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## Introduction

The two institutions, the United States Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) are involved in creating U.S. generally accepted accounting principles (GAAPs) and overseeing as well as regulating the information on investments. They are responsible for setting reporting standards, mandatory disclosure practices and the submission of quarterly and annual reports. Therefore different interest groups want to gain influence over decision-making in both SEC and FASB.

SEC was established in 1934 by the U. S. Congress. It was founded as an independent regulatory agency. Its purpose is to give investors access to “facts about an investment prior to buying it, and so long as they hold it” (SEC 2007). It also has civil enforcement authority and is administering seven major laws.

SEC consists of four Divisions and 18 Offices and is concerned with overseeing corporate disclosure, regulating major securities market participants and the investment management industry as well as investigating possible violations of securities laws, recommending actions and negotiating settlements. The five commissioners of the SEC are appointed by the U.S. President.

FASB was established in 1973. It is an independent, private, not-for-profit organization and a recognized authoritative by the SEC with the mission to “establish and improve standards of financial accounting and reporting” (FASB n.d.).

The board works on the development of generally accepted standards for financial accounting and reporting in the private sector. Based on research it developed broad accounting concepts that act as a conceptual framework, out of which standards for financial reporting are derived (FASB n.d.).

The decision making process of the FASB is open to the public. Actions are taken after the reception of a request or because of the recognition of new trends.

## Lobbying and interest groups

A brief definition of lobbying and lobbying strategies should be given. Afterwards the focus of the chapter will be on the structure, aim and organization of interest groups.

### Lobbying

Lobbying is a focused form of advocacy to influence legislation. In that case advocacy involves identifying, embracing and promoting a cause. Lobbying is targeted toward arenas of legislative or administrative activities (Avner 2002, p.26).

The negotiation between an interest group and a legislator is done by lobbyists. They are responsible to their group and are able to negotiate in different ways.

The primary strategy is direct lobbying in which the lobbyist meets and tries to persuade a legislator. For this purpose the lobbyist has to fulfil certain conditions. The lobbyist must be trustworthy and reliable to the legislator, otherwise the lobbyist will get no future access to his network. Also, the lobbyist must not apply pressure on or impose threats to the legislator and needs to know that bribery is not an option.

The second strategy is indirect lobbying. One is the letter writing campaign strategy. In this case the interest group encourages their members to write letters about a certain circumstance that should get changed and send these letters to the legislator who should be influenced. This strategy is only suitable for large interest groups that can launch a flood of mail but it does not seem to be very effective. Another strategy would be public relations campaigns but these are much more expensive than the first strategy and the effectiveness is also hard to control. Furthermore, there is another strategy which contains the influence of friends and constitutes of a legislator. For this purpose they are invited to join certain campaigns of the interest group and the group hopes that this step will help to influence the legislator on behalf of the group.

A combination of direct and indirect strategies of lobbying might be the most effective way to influence legislators in the long run. In the end a mix of different strategies should be chosen, depending on the legislator's attitude towards lobbying (Holtzmann 1966).

A great problem of lobbying concerns corruption. Politicians might have an incentive to act in the best way for the interest group that provides the highest donations for their political campaigns. This in turn is not necessarily the best way for public interest.

### **Interest groups / pressure groups**

Interest groups, also called pressure groups, are a fundamental phenomenon of modern democratic societies. Governments and non-governmental organisations, like SEC and FASB, seek to draw interest groups into public administration in order to ensure acceptance and effective implementation of the law and try to use the expertise of the pressure groups.

The relationship between government and interest groups could be characterized as circular. An interest group can join, criticize, influence or even ignore the government. It depends on what the interest group wants to achieve in the particular situation. In democracies, interest groups are fellow actors with political parties which should have more power than the interest groups. It should be mentioned that interest groups do not have any kind of legislative or administrative power.

Interest groups developed out of the decreasing power of individuals in the society and the increasing power of government. These groups tend to increase into larger, more highly organized groups to create a concentration of power (Holtzmann 1966).

### **Interest Groups and the SEC**

The Securities and Exchange Commission (SEC) was founded in order to protect investors in the wake of the 1929 stock market crash. The main reasons for its establishment were to examine corporate documents, regulate stock exchanges, provide full disclosure of the marketplace and impose penalties if any of these requirements were violated (SEC 2007).

Ever since its creation interest groups were trying to gain influence over the SEC and with its latest law, the so called Sarbanes-Oxley Act, pressure has been mounting significantly.

The U.S. Congress passed the law named after Senator Paul S. Sarbanes and Representative Michael G. Oxley in 2002. It requires chief executives to attest to the accuracy of corporate financial statements and requires companies to certify that controls are in place to prevent fraud. With limiting company's clearance, partly in favour of increased shareholder rights, a vast number of law suits were thus filed against the SEC on the grounds of violating constitutional law (Corporate Policy 2007). In majority, the filing of the action was carried out by powerful industry and lobby groups, such as the AeA (American Electronics Association), the American Bankers Association and the U.S. Chamber of Commerce (Washington Post 2005).

However, being a government regulatory agency and thus receiving its funds from the government, most pressure is imposed on the SEC by the U.S. Congress. Its role on the one hand is to trigger the process of standard setting and on the other hand to ratify a corresponding law once an agreement about its content and scope is reached. With passing on the administration of the specific law to the SEC, Congress' influence is not ending but it maintains a supervising function through its members (which themselves are influenced by above mentioned lobby groups) (SEC 2007).

An example for initiating a rule-making process is the recent discussion about whether or not the SEC should become involved in foreign policy issues such as international weapons proliferation and human rights abroad by barring certain foreign companies, particularly from China and Russia, from raising capital in the United States. The underlying issue is that Congress members demanded to restrict companies from rogue countries (the so called "global bad actors") the unhindered access to international and especially the American stock exchanges. There they can get external funds from the people by issuing shares or bonds

which is questionable in regard to the international political and economical stability (Internationale Politik 2002). In a specific case, a group of Congressmen claimed to de-list the Chinese oil company PetroChina from the New York Stock Exchange because of its activities in Sudan. It has been accused of significant human rights abuses (Council on Foreign Relations 2006).

In an official statement the SEC was not following entirely the proposal, arguing that it is legally not entitled to refuse foreign companies the access to the American capital market. Even more, it is obliged to provide American investors with all relevant information about these companies and to place shares at their disposal should the occasion arise. However, the SEC extended its public disclosure policy to materially relevant business activities in countries against which the USA imposed sanctions. By doing so, the SEC hopes to scare off “bad actors” and prevent them from enlisting at American stock exchanges (Internationale Politik 2002).

Looking at the supervising function of the Congress, the SEC has recently been accused of lax regulation and prosecution. On the one hand it became public that at times other governmental bodies were more successful in fraud investigations. Exemplary, New York State Attorney General Eliot Spitzer has uncovered many scandals that the SEC never found. Most of them recently in the mutual fund industry, in which insider investors and fund managers themselves got rich at the expense of the fund's smaller investors (PBS 2003). On the other hand Congressional investigators conducted a public inquiry on the SEC after a rather surprising acquittal in an investigation (NYSSCPA 2006). In the specific case, the chief executive of the investment house Morgan Stanley, John Mack, and the hedge fund Pequot Capital Management Inc. were cleared of the suspicion of insider trading, arousing doubts about SEC's integrity (New York Times 2006).

In summary, it becomes obvious that the U.S. Congress puts the most pressure and has the most influence on the SEC. In majority, other industry and lobby groups influence the SEC in

an indirect manner by lobbying the Congress, which in turn can trigger standard setting processes or investigate on possible misdemeanours.

## Interest Groups and the FASB

In 1973, the FASB was set up as an independent accounting standard setting organization. Ever since then, different pressure groups have tried to influence the outcome of FASB's standards setting process. In the following a closer look to two major pressure groups, namely the US Government and auditors, mostly represented by the Big Five, will be provided.

In 1998 McEnroe & Martens (1998) presented a study which questions the independence of the FASB. 74% of the participating CFOs of the biggest 500 US companies claimed that during the agenda setting the FASB does not evaluate all suggestions equally and that the FASB is not free from undue outside influence. Some 70 per cent accused the SEC and 30 per cent blamed the Big Five auditors. AIMR, AICPA and financial analysts were mentioned just by a few.

However, Wyatt (1989) states that the Board “deserves high marks over its 15 year history for avoiding allegations that its standards are designed to favor any given segment of society” (Wyatt 1989, p.97). He claims that even though some standards might reflect lobbyist activities, most of them are in perfect balance with the FASB's conceptual framework.

Since all those statements are quite a few years old, we will examine the issue from a contemporary point of view in the following.

When it comes to government influence on standard setting, several stages could be identified. Congress either directly addresses the FASB or uses the SEC, being a government institution, for its purposes. In 1979 Congress stopped both, SEC and FASB from forcing any company to use an “unflattering method of accounting for drilled holes” (*Badly in need of repair* 2002, p.67). In 1993 FASB proposed that stock options should be accounted as

expenses, leading to a threat from Congress to take away FASB's standard setting powers. A former chief accountant of the SEC, Lynn Turner, commented "they had no choice but to fold, like a cheap tent" (*Badly in need of repair* 2002, p.67).

The Sarbanes-Oxley act of 2002 gave the SEC more overseeing power over the FASB and changed the FASB's funding. It was the answer to numerous major corporate and accounting scandals (Enron, Tyco International and WorldCom), promoting increased standard setting independence from auditors, corporate governance and more financial disclosure. It gave FASB firmer legal status and allowed self funding by levying fees on public companies. However in order to collect those fees the SEC has to approve the board's budget first (McNamee & Dwyer 2003).

Most recently the Financial Accounting Foundation (FAF) has agreed to give the SEC greater power when it comes to appointments to the FASB, leading to fears that increased political influence will be the result (Reilly & Scannell 2007, p.1). Robert E. Denham, chairman of the FAF, does not see FASB's independence threatened by the agreement. Nevertheless, critics of the deal state that the SEC is gradually becoming the parent of the FASB and believe that "this is set up to influence the selection of politically expedient candidates" (Trott cited in Reilly & Scannell 2007, p.2).

Other than government influence, the big auditor firms, also known as the Big Five, play a major role in the standard setting process. The exact impact of influence is hard to obtain, since this form of lobbying is more subtle and secret. Wyatt (2004) complains that rather than being pure professionals, accounting firms got more and more involved in their client's business. By becoming "too cozy with clients" (Wyatt 2004 p.96), they actively helped to circumvent accounting standards. Wyatt blames the evolution of consulting services provided by auditors for that development. But he also mentions investment bankers and security analysts who pressured companies to show growth. They in turn did so by finding willing auditors that "accelerated revenue recognition and delayed expense recognition"

(Wyatt 2004, p.99). In the past, auditors became more and more involved with lobbying the FASB on specific issues that made it easier to achieve their clients' goals. Wyatt (1989, p.98) claims Statements No. 13, 15 and 87 to be examples for possibly undue influence. More complex regulations also provided more loopholes and created more revenue for the auditors, due to a larger demand for consultation.

On the other hand the FASB welcomes inputs from lobbyist to get a broader view over the issue. It therefore developed a system in which all public companies can participate in and state their opinion in a transparent way. However it is questioned if all inputs are treated equally (McEnroe & Martens 1998, p.53).

In conclusion it could not be determined, whether the government's or auditor's influence is bigger. That is because of the more transparent and direct way how Congress and SEC influence the accounting standard's setting on the one hand and the subtle and secret way how most auditors influence the outcome.

## Conclusion

SEC seems to be mostly influenced by the U.S. Congress. Other than the influence of Congress, FASB is also influenced by auditors who are involved in lobbying the FASB to influence the outcome of standard setting. FASB is also influenced by SEC.

However, the U.S. Congress, and the lobbyists behind it, can be seen as the main or at least the most obvious interest group influencing decision-making in both institutions. Accounting standard setting is triggered according to the interest of powerful lobbyists working through Congressmen. The strong influence of Congress challenges the independence of both institutions and has to be judged critically while the influence of auditors is desirable as it helps to consider everyday accounting issues.

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