26. Research on Accounting Policymaking: Applications to Governmental Accounting*

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Various entities have contributed to the establishment of governmental accounting standards, which this article calls governmental accounting policymaking. These bodies include both governmental agencies and professional organizations. This study surveys and evaluates the research that has been conducted on the institutional mechanisms for accounting policymaking as well as the accounting policymaking process itself. Because research on governmental accounting policymaking is scarce, the study includes research on corporate accounting policymaking as well.

Several themes recur in the research on corporate accounting policymaking. One is the intervention of various governmental agencies. Past research has documented various instances in which this has occurred. In addition, some research is reported on the factors that have brought about the intervention in the first place. Several other themes are identified, and research that has been conducted on each of these themes is discussed.

The methodologies, or approaches, that have been followed in conducting research on accounting policymaking are also discussed. To illustrate, one approach is through the analysis of voting records. As before, most of the research deals with the private sector as a prototype of the public sector.

The potential transfer of research themes and methodologies that have been noted in connection with private-sector accounting policy-making to the corresponding areas of governmental accounting policy-making is also discussed. One theme suggested in this respect is the identification of the factors that cause various parties to try to exert an influence on governmental accounting policymaking.

Government accounting has a long history of policy making in the political arena. The Congress in 1921 enacted the Budget and Accounting Act, designating the U.S. General Accounting Office to be responsible for setting accounting standards for federal agencies. States have their own constitutional and statutory provisions for making accounting policies for themselves and local governments in their jurisdiction. Organized professional activities in formally recommending accounting policies began in the 1930s when a National Committee on Municipal Accounting (NCMA) was created by the Municipal Finance Officers Association (MFOA). The NCMA subsequently evolved into the National Committee on Governmental Accounting, and the present National Council on Governmental Accounting in 1974 (Remis, 1981).

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In a manner similar to corporate financial accounting standard setting, trip process began under the leadership of a professional association, and became increasingly formal and pluralistic. Throughout this period however, the policymaking process in governmental accounting received scant attention from researchers. This may, however, well change soon by the establishment of a Government Accounting Standards Board. The establishment of the Financial Accounting Standards Board (FASB) ushered in a period of intensive interest in the politics and policies of financial accounting. If that experience is any indication, the 1980s will likely be an exciting era for research on government accounting policymaking.

The purpose of this study was to survey research on the institutional structure and policymaking process of governmental accounting. The literature search with such a delimitation found precious little in the academic literature even though there is a great deal of debate on the merits of alternative structures for setting government accounting standards (e.g., Granof, 1979; Staats, 1979; Williams, 1979; Wyatt, 1979; papers in the December 1979 issues of The Accounting Forum published by Baruch College). The scope of the search was therefore broadened to encompass research on corporate financial accounting policy-making in general. The following two sections review this body of literature from the thematic and methodological perspectives. An attempt will be made to highlight the propositions tested and the research methods used. Similar studies will be grouped together to facilitate comparison. Collectively, these studies contribute to what Horngren (1976) called a “political conceptual framework” of accounting. The third section discusses the applications of concepts and methods to government accounting policy making.

RESEARCH THEMES

This section will concentrate on various research themes amenable to empirical investigation. It will therefore not include the literature debating whether it is possible or not to set optimal normative financial accounting standards (Demski, 1973, 1974, 1976; Chambers, 1976; Gushing, 1977, 1981; Bejan, 1981). Also, writings merely expounding their authors’ opinions without theoretical or empirical support will be excluded. The core of the literature may be labeled as political analysis of financial accounting.

One of the early statements was made by Horngren (1973, p. 61) as follows:

> My hypothesis is that the setting of accounting standards is as much a product of political action as of flawless logic or empirical findings. Why? Because the setting of standards is a social decision. Standards place restrictions on behavior; therefore they must be accepted by the affected parties. Acceptance may be forced or voluntary or some of both. In a democratic society, getting acceptance is an exceedingly complicated process that requires skillful marketing in a political arena.

Subsequent studies elaborated on this general theme by a sharper definition of the political nature of the accounting policy process. Specifically, politics has been variously interpreted as (1) government intervention, (2) selection of policymakers of preferred backgrounds, (3) interest group lobbying, and (4) differential responsiveness of the policymaking body to interest groups. Each of these possibilities is examined below.

Politics as Government Intervention

This theme has been expounded in several collections of papers (Sterling, 1974; Buckley and Weston, 1979; and Abdel-khalik, 1980). In addition, Horngren (1972, 1973), Moonitz (1974), Solomons (1978) and Kelley-Newton (1980), among others, have documented specific instances where the Congress, the SEC and other federal agencies sought to influence the deliberations of the APB and later the FASB. Congressional inquiries, most notably by the Senate Subcommittee on Reports, Accounting and Management (Metcalf Subcommittee Staff Study, 1976), also serve as reminders of the political environment in which the SEC and the FASB make accounting policies. Hence, there has been considerable debate on the question: “Should (financial) accounting standards be set in the public or private sector?” This was the title of Robert Kaplan’s presentation at the 1979 UCLA Conference on Regulation and the Accounting Profession. This normative question invites considerable arguments, with little prospect of consensus. It has to be reformulated as “Who sets the standards?” or “What is the structural relationship between the SEC and the FASB?” for empirical observation and testing. These questions have been answered differently. Horngren (1972) regarded the relationship as similar to top management-lower management in a decentralized organization. (That is, the Congress delegated corporate accounting standard-setting authority to the SEC, which in turn has delegated it to the FASB. These facts not withstanding, Johnson (1982) questions the constitutionality of the Congressional action.)

Burton, on the other hand, viewed the SEC and the FASB as a partnership (quoted by Horngren, 1972, p. 62.) The FASB routinely sets standards; however, the SEC reserves its statutory authority to intervene on an exceptional basis. Thus it is of considerable theoretical and practical importance to predict when the SEC will intervene. Such a prediction model has not been generalized from the case studies, which point to the following proposition: The greater the divergence between the positions of the SEC and the FASB, the more likely the SEC is to convert its statutory power into actual influence

Another line of research is to inquire into the rationale of government intervention. Government regulation of financial reporting is justified (by politicians and regulators) on grounds of protecting the public interest. This may be called the public interest hypothesis of accounting regulation. May and Sundem (1976) argued that, for accounting policymaking to be a purposive activity, it must have a goal. If so, the maximization of social welfare (or the public interest) seems to be as laudable as any. In support of their position, they stated (p. 748) that "to our knowledge, no one has expressed disagreement with it as an objective." Indeed, statements from policymakers (the chairman of the FASB, the chairman and chief accountant of the SEC) often profess allegiance to the promotion of public interest. Public interest has been translated into less abstract (but still vague) terms, such as satisfying users' information needs and reducing inequity in access to information. One perhaps should not abandon the public interest as an idealized goal. Empirical researchers however, have found it more fruitful to test behavioral theories of regulatory agencies based on what might be called a self-interest hypothesis. Work along this line has been stimulated by economic theories of regulation formulated by Stigler (1971), Posner (1974) and Peltzman (1976). Politics perhaps is another way of describing the interactions of individuals or groups pursuing their self-interests, and has manifested itself in the selection of preferred policy-makers, and the differential responsiveness of the policymakers to interest groups, as discussed below.

Politics in the Selection of Policymakers

Several studies investigated the potential influence on voting behavior of policymakers' prior or current employment affiliation (Meyer, 1974; Rockness and Nikolai, 1977; Patton, 1980; Neuman, 1981a). The underlying theory seems to be that individuals from similar backgrounds, other things being equal, tend to behave similarly and are more likely to form voting blocks. Politics enter the picture indirectly through the appointment of individuals with particular backgrounds and orientations.

The party having appointment power can therefore shape the overall philosophy of policymaking body without meddling in its daily activities. Furthermore, the authority to appoint policy-makers is itself a reflection of the distribution of power, since not all interested parties can nominate or select policy board members. These considerations cast doubt on the “independence” of the policy board. This group of studies was in effect testing the “employment affiliation effect” on policymakers’ behavior. The null hypothesis may be stated as follows: Prior (or current, as the case may be) employment affiliation does not affect the voting behavior of accounting policymakers.

The opposite has been posed by Sunder (1981), who asserted that the proliferation of FASB rules could be traced to “the public accountants, who dominate the FASB with three out of seven members drawn from the ranks of ex-partners of CPA firms,” which “are hardly hurt by the increase in demand for their services.” Gathering systematic and reliable evidence about the motivations of policymakers obviously is a difficult task. Nevertheless, it is important to study their incentives and objectives (Jensen, 1976).

Politics as Interest-Group Lobbying

The accounting policymaking process is subject to the pressures of groups whose economic or political interests are affected, especially if adversely affected. Accounting policymaking bodies typically adopt “due process” to permit and encourage maximum possible participation by concerned parties. The assumption seems to be that participation is a necessary (but insufficient) condition for the acceptance of standards. Some of the written records of the FASB have been analyzed to see whether interested parties succeeded in obtaining favorable financial accounting standards.

It is relatively easy to identify participants in the policymaking process. For example, Armstrong, a former FASB chairman, pointed out (1977, p. 79): “We hear from the accounting firms, and for the most part we hear from them on each issue we raise. Business, on the other hand, responds only when a proposal could have an adverse effect on its own financial statements. Thus, the picture which we see from business is frequently strongly biased.”

Armstrong’s observation has been conceptualized in the group theories approach to the process of financial accounting standard setting (Feroz, 1982a). Feroz draws on the contributions of political scientists to arrive at some predictions concerning interest-group participation in accounting policymaking process: “Out of the total spectrum of ‘interests’ involved in the process of (financial accounting) standard setting, only those who foresee large benefits from securing preferred rules expected to lobby FASB.”

Further, lobbying is likely to be industry-specific rather than being overly general or gratuitous. Finally, group lobbying will be contingent upon the "size" of the group, homogeneity of interest, and information and transaction costs involved.

Given the presence of interest group lobbying, it is natural to look into its effects on the policy board.

Differential Responsiveness of the Policymaking Body

In a generic sense, generally accepted accounting principles have met the approval of some designated parties—e.g., users, auditors, preparers. In this conceptualization, the policymakers perform an agency role of articulating others' preference. In the extreme, the accounting policymaking body is responsive to all interest groups. Given the plurality of interests represented, this is an impossible task. If so, to whom is the policy board more responsive? The Metcalf subcommittee staff study (1976) alleged the dominance of major accounting firms. More generally, one would expect: "The FASB is more responsive to those who have greater power to adversely affect its survival." FASB's responsiveness to various constituent groups has been studied by Brown (1981), Rockness and Nikolai (1977), Haring (1979), Patton (1980), Neuman (1981), and Feroz (1982b).

RESEARCH METHODS

This section analyzes several methods used in research on financial accounting policymaking. They are principally participant-observation case studies, voting records analysis, analysis of demand inputs, and the game-theoretic approach to accounting policymaking.

Participant-Observation Case Studies

Recognition of the political nature of financial accounting policy making (in the sense of government intervention) is reflected in the documentation of the specific instances where the Congress, the SEC, or other federal agencies interfered with the work of the APB and the FASB. Examples are the investment tax credit (Horngren, 1972), marketable securities (Armstrong, 1977), and oil and gas accounting (Kelly-Newton, 1980). Autobiographical accounts written by policymakers themselves shed some light into the "black box" of the policymaking process (e.g., Horngren, 1972, 1973; Armstrong, 1977; Burton, 1977; Gellein, 1978).

These individuals may one day become subjects in process-tracing studies of researchers interested in policymaking judgment formation.

Voting Records Analysis

While participant-observer case studies illuminate the process of policy making, the outcomes of the process—votes—provide objective evidence for empirical research. Some methodological advances have been made in voting records analysis in the past decade. Meyer's [1974] study tested the employment affiliation effect, using the votes of 57 APB members over its entire life time (1959-73). In contrast to Meyer's aggregate analysis, Rockness and Nikolai (1977) used nonmetric multidimensional scaling (MDS) to obtain spatial configuration of the voting patterns of 50 APB members in 31 opinions. Their analysis also did not reveal a significant employment affiliation effect. However, they did find that voting patterns changed over time ("life-cycle effect"). More recently, Patton (1980b) analyzed the voting patterns of the FASB for the period 1973-79. The (former) employment affiliation effect was tested using three different methods—the Chi-square test, voting blocks analysis, and multidimensional scaling. None of these found significant effects. Patton next tested the "threat-situation effects" and failed to reject the null hypothesis that winning FASB coalitions in threatening situations will be less than those in nonthreatening situations. Finally, tests for the life-cycle effects found that dissent rate increased over time, while interagreement rates decreased.

Voting records analysis has the advantage of using objective data about who voted what way. The votes could also be correlated with the characteristics of voters. Thus far, analyses of votes of accounting policy boards have not attempted to relate decision makers' choice to merits of alternatives. Nor does voting records analysis adequately deal with the factors influencing the way the votes turn out. This particular theme is addressed by analysis of demands on the policy board.

Analysis of Demand Inputs to the Policymaking Process

Another major potential influence on accounting policymaking is demands from affected parties. Watts and Zimmerman (1978) analyzed firms' responses to the FASB discussion memorandum on General Price Level Adjustments (GPLA), predicting "large firms which experience reduced earnings due to changed accounting standards favor the change.

All other firms oppose the change if the additional bookkeeping costs justify the cost of lobbying." They used discriminant analysis and claimed that their empirical results support the prediction. In another study, John Earing (1979) analyzed the letters of comments to the FASB on several standards to test the validity of Congressional allegations that the financial accounting policymaking process was dominated by Big Eight accounting firms and large business firms. His analysis concluded that client preferences might not be a key factor in CPA firms' support of FASB standards, and that the FASB in general does not appear to be responsive to business interests. Feroz (1982b) has taken the Watts-Zimmerman study one step further. Instead of a simple yes-no dichotomization of submissions, he adopted a systematic coding scheme to scan the issue-specific "demand inputs" expressed in the letters of comments from 123 firms in 22 SIC industry groups on FASB's General Price Level Adjustments Exposure Draft in 1974. His preliminary findings are that the changes in FASB's positions on GPLA are generally explainable in terms of the structural and behavioral attributes of the various groups. Brown (1981) extended demand input analysis to multiple issues. He analyzed the responses of 27 individuals, firms, and organizations to FASB's discussion memoranda in nine projects. In addition to doing a discriminant analysis with his data, he also did a series of multidimensional scalings to ascertain the relative positions among the respondents and FASB's possible alignment with certain groups. His main conclusion was that major differences existed between the FASB decisions and many of the respondents' preferences, and that empirical results are inconsistent with the assertions that Big Eight firms and the AICPA have exerted undue influence on the FASB.

The Game Theoretic Approach

This strategy has been extensively used by Neuman, who (1981a) applied the size principle to describe the formation of coalitions in the APB and the FASB. The size principle states: "In n-person, zero-sum games, where side-payments are permitted, where players are rational, and where they have perfect information, only minimum winning coalitions occur" (Ricker, 1962, p. 32).

Actual size of winning coalitions has been found to be greater than the expected sizes (minimum winning coalition) due to information effect and threat effect. He also used two power indices, the Shapley-Shubik Index, based on pivotal votes, and the Banzhaf Index, based on swing votes, to empirically estimate the power of the APB and FASB members (1981b) and the SEC (1981c). He (1981b) concluded that the structural changes made from APB to FASB have not significantly changed the voting power of Big Eight representatives, assuming block voting on the basis of employment affiliation.

However, their actual influence has not been any greater than the non-Big Eight representatives.

GOVERNMENT ACCOUNTING POLICYMAKING

Due to the differences in institutional environment, one has to be careful in transferring the substantive propositions and research methods discussed earlier to the public sector. Indeed, the similarities and differences in institutional arrangements for setting accounting standards in private and public sectors are worthy of investigation. The review above showed that the individual studies concerning corporate financial accounting policymaking explicated or tested certain general propositions about policymaking. The purpose of this section is to point out potentially fruitful areas of research in governmental accounting policymaking. To facilitate comparison, this section is organized roughly parallel to the section on research themes. To make the discussion concrete, reference will be made to the process of establishing a Government Accounting Standards Board (GASB), and likely research opportunities.

Alternative institutional arrangements for setting government accounting standards have not been subject to systematic critical analysis of accounting researchers. The sole exception appears to be Patton (1980a). Patton speculated the likely consequences of maintaining the status quo (with the existing National Council on Governmental Accounting) and of transfer of the standard-setting function to the FASB. Later events have shown that these alternatives were both unacceptable to the parties concerned. Patton developed a taxonomy of attributes of accounting standard-setting bodies and process, and made educated guesses as to how policy boards' structural, background, and environment attributes would affect their behavior. The linkages, however, are expectedly complex and often tenuous. Specifying these linkages amounts to building an organization theory of accounting policy boards. Many of the elements in Patton's taxonomy have in fact been relevant considerations in choosing among alternative structures (GASBOC, 1981). In addition to the possibilities studied by Patton, the other alternatives for local government accounting were: a federal institute as provided for in the Williams Bill; a Government Accounting Foundation and a Government Accounting Standards Board as proposed in the February 1981 exposure draft of the GASB Organization Committee; a GASB sponsored by the FAF as recommended in the GASB Organization Committee's final report, issued in October 1981.

These alternatives were developed and debated. Some survived; others failed in the dynamic process of political bargaining. What follows is a brief sketch of how or whether the concept of politics developed earlier are reflected in the last four years' struggle to effect an institutional change.

Politics as External Intervention

There is a long-standing belief that management has the prerogative to design "internal" information systems, but not reports to external parties, for fear of conflict of interests. Hence regulating agencies are created to set standards for corporate financial reporting, and the process has been widely regarded as political in the several senses elaborated earlier.

Since politics enters virtually every aspect of the government process, merely pointing out the political nature of governmental accounting policymaking would not be an original discovery. Modeling the interactions among the multiple parties that seek to influence municipal government accounting will, however, be a worthwhile research endeavor. Here an attempt will be made to explore more carefully the meaning of politics in setting municipal government accounting standards.

Politics may be viewed in the context of intergovernmental relations. The changing nature of intergovernmental relations has led to successive revision of accounting rules and regulations for intergovernmental grants. For example, categorical grants, block grants, and general revenue sharing have different accounting and reporting requirements, because they reflect differing degrees of grantor oversight and control, and grantee accountability. Politics may then be viewed as the grantor's use of the power of the purse to enforce disclosure requirements.

Politics also result from attempts to centralize accounting rule-making power. For the federal government, the Congress gave the comptroller general authority to set accounting standards for federal agencies. States have their constitutional and statutory authority to set their own accounting standards, as well as for their political subdivisions, including local governments. Municipalities may also develop their own detailed accounting procedures. What we find then is a situation where there are 50 authorities directing state and municipal accounting policies; in addition, some 80,000 local governments implement and interpret these policies. Decentralization is probably not too strong a word to describe this situation. In such a system, uniform standards and comparability of financial statements are difficult to achieve. Since a federal system lacks a superstructure for legally mandating across-state uniformity, coordination becomes a sensible strategy.

From the perspective of government officials, attempts by private-sector agencies (such as the FASB) to set accounting policies for their jurisdictions is tantamount to reverse regulation. Public officials seem to appreciate private-sector expertise in accounting, but are reluctant to be subject to the authority of a private-sector body. However, governments are not immune from the influences of the bond market, the federal government, and others. Due to the free rider problem in financing public goods and for other reasons, state and local governments could not set up an accounting standard-setting body on their own. They have instead accepted the alternative of a separate policy board (the GASB) under the auspices of the FAF, after being assured of acceptable representation in the structure and process of setting governmental accounting standards. These considerations have led me to predict?

> State legislatures and local government authorities will adopt an attitude of benign neglect and permit a Government Accounting Standards Board to set accounting standards for them. However, they will reserve their veto power and exercise it when GASB standards create significant adverse economic or political consequences for them.

Politics in the Selection of Policymakers

The willingness of representatives for state and local governments to accept a potentially more efficient and effective accounting standard-setting body has depended on their ability to bargain for adequate representation in the new structure. The GASBOC recommended that the board of trustees of the FAF be expanded to include three representatives from the public sector—one nominated by the Municipal Finance Officers Association (MFOA), one by the National Association of State Auditors, Comptrollers and Treasurers (NASACT) and one by the Big Seven Public Interest Groups (Council of State Governments, International City Management Association, National Association of Counties, National Conference of State Legislatures, National Governors Association, National League of Cities, and U.S. Conference of Mayors). In addition there would be a new governmental consulting and review group (new NCGA) consisting of the above organizations and the U.S. General Accounting Office, American Institute of Certified Public Accountants, Financial Accounting Foundation, American Accounting Association, a municipal bond rating agency, and a municipal bond underwriter, banker, or insurance company. These provisions are consistent with the following proposition: The size of the oversight and advisory board of an accounting standard-setting board will expand until all the parties whose support is necessary have been accommodated.

Politics in the selection of the policy board members themselves is also preordained by virtue of the provision that FAF's initial appointments to the GASB will be subject to the veto of the diverse consulting and review group. Given the heterogeneity of this new NCGA, it is expected that there will be a lot of politics—power struggle and compromise—in the initial GASB appointments. Under this kind of selection procedure, one would not be surprised that: The voting behavior of a Government Accounting Standards Board will be affected by their (former) employment affiliations.

Politics as Interest-Group Lobbying and the Policy Board's Differential Responsiveness

Who participates in the policymaking process? Why? And with what effect? After a GASB has started its operations, researchers will have the opportunities to test the following propositions:

> Given the costs of participation, lobbying activities will be undertaken mainly by those groups which expect to experience significant positive or negative impacts of policy alternatives under consideration.
>
> Lobbyists will not be equally effective in influencing a GASB. The GASB will likely be more responsive to those groups whose support will be critical for its credibility and survival.

One of the first official acts of the GASB will be to accept, modify, or reject standards set by the current National Council on Governmental Accounting as its own standard. That will provide a setting for testing the above propositions.

Additional research is also needed to find out the incentives and effectiveness of specific groups. The following proposition, for example, is advanced regarding the auditing profession: The public accounting profession will lobby for governmental accounting standards with the least possible divergence from corporate accounting standards, so as to avoid two sets of generally accepted accounting principles.

Evaluating the GASB

The final report of the GASB Organization Committee contains a "sunset" clause—there will be a mandatory review of the GASB at the end of five years. Research will therefore be needed to ascertain the appropriate criteria for deciding whether to continue, modify, or discontinue the GASB at that time.

That is, how will the GASB be judged to have succeeded or failed? The criteria may include inputs (financial and political support), throughputs (work load, number of discussion memoranda, exposure drafts issued), outputs (final standards issued), and outcomes (economic and political consequences resulting from the compliance and enforcement of GASB standards). However, cynics would predict that politics will determine the survival of the Government Accounting Standards Board or any other regulatory agency.

As the process of setting governmental accounting standards becomes more formalized and produces significant impacts, research on the process will correspondingly increase. This paper has pointed out some areas worthy of inquiry and proposed several hypotheses for testing. Hopefully, empirical research will generate substantial evidence about the behavior of all the parties involved in setting government accounting standards, including but not limited to the Government Accounting Standards Board.

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