classified by constituent groups as defined in Section 1.3.3 and 6.3; *fasb_pref* is the average priority rating given a potential project by all FASB members participating in the FASAC annual survey; *sec_proxy* is a binary variable that takes the value of 1 for potential projects mentioned favorably by the SEC in its annual report or at quarterly FASAC meetings. See Sections 1.3.2-1.3.4 and 1.6.3 for details.

Panel A: Re-estimation of Table 6 Panel B

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
aud_pref	0.228	-1.190	-0.790	-5.318	-0.034	-4.493
fin_user	-2.136	2.918	-2.809	5.486 *	-1.754	4.594
fin_mixed	10.367 **	89.773 ***	8.998 *	87.040 ***	10.092 *	136.901 ***
prep_pref	3.519	0.671	5.340	5.062	4.826	4.967
other_pref	1.220	1.264	1.151	3.132	1.795	2.506
fasb_pref			3.746	9.518 ***	2.915	7.769 ***
sec_proxy					-1.474	-1.665
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.4033	0.6428	0.4208	0.713	0.4356	0.7166
n	81	67	81	67	81	67

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

Table 1.9: (Continued)

Panel B: Re-estimation of Table 6 Panel B

Y= agenda_addition (t+1)	(1)	(2)	(3)	(4)	(5)	(6)
big_aud	1.552	0.585	0.529	-1.693	0.574	3.369
little_aud	-0.049	-2.480	-0.107	-3.029	0.547	-6.868
fin_user	-2.062	4.286	-2.797 *	5.594	-2.125	0.422
fin_mixed	11.002 *	86.195 ***	9.873 *	89.037 ***	11.604 **	214.274 ***
big_ind	1.584	1.110	2.313	2.205	0.984	-1.155
little_ind	1.188	1.050	1.562	3.150	1.733	16.564
other_pref	1.303	1.442	1.091	2.708	2.157	-0.401
fasb_pref			3.103	8.454 *	2.473	4.861 **
sec_proxy					-1.698	-2.970
Conditional FE	None	Year	None	Year	None	Year
S.E. (Cluster)	Year	Year	Year	Year	Year	Year
Pseduo R-sq	0.3484	0.5237	0.3533	0.5532	0.3623	0.5653
n	81	67	81	67	81	67

Significance levels (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test.

Likewise, Table 1.9, Panel B shows a highly significant effect of *fin_mixed* on FASB agenda decisions while *fin_user* is insignificant across most specifications. Collectively, these results suggest that although the representation of "pure" *user*-type *financial* firms increased post-2001, there was not necessarily an analogous increase in *user* influence on the FASB's agenda decisions. Specifically, Table 1.9 suggests that the shift towards greater *financial* constituent influence post-2002 observed in Tables 1.6 and 1.7 should be interpreted in light of the diverse motives of *financial* constituents as a special-interest group whose incentives may or may not always align with a "pure" *user* perspective.

1.6.4 Other potential influences on the FASB's agenda decisions

In addition to the aggregate preferences of its primary constituents, the FASB likely considers numerous other factors when contemplating the addition of a new project to its technical agenda. To the extent that these factors are correlated with FASAC member preferences, their exclusion from my analysis will lead to omitted variable bias. I am not aware of any theory that exhaustively specifies these factors; nevertheless, I identify and test two factors that warrant consideration as potential alternative explanations for my results.

International accounting convergence

In 1991, the FASB committed to actively consider international accounting standards in the development of its own projects, and since 2002 has actively pursued the objective of convergence. Accordingly, FASB project selection may be influenced by the concurrent agenda of the International Accounting Standards Board (IASB, formerly IASC), which may itself be influenced differentially by the preferences of its broad constituent base. To control for this possibility, I construct a dummy variable ($iasb_{it}$) that is set equal to one if there exists a project to address issue *i* on the IASB's (IASC's) agenda during the 12 months preceding or following the year *t* FASAC Survey or if issue i is included in a previously issued memorandum of understanding between the FASB and IASB.[18] Information on the IASB's (IASC's) technical agenda prior to 2001 is obtained from Cammferman and Zeff (2007) and post 2001 compiled from the IASB Updates available

[18] In October 2002 the FASB and the IASB issued a memorandum of understanding related to convergence efforts. This memorandum of understanding was subsequently reaffirmed and updated in February of 2006.

through www.ifrs.org. Consistent with a heightened focus on international convergence post 2001, *iasb* loads positive and significant (p-value < .10) under most specifications when included in my 2002 to 2006 regressions, but is generally insignificant from 1982 to 2001. For both samples, the primary results on constituent preferences presented in Tables 1.4-1.6 are substantively robust to the inclusion of *iasb*.[19]

Media influence

Although the financial press generally shows little interest in the FASB's activities, the media has in specific instances actively engaged in discussion of a proposed accounting standard (e.g., stock options, pensions). In such instances, heightened media coverage may increase public policy pressure and influence regulators' decisions. If this is the case, and if media attention is systematically correlated with the preferences of a particular constituent group, failure to control for media pressure could lead to biased inferences in my primary analysis. Accordingly, I construct a control variable, $media\_coverage_{it}$, which is equal to the raw number of articles in the *Wall Street Journal* and *Financial Times* during the 12 months preceding each FASAC Survey returned by a Factiva search for the key words FASB (or Financial Accounting Standard's Board) plus a set terms specific to each potential topic *i*, scaled by the total number of articles published over the same period.

Consistent with limited media interest in accounting, *media_coverage* is low across all issues. At the high end, 160 articles discuss accounting for stock options in the year leading up to its eventual addition to the agenda on March 12, 2003. A manual review of

[19] The significant coefficient observed on my SEC control variable (sec_proxy) in Tables 4 and 5 for 1982-2001 (Panel A) is not robust to the inclusion of *iasb*. All other results in Tables 4-6 are robust to the inclusion of *iasb*.

these articles, however, suggests neutral coverage; no unified media opinion as to whether current accounting is inadequate or the issue should be added to the FASB's agenda is apparent. When included in regression analysis, *media_coverage* does not load significant, nor does its inclusion substantively change any of the results reported in Tables 1.4-1.6.

1.7. Conclusion

Motivated by theoretical literature in economics and political science that suggests that determination of a regulatory agenda will have significant economic consequences for the regulated, I examine the significance of *auditor*, *preparer*, and *financial* constituent preferences in the determination of the FASB's technical agenda. Data on constituent preferences is obtained by leveraging a unique institutional feature of the FASB's agenda process, namely, formal consultation with an advisory council (FASAC) deliberately structured to represent the Board's broader constituency in "microcosm." Disaggregated survey data on FASAC member priority ratings from the FASAC Annual Survey for 323 potential projects considered between 1981 and 2006 provide an opportunity to view the contemporaneous preferences of constituents that are otherwise archivally opaque at the agenda setting stage.

Key findings of my analysis are that constituent priorities are a significant determinant of the FASB's project selections, and that prior to 2002 influence is concentrated among only a few players, namely, "Big N" audit firms. Post 2002, potentially congruent with the intent of institutional changes designed to sever financial and institutional dependencies between the FASB and the large audit firms, as well to as increase participation of financial statement *users* in standard setting, Big N audit firms'

priorities no longer appear to dominate the FASB's agenda decision. Instead, results from 2002 to 2006 suggest that the priorities of *financial* constituents weigh most heavily in agenda decisions. Contrary to prior literature that examines later stages of accounting standard setting, I find no evidence to suggest significant influence on the part of industrial *preparers* in agenda setting. Notably, however, disaggregation of *financial* constituents preferences along industry lines suggests that influence is predominantly held by conglomerate firms and industries (commercial banking, investment banking) likely to have mixed incentives as both *preparers* and *users* of financial statements. Results of my analysis are robust to the inclusion of FASB member ex-ante agenda preferences, SEC project priorities, and year-fixed effects.

Broadly, this paper affords a preliminary look at an important dynamic in the political economy of US GAAP: the role of constituents in determining the FASB's technical agenda. Given the far-reaching economic impacts of financial accounting standards (Fields, Lys, and Vincent, 2001), the existence and power of forces that influence the selection of topics to be addressed have strong implications for the potential redistributive consequences of accounting standard setting. Although the limitations embedded in a secondary survey analysis do not enable me to establish conclusively whether the concentration of power in agenda setting shifted around 2002 as a direct result of the host of reforms designed to bolster the FASB's financial independence and/or increase *financial* constituent participation, my results highlight that a shift has occurred. Future research that disentangles the effects of various structural and regulatory reforms could shed light on which changes played the greatest role in effecting this change.

Future work in agenda setting could explore additional factors that might influence the FASB's agenda including the relative influence of public sentiment, accounting scandals, and economic cycles on the quantity and content of topics selected. To what extent, for example, do regulators over-react or under-react in the face of public criticism blaming undesirable economic consequences on poorly crafted accounting regulation? Investigating the influence of constituents after a topic has been added to the Board's agenda (where my study ends) but before a discussion memorandum or exposure draft is issued (where the majority of existing literature begins) constitutes another avenue for future research. Among the questions that merit exploration are how the universe of alternative solutions to an accounting problem are identified and vetted, and what forces influence the FASB's original position, project scope, and timeline.

Chapter 2: The Auditing Oligopoly and Lobbying on Accounting Standards[20]

Abstract

We examine how the tightening of the U.S. auditing oligopoly over the last twenty-five years—from the Big 8 to the Big 6, the Big 5, and, finally, the Big 4—has affected the incentives of the Big N, as manifest in their lobbying preferences on accounting standards. We find, as the oligopoly has tightened, Big N auditors are more likely to express concerns about decreased "reliability" in FASB-proposed accounting standards (relative to an independent benchmark); this finding is robust to controls for various alternative explanations. The results are consistent with the Big N auditors facing greater political and litigation costs attributable to their increased visibility from tightening oligopoly and with decreased competitive pressure among the Big N to satisfy client preferences (who usually demand accounting flexibility at the expense of reliability). The results are inconsistent with the claim that the Big N increasingly consider themselves "too big to fail" as the audit oligopoly tightens.

[20] This chapter was coauthored with Karthik Ramanna and Sugata Roychowdhury.

2.1. Introduction

Auditors play a crucial role in the functioning of capital markets by serving as independent agents that scrutinize firms' financial statements on behalf of shareholders, creditors, and other accounting users. In the United States, they attest that companies, in preparing their financial reports, conform to generally accepted accounting principles (GAAP) largely specified by the Financial Accounting Standards Board (FASB). Since at least the 1970s, the audit market in the U.S. has functioned as an oligopoly, with a few large firms providing audit services for the vast majority of public companies. The past twenty-five years have witnessed a steady tightening of the oligopoly, with the number of big audit firms (hereafter, the Big N) declining from eight in the 1980s to four by 2002, while their combined market share has remained largely unchanged (e.g., GAO, 2008).

A tightening oligopoly significantly alters the competitive landscape in auditing and can influence the interactions between the Big N firms and the broader business and political environment. In doing so, the changing oligopolistic structure of auditing is likely to alter the incentives of Big N firms. We characterize auditors' incentives in fulfilling their fiduciary role in capital markets while simultaneously increasing profits as two-fold: to increase client satisfaction and to decrease expected costs of litigation and regulatory intervention. Our goal is to examine how these incentives evolve in response to the tightening oligopoly.

We capture auditors' changing incentives over time via their comment-letter lobbying on financial reporting proposals of the FASB. Auditors' comment-letter evaluations of new reporting standards proposed by the FASB are key inputs to the

standard-setting process (e.g., Watts and Zimmerman, 1982; Puro, 1984). To capture auditors' incentives, we focus on their assessments of a key attribute of proposed standards: their impact on accounting's "reliability." Specifically, we examine the influence of a tightening audit oligopoly on Big N auditors' changing propensity to express concerns regarding the reliability of proposed standards, conditional on such concerns actually being present in those proposed standards (as measured through an independent, informed benchmarking process).

Reliability of reporting standards is a key attribute of accounting, as identified by the FASB and numerous basic accounting textbooks (e.g., FASB, 1980; Stickney, Weil, Schipper, and Francis, 2010). Reliability limits managers' discretion in accounting choice to reporting methods that are representationally faithful, while additionally being verifiable and neutral (FASB, 1980).[21] Thus, more reliable standards provide a well-defined framework for reporting economic events, facilitating audits and potentially reducing litigation and regulatory costs by restricting client firms' ability to misreport. Auditors' clients, on the other hand, are expected on average to prefer discretion in reporting standards because it provides the flexibility to choose the reporting option that is best suited to an underlying economic transaction.[22] Such discretion, however, can confound verifiability and thus reduce the reliability of standards (which is intended to guard against misreporting).

[21] In 2010 the FASB modified its conceptual framework to move away from "reliability" towards "representational faithfulness." Since this change went into effect after our sample period (1973–2006), we use "reliability," not "representational faithfulness," in our analyses.

[22] Some clients might prefer to constrain accounting discretion for competitive reasons (e.g., to prevent competitors' access to discretion).

As the number of Big N audit firms has declined, there are two primary sets of factors that can prompt the firms to revise their concerns regarding the reliability of proposed standards. First, a decline in the number of Big N firms without a decline in their collective market share has translated into each remaining firm becoming more "visible" as they grow in wealth and influence. The higher visibility of Big N audit firms makes them a more visible target for litigation. The perception of deep pockets heightens motives among capital market participants, including investors, to launch class-action lawsuits against Big N auditors alleging dereliction of fiduciary duties. Visibility to regulators is another potential issue, as it can increase regulators' incentives to scrutinize big audit firms more carefully (this phenomenon is sometimes described as 'political costs'). If the dominating effect of a tightening oligopoly is to increase auditors' visibility, they are more likely to highlight concerns about the reliability of proposed standards when such concerns are present. Reliable standards restrict the exercise of reporting flexibility by managers, and are also more defensible ex-post if clients are suspected of making questionable choices within the framework provided by the standards (e.g., Watts, 2003).

The second effect of a declining number of Big N audit firms is that they enjoy greater security, in terms of both the regulatory and the competitive environments. As the number of Big N auditors capable of undertaking auditing assignments of large and complex clients declines, the potential systemic instability and cost to the financial system that could result from the failure of a single oligopolistic audit firm rises. This can make regulators reluctant to aggressively pursue auditors in the event of irregularities, effectively bestowing upon them the status of "too big to fail." For example, in 2005, the Big

4 audit firm KPMG was revealed to be "peddling illegal tax shelters" among its clients (Nocera, 2005). The U.S. Justice Department signed a deferred prosecution agreement with KPMG, forcing the firm to admit wrongdoing, but sparing it from criminal prosecution. Some in the business press explained the Justice Department's move as being motivated in part by concerns over destabilizing the audit industry in eliminating a key player. Less fettered by the need to manage the risk of regulatory intervention, a tighter Big N oligopoly can be expected to care less about reliability and shift towards a preference for standards favored by their clients, which can help them increase revenue.[23] On the other hand, a more secure business and competitive environment with fewer audit firms can have a countervailing effect. As Big N audit firms compete less with each other for business, the market-driven need to be responsive to clients' preferences is weaker, and auditors can focus on managing their exposures to litigation and regulatory risk. This can make auditors shift their preferences towards standards that are more reliable.[24] Thus the net effect of increasingly secure regulatory and competitive environments from a tightening audit oligopoly is an empirical question.

We measure Big N auditors' changing incentives by looking at their changing propensity to express concerns about "decreased reliability" when such concerns are present. To do so, we first measure the Big N auditors' "raw" mentions of decreased

[23] Catering to client preferences can help auditors increase revenues in a number of ways: e.g., more satisfied clients will probably be more willing to accept higher audit rates, more receptive of cross-sold services such as business-process consulting, and less prone to switch auditors.

[24] More generally, auditors can shift their preferences towards standards that are more compliance oriented, less judgment-based, and more defensible ex post. Our formal prediction is limited to "reliability," consistent with our empirical design and strategy.

reliability in their comment letters on exposure drafts issued by the FASB. Subsequently, we obtain the benchmark (or "true") incidence of decreased reliability in the exposure draft based on the evaluations of two highly experienced research assistants blind to the study's objective (the data are from Allen and Ramanna, 2012). The changing correlations between the Big N auditors' raw mentions of decreased reliability and the benchmark serve as our proxy for the auditors' changing incentives to raise concerns about decreased reliability.[25] We test the validity of our metric by examining whether the Big N auditors' incentives to focus on decreased reliability vary predictably with the intensity of the litigation regime across the 34 years in our sample (1973 through 2006).[26] As expected if the measure is sensible, Big N auditors' exhibit a greater focus on decreased reliability in regimes with higher litigation risk, providing some evidence that our empirical proxy is capturing auditors' incentives. This result, and subsequent results, is also robust to time-series controls.

In our primary tests, we observe that Big N auditors are increasingly concerned with the decreased reliability of proposed standards as the audit oligopoly tightens. Thus, the findings are consistent with Big N audit firms' preferences for standards reflecting heightened concerns about the litigation and political costs associated with their rising visibility. A greater focus among Big N auditors on reliability could also be facilitated by

[25] Our use of this benchmark presumes no systematic hindsight bias in research assistants' evaluations of exposure drafts.

[26] Our sample begins in 1973 because that is the first year of the FASB's operation. Because our sample ends in 2006, our data do not speak to the possible impact of PCAOB inspection reports and of the Financial Crisis of 2008 on Big N lobbying at the FASB. These are important issues for future research.

lower competition among Big N audit firms for clients, with the consequence that Big N auditors have less incentive to cater to their clients' preferences for higher reporting discretion. The results do not offer any support for the notion that Big N audit firms are less concerned with reliability because their declining numbers effectively make them "too big to fail".

We acknowledge that the changing incidence of Big N auditors' concerns around decreased reliability can be a function of the factors that are in fact at least partial determinants of their tightening oligopoly (such as, perhaps, changing litigation risk). However, the objective of our study — to examine the relation between the declining number of Big N audit firms and their incentives vis-à-vis accounting standard setting — would be defeated by controlling for the determinants of that decline. Indeed, if the literature supplied a full theory of the determinants, the results we report probably would, indeed should, be subsumed in a comprehensive analysis of their impact on Big N auditors' incentives.

Other factors influencing auditors' concerns with decreased reliability are of issue to us to the extent that they influence its correlation with "true" concerns as measured by our benchmark. Given the use of year fixed effects in our analysis, these factors would be alternative explanations only if they manifest in a time-series that is similar to changes in the audit oligopoly. While identifying such factors is not easy, we focus on four that might be responsible for our results: (a) macroeconomic cycles, (b) market conditions, (c) the prevalence of fair value standards, and (d) standard setter's ideologies (Allen and Ramanna, 2012). We find that our primary result — auditors increasingly focus on the reliability of

proposed standards as the oligopoly tightens — is robust to this set of controls. Additionally, our results for the post-2002 period are unlikely to be driven by the Big N auditors' support for convergence of U.S. GAAP with International Financial Reporting Standards (IFRS). Finally, we conduct a jackknife analysis to determine whether our inferences are driven by any one exposure draft in the sample. Our conclusions are robust to this analysis, although in three cases, we lose some statistical significance: details are discussed in 2.2.4.

Our findings suggest a greater concern about their rising visibility, together with a lower need to be responsive to their clients' preferences for reporting discretion, has prompted Big N auditors to place a greater emphasis on mitigating decreased reliability in proposed standards. This implies that over time, auditors' appetite for risk-taking, in particular, the level of judgment they are willing to apply in implementing reporting standards has lessened. To the extent that increased reliability is facilitated through "rules-based" accounting, our results suggest an evolving preference for rules over principles among the Big N audit firms. If this preference is manifested in actual GAAP standards, it can provide some descriptive evidence on the evolution of rules-based U.S. GAAP during our sample period.

The remainder of this paper is organized as follows. Section 2.2 develops the hypotheses connecting the tightening audit oligopoly with auditors changing incentives on decreased reliability. Section 2.3 describes the data and research design. Section 2.4 presents and interprets the results. Section 2.5 concludes with a discussion of the study's implications.

2.2. Hypothesis development

2.2.1 The tightening audit oligopoly

The audit business in the US has since at least the 1970s functioned as a relatively tight oligopoly, with a few big firms providing a disproportionately large share of audit services. The dominance of the audit firms has been particularly pronounced among larger clients. In 1988, only eight firms collectively audited approximately 98% of all public companies by sales (82% by number). Thereafter, the concentration of audit firms increased progressively to the point that in 2002, there were only four firms auditing almost 99% of all public companies by sales (78% by number).[27] The specific consolidations that led to the emergence of a Big 4 from a Big 8 are outlined in Table 2.1. Briefly, the consolidations characterize four distinct oligopoly "eras" in our sample period from 1973 through 2006: the Big 8 era (1973-1989), the Big 6 era (1990-1998), the Big 5 era (1999-2002) and the Big 4 era (2003-2006).

The oligopoly in auditing is the focus of national public policy to the point that the U.S. Congress' investigative arm, the Government Accountability Office (GAO), issues periodic studies on the matter. The GAO's 2008 study was explicitly focused on reforms aimed at enhancing "the potential for smaller accounting firms' growth to ease [audit] market concentration," although the report did not call for immediate action (GAO, 2008). Thus, the federal government is also clearly interested in the ramifications of a tightening

[27] See GAO (2003), a study conducted by Government Accountability Office for the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services.

audit oligopoly, providing further impetus for an academic investigation of the phenomenon.

Table 2.1: Evolution of the "Big N" audit oligopoly: From the Big 8 to the Big 4 audit firms

Era	Big 8	Big 6	Big 5	Big 4
Period	1973-1989	1989-1998	1998-2002	2002-2007
Audit Firms	Arthur Andersen	Arthur Andersen	Arthur Andersen	
	Arthur Young Ernst & Whinney/ Ernst & Ernst	Ernst & Young	Ernst & Young	Ernst & Young
	Touche Ross Deloitte, Haskin & Sells	Deloitte Touche	Deloitte Touche	Deloitte Touche
	Peat Marwick	KPMG	KPMG	KPMG
	Coopers Lybrand Price Waterhouse	Coopers Lybrand Price Waterhouse	PwC	PwC

The primary factor driving the increasing concentration of Big N audit firms has been mergers between existing firms. The mergers, in turn, appear to have been motivated by Big N audit firms' attempts to achieve economies of scale in servicing a client base that increasingly spans diverse operational and geographic boundaries. The academic literature has long recognized the benefits associated with economies of scale in the audit industry (e.g., DeAngelo, 1981; Benston, 1985). More recently, the GAO provides survey evidence attributing the growing concentration in the audit industry to the ability of Big N audit firms to make the large investments in technology and human capital that are necessary to provide services to larger, more complex, more global clients (GAO, 2008). Changing

litigiousness over time may have also contributed towards auditors' proclivity to merge. Bigger firms with a wider pool of resources are presumably in a better position to withstand the threats, and costs, arising from class-action lawsuits (GAO, 2008). Higher concentration does not, however, *guarantee* the ability to survive litigation and political threats, as the case of Arthur Andersen demonstrates. In 2002, the criminal indictment of Arthur Andersen for its culpability as auditor in the accounting fraud perpetuated by Enron Corporation led to unprecedented client flight, as well as voluntary departures of several of its partners and staff, ultimately resulting in its dissolution. Indeed, the disappearance of Arthur Andersen represents the one instance in which voluntary mergers were not responsible for the tightening audit oligopoly.

2.2.2 Auditors' incentives for reliability in accounting standards

In building a sustainable business model, auditors are expected to be guided by their incentives to increase profits while ensuring that they fulfill their fiduciary responsibilities and avoid facing undue costs arising out of litigation and regulatory intervention. These incentives are also likely to be driving auditors' preferences regarding financial accounting standards.[28]

In a competitive equilibrium, auditors' wealth is eventually dependent on that of its clients. Clients typically encounter a heterogeneous range of transactions in their operations. Ceteris paribus, they would thus prefer standards that allow them flexibility to choose the most appropriate reporting method for a given transaction, conditional on the

[28] The implicit assumption is that auditors lobby in their self-interest, which is consistent with Kinney's (1986) findings on lobbying at the Auditing Standards Board. Auditors might well lobby in "the general interest." Our empirical strategy controls for this possibility.

economic circumstances underlying that transaction. For example, when Apple originally entered the mobile phone business, it was expected to recognize revenue from iPhone sales over a two-year period, consistent with subscription accounting rules (the typical cellular-service contract duration on iPhones is two years). Apple argued that the subscription model did not reflect the economics of iPhone sales because the company met a substantial fraction of its obligations to iPhone customers at contract initiation. The company lobbied for (and successfully secured) revised accounting standards that allowed it to recognize the bulk of revenue at an iPhone's sale (the fraction of revenue recognized at sale is at Apple's and its auditor's discretion; e.g., Brochet, Palepu, and Barley, 2011). Watts and Zimmerman (1986) argue that managers choose accounting methods to suit their firms' contracting, information, regulatory, and tax environments. Kothari, Ramanna, Skinner (2010, p. 277) argue that "accounting is of strategic importance rather than a compliance tool," so there are "rents to be earned" by firms from customizing their accounting metrics. Both studies provide arguments for firms preferring greater accounting flexibility. Although, in specific circumstances, clients may desire reduced accounting flexibility (e.g., to harm competitors), on average we expect clients to prefer more flexibility in reporting standards to less. Ceteris paribus, clients' preferences for flexibility in accounting standards provides auditors incentives to support accounting rules that allow for reporting discretion since auditors have a self-serving interest in supporting standards that their clients would prefer (Watts and Zimmerman, 1982; Puro, 1984).

Auditors also have to consider that the primary consumers of their services are capital market participants. Auditors bear the fiduciary responsibility of scrutinizing the

financial reports prepared by their clients and assessing whether these reports meet generally accepted accounting principles, and whether they provide a true and fair representation of their clients' financial health and performance. Capital market participants such as investors, financial analysts and regulators can subject auditors to significant scrutiny for negligence, misrepresentation, and fraud. This scrutiny is associated with substantial costs, particularly when there is ex-ante suspicion or ex-post revelation of improper accounting by auditors' clients, for example, to overstate their performance or misrepresent their financial position. Costs arising from capital markets scrutiny include the threat of class-action lawsuits by the investing community (litigation costs, e.g., Lys and Watts, 1994), as well as that of intervention and penalties by regulatory authorities (political costs).

To mitigate litigation and political costs, auditors are likely to prefer standards that allow less room for interpretation and limit the discretion available to managers. Accounting choices of clients are easier to audit when they have to be within the boundaries set by standards that allow less scope for discretion. Further, accounting choices that are within the framework provided by "reliable" standards but that are questioned in litigation or regulatory action ex post are nevertheless more defensible because they have met an ex ante standard of objectivity (e.g., Ramanna and Watts, 2012).

We operationalize auditors' preferences regarding standards as the extent to which they express their concerns about the standards' decreased reliability conditional on such concerns being actually present. Since at least the publication of its conceptual statements in the late 1970s (e.g., FASB, 1978b; 1980), the FASB has viewed "reliability" as one of the

primary desirable attributes of accounting information (FASB, 1980, p. 5). According to the FASB Concept Statement No. 2, reliability requires that financial statement information be representationally faithful with respect to the economic events that it purports to represent, while additionally being verifiable and neutral. Reliability of proposed standards is well-suited to our context, as it is often thought of as limiting managers' discretion in accounting choice (Watts, 2003).

2.2.3 The tightening audit oligopoly and auditors' changing incentives

We expect Big N audit firms' assessments of the reliability of proposed financial reporting standards to reflect changes in their own incentives. With a decrease in the number of Big N audit firms, auditors' considerations regarding the management of both their clients' preferences and their legal and regulatory environment are likely to evolve. We argue the tightening audit oligopoly influences Big N auditors' incentives on "reliability" via two primary channels: (a) the increasing visibility of each individual Big N auditor and (b) the increasingly secure business environment of the surviving Big N audit firms.

Increasing visibility

As fewer audit firms account for an increasing share of the audit market, their role in the determination of best practices in financial reporting becomes more salient. Their perceived growth in size, wealth, and power makes them more prominent economic entities and, in that sense, more "visible." This, in turn, has implications for both their litigation risk as well their expected political costs.

The "deep pocket" theory of litigation suggests that the threat of class-action lawsuits against big audit firms is increasing in the perceived wealth and financial resources of these firms (e.g., Calabresi, 1970; Palmrose, 1988). As the audit market becomes increasingly oligopolistic, a smaller number of big audit firms share the risk of facing class-action lawsuits. Further, the political costs literature also points to an increased probability and intensity of regulatory scrutiny for more visible corporate entities (Watts and Zimmerman, 1978). Big audit firms have the largest clients and are often regarded as more reputable (DeAngelo, 1981), with an influence on audit practices across the rest of the industry. The more visible big audit firms are, the more anxious regulators are likely to be, at least in perception, that the auditors maintain prudent and ethical reporting.

Thus, the threat of both litigation and regulatory intervention are predicted to increase as the visibility of the big audit firms rises with increased consolidation. The failure of Arthur Andersen in 2002, instrumental in reducing the number of big audit firms from five to four, made investors and regulators more sensitive to the possibility of audit failures and malfeasance even at large firms. If the big audit firms perceive their litigation risk and political costs as increasing with a tightening oligopoly, they are expected to exhibit a stronger preference for standards that provide lower discretion to managers, are easier to audit, and also easier to defend against allegations of abuse (more "verifiable"). We expect these forces to manifest as follows: increasingly oligopolistic Big N auditors pay greater attention to the decreased reliability of proposed standards.

Increasingly secure business environment

With the tightening audit oligopoly, the business environment of the audit firms can become more secure in terms of both the regulatory climate and the competitive landscape. The corresponding effects on auditors' concerns regarding the reliability of proposed accounting standards are countervailing with respect to each other.

The increasing significance of each audit firm for the economy can act as a safety net against regulatory enforcement. Litigation and regulatory intervention have the power to severely damage an audit firm's wealth and reputation, and cause it to fail completely (as was the case with Arthur Andersen). As the number of big audit firms declines, a failure of any of the remaining firms would severely restrict the choices available to the client base and additionally, cause a crisis of confidence with investors questioning the reporting quality of the clients audited by the failed firm. The macroeconomic and political consequences of a Big N audit firm failure can generate a classic "too big to fail" scenario, in which regulators are reluctant to pursue enforcement actions against big auditors suspected of malfeasance or of negligence with respect to their fiduciary duties (e.g., Nocera, 2005, in the context of the KPMG tax-shelter example discussed in the introduction). If Big N auditors in a tighter oligopoly perceive themselves as being increasingly insulated against political costs, they are expected to shift their focus from managing the regulatory climate to satisfying the preferences of their clients (or, more generally, to other profit increasing activities), to the extent that there are trade-offs involved. Thus, as auditor concentration rises, we would expect Big N audit firms to exhibit a greater tendency to support standards that grant discretion to their clients, that is,

auditors become less concerned with the decreasing reliability of proposed accounting standards.

The second aspect in which Big N auditors enjoy an increasingly secure business environment as the number of audit firms drops is reduced competition for audit business. As already discussed, auditors are generally expected to be sensitive towards their clients' preferences for standards that offer a wide range of reporting options and the discretion to choose the most relevant option befitting their economic circumstances. The growing concentration of the audit industry over time reduces the severity of competition among Big N audit firms, which can make them less responsive to their clients' demands, and instead more focused on managing their increasingly visible litigation and political costs. As a consequence, Big N auditors would be more concerned about the decreasing reliability of proposed standards as the auditing oligopoly tightens.

To summarize the arguments in this section: The tightening oligopoly in auditing is likely to change Big N auditors' incentives towards decreased reliability in accounting standards. The increased political and litigation costs that come from a tighter audit oligopoly, together with the decreased competitive pressure among the Big N to satisfy client preferences, suggest the Big N are more likely to highlight decreased reliability in proposed accounting standards. But, if as some commentators have argued, individual members of a tighter Big N oligopoly are "too big to fail," concerns over increasing litigation and political costs are misplaced: the Big N, now secure, will cater to clients' preferences for flexibility in accounting standards, which translates into a lower likelihood of

highlighting decreased accounting reliability. The following section proceeds to describe the data and research methods we use to test the arguments above.

There are additional arguments on how a tightening auditing oligopoly might affect the incentives of the Big N on matters beyond decreased reliability in accounting standards. For example, a tightening oligopoly can lower costs to collusion, enabling the Big N to erect competitive barriers via accounting standards — that is, they might lobby for standards that are so complex that only large auditors can afford the human and technological capital to implement; such "complex" standards can also generate additional revenue by creating "busy work." We do not develop these arguments since our empirical tests are focused on decreased reliability. It is unclear how auditors' incentives to support "complex" standards would influence their lobbying preferences on the issue of decreased reliability.

2.3. Data and research design

Our objective is to study the impact of the changing auditing oligopoly on accounting standards. We execute on this objective by investigating whether consolidation in the audit industry has significantly impacted Big N auditors' propensity to discuss decreased reliability in their evaluation of proposed accounting standards, conditional on such concerns existing. We estimate this conditional propensity as the association in a multivariate regression between Big N auditors' reported assessment of decreased reliability and the "true" incidence of decreased reliability as measured by an independent benchmark. Changes in the correlation between Big N auditors' reported assessments and an independent benchmark can provide evidence as to the prevailing incentives in a tightened audit oligopoly.

In Section 2.3.1 we describe construction of our primary regression variables: the dependent variable, Big N auditors' reported assessments of decreased reliability; and the primary independent variable, the benchmark assessment of decreased reliability. In Section 2.3.2 we detail our multivariate regression design and statistical tests. Section 2.3.3 describes our construct validity test. Section 2.3.4 describes our control variables and statistical tests for alternative explanations.

2.3.1 Primary regression variables

Dependent variable: Big N auditors' assessments of decreased reliability

We conduct our analysis of Big N audit firms' assessments of decreased accounting reliability through the lens of the comment letters written by these firms on FASB exposure drafts. Due process for the FASB provides constituents the opportunity to weigh in on a proposed standard by submitting comment letters. Prior research has shown that comment letters have an impact on final standards, so they are meaningful indicators of constituent views (e.g., Ramanna, 2008). Our sample includes comment letters submitted by Big N auditors on the 170 exposure drafts issued from 1973 through 2006 that resulted in one or more SFAS: these data have been used by Allen and Ramanna (2012). In total there are 908 Big N auditor comment letters covering 149 exposure drafts (and 157 SFAS), which represents a participation rate of approximately 80%. See Table 2.2.

Table 2.2: Inventory of Big N auditor comment letter and FASB exposure draft availability

The sample is based on 126 exposure drafts issued between 1973 and 2006 on which the Big N auditors filed comment letters and for which we were able to obtain copies of the original exposure draft from the FASB archives.

Era	Big 8	Big 6	Big 5	Big 4	Total
Period	1973-1989	1989-1998	1998-2002	2002-2006	
EDs issued	109	33	13	15	170
EDs without Big N comment letters	16	3	0	2	21
Initial Sample					
EDs	93	30	13	13	149
SFAS	100	28	10	19	157
Comment Letters	615	173	70	50	908
EDs unavailable for manual review	23	0	0	0	23
Final Sample					
EDs	70	30	13	13	126
SFAS	76	28	10	19	133
Comment Letters	487	167	70	50	774

We measure Big N auditors' reported evaluations of decreased reliability as in Allen and Ramanna (2012). A paper copy of each Big N auditor comment letter was obtained from the FASB public library in Norwalk, Connecticut, digitized using optical character recognition and manual transcription, and analyzed using a custom designed Perl script, which extracted all sentences containing the word stem "reliab." Next, using the output from Perl, a research assistant blind to the intent of our study but trained in accounting principles manually examined the extracted sentences from each comment letter to assess

the substance of the auditors' reference. Based on this evaluation, comment letters where auditors reported decreased reliability as a result of the exposure draft were identified.

Using the above procedure we find that 98 (10.8%) of the Big N auditors' comment letters express the opinion that an exposure draft will decrease accounting reliability. Our construction of the dependent variable (*dec_relb_aud*) is as in Allen and Ramanna (2012):

$$dec\_relb\_aud_{ij} = 1 - \frac{WC\_dec\_relb_{ij}}{WC_{ij}} \qquad (1)$$

In Equation (1), $WC\_dec\_relb_{ij}$ is the word count of the first instance of the word stem "reliab" used in a negative ("decreasing") context in comment letter *i* on exposure draft *j*; and WC_{ij} is the total word count of comment letter *i* on exposure draft *j*. By construction, *dec_relb_aud* is bounded [0,1] and is intended to capture the relative importance a Big N auditor places on its assessment of decreased reliability by using relative word position as a proxy for sentiment intensity. As discussed in Allen and Ramanna (2012), this linguistic assumption is justified by the propensity of comment letters to begin with an introductory paragraph that highlights key issues. The variable construction should result in higher values of *dec_relb_aud* for comment letters in which the author views reliability as sufficiently important in her overall evaluation of an exposure draft to allude to it earlier in the comment letter.[29]

[29] In untabulated tests, we use a dummy variable set to one if dec_relb_aud>0 in lieu of dec_relb_aud; results are substantively invariant to the substitution in the regression specification with all control variables.

Primary independent variable: benchmark assessment of decreased reliability

To create a benchmark of an exposure draft's "true" impact on reliability that is independent of auditor incentives, we utilize the variable *manual_dec_relb* from Allen and Ramanna (2012), which we rename *benchmark* for clarity of interpretation in our setting. *benchmark* is constructed from the evaluations of two highly experienced research assistants who were instructed to manually assess each exposure draft's impact on reliability relative to the status quo of GAAP at the time of issuance. The research assistants employed in this task had a combined total experience in the fields of accounting and finance of over 30 years, as well as MBA degrees from top ranked U.S. business schools. The research assistants were blind to the objectives of the study. By construction, *benchmark* is a binary indicator for each exposure draft, which takes a value of one for exposure drafts categorized by the research assistants as decreasing accounting reliability. Of the 170 exposure drafts in our population, 145 were available to us from the FASB archives for manual evaluation. Merging this sample with our auditor comment letters yields a common sample of 774 auditor comment letters on 126 unique exposure drafts manually evaluated by our research assistants. See Table 2.2.

Summary statistics

Table 2.3 provides summary statistics for our dependent variable (*dec_relb_aud*) and primary independent variable (*benchmark*) across each of the four Big N auditor concentration eras (Big8, Big6, Big5, and Big4). As seen in Table 2.3, raw auditor mentions of decreased reliability are monotonically increasing across the eras: average *dec_relb_aud* increases from a low of 0.04 in the Big 8 era to a high of 0.27 in the Big 4 era. By contrast,

the true incidence of decreased reliability in proposed standards (as measured by *benchmark*) shows no analogous increasing trend. Figures 2.1 and 2.2 present plots of averaged *dec_relb_aud* and *benchmark*, respectively, by year. For both variables we observe substantial time-series variation. The break at 1987 in Figures 2.1 and 2.2 is due to the fact that no exposure drafts were issued by the FASB in that year. Figure 2.2 has three additional breaks at 1973, 1975, and 1997; across these three years the FASB issued ten exposure drafts, none of which were available when creating our *benchmark* variable.

Table 2.3: Summary statistics for Big N auditor and research assistant evaluations of decreased "reliability" in proposed standards

The sample is based on 126 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details.

Variable	Mean	Med	S.D.	Max	Min	n
dec_relb_aud						
Big 8	0.04	0	0.16	0.98	0	487
Big 6	0.10	0	0.26	0.98	0	167
Big 5	0.23	0	0.36	0.94	0	70
Big 4	0.27	0	0.39	0.99	0	50
Total	0.08	0	0.24	0.99	0	774
benchmark						
Big 8	0.16	0	0.37	1.00	0	487
Big 6	0.46	0	0.50	1.00	0	167
Big 5	0.60	1	0.49	1.00	0	70
Big 4	0.46	0	0.50	1.00	0	50
Total	0.29	0	0.50	1.00	0	774

Figure 2.1: Big N Auditor assessments of decreased reliability in proposed standards
The sample is based on 149 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big 8/6/5/4 auditors (hereafter "Big N auditors") in their comment letters. See Section 2.3.1 for details.

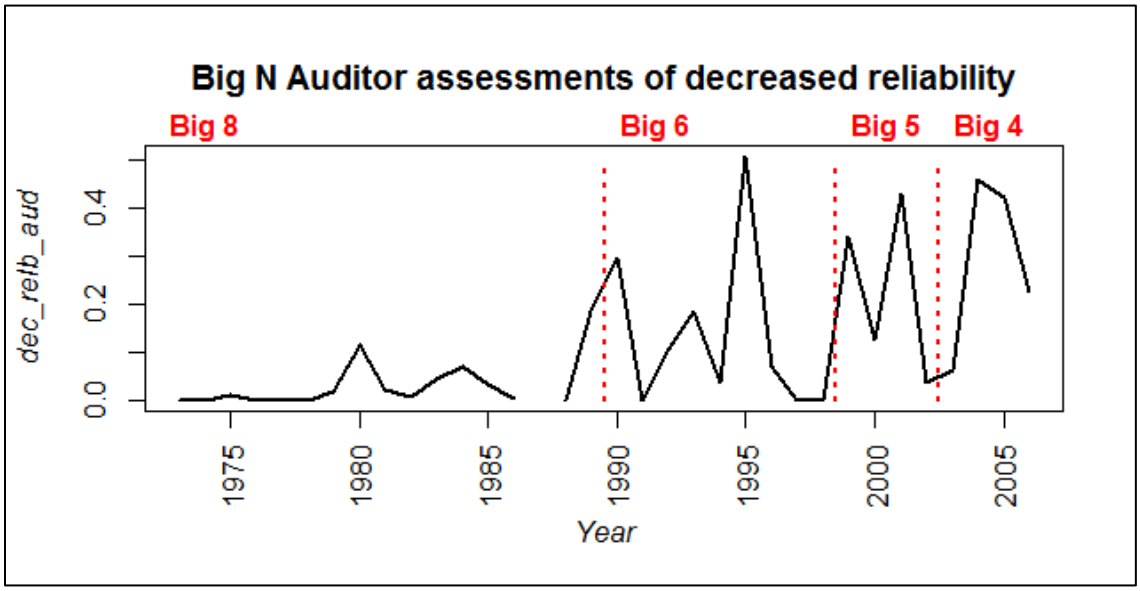
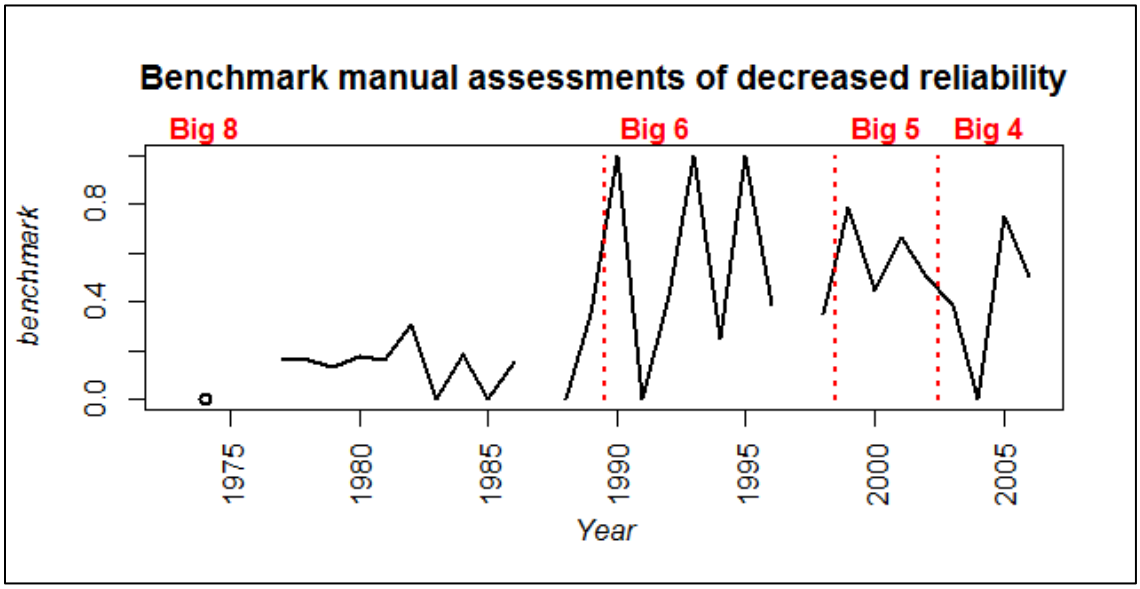


Figure 2.2: Independent research assistant "benchmark" assessments of decreased reliability in proposed standards
The sample is based on 126 exposure drafts issued between 1973 and 2006. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details.



2.3.2 Research design

Our empirical tests are designed to assess the changing correlations between *dec_relb_aud* and *benchmark* over different audit oligopoly regimes. Formally, we estimate the betas from the following regression:

$$dec\_relb\_aud_{ij} = \begin{bmatrix} \alpha_1 \\ \alpha_2 \\ \vdots \\ \alpha_t \end{bmatrix}' * yr\_dummies + \begin{bmatrix} \beta_1 \\ \beta_2 \\ \vdots \\ \beta_t \end{bmatrix}' * yr\_dummies * benchmark_j \quad (2)$$

In the above equation *yr_dummies* is a *t* x 1 vector of year dummies, which allows variation across the intercept and slope estimates by year. There are a variety of factors (e.g., macroeconomic and market conditions) that can impact Big N auditors' mentions of *dec_relb_aud* in ways that may be unrelated to the "true" incidence of decreased reliability (*benchmark*). These factors are likely to vary by exposure draft and time, and their impact in Equation (2) is captured in the alphas (we develop additional tests for alternative explanations in Section 2.3.4). By interacting *yr_dummies* with our *benchmark* variable the above regression, we generate separate beta estimates of the correlation between Big N auditors' assessments and "true" assessments for each year in our sample. For ease of interpretation we include a full set of year dummies and interactions, and accordingly omit a constant term and the main effect on *benchmark* to avoid multicollinearity.

As discussed in Section 2.2.2, there are four distinct auditor concentration "eras" across our sample of SFAS: the Big 8 era (1973-1989), Big 6 era (1990-1998), Big 5 era (1999-2002), and Big 4 era (2003-2006). To test whether year-estimated betas differ

significantly across these four audit eras we use linear combinations of betas to calculate era-average coefficients and standard errors per the following equations.

$$Regime\ Average\ Coefficient = l'\beta = \sum_{k=1}^{K} l_k \beta_k \quad (3)$$

$$se(l'\beta) = [\hat{\sigma}^2 l'(x'x)^{-1} l]^{\frac{1}{2}} \quad (4)$$

In Equations (3) and (4), l is an t x 1 matrix (where t is the sample length) that has element k set to one for each β_k being averaged across a regime and zero otherwise; thus $l'\beta$ is a the simple average of coefficients on *benchmark* from 1973 through 1989 for the Big 8 era, 1990 to 1998 for the Big 6 era, 1999 to 2002 for the Big 5 era, and 2003 to 2006 for the Big 4 era. In Equation (4), $\hat{\sigma}^2$ is the regression's sum of squared residuals divided by the degrees of freedom and x is the matrix of explanatory variables.

To test for significance of differences between era-averaged coefficients (say between Big 8 and Big 6), Equations (3) and (4) are re-estimated setting l such that $l'\beta$ is the difference between the era-averaged coefficients for each era pair. For example, in estimating the difference between Big 8 and Big 6 era coefficients $l_{Big8\text{-}Big6}$ is constructed such that $l'_{Big8-Big6}\beta = l'_{Big8}\beta - l'_{Big6}\beta$. Significance tests of era-averaged coefficients and differences across era-averaged coefficients are based on a Student's t-distribution with n-K degrees of freedom, where n is the sample size and K is the number of regression covariates.

Note that if the Big N auditors' incentives are unchanged across eras or if the auditors are, on average, not self-serving in their lobbying, we are unlikely to find

significant differences between era-averaged beta coefficients. If, on the other hand, Big N auditors' lobbying on exposure drafts is influenced by changing incentives, significant differences between regime averaged coefficients provide evidence as to which incentives dominate as the oligopoly tightens.

2.3.3 Construct validity

As discussed in Section 2.2.1, auditor incentives in standard setting, particularly in highlighting decreased accounting reliability, are likely driven in part by the litigation environment. Specifically, ceteris paribus, in the face of increased (decreased) litigation risk auditors are more (less) likely to highlight decreased reliability in accounting standards. We use this prediction to examine the validity of our regression design: we test whether the correlation between *dec_relb_aud* and *benchmark* varies predictably with changes in the litigation environment in the thirty-four years of our sample period. Specifically, following the evolution of tort law related to auditor liability in our sample period, we identify four distinct litigation eras from 1973 to 2006:

(1) 1973-1982 constitutes our baseline period. During this period tort law governing auditor liability to non-clients for negligence was largely governed by the doctrine of "privity" (Feinman, 2003). Under the doctrine of privity, auditors can only be held liable for negligence to third parties with whom they have a direct contractual relationship.[30]

[30] Kothari, Lys, Smith, and Watts (1988) in their discussion of auditor liability eras identify the Ernst & Ernst v. Hochfelder case in 1976 as demarking a reduction in auditor liability. Applied to our setting, this would suggest that we treat the periods 1973–1976 and 1977–1982 differently. We do not do so because we lack sufficient observations (based on limited data to construct the benchmark variable) to generate regression betas for the 1973-1976 period.

(2) 1983-1991 was a period marked by increase in litigation pressure felt by the large auditing firms. Two major court rulings in 1983, Rosenblum v. Adler and Citizens State Bank v. Timm Schmidt and Co., set precedents for the use of "reasonable foreseeability" rather than "privity" as the standard for negligence (Kothari et al., 1988). Under the doctrine of "reasonable foreseeability," auditor litigation risk is significantly increased; an auditor is potentially liable to any party that might have been reasonably expected to rely on a client's audited financial statements. Also in 1983, the U.S. courts held that auditors could be sued under the Racketeer Influenced and Corrupt Organization Act (RICO) of 1970 (Lys and Watts, 1994).

(3) 1992-2002 was a period that saw a series of reforms aimed at decreasing auditor liability. In 1992, two court cases Bily v. Arthur Young and Co. and Security Pacific Business Credit v. Peat Marwick Main, reversed the precedent set in Rosenblum. Rejecting the doctrine of "reasonable foreseeability", both court cases instead applied the doctrine of "known users" (Feinman, 2003). By this standard auditor liability for negligent misrepresentation to non-clients is limited to third parties whom the auditor *knows* rely on its audit reports. Also, in 1992 the AICPA amended Section 505 of its Code of Professional Conduct to allow member firms to incorporate as limited liability partnerships; and, the Big N firms all converted shortly thereafter (Choi, Doogar, and Ganguly, 2004). In 1994, the Supreme Court eliminated auditors' liability for aiding and abetting rule 10b-5 violations (Central Bank of Denver v. First Interstate Bank of Denver). And finally, in 1995 the Private Securities Litigation Reform Act of 1995 further reduced auditor liability by limiting key aspects of their liability under the 1934 Securities Act and under RICO (Ali and Kallapur,

2001). The sum effect of these changes was a reduction in litigation risk for auditors relative to the prior period.

(4) 2003-2006 was a period marked by increased litigation risk relative to the prior period. The provisions of the Sarbanes Oxley Act of 2002 (SOX) left largely untouched the private civil liability standards for auditors, but established the Public Company Accounting Oversight Board for increased oversight and visibility of Big N audit firms. Further, the high visibility of corporate accounting scandals from 2001-2002, the demise of Arthur Andersen, and the ensuing wave of investigations and penalties for public accounting firms likely heightened Big N audit firms incentives to minimize litigation risk (Cahan and Zhang, 2006). We note that this period coincides directly with the "Big 4" era identified in our primary analysis.

To the extent that our regression design allows us to generate estimates of the correlation between auditor assessments of an exposure draft and the benchmark assessments that are meaningful proxies for auditor incentives, a distinct pattern in average regression betas should present across the four litigation eras defined above. The specific predictions are summarized in the chart below.

Era	***Legal Liability Standard***	***Beta Predictions (relative to preceding period)***
1973-1983	Privity	Baseline
1984-1992	Reasonable Foreseeability	Increased Beta
1993-2002	Known Users (and Limited Liability)	Decreased Beta
2003-2006	SOX	Increased Beta

In these construct validity tests, the statistical significance of regime-average betas and comparisons across betas are made using the linear-combination process described in the prior subsection (Eq 3 and Eq 4).

2.3.4 Control variables and tests of alternative explanations

The incidence of Big N auditors' "raw" concerns about decreased reliability (*dec_relb_aud*) can be a function of numerous factors that vary over time, such as macroeconomic and market conditions. To the extent that these factors are unrelated to the "true" incidence of decreased reliability (*benchmark*), our use of year fixed-effects in Equation (2) serves as a control in the multivariate regressions. But these factors may affect the *benchmark* variable as well. If such factors are unrelated to the tightening audit oligopoly but manifest in a time series that is similar to the auditor eras, our interpretation of the linear combinations (over auditor eras) of betas in Equation (2) as representing the association between Big N auditor incentives and the tightening audit oligopoly is confounded. We are not aware of any theory that exhaustively specifies these factors (largely because the literature is lacking a theory for the tightening auditor oligopoly), but we identify four factors that nevertheless warrant consideration as potential alternative explanations: macroeconomic cycles, market conditions, increased fair-value-based accounting, and standard setters' ideologies.

Macroeconomic cycles and market conditions

Periods of recession increase the probability of financial distress and corporate failure, and accordingly may heighten auditor concern with legal liability (St. Pierre and

Anderson, 1984). If this is the case, Big N audit firms may be more likely, ceteris paribus, to recognize and highlight issues of decreased reliability in their responses to exposure drafts proposed during recessions than during periods of macroeconomic growth. The same argument can be made with regards to the prevailing market conditions. To control for these possibilities, we generate two control variables: *macro_growth* is a binary variable set equal to one for exposure drafts issued during a period of economic growth, as defined by the NBER, and zero for exposure drafts issued during a period of economic contraction; *market_ret* is a continuous variable set equal to the annual value-weighted market return for the 12 months directly preceding the month in which an exposure draft was issued.

Fair-value accounting

Audit firms may have preferences against the increased use of fair value in financial reporting. Fair value estimates can be more difficult to audit than historical costs, and the use of fair values can increase litigation risk for auditors (e.g., Watts, 2003). Accordingly, Big N auditors, hoping to deter the increased use of fair value methods, may be more likely to voice concerns regarding decreased reliability for exposure drafts that increase the use of fair values than for those that do not. To control for this possibility we rely on data from Allen and Ramanna (2012), who construct a variable based on independent research assistants' evaluations of exposure drafts' use of fair-value methods. For our analysis, we generate a binary control variable (*fair_value*) that takes the value of one for exposure drafts that increase the use of fair values for asset write downs, asset recognition and measurement, liability recognition and measurement, disclosure, or recognition in the income statement; zero otherwise.

Standard-setters' ideologies

Allen and Ramanna (2012) show that standards proposed by FASB boards with a higher proportion of members from the financial services industry (*pct_fin_fasb*) are more likely to be viewed by the Big N audit firms as decreasing accounting reliability. Accordingly, we include *pct_fin_fasb* as a control variable in our analysis; *pct_fin_fasb* is a continuous variable equal to the proportion of FASB members in office at the issuance of an exposure draft who were employed in the financial services industry (defined as investment banking and investment management) immediately prior to their appointment to the board.

Construction of our four control variables, and a list of years classified as "high" and "low" subsample for each variable are summarized in the below chart.

Variable	***Classification Criteria***	***"High" subsample***	***"Low" subsample***
macro_growth	Years are denoted as "growth" if the mean value of *macro_growth*>.5 across all exposure drafts in our sample for that year, and "recession" otherwise.	"Growth:" 1975-1979, 1981, 1983-2000, 2002-2006	"Recession:" 1973-1974, 1980, 1982, 2001
market_ret	Years are denoted as "positive" if the mean value of *market_ret* >0 across all exposure drafts in our sample for that year and "negative" otherwise	"Positive:" 1975-1981, 1983, 1985-1987, 1989, 1991-1993, 1995-1997, 1999, 2003-2006	"Negative:" 1973, 1974, 1982, 1984, 1988, 1990, 1994, 1998, 2000-2002
fair_value	Years are denoted as "No FV" if *fair_value* = 0 for all sample exposure drafts proposed during that year, else "FV increasing"	"FV increasing:" 1977, 1983-1984, 1989, 1992, 1994, 1996, 1998-2006	"No FV:" 1974, 1978-1982, 1985-1986, 1988, 1990, 1991, 1993, 1995, 1997

pct_fin_fasb	Years are denoted as "Financial FASB" if *pct_fin_fasb*>0 for at least one exposure draft in our sample from that year and "No Financial FASB" otherwise	"Financial FASB:" 1993-2006	"No Financial FASB:" 1973-1992

Tests of alternative explanations

Table 2.4 provides summary statistics for each of the four control variables described above. As shown in Figures 2.3 through 2.6, none of these factors manifest in a pattern that is identical to the changes in the audit oligopoly, suggesting they are unlikely to confound inferences in our multivariate regressions. Nevertheless, to understand better the potential impact of these factors in our setting, we perform two separate tests. First, we separate our sample into periods of high and low macro conditions, market returns, fair-value use, and proportion of financial-services members on the FASB. Segregation of years into high and low periods on each variable is achieved as follows.

Table 2.4: Summary statistics for potential control variables

The sample is based on 126 exposure drafts issued between 1973 and 2006. *macro_growth* is a binary variable set equal to one for exposure drafts (EDs) issued during a period of economic growth, as defined by the NBER, and zero for EDs issued during a period of economic contraction; *market_ret* is the annual value-weighted market return for the 12 months directly preceding the month in which an ED was issued. *fair_value* is a binary variable which takes a value of one for EDs determined by independent research assistant evaluation to increase the use of fair values. *pct_fin_fasb* is an ED-level measure of the proportion of extant FASB members with most recent former employ in financial services. See Section 2.3.4 for details.

Variable	Mean	Med	S.D.	Max	Min
macro_growth	0.78	1.00	0.41	1.00	0.00
market_ret	0.13	0.11	0.18	0.67	-0.31
fair_value	0.20	0.00	0.40	1.00	0.00
pct_fin_fasb	0.05	0.00	0.08	0.29	0.00

Figure 2.3: Average growth versus recession macroeconomic trends by year
The sample is based on 149 exposure drafts issued between 1973 and 2006. *macro_growth* is a binary variable set equal to one for exposure drafts (EDs) issued during a period of economic growth, as defined by the NBER, and zero for EDs issued during a period of economic contraction. See Section 2.3.4 for details.

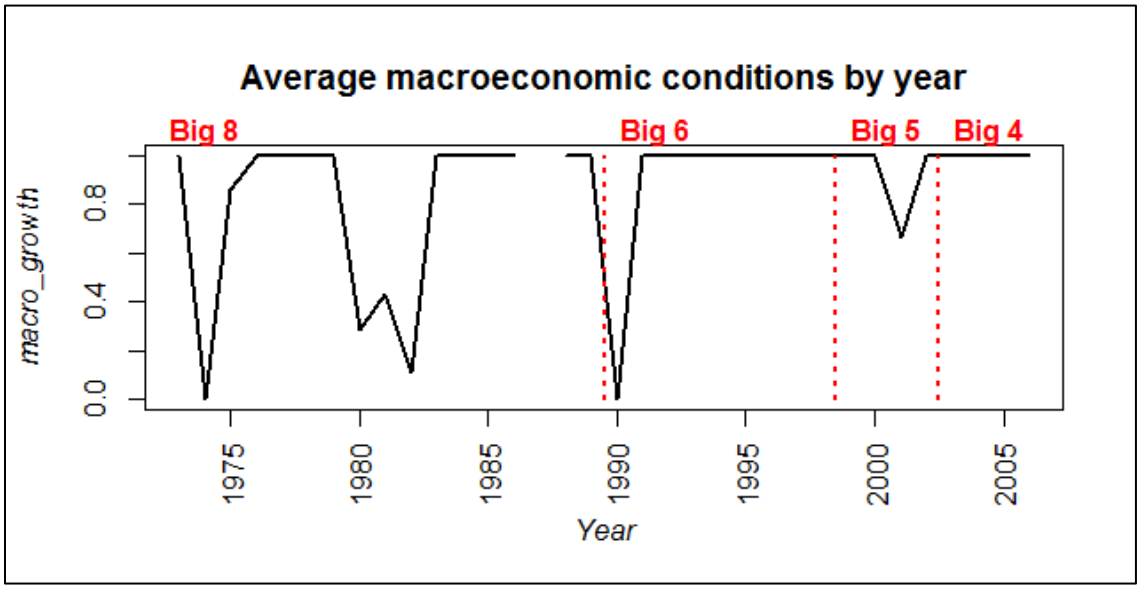


Figure 2.4: Average value-weighted market returns by year

The sample is based on 149 exposure drafts issued between 1973 and 2006. *market_ret* is the annual value-weighted market return for the 12 months directly preceding the month in which an ED was issued. See Section 2.3.4 for details.

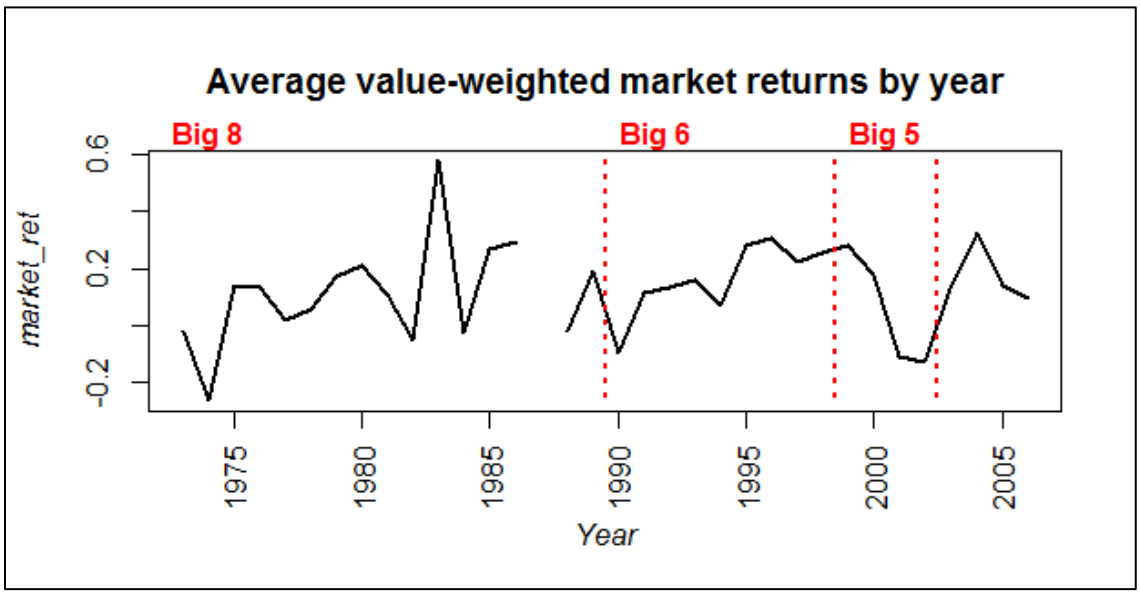


Figure 2.5: Proportion of proposed standards issued that increase the use of fair values

The sample is based on 126 exposure drafts issued between 1973 and 2006. *fair_value* is a binary variable which takes a value of one for EDs determined by independent research assistant evaluation to increase the use of fair values. See Section 2.3.4 for details.

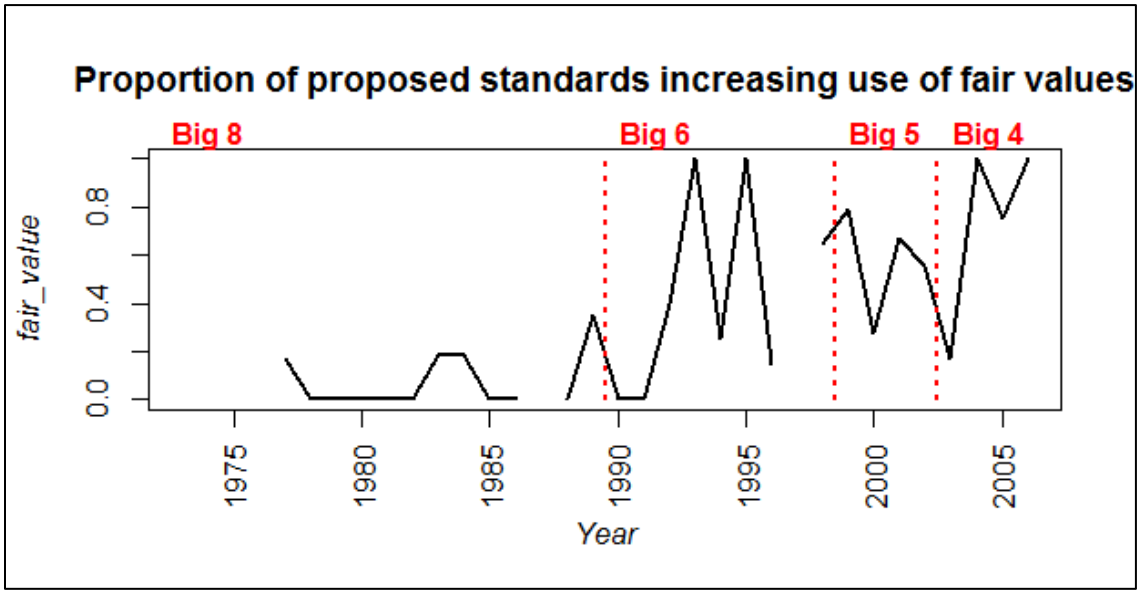
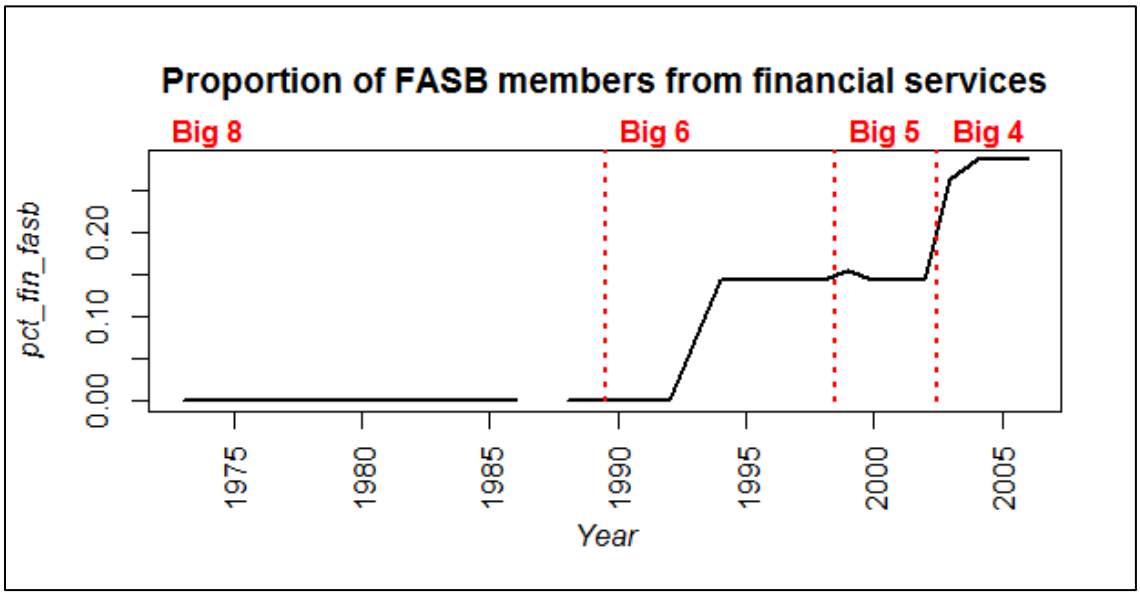


Figure 2.6: Proportion of FASB members most recently employed in financial services

The sample is based on 149 exposure drafts issued between 1973 and 2006. *pct_fin_fasb* is an ED-level measure of the proportion of extant FASB members with most recent former employ in financial services. See Section 2.3.4 for details.



For each of the above subsamples, we compute era-average betas from our primary regression results (Eq 2). Two sided *t*-tests are used to assess whether there is a significant difference between the era-average betas from "growth" versus "recession" years, "positive" versus "negative" market return years, "fair value increasing" versus "no fair value" years; and years with "no financial FASB" versus at least one "financial FASB" member serving.

Second, we re-estimate our primary regression (Eq 2), including the additional controls for *macro_growth, market_ret, fair_value*, *pct_fin_fasb*, and their respective interaction controls with *benchmark* (*macro_growth*benchmark, market_ret*benchmark, fair_value*benchmark, pct_fin_fasb*benchmark*). Using this regression output we re-compute the era-average betas for each auditor concentration era (Eq 3 and Eq 4) and test for significance of differences. The full specification of this model is as follows:

$$dec\_relb\_aud_{ij} = \begin{bmatrix}\alpha_1\\ \alpha_2\\ \vdots\\ \alpha_t\end{bmatrix}' * yr\_dummies + \begin{bmatrix}\beta_1\\ \beta_2\\ \vdots\\ \beta_t\end{bmatrix}' * yr\_dummies * benchmark_j$$

$$+ \begin{bmatrix}\gamma_1\\ \gamma_2\\ \vdots\\ \gamma_8\end{bmatrix}' * \begin{bmatrix} macro\_growth \\ market\_ret \\ fair\_value \\ pct\_fin\_fasb \\ macro\_growth * benchmark \\ market\_ret * benchmark \\ fair\_value * benchmark \\ pct\_fin\_fasb * benchmark \end{bmatrix} \quad (5)$$

Beyond the four potential alternative explanations discussed above — macro and market conditions, increased fair-value-based accounting, and standard setters' ideologies — the globalization of accounting standard setting, particularly the convergence project between the FASB and the International Accounting Standards Board (IASB) since 2002, may have affected the Big N auditors' incentives on decreased reliability. Specifically, IFRS standards proposed by the IASB, of which the Big N has been largely supportive (e.g., Botzem and Quack, 2009), are generally considered to be "principles-based," emphasizing flexibility and fair-value accounting at the expense of reliability. Thus, if support for the convergence of U.S. GAAP with IFRS determined the Big N auditors' lobbying positions on decreased reliability post 2002, we would expect it to lower the era-average beta coefficient from the Big 4 era (2003-2006). Further, under this explanation, the difference between the Big 4 era-averaged beta coefficient and prior era-averaged beta coefficients would not be positive. We use this prediction to test the alternative explanation that support for IFRS convergence determined the Big N auditors' incentives on decreased reliability post 2002.

2.4. Results

2.4.1 Construct validity tests

Table 2.5 presents the results of our construct validity tests to determine whether average regression coefficients vary predictably with changes in the litigation environment. The underlying regression for Table 2.5 is from Eq 2; beta coefficients measure the propensity of Big N auditors to express concerns about decreased reliability (*dec_relb_aud*) relative to our *benchmark* assessment of an exposure draft's "true" impact on decreased

reliability. Column (1) of Table 2.5 reports the average beta observed for each of the four auditor litigation eras. Differences in average coefficients for each pair of eras are presented in columns (2) through (4). Statistical significance is reported based on heteroskedastic-robust standard errors.

Table 2.5: Construct validity tests: Average auditor litigation era coefficients from an OLS regression from dec_relb_aud on benchmark assessments of decreased reliability

The sample is based on 126 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details. Regression structure includes year fixed effects and interacts *benchmark* with year dummies to allow variation across the intercept and slope estimates by year. Average era coefficients and heteroskedastic robust standard errors are obtained using linear combination as detailed in Section 2.3.2. See Section 2.3.3 for detail on auditor litigation eras. ***, **, and * denote statistical significance at the 99%, 95%, and 90% confidence levels, respectively.

Auditor litigation era			*Foreseability*	*Known Users*	*SOX*
1977-1983	***Privity***	-0.03 ***	0.34 ***	0.22 ***	0.37 ***
1984-1992	***Foreseability***	0.31 ***		-0.12 *	0.03
1993-2002	***Known Users***	0.18 ***			0.16 *
2003-2006	***SOX***	0.34 ***			
		(1)	(2)	(3)	(4)

As shown in column (1), litigation era averaged coefficients vary according to our predictions (see Section 2.3.3): Big N auditor concern with decreased reliability conditional on an exposure drafts "true" impact, is lowest under the legal standard of "privity" (-0.03), increases under the more relaxed doctrine of "reasonable foreseeability" (0.31), decreases under the more stringent standard of "known users" (0.18), and increases again post-SOX (0.34). Pairwise differences across each of these eras are presented in columns (2) through (4). All predicted differences (diagonal elements) are statistically significant at the 90% confidence level (p-value<0.10). The comparison between "reasonable foreseeability" and

"SOX" is not statistically significant. We had no ex-ante prediction on this comparison since "reasonable foreseeability" and "SOX" represent two relatively high litigation-risk eras. Overall, Table 2.5 offers assurance that the regression design can provide meaningful estimates for the changing incentives of Big N audit firms in standard setting.

2.4.2 Multivariate results

Table 2.6 presents the results of our multivariate tests to determine how auditor incentives in standard setting have changed with a tightening audit oligopoly. The underlying regression and presentation of Table 2.6 is identical to that of Table 2.5, except that regression coefficients are averaged across the four auditor concentration eras as opposed to litigation eras. Column (1) of Table 2.6 suggests average coefficients are monotonically increasing across eras; average beta is 0.09 in the Big 8 era, 0.14 in the Big 6 era, 0.24 in the Big 5 era and 0.34 in the Big 4 era. This trend is consistent with predictions that a tightening oligopoly will heighten auditor concern with litigation and political visibility risk, as well as decrease the competitive pressure for Big N auditors to advocate for greater flexibility in standards on their clients behalf. Increasing average coefficients suggest these factors subsume any decrease in auditor concern resulting from an increased perception of being "too big to fail". Differences are significant (p-value<.05) when comparing: Big 8 to Big 5 and Big 4; and Big 6 to Big 4. The other differences are not statistically significant, warranting restraint in drawing strong inferences from the analysis in Table 2.6.

Table 2.6: Average Big N audit era coefficients from an OLS regression from dec_relb_aud on benchmark assessments of decreased reliability

The sample is based on 126 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details. Regression structure includes year fixed effects and interacts *benchmark* with year dummies to allow variation across the intercept and slope estimates by year. Average era coefficients and heteroskedastic robust standard errors are obtained using linear combination as detailed in Section 2.3.2. ***, **, and * denote statistical significance at the 99%, 95%, and 90% confidence levels, respectively.

Big N audit era			***Big 6***	***Big 5***	***Big 4***
1973-1989	***Big 8***	0.09 ***	0.05	0.15 **	0.25 ***
1990-1998	***Big 6***	0.14 ***		0.10	0.20 **
1999-2002	***Big 5***	0.24 ***			0.10
2003-2006	***Big 4***	0.34 ***			
		(1)	(2)	(3)	(4)

2.4.3 Tests of alternative explanations

Table 2.7 presents our analysis on the impact of four factors that may be correlated with both Big N auditor "raw" concerns about decreased reliability (*dec_relb_aud*) and the "true" incidence of decreased reliability (*benchmark*) for each exposure draft (see Section 2.3.4): macroeconomic cycles (Panel A), average market returns (Panel B), fair-value use in proposed standards (Panel C), and the proportion of FASB members most recently employed in financial services (Panel D). Each panel has two columns: column (1) presents era-averaged betas for "high" and "low" values of the four factors as defined in Section 2.3.3. Column (2) shows the difference between these era-averaged coefficients. Statistical significance is reported using heteroskedastic-robust standard errors.

Table 2.7: Tests of alternative explanations: Coefficients from an OLS regression from dec_relb_aud on benchmark assessments of decreased reliability

The sample is based on 126 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details. Regression structure includes year fixed effects and interacts *benchmark* with year dummies to allow variation across the intercept and slope estimates by year. Average era coefficients are calculated over years of "high" versus "low" *macro_growth*, *market_ret*, *fair_value* and *pct_fin_fasb* using linear combination as detailed in Section 2.3.2 and 2.3.4. *macro_growth* is a binary variable set equal to one for exposure drafts (EDs) issued during a period of economic growth, as defined by the NBER, and zero for EDs issued during a period of economic contraction; years are denoted as "growth" if the mean value of *macro_growth*>.5 and "recession" otherwise. *market_ret* is the annual value-weighted market return for the 12 months directly preceding the month in which an ED was issued; years are denoted as "positive" if the mean value of *market_ret*>0 and "negative" otherwise. *fair_value* is a binary variable that takes a value of one for EDs determined by independent research assistant evaluation to increase the use of fair values; years are denoted as "No FV" if *fair_value*=0 for all EDs proposed during that year and "FV increasing" otherwise. *pct_fin_fasb* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management; years are denoted as "Financial FASB" if *pct_fin_fasb*>0 and "No Financial FASB" otherwise. Standard errors are heteroskedastic-robust. ***, **, and * denote statistical significance at the 99%, 95%, and 90% confidence levels, respectively.

Panel A: *macro_growth*

		Recession
Growth	0.17 ***	0.00
Recession	0.17 ***	
	(1)	(2)

Panel B: *market_ret*

		Negative
Positive	0.17 ***	0.00
Negative	0.17 ***	
	(1)	(2)

Panel C: *fair_value*

		No FV
FV increasing	0.25 ***	-0.29 ***
No FV	-0.03 ***	
	(1)	(2)

Panel D: *pct_fin_fasb*

		No Fin FASB
Fin FASB	0.23 ***	-0.13 ***
No Fin FASB	0.10 ***	
	(1)	(2)

Panels A and B of Table 2.7 suggest that the average correspondence between "raw" auditor concern with decreased reliability and the "true" incidence of decreased reliability is largely invariant to both macroeconomic cycles (*macro_growth*) and average market returns (*market_ret*). Columns (1) of Panels A and B show average betas are 0.17 across years with macro-economic "growth" and with macro-economic "recession" as well as across those years with positive average market returns and negative average market

returns. As shown in columns (2) of Panels A and B, differences are, in both cases, statistically insignificant.

By contrast, Panels C and D of Table 2.7 suggest that the fair-value impact of an exposure draft as well as the proportional membership of FASB members having a financial services background has a significant effect on Big N auditors' propensity to express concern about decreased reliability, conditional on such concern being present. Panel C suggests that the average beta increases from -0.03 in years for which no fair-value increasing standards are proposed, to 0.25 in years that have at least one fair-value increasing exposure draft. The difference in average betas (0.28) is statistically significant (p-value<.01). Similarly, Panel D suggests that the average beta is significantly higher (p-value<0.01) in years where at least one FASB member was previously employed in the financial-services sector (0.23) compared to years in which no FASB member has a financial-services background (0.10).

Collectively Panels C and D of Table 2.7 suggest that the fair-value impact of a proposed standard as well as the proportional composition of FASB board members may affect the correlation between "raw" propensities of Big N auditors to comment on decreased reliability (*dec_relb_aud*) and the "true" instance of decreased reliability in an exposure draft (*benchmark*). Accordingly, including controls for these variables in our primary regression design is important to generating unbiased estimation of betas that are consistent with our intended interpretation for them. By contrast, Panels A and B suggest that macroeconomic cycles and average market returns do not affect the correlation between Big N auditor concerns with decreased reliability and true concerns; as such, the

inclusion of year-fixed effects in our primary specification should adequately capture the effect of these factors.

2.4.4 Multivariate results after controlling for alternative explanations

Table 2.8 presents average auditor concentration era betas obtained by re-estimating our primary regression after including both main effect and interaction controls for those factors observed to be statistically significant in Table 2.7: the fair-value impact of an exposure draft (*fair_value* and *fair_value*benchmark*), and the proportion of FASB members with financial services background (*pct_fin_fasb* and *pct_fin_fasb*benchmark*). Table 2.8 is otherwise identical to Table 2.6. Column (1) of Table 2.8 suggests that Big N auditor concern with decreased reliability, conditional on an exposure statements "true" impact, is increasing monotonically with increased concentration of the audit oligopoly, consistent with the results of Table 2.6. Columns (2) through (4) provide pairwise differences between era-averaged betas, which are all positive and statistically significant (p-values<0.5). Thus, results of Table 2.8, similar to those of Table 2.6, are consistent with Big N auditors facing greater political and litigation costs attributable to their increased visibility from tightening oligopoly and with decreased competitive pressure among the Big N to satisfy client preferences (who usually demand accounting flexibility at the expense of reliability). These forces appear to dominate any increased perception by the Big N that they are "too big to fail" as the audit oligopoly tightens.

Table 2.8: Average Big N audit era coefficients from an OLS regression from dec_relb_aud on benchmark assessments of decreased reliability, after controlling for alternative explanations

The sample is based on 126 exposure drafts issued between 1973 and 2006. *dec_relb_aud* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big 8/6/5/4 auditors (hereafter, "Big N auditors") in their comment letters. *benchmark* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 2.3.1 for details. Regression structure includes year fixed effects and interacts benchmark with year dummies to allow variation across the intercept and slope estimates by year. Control variables *fair_value*, *fair_value*benchmark*, *pct_fin_fasb* and *pct_fin_fasb*benchmark* were also included in regression. *fair_value* is a binary variable which takes a value of one for EDs determined by independent research assistant evaluation to increase the use of fair values. *pct_fin_fasb* is an ED-level measure of the proportion of extant FASB members with most recent former employ in financial services. Average era coefficients and heteroskedastic robust standard errors are obtained using linear combination as detailed in Section 2.3.2. ***, **, and * denote statistical significance at the 99%, 95%, and 90% confidence levels, respectively.

Big N audit era			***Big 6***	***Big 5***	***Big 4***
1973-1989	***Big 8***	0.08	0.38 **	0.60 ***	1.14 ***
1990-1998	***Big 6***	0.46 ***		0.22 **	0.76 **
1999-2002	***Big 5***	0.68 **			0.54 ***
2003-2006	***Big 4***	1.22 ***			
		(1)	(2)	(3)	(4)

In Table 2.8, the era-average beta coefficient from the Big 4 era is greater than that from any other era. This positive difference is inconsistent with the proposition that support for IFRS convergence determined the Big N auditors' incentives on decreased reliability post 2002. As noted earlier, support for IFRS convergence is expected to decrease the Big 4 era coefficient, given the principles-based nature of IFRS that emphasizes flexibility and fair-value accounting at the expense of reliability.

For completeness in un-tabulated analysis we also test whether the results of Table 2.8 are robust to the inclusion of *macro_growth* and *market_ret* and the corresponding interaction terms (*macro_growth*benchmark*, *market_ret*benchmark*). The results presented in Table 2.8 are substantively unchanged when we include these additional controls with one exception: the pair-wise difference between Big 6 and Big 5 era average

coefficients is no longer significant at conventional levels. This change can be related to decreased power: observed variance inflation factors (a test for multicollinearity) for *macro_growth*benchmark* and *market_ret*benchmark* are 39.8 and 23.0, respectively.

2.4.5 Jackknifing

Because the inferences from the regressions described thus far are based on a relatively small sample of 126 exposure drafts, we conduct a jackknife analysis to test whether any one exposure draft is critical to our conclusions. Specifically, we successively eliminate each exposure draft that is used in the calculation of era-average coefficients and determine whether the statistical inferences from Table 2.8 continue to hold. We find that the inferences are robust to the jackknife analysis in all but three cases, where the difference between Big 6 and Big 5 era-averaged coefficients is positive but not statistically significant. All three cases pertain to exposure drafts issued in the Big 5 era.[31] The exclusion of these exposure drafts (and associated comment letters) lowers the precision of the Big 5 era coefficient and thus the power to detect the statistical difference between that coefficient and the Big 6 era coefficient.

2.5. Conclusion

The U.S. auditing industry has been characterized as an oligopoly for at least the last forty years, but the structure of that oligopoly has successively tightened from eight key players to four over the last twenty-five years. The tightening oligopoly is likely to change

[31] The three exposure drafts are: (1) "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Elective Date of FASB Statement No. 133: an amendment of FASB Statement No. 133," issued May 1999; (2) "Business Combinations and Intangible Assets—Accounting for Goodwill," issued February 2001; and (3) "Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections," issued November 2001.

the incentives of the surviving Big N auditors, with implications for their role in our market economy. The U.S. Government Accountability Office, the Congress' key independent oversight agency, has investigated the tightening oligopoly and, from time to time, issued reports aimed at increasing the number of major players in the audit industry (e.g., GAO, 2008). Motivated by the economic and public policy implications of the tightening audit oligopoly, we investigate the changing relation between the Big N and accounting standards.

Accounting standards are a key input in the audit process and, through their effects on financial reporting, can impact capital allocation decisions in the economy. We study the impact of the tightening audit oligopoly on Big N auditors' propensity to discuss decreased "reliability" in accounting standards proposed by the FASB. "Reliability" is a key attribute of accounting, as recognized by the FASB and several accounting textbooks (e.g., FASB, 1980; Stickney et al., 2010). Moreover, reliability is directly relevant to auditors because it entails "verifiability," which is a key aspect of auditing. Verifiable standards mitigate the litigation and regulatory risks embedded in auditors' certification of financial reports (e.g., Watts, 2003). Beyond reliability, there are likely to be other accounting properties such as comparability, consistency, and relevance that are important to auditors: future work can explore the impact of changing audit oligopoly on these properties as well.

We find that Big N auditors are more likely to identify decreased reliability in proposed standards as the auditing oligopoly has tightened. Our inferences are facilitated through the use of a "benchmark" assessment of proposed standards' decreased reliability: the benchmark is obtained through a standard dual-coder model using highly experienced

accounting and finance professionals blind to the study's objectives. The findings are consistent with Big N auditors perceiving higher litigation and political costs from the increased visibility that accompanies tighter oligopoly. The findings are also consistent with tighter oligopoly decreasing competition among the surviving Big N to satisfy client preferences in accounting standards (preferences for accounting flexibility at the expense of verifiability). The findings are not consistent with the concern that tightening oligopoly has rendered the surviving Big N "too big to fail."

Collectively, the results suggest that, as the oligopoly in auditing has tightened, Big N auditors are more prone to eschew the judgment and risks inherent in less reliable accounting standards. If these sentiments — measured in the auditors' comment letters on proposed standards — manifested in the final standards issued by the FASB, the results provide some descriptive evidence on the evolution of "rules" over "principles" in U.S. GAAP. The growth of rules-based accounting standards is significant because it can result in a collectivization of auditing and financial reporting risks in ways that can be sub-optimal for capital allocation (Kothari et al., 2010).

The results are robust to the inclusion of controls that capture other time-based factors that can impact auditors' propensity to identify decreased reliability in proposed standards (factors such as extant macroeconomic or stock market conditions). The findings are also robust to controls for the incidence of fair-value methods in proposed accounting standards and for the proportion of FASB members from the financial services sector. Fair-value accounting, which is expected to decrease accounting reliability, is one of the major developments in accounting standards over the last twenty years, and prior research has

shown that the incidence of fair-value methods in proposed standards is tied to the proportion of financial-services FASB members (Allen and Ramanna, 2012).

More generally, the nature of our multivariate regression design is such that alternative explanations that do not manifest in a time-series that is similar to the consolidation of the audit industry are unlikely to confound our inferences. That said, our empirical strategy is focused on the effects of tightening oligopoly, not its causes. Numerous factors such as globalization, the increased scale and complexity of business, improved information technology, and changing litigiousness are thought to have precipitated changes in the audit industry (e.g., GAO, 2008). Our findings are likely to be explained by a full consideration of the determinants of audit oligopoly (although the literature currently lacks such a theory), and thus must be interpreted accordingly. The results herein provide a pivot for future research on the changing audit oligopoly, its determinants and consequences.

Chapter 3: Towards an Understanding of the Role of Standard Setters in Standard Setting

Abstract

We investigate the effect of standard setters in standard setting: We examine how certain professional and political characteristics of FASB members and SEC commissioners predict the accounting "reliability" and "relevance" of proposed standards. Notably, we find FASB members with backgrounds in financial services are more likely to propose standards that decrease "reliability" and increase "relevance," partly due to their tendency to propose fair-value methods. We find opposite results for FASB members affiliated with the Democratic Party, although only when excluding financial-services background as an independent variable. Jackknife procedures show that results are robust to omitting any individual standard setter.

3.1. Introduction

As the Financial Accounting Standards Board (FASB) closes in on four decades, the role of its standards in shaping U.S. and international corporate reporting is widely acknowledged. An empirical literature on the political economy of FASB standard setting has emerged over that period to explore the origins of accounting standards largely through an analysis of constituent comment-letter lobbying (e.g., Watts and Zimmerman, 1978). But such comment-letter lobbying is only part of the political economy that determines accounting standards (e.g., Ramanna, 2008, studies the role of congressional intervention). At the core of the standard-setting process are the individuals that comprise the FASB and its sanctioning authority, the Securities and Exchange Commission (SEC). In this paper, we develop and test some exploratory hypotheses with a view towards building an understanding of the role of FASB and SEC regulators in U.S. GAAP.

Although the idea that FASB and SEC regulators can matter in standard setting is intuitively appealing, it has not been subject to empirical testing. This is due in part to limited data availability, but also in part to neoclassical economics, which is widely used in accounting research and tends to view "individuals" as "so empirically unimportant as to allow the use of Occam's razor in positive models" (e.g., Kalt and Zupan, 1984, p. 279). Recently, however, empiricists in finance and accounting have begun exploring the role of individuals on equilibrium outcomes, particularly in the context of individual managers and firm policies (e.g., Bertrand and Schoar, 2003; Bamber, Jiang, and Wang, 2010; Dyreng, Hanlon, and Maydew, 2010). Moreover, in the regulation literature itself, there is some evidence of regulators' preferences mattering in outcomes at both the congressional (e.g.,

Kau and Rubin, 1979) and the bureaucratic agency levels (e.g., Gormley, 1979). Thus, in the context of accounting standard setting, tests of influence of FASB and SEC regulators can help refine our understanding of the political economy of U.S. GAAP.

We conduct our study through an analysis of FASB exposure drafts proposed from 1973 (the FASB's inception) through 2007. There are 149 such exposure drafts in our sample after data limitations. Our primary tests involve regressing assessments of the nature of an exposure draft on the average background characteristics of extant FASB and SEC regulators.

We evaluate a proposed SFAS (Statement of Financial Accounting Standards) by focusing in particular on its impact on accounting "relevance" and "reliability"—two characteristics usually cited as fundamental accounting properties in accounting textbooks (e.g., Stickney, Weil, Schipper, and Francis, 2010, pp. 23, 114). There are no obvious metrics to use in evaluating exposure drafts; our choice of "relevance" and "reliability" reflects our judgment on their importance to accounting. Since at least the publication of its conceptual statements in the late 1970s (e.g., FASB, 1978b, 1980), the FASB itself has viewed "relevance" and "reliability" as "the two primary qualities that make accounting information useful for decision making" (FASB, 1980, p. 5), adding that "serious disagreement" often arises "about whether the superior relevance of the results of one [accounting] method outweighs the superior reliability of the results of [another]" (FASB, 1980, p. 8). Moreover, the increased prominence, since the mid-1990s, of fair-value accounting in standard setting has generated additional interest in the "trade-off" between "relevance" and "reliability." The FASB has often justified the increased use of fair values by

arguing it will increase the "relevance" of accounting numbers (e.g., Johnson, 2005). In contrast, some academics have argued accounting estimates generated under fair-value accounting will decrease the "reliability" of financial reports (e.g., Watts, 2003).[i]

To obtain assessments of exposure drafts' impact on "relevance" and "reliability" that are independent of researcher judgment, we develop a measure based on comment letters filed by the Big 8/6/5/4 auditors (hereafter, "Big N auditors"). There are 908 such comment letters in our sample after data limitations. The advantage to using Big N auditors' comment letters is that they are available on most exposure drafts in our sample period and are contemporaneous (i.e., no hindsight bias). The letters are, however, likely to reflect the auditors' private incentives, which can confound inferences if endogenous to our explanatory variables (i.e., the characteristics of FASB and SEC regulators). To mitigate this concern, in robustness tests we use an alternative assessment of the exposure drafts from two seasoned research assistants (with over thirty years of combined experience in accounting) blind to the objective of this study.

We build a biographical database of all 39 FASB members and all 41 SEC commissioners serving between 1973 and 2007. Drawing on empirical political-economy research that has examined the characteristics of regulators on regulation (see Dal Bo, 2006, for a review), we focus on two sets of characteristics: professional and political. The professional characteristics are length of regulatory tenure, industry background in auditing, and industry background in investment banking/ investment management

[i] While "reliability" and "relevance" can be trade-offs in some circumstances, it is an empirical question as to whether these concepts are always at odds with each other.

(hereafter, "financial services");[ii] the political characteristics are affiliations, if any, with the Democratic and Republican parties. Prior research has consistently found high correlations between regulators' professional and political characteristics and so has examined these characteristics both independently and jointly in multivariate regressions. We adopt this approach in our empirical design.

In examining professional characteristics independently, we find that longer average FASB and SEC tenures are associated with exposure drafts perceived by auditors as decreasing accounting "reliability;" but, we find no evidence of an association between the regulators' tenures and exposure drafts' "relevance." If decreased "reliability" is an undesirable property of accounting (e.g., Watts, 2003), the result is consistent with longer regulatory tenures compromising accounting quality.[iii] Concerning industry backgrounds, we expect regulators with prior employment in auditing to be more sympathetic to accounting "reliability" (since "reliable" accounting lowers auditors' litigation risk; e.g., Watts, 2003); in contrast, we expect members with prior employment in financial services to be sympathetic to valuation-relevant accounting (e.g., ICI, 2008), and thus more likely to promote "relevance" at the expense of "reliability" (e.g., Johnson, 2005). We do not find results associating regulators' careers in auditing with "reliability" and "relevance." However, we find evidence that exposure drafts proposed by FASB members and SEC commissioners with prior experience in financial services are viewed by the Big N auditors

[ii] When studying industry background, the regulatory literature has focused on industries most closely associated with the regulations being studied. In our setting, we focus on auditing and financial services, viewing them as front-line intermediaries in the production and use of accounting information.

[iii] Stigler (1971) argues that longer regulatory tenures compromise regulation by promoting greater "coziness" between regulators and the regulated.

as decreasing accounting "reliability." Further, in the case of FASB members, experience in financial services is associated with exposure drafts viewed by the Big N auditors as increasing accounting "relevance." Additional analysis suggests these associations are partly due to the tendency of FASB members with financial-services backgrounds (the proportion of which increases in our sample period) to propose standards that use fair-value methods.

In studying regulators' political characteristics, we are motivated by prior political-science research that has shown that political affiliations are salient predictors of regulator behavior: for example, Cohen (1986) provides evidence that Democratic regulators are on average less sympathetic to corporate interests. In examining political characteristics independently, we find evidence that increased proportional membership of Democrats on the FASB is associated with exposure drafts that are perceived by the Big N auditors as both increasing accounting "reliability" and decreasing accounting "relevance." However, when we examine the regulators' professional and political characteristics jointly, we find that the results on backgrounds in financial services alone survive. Thus, in our population and time period, political affiliation does not appear to be a significant factor beyond financial services affiliation. We note that there is no *ex-ante* theory that suggests either professional or political characteristics are more important than the other in explaining regulatory decisions (e.g., Dal Bo, 2006), thus future research is needed to draw more definitive conclusions.

There are certain other caveats to our analysis. First, the small population of regulators in our study might mean that influential observations are driving reported

statistical significance. We mitigate this concern through a jackknifing procedure where we re-estimate all regressions successively eliminating each regulator to determine if she/he is instrumental to inferences: this procedure does not alter inferences on variables discussed as statistically significant. Second, the scope of our study is limited by our choice of dependent and independent variables: other dependent variables (e.g., "comparability," compliance costs, net-income effect) and independent variables (e.g., age, gender, education) can be considered. Thus, our findings should be interpreted as the result of a first look at the relationship between standard setters and GAAP.

These caveats notwithstanding, the results described above are robust to numerous substantive and econometric controls, including controls for cross-sectional dependence of observations, auditor-specific effects, and aggregate market conditions. Additionally, we conduct a number of sensitivity tests, including (i) using research assistants' (instead of the Big N auditors') evaluations of exposure drafts; (ii) assigning greater weight to FASB and SEC chairmen when calculating the average background characteristics of extant regulators (to assess if chairmen are more important in standard setting); and (iii) restricting our analysis to periods of economic growth (to assess the sensitivity of our findings to broader macroeconomic conditions). These results are discussed in Section 3.5.

Broadly, the evidence in this paper suggests individual standard setters have equilibrium effects on standard setting. Kothari, Ramanna, and Skinner (2010) summarize two theories to explain accounting standard setting: "capture" and "ideology." Under capture theory, constituent lobbying determines standard-setting outcomes since regulators are "captured" by their special-interest constituents; under ideology theory,

constituent lobbying is only one input to standard setting, which is also influenced by regulators' ideologies. If accounting standard setting is more aptly described by ideology theory, one would expect to see the systematic impact of regulators' characteristics in accounting standards, as we find. However, empirically it is difficult to rule out "capture" because the selection of regulators is itself a political process, which may be beholden to special interests. For example, our findings associating the growing proportion of FASB members from financial services to fair-value standards can be explained by the growth of the financial-services sector over our sample period: changing political economies associated with the growth of finance may have resulted in the increased proportion of finance-industry veterans on the FASB, who in turn proposed fair-value standards. Going forward, a research program in this area that draws on our initial look at the question can provide additional insights into the role of individual regulators and special-interest politics on the nature of accounting regulation.

The rest of the paper is organized as follows. Section 3.2 lays out the motivation for our research-design choices and discusses associated limitations. Section 3.3 describes the construction of variables and develops associated hypotheses. Section 3.4 discusses descriptive statistics and the multivariate regression strategy. Section 3.5 presents and interprets the multivariate results, including robustness tests. Section 3.6 concludes.

3.2. Motivating research-design choices

3.2.1. Which dependent variables?

To empirically assess the role of standard setters in standard setting, we require a reasonable and parsimonious metric to evaluate proposed standards. The analogous

literature that explores the role of individual managers in firm policies generally employs explicit performance and governance metrics such as earnings, stock returns, disclosure standards, and accounting quality.[iv] Such obvious metrics are not applicable to our setting. In evaluating standards, we use "reliability" and "relevance" as discussed above. "Reliability" and "relevance" are widely viewed as being among accounting's "fundamental qualitative characteristics" by both academics (e.g., Stickney et al., 2010, p. 765; Dyckman, Magee, and Pfeiffer, 2011) and the FASB (e.g., FASB, 1978b, 1980).[v,vi] In addition to "reliability" and "relevance," there are likely other possible metrics to evaluate accounting standards, including "comparability," "consistency," and whether the standards are income increasing. In this sense, there is considerable scope for additional research along the lines we have pursued.

[iv] See, for example, Bamber et al. (2010); Dyreng et al. (2010); and Ge, Matsumoto, and Zhang (2011).

[v] The classification of standards as along "reliability" and "relevance" can also be related to research on the demands of debtholders versus equityholders on financial reporting practices. Debtholders are usually seen as demanding "reliability" (e.g., Watts, 2003), while equityholders are seen as demanding either "relevance" (e.g., Barth, 2006) or both "reliability" and "relevance" (e.g., LaFond and Watts, 2008).

[vi] Recently, the FASB modified its conceptual framework to move away from "reliability" towards "representational faithfulness." This change was likely made (at least in part) due to criticisms that the FASB was undermining the "reliability" of accounting standards (e.g., Watts, 2003). In response to these criticisms, some FASB members argued that "reliability" had been "misunderstood" to mean "verifiability;" the concept of "representational faithfulness" was advanced to replace "reliability" (e.g., Schipper, 2005). The change was proposed at a joint FASB-IASB board meeting on May 25, 2005, and the change was introduced into the conceptual framework in 2010. Since the change was initiated towards the end of our sample period, and went into effect after our sample period, we use "reliability," not "representational faithfulness," in our analyses.

3.2.2. Which independent variables?

In selecting the characteristics of FASB members and SEC commissioners to study, we are motivated by prior political-economy research in this area. Dal Bo (2006), in a recent review, notes that empirical research on the role of regulators in regulation, while (p. 215) "well short of abundant," has largely focused on regulators' professional characteristics—particularly, industry backgrounds—and regulators' political party affiliation. In addition, he points to empirical work on the role of regulators' terms-in-office on regulatory outcomes. Given the exploratory nature of our study, we focus on these independent variables.

On industry backgrounds, *ex ante*, we have a broad choice of industry classifications to organize the data (e.g., SIC codes). However, given the limited number of FASB members (n=39) and SEC commissioners (n=41) in our sample period, we are unable to use such broad-based industry classifications. Prior empirical research on regulators' industry backgrounds has focused on industries most closely associated with those regulations (e.g., Cohen, 1986, studies whether Federal Communications Commission, FCC, regulators with broadcasting industry experience are more supportive of that industry). In our case of studying accounting standard setting, we identify auditing and financial services as the most closely associated industries. We focus on backgrounds in auditing because accounting and auditing are joint products in financial reporting and because of the historical evidence on the close input of the audit industry in standard setting (e.g., Watts and Zimmerman, 1982, 1983). We focus on backgrounds in financial services because the financial services industry is a front-line intermediary in using accounting information.

This includes investment management, which uses accounting information on the buy side, and investment banking, which uses accounting information on the sell-side. Thus, we expect an investigation of standard setters with backgrounds in auditing and financial services to provide a useful lens into standard setting.[vii]

3.2.3. Limitations of the research design

We attempt to provide some empirical evidence on the role of standard setters in standard setting. Such evidence can complement existing findings on the role of constituent comment-letter lobbying and congressional intervention in standard setting (see Kothari et al., 2010, for a recent review). Empirically, we focus on the association between standard setters and the exposure drafts they propose. Exposure drafts appear prior to *direct* comment-letter lobbying and thus provide a relatively clean setting (relative to final standards) to examine the role of standard setters. Of course, constituent lobbying can influence the exposure draft process as well, but such *ex-ante* lobbying is difficult to observe, and our research design does not address its possible effects on standard setting. Further, it is possible that the selection of regulators to the FASB and SEC is itself a function of constituent lobbying. Such lobbying, in turn, is likely driven by extant economic and political circumstances, for example, macroeconomic conditions, globalization (e.g., growth

[vii] In addition to tenure lengths, industry backgrounds, and party affiliation, it is possible that other characteristics of FASB and SEC regulators also matter. For example, in the context of studying the idiosyncratic styles of CEOs, Bertrand and Schoar (2003) examine whether managers' age, gender, and education matter. In unreported tests, we examine whether such characteristics of FASB and SEC regulators are systematically associated with the standards they propose. We also test whether the regulators' backgrounds in academia and government systematically vary with their proposals. The results are inconclusive.

of IFRS), the rise of the financial services sector, or the rise of information technologies.[viii] While our research design allows us to infer a role for standard setters in standard setting, it does not allow us to conclusively establish whether this role derives from some intrinsic ideology of regulators or from prevailing political economies.

3.3. Variable measurement and hypotheses

3.3.1. Dependent variables: decreased "reliability" and increased "relevance"

To evaluate the FASB exposure drafts in our sample period independently of researcher judgment, we rely on two separate methods. First, we examine relevant comment letters filed by the Big N auditors. Second, we use two research assistants who are blind to the objectives of the study to manually assess the exposure drafts (this process is described later in the sub-section).

The key advantage to using Big N auditors' comment letters is that they provide a consistent and contemporaneous source of exposure-draft evaluations. The evaluations are consistent in that the Big N auditors comment on a large majority of exposure drafts in our sample period, so we do not have to rely on evaluations from disparate sources. The evaluations are contemporaneous in that the letters do not suffer from hindsight bias. Moreover, Big N auditors are sophisticated consumers of accounting standards, so we expect their evaluations to have information content.

The changing industrial organization of the U.S. auditing oligopoly means that our set of "Big N auditors" begins with the "Big 8" in 1973 and ends with the "Big 4" in 2007.

[viii] On the role of macroeconomics on regulation, Bertomeu and Magee (2011) propose a model where accounting regulators are subject to different political pressures during different stages of the economic cycle.

Table 3.1 provides a timeline of the changing dynamics of the U.S. audit industry. There are 170 distinct FASB exposure drafts that became 163 distinct SFAS in our sample period, 1973–2007. The absence of Big N auditor comments letters on six SFAS over that period decreases our sample size to 157 SFAS (Table 3.1 provides details on the SFAS without comment letters). These 157 SFAS can be traced back to 149 distinct exposure drafts (several exposure drafts resulted in multiple SFAS). There are collectively 908 unique comment letters by the Big N auditors on the 149 exposure drafts. We obtain paper copies of these comment letters from the FASB archives in Norwalk, Connecticut, and then digitize the comment letters using a combination of optical character recognition software and manual transcription. The digitized letters are then analyzed for contextually relevant occurrences of word stems "relevan" and "reliab" to create our auditor-based measures of the exposure drafts' impact on decreased "reliability" and increased "relevance" using a process described in Appendix C. Based on that process, we define two variables, *inc_relv* and *dec_relb*, intended to capture the intensity of auditors' concerns that a proposed standard will increase "relevance" and decrease "reliability," respectively. The variables *inc_relv* and *dec_relb* are defined as follows. For each Big N auditor comment letter "*i*" on a proposed SFAS "*j*":

$$inc\_relv_{ij} = 1 - \frac{WC\_inc\_relv_{ij}}{WC_{ij}} \qquad \ldots (1)$$

$$dec\_relb_{ij} = 1 - \frac{WC\_dec\_relb_{ij}}{WC_{ij}} \qquad \ldots (2)$$

Table 3.1: Big N auditor comment-letter availability

The sample is the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters.

Era	Big 8	Big 6	Big 5	Big 4
Period	1973-1989	1989-1998	1998-2002	2002-2007
Audit Firms	Arthur Anderson	Arthur Anderson	Arthur Anderson	
	Arthur Young Ernst & Whinney/ Ernst & Ernst	Ernst & Young	Ernst & Young	Ernst & Young
	Touche Ross Deloitte, Haskin & Sells	Deloitte Touche	Deloitte Touche	Deloitte Touche
	Peat Marwick	KPMG	KPMG	KPMG
	Coopers Lybrand Price Waterhouse	Coopers Lybrand Price Waterhouse	PWC	PWC
# of SFAS issued	104	30	10	19
# SFAS w/ zero CLs	4	2	0	0
	SFAS 89, 98, 101, 103	*SFAS 109, 124*		
Remaining Sample	100	28	10	19

The four proposed SFAS from 1973–1989 with no comment letters from the Big 8 are: SFAS 89 (which made supplementary information of price-level information voluntary); SFAS 98 (accounting for sale-leasebacks); SFAS 101 (disclosure issues in certain regulated entities); and SFAS 103 (resetting the effective date of another standard). The two proposed SFAS from 1989–1998 with no comment letters from the Big 6 are: SFAS 109 (re: accounting for income taxes) and SFAS 124 (re: accounting for certain investments held by non-profits).

In the above equations, $WC\_inc\_relv_{ij}$ is the word count of the first instance of the word stem "relevan" used in the context of increased "relevance" in comment letter "*i*" on proposed SFAS "*j*;" $WC\_dec\_relb_{ij}$ is the word count of the first instance of the word stem "reliab" used in the context of decreased "reliability" in comment letter "*i*" on proposed SFAS "*j*;" WC_{ij} is the total word count of comment letter "*i*" on proposed SFAS "*j*." In measuring *inc_relv* and *dec_relb*, we focus on the *relative* positions of the word stems "relevan" and "reliab" within a comment letter in order to get a measure of the *relative* importance of the auditors' sentiments on "relevance" and "reliability." The implicit assumption is that the stronger an auditor feels on "relevance" or "reliability," the earlier

the concept will be discussed in the comment letter.[ix] By construction, *inc_relv* and *dec_relb* are confined to the range [0, 1] and are expected to increase in the strength of an auditor's opinion of an exposure draft's impact on increased "relevance" and decreased "reliability," respectively.

The Big N auditors' evaluations of exposure drafts are likely to be influenced by their private incentives: for example, if auditors are biased towards identifying decreased "reliability" over increased "relevance" because of litigation concerns, or if auditors are biased by the extant composition of their client base.[x] In our tests, we do not expect these incentives to be correlated with our independent variables (i.e., the characteristics of FASB and SEC regulators), thus we expect these biases to add a scalar or a random variable to the regressand. Nevertheless, to mitigate the concern that auditor incentives can affect inferences in our tests, we supplement our auditor-based evaluations of the FASB exposure drafts with manual assessments by two research assistants who are blind to the objectives of the study but have extensive experience and practical familiarity with accounting. We use the standard dual-coder model in having the research assistants evaluate the exposure drafts. That is, the research assistants first independently evaluate each exposure draft based on a rubric discussed in Appendix D; then, the research assistants meet to resolve, if

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[ix] This assumption is consistent with the usual format of comment letters, which generally begin with an introductory paragraph highlighting key issues before tackling technical details in the body of the letter. Thus, if "relevance" and "reliability" are sufficiently important concerns for a letter writer, we expect the terms to be mentioned in the introductory paragraph, resulting in higher scores on *inc_relv* and *dec_relb*. In untabulated analysis, we tested the robustness of our results to this assumption by defining alternative binary dependent variables that are not sensitive to the relative location of substantive references to "relevance" and "reliability." Results of this analysis are inconsistent with the concern that location-based construction may be driving our primary results.

[x] Nelson, Elliott, and Tarpley (2002) provide some survey-based evidence on auditors' incentives.

possible, instances of disagreement in their assessments. Of the 170 exposure drafts that became the 163 SFAS in our sample period, we are able to obtain, from the FASB archives, copies of 145 exposure drafts representing 137 distinct SFAS. Copies of the remaining exposure drafts, all dating from the 1980s and before, are not readily available in the FASB archive.[xi] The 145 exposure drafts are manually assessed and then merged with the 149 exposure drafts for which we have auditor-based evaluations, yielding a common sample of 126 exposure drafts. In the subsequent section, we explore the correlation in our dependent variables across the auditor and research-assistant evaluations. The research assistants' evaluations of decreased "reliability" and increased "relevance" are denoted *Manual_dec_relb* and *Manual_inc_relv*, respectively.

3.3.2. Independent variables: characteristics of FASB members and SEC commissioners

As noted earlier, our primary tests focus on the professional characteristics (i.e., tenure lengths and industry backgrounds) and political characteristics (i.e., party affiliations) of FASB members and SEC commissioners, because prior literature has studied these variables in the context of other regulators (e.g., Gormley, 1979; Cohen, 1986; Dal Bo, 2006, Leaver, 2009). The first FASB members took office in 1973 (shortly after the FASB's founding), and there have been 39 members on the board through December 2007. For each of these 39 members, we collect data on their length of tenure on the FASB, their backgrounds, if any, in auditing and financial services, and their political affiliations. In the

[xi] In the case of several exposure drafts from the 1980s and before, only one paper copy exists at the FASB archive. The FASB publications department is in the process of digitizing all historic records, but the exposure drafts missing from our study were not available at the time we conducted the analysis.

same period, there have been 41 SEC commissioners, and we collect similar data on the commissioners.

Data on the duration of service on the board and the most recent employer prior to appointment to the board for FASB members are obtained primarily from two sources: (1) press notices issued by the FASB at a member's initial appointment; and (2) the FASB's annual informational bulletin, "Facts about FASB." We create two non-exhaustive indicator variables to classify the members' pre-FASB employers for further analysis: the first variable identifies whether a member worked for an audit firm prior to joining the board; the second whether the member worked for an investment bank or investment management firm. The equivalent data on the SEC commissioners' tenure and professional background are obtained from the SEC's historical archives, as well as from newspaper biographies of the commissioners (usually published upon the commissioners' initial appointment).

In addition, we also build a database of the 39 FASB members' political affiliations. Conceptually, we are interested in whether the members identify as Democrats or Republicans. Since members of the FASB are not explicit political appointees (they are appointed by the non-governmental Financial Accounting Foundation), the members' party affiliations are not readily known. Thus, we infer members' political identities by studying the history of their campaign contributions (if any). The Federal Election Commission (FEC) archives data on campaign contributions over $200 by U.S. individuals. Members contributing to the Democratic Party are coded as Democrats; those contributing to the Republican Party are coded Republicans; while members not contributing to either party

are not assigned a political identity.[xii] In the case of SEC commissioners, party affiliations are declared at or prior to appointment, so political identities need not be inferred from campaign contributions.

Our empirical tests are concerned with evaluating the influence of FASB and SEC regulators on exposure drafts. Accordingly, for each exposure draft in our sample, we average the personal characteristics of all FASB members and SEC commissioners in office at the time. For example, for the exposure draft that became SFAS 106, we average across the seven FASB members and five SEC commissioners in office as of February 1989 (the date the exposure draft was issued) their lengths of service on the board (hereafter, *Tenure FASB* and *Tenure SEC*, respectively). Similarly, we compute across the members and commissioners, the proportion with prior employment in auditing (hereafter, *% Auditor FASB* and *% Auditor SEC*, respectively), the proportion with prior employment in investment banking/ investment management (hereafter, *% Financial FASB* and *% Financial SEC*, respectively), the proportion contributing to the Democratic Party (hereafter, *% Dem Donor FASB* and *% Democrat SEC*, respectively). We also compute the proportion of FASB members contributing to the Republican Party (hereafter, *% Rep Donor FASB*). An equivalent variable for SEC commissioners is obviated by the fact that the proportion of Republicans and Democrats in the SEC sample is collectively exhaustive. In subsequent empirical tests, we do not include *% Auditor SEC* because only one of the 41

[xii] To the extent that the FEC database is not comprehensive, our measure of political contributions is measured with error. However, we are not aware of any reason for the FEC excluding contributors over $200.

SEC commissioners that served during our sample period worked for an audit firm prior to appointment to the commission.

The assumption implicit in averaging FASB members' and SEC commissioners' characteristics by exposure draft is that these documents represent the average position of the members and commissioners, respectively, in office at the time.[xiii] In sensitivity tests described later, we examine the robustness of our results to assigning greater weight to FASB and SEC chairmen when calculating the average background characteristics.

3.3.3. Hypotheses development

Tenure FASB and *Tenure SEC* can be used to assess the impact of the average length of standard-setters' terms on regulatory capture. In the classical economic theory of regulation (Stigler, 1971), longer terms (i.e., higher values of *Tenure FASB* and *Tenure SEC*) signify greater "coziness" between regulators and the regulated, compromising regulatory outcomes. However, Leaver (2009) develops and tests a model of regulation where longer terms insulate regulators from political pressure, thus improving regulatory outcomes. If decreased "reliability" is an undesirable accounting property, a positive association between *Tenure FASB*/*Tenure SEC* and our proxies for decreased "reliability" (i.e., *dec_relb* and *Manual_dec_relb*) is consistent with longer term-lengths compromising regulatory outcomes per Stigler's theory. Similarly, if increased "relevance" augments accounting, a negative association between *Tenure FASB*/*Tenure SEC* and our proxies for increased "relevance" (i.e., *inc_relv* and *Manual_inc_relv*) is consistent with Stigler's theory.

[xiii] The maximum number of FASB members (SEC commissioners) at any given time during our sample period is seven (five). However, because new members do not immediately take office upon the resignation of another member, the size of the board can on occasion be less than seven (five).

% Auditor FASB, *% Financial FASB,* and *% Financial SEC* can be used to assess the impact of FASB members' and SEC commissioners' industry backgrounds on accounting standard setting. Prior research in political science has shown that regulators tend to be more supportive of the industries they hail from (perhaps because they seek employment or consulting opportunities in those industries upon completion of their regulatory terms, e.g., Cohen, 1986). Given their role in assuring financial reports, and the substantial legal liability associated with this role (e.g., Kellogg, 1984; Watts, 2003), we expect auditors, *ex ante*, to be more sympathetic to standards promoting "reliability" at the expense of "relevance." Moreover, if accounting regulators' industry backgrounds matter in standard setting, FASB members and SEC commissioners with backgrounds in auditing will, *ceteris paribus*, be more likely associated with standards promoting "reliability" (potentially over "relevance"). Thus, we predict negative coefficients between *% Auditor FASB* and our proxies for both decreased "reliability" and increased "relevance." In contrast, *ceteris paribus*, we expect FASB members and SEC commissioners with backgrounds in financial services (defined as investment banking and investment management) to be more supportive of standards expected to improve accounting's relevance through the use of fair values.[xiv] Moreover, if the FASB is correct about its arguments linking fair values to increased "relevance" and, sometimes, decreased "reliability" (Johnson, 2005), regulatory backgrounds in financial services are likely to result in standards with such properties.

[xiv] Anecdotal evidence is consistent with this conjecture: e.g., the Investment Company Institute, the U.S. industry association for investment management firms, has strongly supported the use of fair-value accounting (ICI, 2008). Further, the Big 3 investment banks—Goldman Sachs, Morgan Stanley, and Merrill Lynch—were all enthusiastic supporters of fair-value-based rules for mergers and acquisitions, including in subsequent goodwill impairment testing, during the standard-setting process for SFAS 141 and 142 (e.g., Ramanna, 2006).

Thus, we predict positive coefficients between *% Financial FASB/ % Financial SEC* and our proxies for both increased "relevance" and decreased "reliability."

The empirical literature in political science has also considered the implications of regulators' political affiliations on regulations, finding that Democratic regulators are on average less sympathetic to regulations benefiting corporate interests (Dal Bo, 2006). Extending this finding to accounting regulations, we can expect Democratic FASB and SEC regulators to be more sympathetic to standards that mitigate corporations' information advantage over outsiders. Evidence that corporations' information advantage benefits managers (e.g., Healy and Whalen, 1999), is germane to this prediction. Such benefits can engender anti-corporate sentiment (e.g., a perception that managers exploit information advantages to receive "excess compensation") that is more likely to resonate with Democrats. Linking Democrats' relative focus on mitigating corporations' information advantage to promoting "reliability" over "relevance" is trickier. On the one hand, increased "reliability" over "relevance" can mitigate corporations' information asymmetry over outsiders because: (1) ceteris paribus, managers are inherently more likely to emphasize good news over bad news (e.g., Kothari, Shu, Wysocki, 2009); (2) regulatory solutions that are focused on mitigating corporations' information advantage emphasize, on average, timely discussion of bad news (e.g., Watts, 2003); and (3) such solutions—conservatism and verifiability—result in greater "reliability" over "relevance" (e.g., Kothari et al., 2010, p. 256). On the other hand, firms themselves have incentives to prefer "reliability" to "relevance," for example, corporations can benefit from accounting conservatism (e.g., through lower capital costs; LaFond and Watts, 2008; Zhang, 2008). Thus, the equilibrium

relation between *% Dem Donor FASB/ % Democrat SEC* and our proxies for increased "relevance"/ decreased "reliability" is an empirical question. *Ex ante*, we have no prediction on *% Rep Donor FASB*. Nevertheless, we include this variable in our analysis because *% Dem Donor FASB* and *% Rep Donor FASB* are not collectively exhaustive, and an analysis with *% Rep Donor FASB* can provide additional insights.[xv]

3.4. Descriptive statistics and multivariate research design

3.4.1. Descriptive statistics

Appendix E provides a summary definition of all variables in the study. Table 3.2, Panel A reports summary statistics for our measures of decreased "reliability" (*dec_relb* and *Manual_dec_relb*) and increased "relevance" (*inc_relv* and *Manual_inc_relv*). The comment-letter-based statistics are for the 908 Big N auditor comment letters, and the manually assessed statistics are for the 145 exposure drafts examined by our research assistants. The mean value of *dec_relb* (*Manual_dec_relb*) is 0.07 (0.31) and the median value is zero (zero). There is considerable variation in *dec_relb* (standard deviation is 0.22), and much of the variation is across (and not within) proposed standards. The maximum average value of *dec_relb* is observed on the exposure draft for SFAS 141R, Business Combinations. A major provision in this exposure draft was to allow an acquirer to recognize acquired net assets at their fair values, without regard to the cost of the acquisition. Eliminating acquisition cost as the upper bound for net-asset-value recognition

[xv] Two additional factors can confound predictions on political affiliation. First, the variables *% Dem Donor FASB* and *% Rep Donor FASB* are not collectively exhaustive because we cannot identify the political affiliation, if any, for FASB members in our sample who have never made campaign contributions in excess of $200. Second, the political distance between Democrats and Republicans on the FASB is unlikely to be as wide as that in the general population, because FASB members are usually drawn from the relatively homogenous business community (including investors' representatives).

can introduce considerable subjectivity in financial reporting; thus it seems reasonable that SFAS 141R's exposure draft received a high *dec_relb* score.

Table 3.2: Summary statistics of and correlations between measures of decreased "reliability" and increased "relevance"

The sample is based on 157 proposed SFAS issued between 1973 and 2007. *inc_relv* is an assessment that a proposed SFAS will increase accounting "relevance" as expressed by the Big 8/6/5/4 auditors (hereafter "Big N auditors") in their comment letters. *dec_relb* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. *Manual_inc_relv* is an assessment that a proposed SFAS will increase "relevance" as determined by two independent reviewers. *Manual_dec_relb* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 3.3 for details.

PANEL A: Summary statistics

Variable	Mean	Median	S.D.	Maximum	Minimum
dec_relb	0.07	0.00	0.22	0.99	0.00
inc_relv	0.04	0.00	0.17	0.98	0.00
Manual_dec_relb	0.31	0.00	0.46	1.00	0.00
Manual_inc_relv	0.65	0.00	1.20	5.00	0.00

PANEL B: Pearson correlations (Spearman above the diagonal)

	Variable	*(1)*		*(2)*		*(3)*		*(4)*	
(1)	*dec_relb*	1.000		0.205	**	0.347	***	0.502	***
(2)	*inc_relv*	0.225	***	1.000		0.151	*	0.238	***
(3)	*Manual_dec_relb*	0.341	***	0.147	*	1.000		0.596	***
(4)	*Manual_inc_relv*	0.502	***	0.203	**	0.609	***	1.000	

Significance levels: (*) 10% level, (**) 5% level, (***) 1% level using a 2 tailed test with S.E. clustered by SFAS

The mean value of *inc_relv* (*Manual_inc_relv*) is 0.04 (0.65). The median values of *inc_relv* and *Manual_inc_relv* are zero. The standard deviation of *inc_relv* is 0.17 (over four times the mean), suggesting, as with *dec_relb*, that there is considerable variance among comment letters in their assessments on increased "relevance." In unreported tests, we find that over two-thirds of this variation is across (and not within) proposed standards. The maximum average value of *inc_relv* for any given proposed SFAS is observed on the

exposure draft for SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 is a standard intended to "improve relevance of financial statements" (FASB, 2007b), so the high *inc_relv* score on the exposure draft is consistent with *inc_relv* measuring increased "relevance."

In untabulated tests, we further examine the validity of *inc_relv* and *dec_relb* as measures of increased "relevance" and decreased "reliability," respectively. Specifically, we randomly sampled 54 of the 908 big auditor comment letters (6%) to manually assess whether the letters expressed sentiments on increased "relevance" and decreased "reliability." In all but five of the 54 sampled letters (9%), our evaluation agreed with *inc_relv* and *dec_relb*. In all five exceptions, *inc_relv* and *dec_relb* were coded zero because the actual word stems "relevan" and "reliab" were never used, while our manual assessment was that the letters did in fact express sentiments on increased relevance and/or decreased reliability (i.e., there are no false positives in the coding of *inc_relv* and *dec_relb*). The 9% misclassification refers exclusively to false negatives, which essentially result in a low power issue, biasing against finding results.

Table 3.2, Panel B reports Pearson (Spearman above the diagonal) correlation coefficients between the dependent variables discussed above. The p-values on the correlation coefficients are based on clustering at the SFAS level.[xvi] The variables *dec_relb* and *Manual_dec_relb* (*inc_relv* and *Manual_inc_relv*) are significantly correlated with each other, ρ=0.341 (ρ=0.203), at the 95% confidence level or higher, suggesting that our

[xvi] That is, significance of correlation coefficients is computed using the t distribution as $Pr\left(\frac{\rho*\sqrt{n-2}}{\sqrt{(1-\rho^2)}} > t(n-2)\right)$, where ρ is the Pearson correlation coefficient and n is the number of clusters (i.e., SFAS).

comment-letter-based proxies and our manually assessed proxies capture similar concepts. The various proxies for decreased "reliability" and increased "relevance" are also significantly correlated with each other. This result is consistent with the FASB's conception of "relevance" and "reliability" as trade-offs.

Table 3.3: Panel A Summary statistics on explanatory variables

The sample is based on the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners.

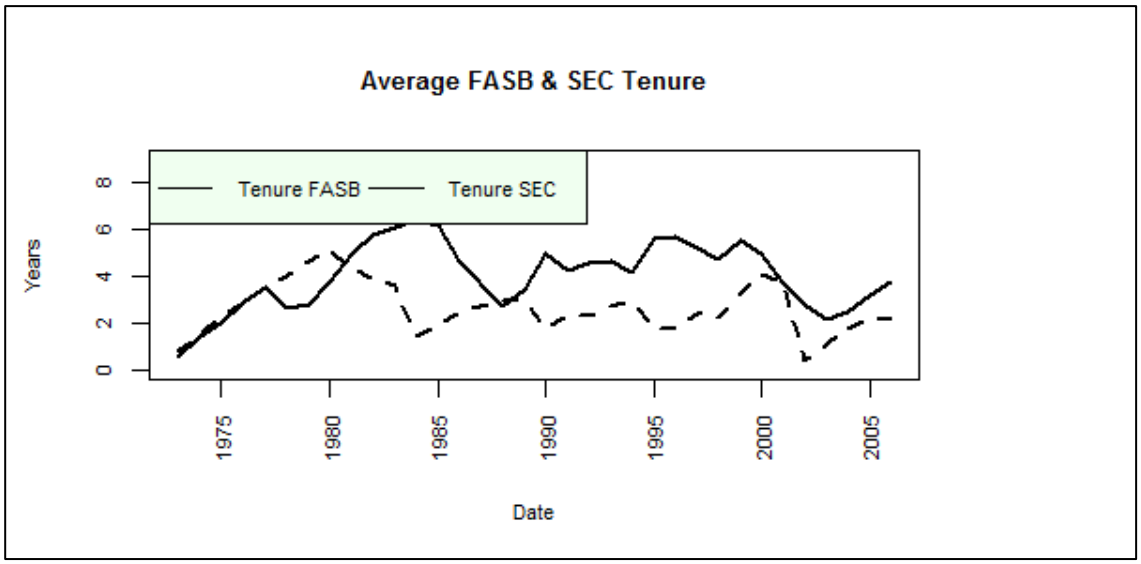
Variable	Mean	Median	S.D.	Maximum	Minimum
FASB & SEC Professional Characteristics					
Tenure FASB	4.2	4.3	1.5	6.7	0.6
% Auditor FASB	39.52%	42.86%	7.80%	57.14%	16.67%
% Financial FASB	4.35%	0.00%	8.05%	28.57%	0.00%
Tenure SEC	3.1	3.0	1.2	6.2	0.2
% Financial SEC	15.15%	20.00%	16.62%	66.67%	0.00%
FASB & SEC Political Characteristics					
% Rep Donor FASB	18.01%	14.29%	12.37%	42.86%	0.00%
% Dem Donor FASB	16.73%	14.29%	17.20%	66.67%	0.00%
% Democrat SEC	44.99%	40.00%	20.22%	100.00%	0.00%

Table 3.3, Panel A reports summary statistics for the FASB members' and SEC commissioners' personal characteristics. These measures constitute the set of explanatory variables in subsequent regression-based tests. The mean value of *Tenure FASB* is 4.2 and the median is 4.3, suggesting that, on average, an exposure draft is issued by a board with just over four years of individual service experience. In contrast, the mean and median

values of *Tenure SEC* are 3.1 and 3.0, respectively, suggesting SEC commissioners are on average less experienced in their extant jobs. Figure 3.1 plots the time series of *Tenure FASB* and *Tenure SEC* over the sample period. There does not appear to be any discernible time trend in average service experience on the two bodies.

Figure 3.1: Average tenure of FASB members and SEC commissioners by proposed SFAS, 1973–2007

The sample is the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an exposure draft (ED)-level measure of the average tenure in years of all extant FASB members. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners.

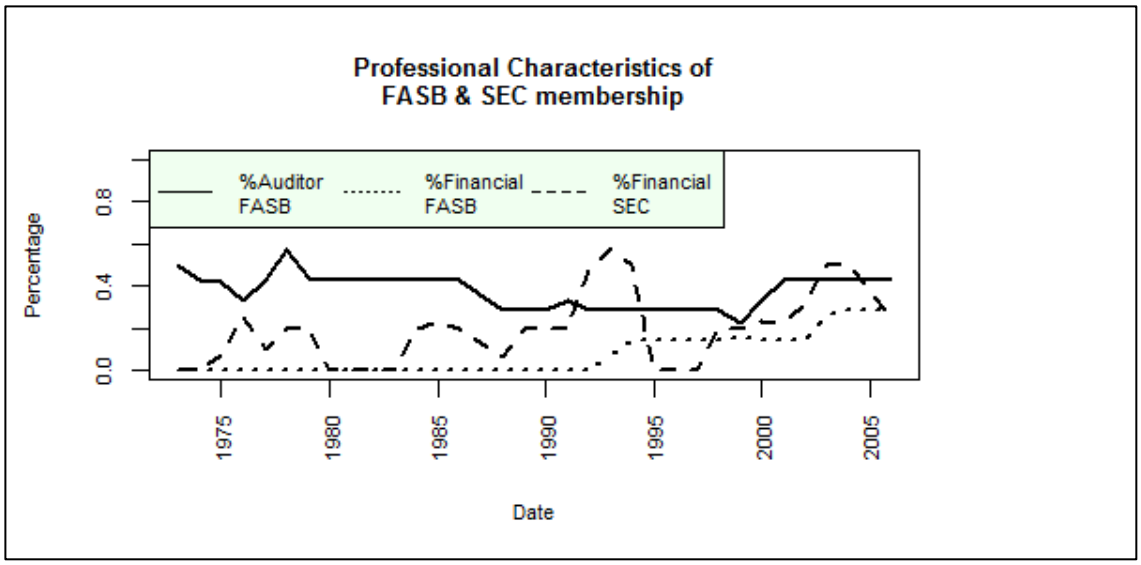


On average, about 40% of FASB members were most recently employed in auditing (*% Auditor FASB*), while about 4% of FASB members were most recently employed in investment banking/ investment management (*% Financial FASB*). Figure 3.2 plots the time series of these two variables over the 1973–2007 period: *% Auditor FASB* appears to have held steady over time, while *% Financial FASB*, which was zero through about the mid-1990s, appears to have increased to just under 30% in 2007. The average proportion of SEC commissioners most recently employed in financial services (*% Financial SEC*), at 15%,

is higher than the corresponding FASB statistic. Figure 3.2 also plots the trend in *% Financial SEC*, which appears to show considerable time series variation.

Figure 3.2: Proportion of FASB members and SEC commissioners with prior employment in auditing and financial services

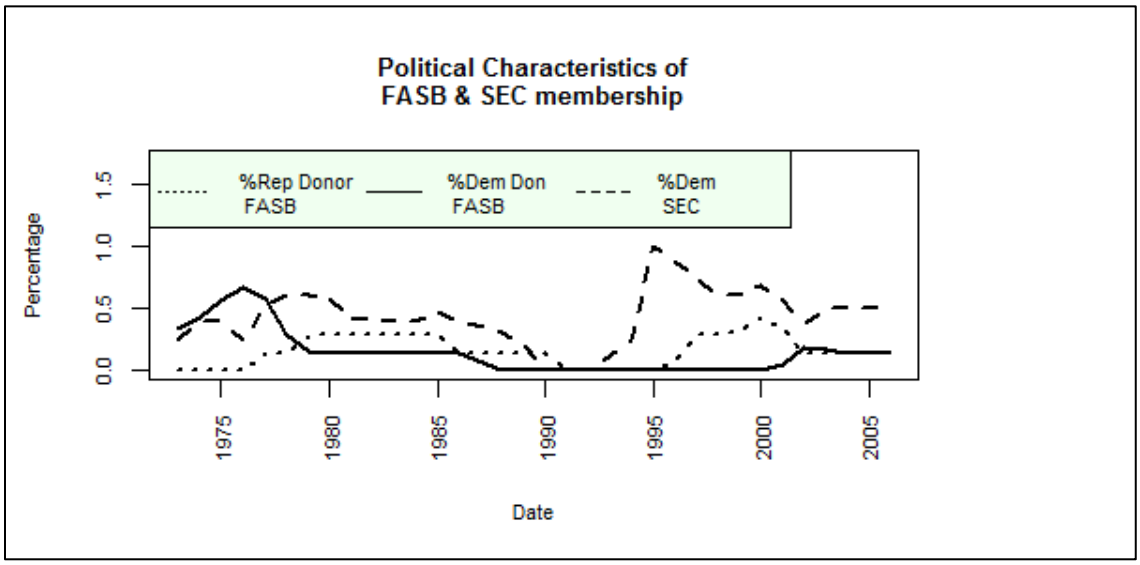
The sample is the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services.



The average (median) proportion of FASB members contributing to the Democratic Party, *% Dem Donor FASB*, is 16.73% (14%). The statistics are similar for *% Rep Donor FASB* at 18% (14%). Figure 3.3 plots the time series of these two variables: *% Dem Donor FASB* is higher than *% Rep Donor FASB* in the first few years of the FASB's existence, while *% Rep Donor FASB* is higher in the period between 1995 and 2002. The average proportion of Democratic SEC commissioners (*% Democrat SEC*) is 45%, which indicates the average statistic for Republican SEC commissioners in about 55%. Overall, the partisan proportions for SEC commissioners are higher than those for FASB members because the former are known with certainty and are collectively exhaustive in the sample. The time

series variation in *% Democrat SEC* (Figure 3.3) is predictable, given that commissioners are appointed by the U.S. president.[xvii]

Figure 3.3: Proportion of FASB members and SEC commissioners by political identity
The sample is the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners.



Pearson correlations (Spearman above the diagonal) between the explanatory variables in Panel A, Table 3.3 are shown in Panel B, Table 3.3. Statistical inferences are based on clustering by year. There are strong correlations between the background variables (i.e., tenure and prior employment) and the personal politics variables among FASB members and SEC commissioners. For example, *Tenure FASB* is positively associated with *% Rep Donor FASB* (0.428) and negatively associated with *% Dem Donor FASB* (-0.521); *% Auditor FASB* is positively associated with both *% Rep Donor FASB* (0.216) and *%*

[xvii] No more than three of the five SEC commissioners at any given time can belong to the same party; so, for example, a Democratic U.S. president cannot name five Democrats to the commission. Nevertheless, the proportion of SEC commissioners from the same party does sometimes exceed three-fifths because of vacancies and time lags between appointments.

Dem Donor FASB (0.519). Also, *% Financial SEC* is negatively associated with *% Democrat SEC*. These correlations are consistent with findings in prior research involving the backgrounds and personal politics of FCC commissioners (e.g., Gormley, 1979; Cohen, 1986).

Table 3.3 Panel B
Pearson correlations between explanatory variables (Spearman above the diagonal)
The sample is based on the 157 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners.

		FASB/SEC Professional Characteristics					FASB/SEC Political Charac.		
		(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
FASB/SEC Professional Characteristics	*(1) Tenure FASB*	1.000	-0.255 ***	0.022	0.002	-0.155 *	0.441 ***	-0.447 ***	0.020
	(2) % Auditor FASB	-0.276 ***	1.000	-0.405 ***	0.295 ***	-0.175 **	0.229 ***	0.787 ***	0.175 **
	(3) % Financial FASB	-0.035	-0.311 ***	1.000	-0.356 ***	0.351 ***	-0.066	-0.448 ***	0.348 ***
	(4) Tenure SEC	0.053	0.282 ***	-0.365 ***	1.000	-0.306 ***	0.531 ***	0.093	0.193 **
	(5)% Financial SEC	-0.122	-0.215 ***	0.403 ***	-0.320 ***	1.000	-0.222 ***	-0.245 ***	-0.146 *
FASB/SEC Political Characteristics	*(6) % Rep Donor FASB*	0.428 ***	0.216 ***	-0.067	0.529 ***	-0.275 ***	1.000	-0.108	0.346 ***
	(7) % Dem Donor FASB	-0.521 ***	0.519 ***	-0.320 ***	-0.030	-0.249 ***	-0.284 ***	1.000	0.052
	(8) % Democrat SEC	0.068	0.149 *	0.336 ***	0.135 *	-0.341 ***	0.284 ***	0.022	1.000

3.4.2. Multivariate research design

We are interested in assessing how our measures of FASB proposals' impact on "reliability" and "relevance" vary with characteristics of standard setters. Accordingly, the dependent variables in our regressions are variously, *dec_relb*, *inc_relv*, *Manual_dec_relb*, and *Manual_inc_relv*. In specifying the explanatory variables in these regressions, we follow prior research on regulators by examining the effect of professional and political characteristics both independently and jointly. In the first set of regressions, we only include as explanatory variables the measures of FASB and SEC regulators' professional

characteristics: *Tenure FASB*, *% Auditor FASB*, *% Financial FASB*, *Tenure SEC*, and *% Financial SEC*. We do not include measures of the regulators' political characteristics because of the high, observed correlations between political and personal characteristics.[xviii] Appropriately, results from such regressions must be interpreted as exploratory, not definitive. The formal specification for our first set of regressions is given in Equation (3).

$$DepVar_{ij} = f(Tenure\ FASB_j, \%Auditor\ FASB_j, \%Financial\ FASB_j,$$
$$Tenure\ SEC_j, \%Financial\ SEC_j) \ldots (3)$$

In Equation (3), "*i*" is a big auditor comment letter and "*j*" is an exposure draft. Standard errors in estimating Equation (3) are clustered two-ways, by proposed SFAS and big auditor (using the method described in Petersen, 2009). We estimate two specifications of Equation (3) (and all subsequent regressions), one with Big N auditor fixed effects and one without. The Big N auditor fixed effects specifically identify the "Big 5" auditors; thus for example, a comment letter by Touche Ross from the period preceding the establishment of Deloitte & Touche will be identified by a Deloitte & Touche fixed effect.

We test for the association between our dependent variables and the FASB and SEC regulators' political characteristics (i.e., *% Dem Donor FASB*, *% Rep Donor FASB*, *%*

[xviii] In his review of the literature on regulators' impact on regulation, Dal Bo (2006, p. 217) notes that "although industry background seems to matter, it is not clear that it has a very strong effect once one considers the role of political affiliations." He attributes this result to the high correlations, noting, for example, that in the case of the FCC, "no Democratic administration appointed a commissioner with [broadcasting] industry background" during the 1955–1974 period. In essence, there is no *ex-ante* theory that suggests either professional or political characteristics are more important than the other in explaining regulatory decisions, and, given the given the high correlations and small sample sizes in these regressions, there is some value to examining professional and political characteristics independently.

Democrat SEC) in a second set of regressions. The formal specification for our second set of regressions is given in Equation (4) below.

$$DepVar_{ij} = f(\%Rep\ Donor\ FASB_j, \%Dem\ Donor\ FASB_j, \%Democrat\ SEC_j) \ldots (4)$$

In Equation (4), *DepVar* and the subscripts "*i*" and "*j*" are as defined in Equation (3). Standard error clusters are also as described earlier.

In a final set of regressions, we include all independent variables described in Equations (3) and (4). Coefficients in all regressions are estimated using ordinary least squares (OLS). We report results both with and without controls for two market-based variables: the annual value-weighted market return (*VWRETD*) and the standard deviation of the daily value-weighted market return (*sd_VWRETD*) in the twelve months preceding the issuance of a proposed SFAS.

3.5. Multivariate results

3.5.1. Results using Big N auditors' comment letters

Table 3.4 reports OLS estimation results where the measure of decreased "reliability" from auditor comment letters (*dec_relb*) is the dependent variable. There are seven columns to Table 3.4. In the first three columns, FASB members' and SEC commissioners' professional characteristics are the explanatory variables (as in Equation (3)); in columns four to six, FASB members' and SEC commissioners' political affiliations are the explanatory variables (as in Equation (4)); the seventh column reports the regression combining all explanatory variables. In the first and fourth columns, we do not include the market-based variables, *VWRETD* and *sd_VWRETD*, as temporal economic controls; in all

other columns, these variables are included. In addition, columns two and five do not include auditor fixed effects, whereas columns three, six, and seven do. In the following discussion, we focus on the results from columns three, six, and seven, since these columns have the most exhaustive specifications, only discussing the other columns when inferences differ. All regressions in Table 3.4 use the sample of 908 comment letters. Standard errors in all regressions are clustered by Big N auditor and SFAS, and are robust to heteroskedasticity.

When professional characteristics are examined independently, we find both *Tenure FASB* and *Tenure SEC* are positively associated with decreased "reliability," suggesting that longer terms of service on the FASB and SEC are associated with a perception of decreased accounting "reliability" (the coefficient on *Tenure FASB* is insignificant when market-based controls are excluded). If decreased "reliability" is an undesirable accounting property, this result is consistent with longer term-lengths compromising regulatory outcomes, per Stigler's theory of regulation. To put the coefficients' magnitudes in perspective, the implication from column (3) is that a one standard deviation increase in FASB tenure (SEC tenure) is associated with a decrease in "reliability" that is about 30% (38%) of the mean *dec_relb* value. We also find evidence that *% Financial FASB* and *% Financial SEC* are positive and significant predictors of FASB proposals perceived as decreasing accounting "reliability." A one standard deviation increase in *% Financial FASB* (*% Financial SEC*) is associated with a decrease in "reliability" that is about 74% (49%) of the mean *dec_relb* value. This evidence is consistent with the proposition that a prior career in investment banking/ investment management predisposes standard setters to produce standards that

deemphasize accounting "reliability." Contrary to our expectations, we find no evidence in Table 3.4 linking *% Auditor FASB* and decreased "reliability."

Table 3.4: OLS regression of *dec_relb* on the characteristics of FASB members and SEC commissioners

Sample is 908 big auditor comment letters written on 149 exposure drafts that became 157 SFAS issued between 1973 and 2007. *dec_relb* is an assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. See Section 3.3 for details. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners. The market variables are *VWRETD* and *sd_VWRETD*. *VWRETD* is the annual value-weighted market return (from CRSP) for the 12 months directly preceding the month in which a proposed SFAS was issued. *sd_VWRETD* is the standard deviation of daily *VWRETD* for the 12 months directly preceding the month in which a proposed SFAS was issued. Figures in italics and parentheses are standard errors.

Table 3.4: (Continued)

	Professional characteristics			Political characteristics			All
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tenure FASB	0.0086	0.0137 *	0.0140 *				0.0129
	(0.0065)	*(0.0077)*	*(0.0077)*				*(0.0148)*
% Auditor FASB	-0.1824	-0.1597	-0.1679				-0.1943
	(0.2119)	*(0.2099)*	*(0.2069)*				*(0.2142)*
% Financial FASB	0.6668 ***	0.6672 ***	0.6438 ***				0.5506 **
	(0.2047)	*(0.1994)*	*(0.2024)*				*(0.2211)*
Tenure SEC	0.0196 *	0.0216 *	0.0220 **				0.0202
	(0.0106)	*(0.0110)*	*(0.0110)*				*(0.0128)*
% Financial SEC	0.1804	0.2101 *	0.2075 *				0.2393 *
	(0.1108)	*(0.1254)*	*(0.1258)*				*(0.1381)*
% Rep Donor FASB				-0.0516	-0.07579	-0.0686	0.0099
				(0.1270)	(0.1144)	*(0.1143)*	*(0.1889)*
% Dem Donor FASB				-0.2540 ***	-0.26618 ***	-0.2615 ***	-0.0102
				(0.0764)	(0.0809)	*(0.0787)*	*(0.0664)*
% Democrat SEC				0.0703	0.080215	0.0794	0.0513
				(0.0793)	(0.0845)	*(0.0849)*	*(0.0939)*
Market Vars	No	Yes	Yes	No	Yes	Yes	Yes
Fixed Effects	No	No	Auditor	No	No	Auditor	Auditor
S.E. Cluster	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor
N Obs	908	908	908	908	908	908	908
R-Sq	0.1013	0.1067	0.1233	0.0383	0.0412	0.0616	0.1245

Significance levels: (*) 10% level, (**) 5% level, (***) 1% level using a two-tailed t-test.

When political characteristics are examined independently, the coefficient on *% Dem Donor FASB* is significant and negative in explaining *dec_relb*. The implication from column (6) is that a one standard deviation increase in *% Dem Donor FASB* is associated with an increase in "reliability" that is about 64% of the mean *dec_relb* value. The evidence suggests that increased proportional representation of Democrats on the FASB is associated with the production of standards that are viewed as increasing accounting "reliability." We do not find a similar result with the proportion of Democrats on the SEC.

In combining all explanatory variables in column (7), only the results on *% Financial FASB* and *% Financial SEC* are statistically significant. This result is consistent with prior studies that combine regulators' professional and political characteristics, where high correlations between these variables and the small population size are seen to confound statistical inferences (Dal Bo, 2006). However, in unreported tests we find variance inflation factors from this regression are inconsistent with severe multicollinearity suggesting that, for our sample, financial services affiliation is the overriding explanatory variable.

Table 3.5 reports OLS estimation results where the measure of increased "relevance" from auditor comment letters (*inc_relv*) is the dependent variable. Table 3.5 is otherwise identical to Table 3.4 in all respects. As in Table 3.4, we focus on discussing results from columns three, six, and seven of Table 3.5. When professional characteristics alone are the explanatory variables, we find only *% Financial FASB* is a positive and significant predictor of FASB proposals perceived as increasing accounting "relevance." In column (3), one standard deviation increase in *% Financial FASB* is associated with an increase in "relevance" that is about 73% of its mean value. This evidence is consistent with the proposition that a prior career in investment banking/ investment management predisposes standard setters to produce standards that increase accounting "relevance."

Table 3.5: OLS regression of inc_relv on the characteristics of FASB members and SEC commissioners

Sample is 908 big auditor comment letters written on 149 exposure drafts that became 157 SFAS issued between 1973 and 2007. *inc_relv* is an assessment that a proposed SFAS will increase accounting "relevance" as expressed by the Big 8/6/5/4 auditors (hereafter "Big N auditors") in their comment letters. See Section 3.3 for details. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners. The market variables are *VWRETD* and *sd_VWRETD*. *VWRETD* is the annual value-weighted market return (from CRSP) for the 12 months directly preceding the month in which a proposed SFAS was issued. *sd_VWRETD* is the standard deviation of daily *VWRETD* for the 12 months directly preceding the month in which a proposed SFAS was issued. Figures in italics and parentheses are standard errors.

	Professional characteristics			**Political characteristics**			**All**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tenure FASB	0.0015	-0.0013	-0.0014				-0.0001
	(0.0031)	*(0.0031)*	*(0.0031)*				*(0.0051)*
% Auditor FASB	-0.1852	-0.2096	-0.2105				-0.1150
	(0.1362)	*(0.1410)*	*(0.1412)*				*(0.1042)*
% Financial FASB	0.3388 *	0.3516 *	0.3634 *				0.5514 ***
	(0.1973)	*(0.1935)*	*(0.1937)*				*(0.1933)*
Tenure SEC	0.0025	0.0021	0.0019				0.0056
	(0.0037)	*(0.0038)*	*(0.0039)*				*(0.0053)*
% Financial SEC	0.0927	0.0708	0.0720				-0.0052
	(0.0717)	*(0.0777)*	*(0.0782)*				*(0.0676)*
% Rep Donor FASB				-0.1722 *	-0.158942 *	-0.1624 *	-0.0441
				(0.1017)	(0.0921)	*(0.0942)*	*(0.1275)*
% Dem Donor FASB				-0.1608 ***	-0.1497 **	-0.1520 **	-0.0432
				(0.0609)	(0.0598)	*(0.0611)*	*(0.0627)*
% Democrat SEC				-0.0043	-0.01291	-0.0122	-0.1090
				(0.0884)	(0.0874)	*(0.0881)*	*(0.0963)*
Market Vars	No	Yes	Yes	No	Yes	Yes	Yes
Fixed Effects	No	No	Auditor	No	No	Auditor	Auditor
S.E. Cluster	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor	SFAS Auditor
N Obs	908	908	908	908	908	908	908
R-Sq	0.0594	0.0634	0.0681	0.03	0.032	0.0349	0.0775

Significance levels: (*) 10% level, (**) 5% level, (***) 1% level using a two-tailed t-test.

When political characteristics alone are the explanatory variables, we find *% Dem Donor FASB* is significant and negative in explaining *inc_relv*. In column (6), one standard deviation increase in *% Dem Donor FASB* is associated with a decrease in "relevance" that is about 65% of the mean *inc_relv* value. Column (6) also reveals a statistically negative association between *% Rep Donor FASB* and proposals perceived as increasing "relevance." We are not aware of a theory to interpret this result. In combining all explanatory variables in column (7) of Table 3.5, only the coefficient on *% Financial FASB* is statistically significant.

To summarize the key findings from Tables 3.4 and 3.5: across tests using auditor comment letters, the data are consistent with the proposition that a prior career in financial services predisposes FASB standard setters to favor accounting "relevance" over "reliability."

3.5.2. Results using manual assessments of exposure drafts

Our primary comment-letter-based measures of decreased "reliability" and increased "relevance" are sensitive to auditors' distinct incentives, which may be endogenous to our explanatory variables. Accordingly, we use manual assessments by two research assistants, as discussed in Section 3.3 and Appendix D, as alternative dependent variables (*Manual_dec_relb* and *Manual_inc_relv*) to address this concern.

Table 3.6, Panel A presents the descriptive statistics for: (A) the exposure drafts common to both our manual and comment-letter sample (n=126); (B) the sub-sample of exposure drafts for which we only have manual assessments (n=19); and (C) the sub-sample of exposure drafts for which we only have auditor comment letters (n=23). Using a

two-sample differences-in-means t-test we compare the average values of explanatory variables across the three groups. Of particular note, *Tenure FASB* and *Tenure SEC* are significantly lower in sub-sample (C), while *% Dem Donor FASB* is significantly higher. These differences are largely caused by data availability for the manually assessed sub-sample. That sub-sample (columns (A) and (B)) excludes several exposure drafts from the early years of the FASB (1980s and before), a period characterized by lower values for *Tenure FASB* and *Tenure SEC* and higher values for *% Dem Donor FASB*, as shown in Figures 3.1–3.3.

Table 3.6, Panel B presents OLS estimation results where *Manual_dec_relb* and *Manual_inc_relv* are the dependent variables. There are six columns to Table 3.6, Panel B: *Manual_dec_relb* is the dependent variable for the first three columns, *Manual_inc_relv* for the next three. The first column for each dependent variable includes only regulators' professional characteristics as independent variables; the second column for each dependent variable includes only regulators' political characteristics as independent variables; the final column for each dependent variable includes both professional and political characteristics. In all columns, we include auditor fixed effects and the market-based controls. Each regression is based on 126 observations, one for each exposure draft where both auditor comment letters and manual assessments are available. Standard errors are heteroskedasticity robust.

The results in Table 3.6, Panel B show that *% Financial FASB* is a significant determinant of both *Manual_dec_relb* and *Manual_inc_relv*, which is consistent with regression results using auditor comment letters (Tables 3.4 and 3.5). As in Table 3.4, we

find a significant negative coefficient on *% Dem Donor FASB* in regressions on *Manual_dec_relb* that include only political variables; we do not find a similar result on *Manual_inc_relv*. In contrast to Table 3.4, in Table 3.6, Panel B we do not find significant coefficients on *Tenure FASB*, *Tenure SEC*, and *% Financial SEC* in regressions on *Manual_dec_relb*. The non-results on the tenure variables are likely explained by the exclusion of several exposure drafts in the Table 3.6, Panel B regressions due to data limitations, as discussed above.

Table 3.6: Panel A–Differences in means of explanatory variables across the comment-letter and manually assessed sub-samples

Two-sample differences-in-means t-tests are performed on pairs of three distinct sub-samples. Sub-sample A is the 126 exposure drafts for which we have both manual assessments and auditor comment letters. Sub-sample B is the 19 exposure drafts for which we have manual assessments but no auditor comment letters. Sub-sample C is the 23 exposure drafts for which we have auditor comment letters but no manual assessments. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners.

	A	*A&B*	**B**	*B&C*	**C**	*C&A*
Tenure FASB	4.335		4.277	***	2.907	***
% Auditor FASB	0.389		0.396		0.419	***
% Financial FASB	0.064		0.038	*	0.000	***
Tenure SEC	3.018		3.028		2.427	**
% Financial SEC	0.188		0.137		0.076	
% Rep Donor FASB	0.191		0.173	**	0.087	***
% Dem Donor FASB	0.126		0.140	***	0.405	***
% Democrat SEC	0.453		0.464		0.389	**
# of exposure drafts	126		19		23	
Big N auditor comment letters available	Yes		No		Yes	
Manual assessments available	Yes		Yes		No	

Significance levels: (*) 10% level, (**) 5% level, (***) 1% level using a two-tailed t-test.

Table 3.6: Panel B–OLS regression of Manual_dec_relb and Manual_inc_relv on the characteristics of FASB members and SEC commissioners

Sample is the 126 exposure drafts for which we have both auditor comment letters and manual assessments (See Table 3.6, Panel A). *Manual_inc_relv* is an assessment that a proposed SFAS will increase "relevance" as determined by two independent reviewers. *Manual_dec_relb* is an assessment that a proposed SFAS will decrease "reliability" as determined by two independent reviewers. See Section 3.3 for details. *Tenure FASB* is an ED-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an ED-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an ED-level measure of the proportion of extant Democratic SEC commissioners. The market variables are *VWRETD* and *sd_VWRETD*. *VWRETD* is the annual value-weighted market return (from CRSP) for the 12 months directly preceding the month in which a proposed SFAS was issued. *sd_VWRETD* is the standard deviation of daily *VWRETD* for the 12 months directly preceding the month in which a proposed SFAS was issued. Figures in italics and parentheses are standard errors.

Table 3.6: (Continued)

	Manual_dec_relb			*Manual_inc_relv*		
	(1)	(2)	(3)	(4)	(5)	(6)
Tenure FASB	0.0313		0.0551	0.0015		0.0302
	(0.0352)		*(0.0448)*	*(0.0943)*		*(0.1241)*
% Auditor FASB	-0.8485		-0.2959	-2.1387		-1.6739
	(0.5551)		*(0.7059)*	*(1.4911)*		*(1.8935)*
% Financial FASB	1.3714 **		1.9236 ***	5.8551 ***		8.7955 ***
	(0.5541)		*(0.6928)*	*(1.6954)*		*(1.9482)*
Tenure SEC	0.0250		0.0588	0.0467		0.1058
	(0.0419)		*(0.0495)*	*(0.1008)*		*(0.1292)*
% Financial SEC	0.2801		0.0261	0.8158		-0.3722
	(0.3030)		*(0.3493)*	*(0.8384)*		*(0.9230)*
% Rep Donor FASB		-0.7617 *	-0.7157		-2.3263 ***	-0.2012
		(0.4181)	*(0.5874)*		(0.8732)	*(1.3590)*
% Dem Donor FASB		-0.6918 **	-0.1197		-1.2018	0.8250
		(0.3165)	*(0.3951)*		(1.0331)	*(1.3185)*
% Democrat SEC		0.0833	-0.2491		-0.0319	-1.8942 ***
		(0.2231)	*(0.2971)*		(0.5728)	*(0.6855)*
Market Vars	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects	No	No	No	No	No	No
S.E.	Robust	Robust	Robust	Robust	Robust	Robust
N Obs	126	126	126	126	126	126
R-Sq	0.1253	0.0717	0.1482	0.2771	0.0696	0.3294

Significance levels: (*) 10% level, (**) 5% level, (***) 1% level using a two-tailed t-test.

Overall, to summarize the key findings from Tables 3.4, 3.5, and 3.6: across tests using auditor comment letters and manual assessments of exposure drafts, the data are consistent with the proposition that a prior career in financial services predisposes FASB standard setters to favor accounting "relevance" over "reliability." Our coding rubric for the

manual assessment of exposure drafts' focus on "relevance" over "reliability" relies on the use of fair-value methods in these proposals (see Appendix D for details). Thus, the key finding on financial services affiliation can be explained, in part, as the tendency of regulators with a financial services background to propose standards that use fair-value methods in recognition and disclosure. When combined with the descriptive evidence from Figure 3.2 and Table 3.3, which shows an increase in the proportion of FASB members from financial services from the mid-1990s through 2007, this result can provide a partial explanation for the growth of fair-value accounting.

3.5.3. Robustness and sensitivity tests

With the small population of FASB and SEC regulators in our sample, there is a concern that one individual with an extremely strong personality can be driving the results described thus far. The analogous literature on managers and firm policies employs technologies around job-switching to address this concern (e.g., Bertrand and Schoar, 2003). Due to the unique nature of the task we study, i.e., standard setting not corporate management, we cannot employ these technologies. An alternative robustness test is a jackknifing procedure where we re-estimate all our regressions successively eliminating each regulator (and reconstructing all independent variables accordingly) to determine if any member was instrumental to our statistical inferences. Unreported results obtained from this procedure are inconsistent with the proposition that any one FASB member is instrumental to the factors previously identified as statistically significant: Across 39 jackknifed subsamples—each eliminating one FASB member—we find no cases where

elimination of an individual from our sample changes the sign or significance of our primary results.[1]

The implicit assumption underlying construction of our independent variables is that an exposure draft represents the average position of all extant FASB members and SEC commissioners; however, it is possible that the chairmen of these groups have greater influence than other members. In unreported robustness tests, we examine the effects of assigning greater weight to FASB and SEC chairmen when calculating the average background characteristics of an extant board. In particular, we assign the background characteristics of FASB and SEC chairmen twice the weight of non-chair members. While the choice of doubling the weight on chairmen is admittedly arbitrary, the objective of this test is simply to assess whether the relative importance of FASB chairmen subsumes the results shown earlier. All substantive results discussed in Tables 3.4 and 3.5 are robust to the procedure described above.

Finally, as discussed earlier, it is possible that the selection of a set of regulators on the FASB and SEC in a given time period depends, at least in part, on more fundamental macroeconomic conditions. Accordingly, we study the sensitivity of our results to these conditions. In restricting the sample to periods of expansion in the U.S. economy (as identified by the NBER), financial services background and Democratic Party affiliations remain significant predictors of increased "relevance" (*inc_relv*) and decreased "reliability" (*dec_relb*), consistent with results reported in Tables 3.4 and 3.5. The only result from

[1] The successive elimination of two FASB members in the jackknife procedure does turn, in some cases, the previously insignificant coefficient on *%Auditor FASB* significantly negative (as predicted): one of these members has a financial services background, the other an auditing background. One implication is that our failure to find evidence on *%Auditor FASB* in the regression that includes all independent variables is driven by the influential effects of these members.

those tables not carrying through is the negative coefficient on *% Rep Donor FASB* on *inc_relv* for which we have no *ex-ante* prediction and which is not consistent across all specifications.

3.6. Conclusions

Motivated by an interest in broadening the understanding of accounting standard setting beyond the role of constituent comment-letter lobbying and congressional intervention, we examine the role of FASB and SEC regulators in the process. Specifically, we examine how the professional and political characteristics of these regulators vary in the nature of exposure drafts proposed from 1973 to 2007. Because there is no obvious metric to evaluate the proposals, we rely principally on Big N auditors' contemporaneous evaluations of the exposure drafts along dimensions of "reliability" and "relevance." Our focus on "reliability" and "relevance" reflects our judgment on their importance to accounting, also evidenced in several leading accounting textbooks and in the FASB's conceptual framework. The regulators' professional characteristics we study are tenure, background in auditing, and background in financial services; the political characteristics are affiliation, if any, with the Democratic and Republican parties. Our key finding is that FASB members with a prior professional affiliation with the financial services industry are more likely to propose standards that decrease "reliability" and increase "relevance," partly due to their tendency to propose fair-value methods of measurement. Given that the proportion of FASB members from the financial services industry has increased from the mid-1990s to 2007, this finding can provide a partial explanation for the growth of fair-

value accounting. We also find that FASB members affiliated with the Democratic Party are more likely to propose standards that increase "reliability" and decrease "relevance," although only when excluding financial-services affiliation as an independent variable. Since our statistical inferences are based on a small population of FASB and SEC regulators, we conduct jackknifed sensitivity analyses: we find no evidence that any one regulator is driving inferences.

Broadly, the paper provides a first empirical look at an important feature in the political economy of U.S. GAAP: the role of regulators at the FASB and SEC. While our research design does not allow us to distinguish whether the documented role of regulators derives from some intrinsic ideology of these individuals or from more primitive selection effects that place these regulators in office, our study takes the first important step of examining the impact of individual standard setters on standard setting (in the spirit of Bertrand and Schoar's analogous study of managers on firm policies). Our study highlights opportunities for work on the question of how accounting regulators are chosen, including issues such as whether there is a "revolving door" between standard setters and special-interest groups. Moreover, as accounting institutions worldwide reorganize in response to globalization, such research can have important practical implications in the area of regulatory design.[2]

[2] For example, in the past five years, both Canada and China have undertaken some revamping of their standard-setting institutions (e.g., Ramanna and Cheng, 2009; Ramanna, Donovan, and Dai, 2010). Further, in the U.S., between 2008 and 2010, the FASB has pared down and increased its membership from seven to five and back to seven, in order to "protect and maintain its efficiency" (FAF, 2008, 2010). Given the paucity of evidence to guide such structural changes, most, if not all of the institutional transformations have been *ad hoc*.

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Appendix A: Illustrative excerpts from the 1998 and 2002 FASAC Surveys and associated Summaries of Responses

From 1982-2001 the annual FASAC Survey provided a list of potential projects for addition to the Board's agenda and asked respondents to score each topic according to a pre-defined Likert Scale. Participant responses to the Survey were subsequently presented to Board members in a document entitled "Summary of Responses to the Annual FASAC Survey" (hereafter Summary of Responses) that reported both average participant ratings as well as individual responses.

From 2002-2006 the annual FASAC Survey did not provide a list of potential projects but rather asked participants to write in the five projects they felt were most important for the Board to include on its agenda. Individual responses to the Survey as well as a tally of "Top-5" mentions afforded to each project were subsequently presented to Board members in the Summary of Responses.

Excerpts from the 1998 and 2002 FASAC Surveys and Summaries of Responses are provided in this appendix for illustrative purposes.

Illustrative excerpts from 1998

FASAC Survey instructions

"The Board and staff receive many requests and suggestions to add items to the agenda from various sources, including FASAC, the AICPA, and the SEC, among others… This section asks your views on which subjects—if any—the Board should consider for addition to its agenda. The Board also would be interested in other topics, not listed, that you believe should be addressed…Please evaluate the topics in this section on a scale of 1 to 5, with "1" being the highest priority and "5" the lowest. A score of "1" would indicate… respondents are [also] encouraged to comment [qualitatively]"

Summary of Responses

"Comments provided by respondents about possible future agenda projects are detailed below.

1. ***Accounting for Intangible Assets***
   The average score by group of respondent is as follows

Council Members	*2.94*
Board Members	*2.38*

   Comments provided by respondents and the score assigned by each were:

   Ciesielski (1) There is a need for the project. There have been problems in this area for 30-plus years…Highest priority because (1) existing accounting is producing balance sheets that are not particularly meaningful…

…

Illustrative excerpts from 2002

FASAC Survey instructions

"The current financial reporting environment is one of uncertainty and transition affected by, among other things, corporate bankruptcies, accounting irregularities, and legislation to regulate the accounting profession. Given that environment, we think it is appropriate to begin the 2002 annual FASAC survey with a blank piece of paper. If the FASB was setting its agenda today, what are the five most important issues the Board should address? Please be as specific as possible and give the reasons for your response."

Summary of Responses

"The table below summarizes the five issues that appeared most often in Council members' responses. Board member responses are shown for comparison…"

Topic	Council Members	Board Members
Revenue Recognition	19	7
Consolidations	13	4
Codification and Simplification of Standards	10	1
Financial Performance Reporting	8	7
Business Combinations—Purchase Method Procedures	7	1

"Individual responses appear below. We have included a brief reference to the issues cited by the respondent, followed by more detailed comments (if any) on each issue.

Anderson
Revenue Recognition
Financial Performance Reporting
Cash Flow Reporting
Disclosures about Intangibles
Accounting for Leases

Revenue recognition is a central accounting issue and the literature on revenue recognition has become inadequate as a result of…

…

Wulff
Simplification and Codification
Reporting Financial Performance
Revenue Recognition
Fair Value Measurement
ST International Convergence

Simplification and Codification: transitioning to principles-based standards…"

Appendix B: Classification of *financial* FASAC into large and small constituencies by total assets

Panel A: Total Assets Cutoff Value for *big_fin* by year (in $millions)

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
2,746	**2,761**	**3,474**	**3,791**	**4,608**	**4,023**	**4,618**	**4,975**	**5,770**	**6,645**	**6,708**
1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	
7,633	**11,022**	**12,272**	**12,676**	**13,860**	**14,817**	**22,634**	**24,908**	**25,456**	**25,142**	

Appendix B: (Continued)

Panel B: Commenting FASAC member financial institutions

big_fin		*little_fin*	
Investment Banking/Management*			
Bear Stearns & Co.	1989 - 1992	Grace & White Inc.	1979 - 1983
Goldman Sachs & Co.	1998 - 2001	SoundView Financial Group	1993 - 1994
Bear Stearns & Co.	2002 - 2005	Harris Investment Management	1995 - 1998
J.P.Morgan Chase & Co.	2002 - 2005	Aubrey G. Lanston & Co.	2001 - 2004
Capital Group	2003 - 2006	William Blair & Co.	2003 - 2006
Putnam Investments	2004 - 2007		
Commercial Banking/Bank Holding Company*			
Irving Trust Co.	1980 - 1983	Florida National S&L	1980 - 1983
Morgan Guaranty Trust Co.	1982 - 1983	United Virginia Bank	1981 - 1985
Wachovia Bank	1983 - 1987	Astoria Federal S&L	1987 - 1990
Norwest Corp.	1985 - 1986	Grundy National Bank	1989 - 1992
Citicorp	1985 - 1988	Boston Savings Bank	1991 - 1994
First National Bank of Boston	1987 - 1990	Grundy National Bank	1992 - 1995
BankAmerica Corp.	1989 - 1992	Andover Bancorp	1993 - 1996
National Westminster Bank	1992 - 1995	People's Bank	1995 - 1998
First Chicago Corp.	1993 - 1996	Patelco Credit Union	2003 - 2006
Chase Manhattan Bank	1993 - 1996		
Bank of Boston	1996 - 1999		
GE Capital	1999 - 2002		
Wells Fargo Bank	2006 - 2009		
Private Equity/Venture Capital			
Warburg Pincus	2006 - 2009	Greenspan O'Neil Associates	1985 - 1988
		Crabtree Ventures	2001 - 2004
Insurance			
Lincoln National Corp.	1988 - 1991	New England Mutual Life	1983 - 1987
Aetna Life & Casualty	1992 - 1995		
C.N.A Financial	1993 - 1996		
Pension Fund			
US Steel and Carnegie Pension	1993 - 1996		
Rating Agency			
Moody's	1999 - 2002	Duff & Phelps	1989 - 1992
Standard & Poors	2003 - 2006	Duff & Phelps	1996 - 1999
Moody's	2005 - 2008		

*Post the Gramm-Leach-Bliley Act in 1999 financial holding companies may engage in both investment banking and commercial banking activities

Appendix C: Details of the process for creating auditor-based measures of decreased "reliability" and increased "relevance"

We use a custom-designed Perl script to analyze the Big N auditors' comments letters. For each comment letter, the Perl program first identifies all instances of the word stems "relevan" and "reliab." The program then outputs: (1) the exact position within the comment letter where a word stem of interest occurs (the position of a word stem is reported as its word count from the beginning of the document); (2) the entire sentence containing the identified word stem; and (3) the total word count for the letter.

Next, a research assistant (RA) trained in accounting principles, but blind to the intent of our study, manually examines both the first sentence referencing "relevan" and the first sentence referencing "reliab." On each sentence, the RA determines whether the word stem in question is being used in: (1) a positive context, i.e., whether the letter is indicating that the proposed standard will increase "relevance"/ "reliability;" (2) a negative context, i.e., whether the letter is indicating that the proposed standard will decrease "relevance"/ "reliability;" or (3) a context that is irrelevant to the use of "relevance" and "reliability" as accounting principles. Examples of the RA's assessments from actual sentences in the comment letters are below.

- Positive context: "We support the approach followed in the Exposure Draft and believe that application of those standards will provide relevant and understandable information as well as an appropriate balance between comparability and flexibility." Source: Arthur Andersen's comment letter on proposed SFAS 117.
- Negative context: "We also believe the Proposed Standard exacerbates the complexities of Statement 125 and permits recognition of revenue that cannot be reliably measured." Source: Deloitte's comment letter on proposed SFAS 140.
- Irrelevant usage: "The auditor should familiarize himself with the relevant provisions of the partnership agreement." Source: Arthur Andersen's comment letter on proposed SFAS 102.

In instances where the research assistant identifies the comment letter's first use of "relevance"/ "reliability" as irrelevant to accounting principles, the RA proceeds to the second sentence containing the word stem in question. This process continues until the RA encounters either a positive or negative use of "relevance"/ "reliability" or the RA determines that all uses of "relevance"/ "reliability" in the comment letter are irrelevant to accounting principles.

Appendix D: Coding rubric for research-assistant-based measures of decreased "reliability" and increased "relevance"

The research assistants were instructed to evaluate the exposure drafts recording their perspective on whether the underlying proposal would decrease "reliability," where "reliability" is defined as per the FASB as, "The quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent." The resulting variable is a binary indicator denoted *Manual_dec_relb*. To obtain research assistants' assessments of exposure drafts' increased "relevance," we rely on the following procedure: we asked the research assistants to score each exposure draft on the nature of its use of fair-value accounting. Our focus on "fair values" in measuring "increased relevance" is motivated by the FASB viewing the former as resulting in the latter (e.g., Johnson, 2005). In particular, research assistants scored each exposure draft on a score of 0–5, with unit scores for each of the following: (1) the introduction of fair-value accounting for asset write-downs; (2) the introduction of fair-value accounting for asset recognition and remeasurement; (3) the introduction of fair-value accounting for liability recognition and remeasurement; (4) the recognition of fair-value changes in the income statement; and (5) the required disclosure of fair-value amounts. The resulting count variable is denoted, *Manual_inc_relv*.

Assessing *Manual_dec_relb* and the components of *Manual_inc_relv* requires the exercise of professional judgment. Accordingly, both research assistants employed for this task are seasoned professionals, with MBA degrees from top-ranked U.S. business schools (as per U.S. News rankings) and with combined industrial work experience in finance and accounting exceeding thirty years. We recruited both research assistants specifically to evaluate the FASB exposure drafts, and both were selected for their practical familiarity with accounting.

Of the 145 exposure drafts coded by the two research assistants, 105 received identical evaluations on *Manual_dec_relb*, while 114 received identical evaluations on *Manual_inc_relv*. On the exposure drafts with differing evaluations, the research assistants were able to resolve all differences in subsequent discussions. At no point in this process were the research assistants apprised of the study's hypotheses or its independent variables. Research assistants were compensated on a flat hourly wage (i.e., no performance-based pay).

Appendix E: Variable definitions

VARIABLE	DESCRIPTION
Dependent Variables	
inc_relv	Assessment that a proposed SFAS will increase accounting "relevance" as expressed by the Big 8/6/5/4 auditors (hereafter "Big N auditors") in their comment letters. See Section 3.3.
dec_relb	Assessment that a proposed SFAS will decrease accounting "reliability" as expressed by the Big N auditors in their comment letters. See Section 3.3.
Manual_inc_relv	Assessment that a proposed SFAS will increase "relevance" as determined by 2 independent reviewers. See Section 3.3.
Manual_dec_relb	Assessment that a proposed SFAS will decrease "reliability" as determined by 2 independent reviewers. See Section 3.3.
FASB & SEC Professional Characteristics	
Tenure FASB	Exposure draft (ED)-level measure of the average tenure in years of all extant FASB members
% Auditor FASB	ED-level measure of the proportion of extant FASB members with most recent former employ in auditing.
% Financial FASB	ED-level measure of the proportion of extant FASB members with most recent former employ in investment banking/investment management
Tenure SEC	ED-level measure of the average tenure in years of all extant SEC commissioners
% Financial SEC	ED-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services
FASB & SEC Political Characteristics	
%Rep Donor FASB	ED-level measure of the proportion of extant FASB members making campaign contributions to the Republican party or candidates.
% Dem Donor FASB	ED-level measure of the proportion of extant FASB members making campaign contributions to the Democratic party or candidates
% Democrat SEC	ED-level measure of the proportion of extant Democratic SEC commissioners.
Other Variables	
VWRETD	Annual value-weighted market return (from CRSP) for the 12 months directly preceding the month in which ED was issued.
sd_VWRETD	Standard deviation of daily VWRETD (CRSP) for the 12 months directly proceeding the month in which an ED was issued

Appendix F: Dependent variable scores by exposure draft

SFAS	ED Title	ED Date	*dec_ relb*	*inc_ relv*	*Manual_ dec_relb*	*Manual_ inc_relv*
SFAS001	Disclosure of Foreign Currency Translation Information	10/19/73	0.000	0.000	NA	NA
SFAS002	Accounting for Research and Development Costs	06/05/74	0.000	0.000	NA	NA
SFAS003	Reporting Accounting Changes in Interim Financial Statements: an amendment of APB Opinion No. 28	11/11/74	0.000	0.000	0.000	0.000
SFAS004	Reporting Gains and Losses and Extinguishments of Debt: an amendment of APB Opinion No. 30	01/31/75	0.000	0.000	NA	NA
SFAS005	Accounting for Contingencies	10/21/74	0.000	0.000	NA	NA
SFAS006	Classification of Short-term Obligations Expected to Be Refinanced: an amendment of ARB No. 43, Chapter 3, Section A	11/11/74	0.000	0.000	NA	NA
SFAS007	Accounting and Reporting by Development Stage Companies, Subsidiaries, Divisions and Other Components	07/19/74	0.000	0.000	NA	NA
SFAS008	Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements	12/31/74	0.000	0.000	NA	NA
SFAS009	Accounting for Income Taxes--Oil and Gas Producing Companies: an amendment of APB Opinions No. 11 and 23	04/25/75	0.000	0.000	NA	NA
SFAS010	Extension of "Grandfather" Provisions for Business Combinations: An Amendment of APB Opinion No. 16	09/08/75	0.000	0.000	NA	NA
SFAS011	Accounting for Contingencies--Transition Method: An Amendment of FASB Statement No.5	10/31/75	0.000	0.000	NA	NA
SFAS012	Accounting for Certain Marketable Securities	11/06/75	0.000	0.000	NA	NA
SFAS013	Accounting for Leases	08/26/75	0.000	0.000	NA	NA
SFAS013	Accounting for Leases: Revision of Exposure Draft Issued August 26, 1975	07/22/76	0.000	0.000	NA	NA
SFAS014	Financial Reporting for Segments of a Business Enterprise	09/30/75	0.094	0.000	NA	NA
SFAS015	Restructuring of Debt in a Troubled Loan Situation	11/07/75	0.000	0.000	NA	NA
SFAS015	Accounting by Debtors and Creditors for Troubled Debt Restructurings	12/30/76	NA	NA	1.000	0.000
SFAS016	Prior Period Adjustments	07/29/76	0.000	0.000	NA	NA
SFAS017	Accounting for Leases--Initial Direct Costs: An Amendment of FASB Statement No. 13	08/08/77	0.000	0.000	0.000	0.000
SFAS018	Financial Reporting for Segments of a Business Enterprise--Interim Financial Statements: An Amendment of FASB Statement No. 14	09/20/77	0.000	0.000	0.000	0.000
SFAS019	Financial Accounting and Reporting by Oil and Gas Producing Companies	07/15/77	0.000	0.000	0.000	0.000
SFAS020	Accounting for Forward Exchange Contracts / an amendment of FASB Statement No. 8	11/07/77	0.000	0.000	0.000	0.000
SFAS021	Suspension of the Reporting of Earnings per Share and Segment Information by Nonpublic Enterprises: an amendment of APB Opinion No. 15	02/27/78	0.000	0.000	0.000	0.000
SFAS022 /SFAS023	Accounting for Leases: I Inception of the Lease: An Amendment of FASB Statement No. 13 II Changes in the Provisions of Lease Agreements Resulting from Refundings of Tax-Exempt Debt: an amendment of FASB Statement No. 13	12/19/77	0.000	0.000	0.000	0.000
SFAS024	Reporting Segment Information in Financial Statements That Are Presented With Another Enterprise's Financial Report: an amendment of FASB Statement No. 14	07/19/78	0.000	0.000	0.000	0.000
SFAS025	Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies: an amendment of FASB Statement No. 19	11/07/78	0.000	0.000	0.000	0.000
SFAS026	Profit Recognition on Sales-Type Leases of Real Estate: an amendment of FASB Statement No. 13	12/22/78	0.000	0.000	0.000	0.000
SFAS027	Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases: an amendment of FASB Statement No. 13	02/13/79	0.000	0.000	0.000	0.000
SFAS028	Accounting for Sales with Leasebacks: an amendment of FASB Statement No. 13	12/21/78	0.000	0.000	1.000	0.000
SFAS029	Determining Contingent Rentals	12/21/78	0.000	0.000	0.000	0.000
SFAS030	Disclosure of Information about Major Customers: an amendment of FASB Statement No. 14	03/29/79	0.000	0.000	0.000	0.000
SFAS031	Accounting for Income Taxes Related to U.K. Tax Legislation Concerning Stock Relief	07/30/79	0.000	0.000	1.000	0.000
SFAS032	Specialized Accounting and Reporting Principles and Practices in AICPA Industry Accounting Guides, Industry Audit Guides, and Statements of Position: an amendment of APB Opinion No. 20	06/01/79	0.000	0.000	0.000	0.000
SFAS033	Financial Reporting in Units of General Purchasing Power	12/31/74	NA	NA	NA	NA
SFAS033	Financial Reporting and Changing Prices	12/28/78	NA	NA	0.000	0.000
SFAS033	Constant Dollar Accounting: supplement to an exposure draft of a proposed Statement of Financial Accounting Standards, Financial Reporting in Units of General Purchasing Power	03/02/79	0.086	0.000	0.000	0.000
SFAS034	Capitalization of Interest Cost	12/15/78	0.000	0.000	0.000	0.000
SFAS035	Accounting and Reporting by Defined Benefit Pension Plans	04/14/77	0.000	0.116	1.000	4.000
SFAS035	Accounting and Reporting by Defined Benefit Pension Plans: revision of exposure draft issued April 14, 1977	07/09/79	NA	NA	1.000	3.000
SFAS036	Disclosure of Pension and Other Post-Retirement Benefit Information: an amendment of APB Opinion No. 8	07/12/79	0.000	0.000	0.000	0.000
SFAS037	Balance Sheet Classification of Deferred Income Taxes: an amendment of APB Opinion No. 11	03/14/80	0.000	0.000	0.000	0.000
SFAS038	Accounting for Preacquisition Contingencies of Purchased Enterprises: an amendment of APB Opinion No. 16	12/26/79	0.000	0.000	1.000	0.000
SFAS039 /SFAS040/S FAS041	Financial Reporting and Changing Prices: Specialized Assets—a supplement to FASB Statement No. 33	04/21/80	0.448	0.130	0.000	1.000

Appendix F (Continued)

SFAS	ED Title	ED Date	*dec_ relb*	*inc_ relv*	*Manual_ dec_relb*	*Manual_ inc_relv*
SFAS042	Determining Materiality for Capitalization of Interest Cost: an amendment of FASB Statement No. 34	04/22/80	0.000	0.000	0.000	0.000
SFAS043	Accounting for Compensated Absences	12/17/79	0.050	0.000	0.000	0.000
SFAS044	Accounting for Intangible Assets of Motor Carriers: an amendment of Chapter 5 of ARB 43 and an interpretation of APB Opinions 17 and 30	10/24/80	0.000	0.000	0.000	0.000
SFAS045	Accounting for Franchise Fee Revenue	12/01/80	0.000	0.000	NA	NA
SFAS046	Financial Reporting and Changing Prices: Motion Picture Films; a supplement to FASB Statement No. 33	02/09/81	0.000	0.057	0.000	0.000
SFAS047	Disclosure of Guarantees, Project Financing Arrangements, and Other Similar Obligations: an amendment of FASB Statement No. 5	03/31/80	0.000	0.000	0.000	0.000
SFAS047	Disclosure of Obligations: I Disclosure of Indirect Guarantees of Indebtedness of Others: an interpretation of FASB Statement No. 5	11/14/80	NA	NA	0.000	0.000
SFAS048 /SFAS049	Accounting for Certain Product Sales I Revenue Recognition When Right of Return Exists II Accounting for Product Financing Arrangements	02/09/81	0.000	0.000	NA	NA
SFAS050 /SFAS051 /SFAS053 /SFAS063	Accounting by the Entertainment Industry I Motion Picture Films II Broadcasting III Cable Television IV Records & Music	06/12/81	0.000	0.000	NA	NA
SFAS052	Foreign Currency Translation	08/28/80	NA	NA	0.000	0.000
SFAS052	Foreign Currency Translation; revision of exposure draft issued August 28,1980	06/30/81	0.104	0.000	NA	NA
SFAS054	Financial Reporting and Changing Prices: Investment Companies: an amendment of FASB Statement No.33	11/16/81	0.000	0.000	0.000	0.000
SFAS055	Determining whether a Convertible Security is a Common Stock Equivalent: an amendment of APB Opinion No. 15	11/06/81	0.093	0.000	0.000	0.000
SFAS056	Applicability of FASB Statement No. 32 to AICPA Statements of Position and Guides on Accounting and Auditing Matters: an amendment of FASB Statement No. 32	11/06/81	0.000	0.000	1.000	0.000
SFAS057	Related Party Disclosures	11/06/81	0.125	0.000	0.000	0.000
SFAS058	Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by The Equity Method; an amendment of FASB	09/30/81	0.000	0.000	0.000	0.000
SFAS059	Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units: an amendment of FASB Statement No. 35	02/22/82	0.000	0.000	0.000	0.000
SFAS060 /SFAS061	Accounting by the Insurance Industry I Accounting and Reporting by Insurance Enterprises II Accounting for Title Plant	11/18/81	0.000	0.000	0.000	0.000
SFAS062	Capitalization of Interest Cost in Situations Involving Tax-Exempt Borrowings and Certain Gifts and Grants: an amendment of FASB Statement No. 34	12/22/81	0.000	0.000	1.000	0.000
SFAS064	Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements: an amendment of FASB Statement No. 4	02/23/82	0.000	0.000	0.000	0.000
SFAS065	Accounting for Certain Mortgage Banking Activities	02/03/82	0.000	0.000	0.000	0.000
SFAS066 /SFAS067	Accounting for Certain Real Estate Transactions I Accounting for Costs and Initial Rental Operations of Real Estate Projects II Accounting for Sales of Real Estate	12/15/81	0.000	0.000	0.000	0.000
SFAS068	Research and Development Arrangements	04/27/82	0.000	0.000	1.000	0.000
SFAS069	Disclosures about Oil and Gas Producing Activities: an amendment of FASB Statements 19 and 25	04/15/82	0.000	0.000	0.000	1.000
SFAS070	Financial Reporting and Changing Prices: Foreign Currency Translation: an amendment of FASB Statement No. 33	12/22/81	NA	NA	0.000	0.000
SFAS070	Financial Reporting and Changing Prices: Foreign Currency Translation: an amendment of FASB Statement No. 33 (Revision of 12/22/81 ED	08/19/82	0.000	0.000	0.000	0.000
SFAS071	Accounting for the Effects of Regulation of an Enterprise's Prices Based on Its Costs	03/04/82	0.061	0.000	1.000	0.000
SFAS072	Accounting for Certain Acquisitions of Banking or Thrift Institutions: an amendment of APB Opinion No. 17 and an interpretation of APB Opinion No. 16	10/07/82	0.000	0.000	0.000	0.000
SFAS073	Reporting a Change in Accounting for Railroad Track Structures: an amendment of APB Opinion No. 20	04/12/83	0.000	0.000	0.000	0.000
SFAS074	Accounting for Special Termination Benefits Paid to Employees	12/28/82	0.000	0.000	1.000	0.000
SFAS075	Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units: an amendment of FASB Statement No. 35	06/07/83	0.000	0.000	0.000	0.000
SFAS076	Extinguishment of Debt and the Offsetting of Restricted Assets against Related Debt: an amendment of APB Opinion No. 26 and FASB Statement No. 34	10/13/82	NA	NA	0.000	0.000
SFAS076	Extinguishment of Debt: an amendment of APB Opinion No. 26 (Revision of 10/31/82 ED)	07/14/83	0.000	0.000	0.000	0.000
SFAS077	Accounting and Reporting by Transferors for Transfers of Receivables with Recourse	11/18/81	NA	NA	0.000	0.000
SFAS077	Reporting by Transferors for Transfers of Receivables with Recourse (Revision of 11/18/81 ED)	08/31/82	0.000	0.000	0.000	0.000
SFAS078	Classification of Obligations That Are Callable by the Creditor: an amendment of Chapter 3A of ARB No. 43	07/30/82	0.000	0.000	0.000	0.000
SFAS079	Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises: an amendment of APB Opinion No. 16	10/04/83	0.000	0.000	0.000	0.000
SFAS080	Accounting for Futures Contracts	07/14/83	0.239	0.000	0.000	2.000
SFAS081	Disclosure of Postretirement Health Care and Life Insurance Benefits Information	07/03/84	0.000	0.000	0.000	0.000
SFAS082	Financial Reporting and Changing Prices: Elimination of Certain Disclosures: an amendment of FASB Statement No. 33	10/10/84	0.000	0.000	0.000	0.000
SFAS083	Designation of AICPA Guides and Statement of Position on Accounting by Brokers and Dealers in Securities, by Employee Benefit Plans, and by Banks as Preferable for Purposes of Applying APB Opinion 20: an amendment of FASB Statement No. 32 and a rescission of FASB Interpretation No. 10	12/06/84	0.000	0.000	NA	NA
SFAS084	Induced Conversions of Convertible Debt: an amendment of APB Opinion No. 26	12/06/84	0.000	0.000	0.000	0.000
SFAS085	Yield Test for Determining whether a Convertible Security is a Common Stock Equivalent: an amendment of APB Opinion No. 15	12/06/84	0.000	0.000	0.000	0.000

Appendix F (Continued)

SFAS	ED Title	ED Date	*dec_ relb*	*inc_ relv*	*Manual_ dec_relb*	*Manual_ inc_relv*
SFAS086	Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed	08/31/84	0.471	0.000	1.000	2.000
SFAS087	Employers' Accounting for Pensions	03/22/85	0.096	0.000	NA	NA
SFAS088	Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits	06/14/85	0.000	0.000	0.000	0.000
SFAS089	Financial Reporting and Changing Prices: Current Cost Information	12/14/84	NA	NA	0.000	0.000
SFAS089	Financial Reporting and Changing Prices	09/30/86	NA	NA	0.000	0.000
SFAS090 /SFAS092	Regulated Enterprises -- Accounting for Phase-in Plans, Abandonments, and Disallowances of Plant Costs: an amendment of FASB Statement No. 71	12/19/85	0.000	0.000	NA	NA
SFAS091	Accounting for Nonrefundable Fees and Costs Associated with Originating and Acquiring Loans: an amendment of FASB Statements 13, 60, and 65 and a rescission of FASB Statement No. 17	12/31/85	0.000	0.000	0.000	0.000
SFAS093	Recognition of Depreciation by Not-for-Profit Organizations	12/23/86	0.000	0.000	0.000	0.000
SFAS094	Consolidation of All Majority-Owned Subsidiaries—an amendment of ARB No. 51, with related amendments of APB Opinion No. 18 and ARB No. 43, Chapter 12	12/16/86	0.000	0.013	0.000	0.000
SFAS095	Reporting Income, Cash Flows, and Financial Position of Business Enterprises	11/16/81	NA	NA	0.000	0.000
SFAS095	Statement of Cash Flows	07/31/86	0.000	0.122	0.000	0.000
SFAS096	Accounting for Income Taxes	09/02/86	0.023	0.157	0.000	0.000
SFAS097	Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Insurance Contracts and for Realized Gains and Losses from the Sale of Investments	12/23/86	0.000	0.000	1.000	0.000
SFAS098	Sale and Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases	08/31/87	NA	NA	0.000	0.000
SFAS099	Deferral of the Effective Date of Recognition of Depreciation by Not-for-Profit Organizations	06/06/88	0.000	0.000	0.000	0.000
SFAS100	Accounting for Income Taxes—Deferral of the Effective Date of FASB Statement No. 96: an amendment of FASB Statement No. 96	10/13/88	0.000	0.000	0.000	0.000
SFAS101	Regulated Enterprises—Accounting for the Discontinuation of Application of FASB Statement No. 71	07/08/88	NA	NA	0.000	0.000
SFAS102	Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Held for Resale	11/30/88	0.000	0.000	0.000	0.000
SFAS103	Accounting for Income Taxes—Deferral of the Effective Date of FASB Statement No. 96: an amendment of FASB Statement No. 96	10/19/89	NA	NA	NA	NA
SFAS104	Statement of Cash Flows—Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions	07/25/89	0.000	0.151	0.000	0.000
SFAS105	Disclosure about Financial Instruments	11/30/87	NA	NA	1.000	1.000
SFAS105	Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial instruments with Concentrations of Credit Risk	07/21/89	0.000	0.000	0.000	0.000
SFAS106	Employers' Accounting for Postretirement Benefits Other Than Pensions	02/14/89	0.533	0.000	1.000	4.000
SFAS107	Disclosures about Market Value of Financial Instruments	12/31/90	0.244	0.593	1.000	1.000
SFAS108	Accounting for Income Taxes—Deferral of the Effective Date of Statement No. 96, an amendment of FASB Statement No. 96	06/17/91	0.000	0.000	0.000	0.000
SFAS109	Accounting for Income Taxes	06/05/91	NA	NA	0.000	0.000
SFAS110	Reporting by Defined Benefit Pension Plans of Investment Contracts: an amendment of FASB Statement No. 35	03/20/92	0.000	0.326	1.000	1.000
SFAS111	Rescission of FASB Statement No. 32 and Technical Corrections	06/30/92	0.000	0.000	0.000	0.000
SFAS112	Employers' Accounting for Postretirement Benefits: an amendment of FASB Statements No. 5 and 43	05/12/92	0.000	0.000	0.000	0.000
SFAS113	Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts	03/20/92	0.049	0.121	0.000	0.000
SFAS114	Accounting by Creditors for Impairment of a Loan: an amendment of FASB Statements No. 5 and 15	06/30/92	0.210	0.124	1.000	2.000
SFAS115	Accounting for Certain Investments in Debt and Equity Securities	09/09/92	0.507	0.000	1.000	4.000
SFAS116	Accounting for Contributions Received and Contributions Made and Capitalization of Works of Art, Historical Treasurers, and Similar Assets	10/31/90	0.000	0.000	1.000	2.000
SFAS116	Accounting for Contributions Received and Contributions Made (Revision of 10/31/90 ED)	11/17/92	0.379	0.000	1.000	0.000
SFAS117	Financial Statements of Not-for-Profit Organizations	10/23/92	0.000	0.589	0.000	0.000
SFAS118	Accounting by Creditors for Impairment of a Loan—Income Recognition: an amendment of FASB Statement No. 114	03/31/94	0.000	0.000	0.000	0.000
SFAS119	Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments	04/14/94	0.000	0.137	0.000	1.000
SFAS120	Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts: an amendment of FASB Statements No. 60, 97, and 113 (Includes Proposed AICPA Statement of Position, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises)	03/24/94	0.000	0.000	0.000	0.000
SFAS121	Accounting for the Impairment of Long-Lived Assets	11/29/93	0.000	0.000	1.000	3.000
SFAS122	Accounting for Mortgage Servicing Rights and Excess Servicing Receivables and for Securitization of Mortgage Loans an amendment of FASB Statement No. 65	06/28/94	0.148	0.030	1.000	4.000
SFAS123	Accounting for Stock-Based Compensation	06/30/93	0.372	0.000	1.000	2.000
SFAS123R	Share-Based Payment: an amendment of FASB Statements No. 123 and 95	03/31/04	0.318	0.466	0.000	2.000
SFAS124	Accounting for Certain Investments Held by Not-for-Profit Organizations	03/31/95	NA	NA	0.000	3.000

Appendix F (Continued)

SFAS	ED Title	ED Date	*dec_ relb*	*inc_ relv*	*Manual_ dec_relb*	*Manual_ inc_relv*
SFAS125	Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities	10/24/95	0.510	0.120	1.000	2.000
SFAS126	Elimination of Certain Disclosures abut Financial Instruments by Small Nonpublic Entities: an amendment of FASB Statement No. 107	09/20/96	0.000	0.000	0.000	0.000
SFAS127	Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125: an amendment of FASB Statement No. 125	11/11/96	0.000	0.000	0.000	0.000
SFAS128 /SFAS129	Earnings per Share and Disclosure of Information about Capital Structure	01/19/96	0.000	0.135	0.000	0.000
SFAS130	Reporting Comprehensive Income	06/20/96	0.000	0.000	0.000	0.000
SFAS131	Reporting Disaggregated Information about a Business Enterprise	01/19/96	0.018	0.000	1.000	0.000
SFAS132	Employers' Disclosures about Pensions and Other Postretirement Benefits: an amendment of FASB Statements No. 87, 88, and 106	06/30/97	0.000	0.000	0.000	1.000
SFAS132R	Employers' Disclosures about Pensions and Other Postretirement Benefits: an amendment of FASB Statements No. 87, 88, and 106 and a replacement of FASB Statement No. 132	09/12/03	0.163	0.131	0.000	1.000
SFAS133	Accounting for Derivative and Similar Financial Instruments and for Hedging Activities	06/20/96	0.101	0.046	1.000	3.000
SFAS134	Accounting for Mortgage-Backed Securities and Certain Other Interests Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise: an amendment of FASB Statement No. 65	4/10;98	0.000	0.000	1.000	2.000
SFAS135	Amendments to FASB Statement No. 66, Rescission of FASB Statement No. 75, and Technical Corrections	10/13/98	0.000	0.000	0.000	0.000
SFAS136	Transfers of Assets in Which a Not-for-Profit Organization Acts as an Agent, Trustee, or Intermediary: an Interpretation of FASB Statement No. 116	12/29/95	NA	NA	0.000	0.000
SFAS136	Transfers of Assets involving a Not-for-Profit Organization That Raises or Holds Contributions for Others	07/17/98	0.000	0.000	0.000	3.000
SFAS137	Accounting for Derivative Instruments and Hedging Activities—Deferral of the Elective Date of FASB Statement No. 133: an amendment of FASB Statement No. 133	05/20/99	0.000	0.000	0.000	0.000
SFAS138	Accounting for Certain Derivative instruments and Certain Hedging Activities: an amendment of FASB Statement No. 133	03/03/00	0.000	0.000	0.000	0.000
SFAS139	Rescission of FASB Statement No. 53	10/16/98	0.000	0.000	0.000	0.000
SFAS140	Accounting for Transfers of Financial Assets: an amendment of FASB Statement No. 125	06/28/99	0.378	0.000	1.000	2.000
SFAS141 /SFAS142	Business Combinations and Intangible Assets	09/07/99	0.461	0.152	1.000	3.000
SFAS141R	Business Combinations: a replacement of FASB Statement No. 141	06/30/05	0.909	0.477	1.000	5.000
SFAS142	Business Combinations and Intangible Assets—Accounting for Goodwill (Revision of 9/7/99 ED)	02/14/01	0.647	0.041	1.000	3.000
SFAS143	Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets	02/07/96	0.000	0.000	1.000	1.000
SFAS143	Accounting for Obligations Associated with the Retirement of Long-Lived Assets (Revision of 2/7/96 ED)	02/17/00	0.452	0.278	1.000	0.000
SFAS144 /SFAS146	Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections	11/15/01	0.158	0.376	1.000	2.000
SFAS145	Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities	06/30/00	0.000	0.000	0.000	0.000
SFAS145	Rescission of FASB Statements No. 4, 44, and 64 and Technical Corrections—Amendment of FASB Statement No. 13 (Revision of 11/15/01 ED)	02/14/02	0.000	0.000	0.000	0.000
SFAS147	Acquisitions of Certain Financial Institutions: an amendment of FASB Statements No. 72 and No. 144 and FASB Interpretation No. 9	05/10/02	0.000	0.000	1.000	3.000
SFAS148	Accounting for Stock-Based Compensation--Transition and Disclosure: and amendment of FASB Statement No. 123	10/04/02	0.000	0.000	1.000	1.000
SFAS149	Amendment of Statement 133 on Derivative Instruments and Hedging Activities	05/01/02	0.132	0.000	0.000	1.000
SFAS150	Accounting for Financial Instruments with Characteristics of Liabilities: Equity, or Both	10/27/00	0.297	0.000	0.000	0.000
SFAS151	Inventory Costs: an amendment of ARB No. 43, Chapter 4	12/15/03	0.000	0.000	0.000	0.000
SFAS152	Accounting for Real Estate Time-Sharing Transactions: an amendment of FASB Statements No. 66 and 67	02/20/03	0.000	0.000	0.000	0.000
SFAS153	Exchanges of Productive Assets: an amendment of ABP Opinion No. 29	12/15/03	0.161	0.000	1.000	1.000
SFAS154	Accounting Changes and Error Corrections: a replacement of ABP Opinion No. 20 and FASB Statement No. 3	12/15/03	0.000	0.000	1.000	0.000
SFAS155	Accounting for Certain Hybrid Financial Instruments: an amendment of FASB Statements No. 133 and 140	08/11/05	0.190	0.397	1.000	2.000
SFAS156	Qualifying Special-Purpose Entities and Isolation of Transferred Assets: an amendment of FASB Statement No. 140	06/10/03	NA	NA	1.000	0.000
SFAS156	Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140 (Revision of 6/10/03 ED)	08/11/05	0.003	0.113	1.000	4.000
SFAS156	Accounting for Transfers of Financial Assets: an amendment of FASB Statement No. 140 (Revision of 6/10/03 ED)	08/11/05	NA	NA	1.000	0.000
SFAS157	Fair Value Measurements	06/23/04	0.599	0.245	0.000	2.000
SFAS158	Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans: an amendment of FASB Statements No. 87, 88, 106, and 132(R)	03/31/06	0.000	0.000	0.000	1.000
SFAS159	The Fair Value Option for Financial Assets and Financial Liabilities: Including an amendment of FASB Statement No. 115	01/25/06	0.451	0.669	1.000	4.000
SFAS160	Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries: a replacement of ARB No. 51	06/30/05	0.586	0.000	1.000	4.000