



# **Towards an understanding of the role of standard setters in standard setting**

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## **Towards an understanding of the role of standard setters in standard setting\***

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### **Abstract**

We investigate the idiosyncratic influence of standard setters in standard setting. In particular, we examine how FASB members' length of tenure on the board, their past professional experience, and their political contributions vary with the degree to which the accounting standards they propose are perceived as increasing accounting "relevance" and/or decreasing accounting "reliability." Among other results, we find that length of tenure on the board and a prior career in investment banking/ investment management are associated with proposing standards perceived as decreasing accounting "reliability;" while contributions to the Democratic Party are associated with proposing standards perceived as increasing accounting "reliability." Broadly, the evidence, by highlighting the influence of standard setters, can broaden our understanding of the political economy of standard setting beyond the role of corporate lobbying.

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## **Towards an understanding of the role of standard setters in standard setting**

### **1. Introduction**

We examine how the backgrounds of Financial Accounting Standards Board (FASB) members influence the nature of accounting standards proposed between 1973 and 2007. In particular, we investigate how members' length of tenure on the FASB, their past professional experience, and their political contributions vary with the degree to which the accounting standards they propose are perceived as increasing accounting "relevance" and/or decreasing accounting "reliability." Among other results, we find that length of service on the board and a prior career in investment banking/ investment management are associated with proposing standards perceived as decreasing accounting "reliability;" while affiliation with the Democratic Party is associated with proposing standards perceived as increasing accounting "reliability." The results can shed light on the idiosyncratic influence of standard setters in standard setting.

The study can be viewed in the context of the extant literature on the political economy of accounting standard setting. That literature has examined the origins of accounting standards through an analysis of corporate lobbying on FASB proposals (e.g., Watts and Zimmerman, 1978).<sup>1</sup> But corporate lobbying is only part of the political economy that determines accounting standards. At the core of the standard setting process are the individuals that constitute the FASB. These board members can wield considerable influence over standard setting through their control of the FASB agenda (e.g., Leftwich, 1995). That is, while corporate lobbying is likely to influence the nature of accounting standards proposed by the FASB, the board members themselves are likely to shape GAAP by controlling which standards are proposed.<sup>2</sup> In this

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<sup>1</sup> For example, in a recent study, Ramanna (2008) investigates corporate lobbying on two prominent fair-value standards, SFAS 141/42: by investigating which companies support a standard and why, researchers can anticipate how that standard will be used.

<sup>2</sup> Lobbying also possibly influences agenda setting at the FASB, but this ex ante lobbying is usually unobservable.

paper, we develop and test some exploratory hypotheses with a view towards building an understanding of the idiosyncratic influence of FASB members on GAAP.

We conduct our study of FASB members' influence on standard setting through an analysis of the Statements of Financial Accounting Standards (SFAS) they propose. There are 151 such SFAS in our sample period, 1973–2007 (after data limitations). Our primary tests involve regressing assessments of the nature of a proposed SFAS on the average background characteristics of the extant FASB.

We evaluate a proposed SFAS by focusing in particular on its impact on “relevance” and “reliability.” Since at least the publication of its conceptual statements in the late 1970s (e.g., FASB, 1978; 1980), the FASB 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). The increased prominence, since the mid-1990s, of fair-value accounting in standard setting has generated more 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).

To obtain assessments of a proposed standard's impact on “relevance” and “reliability” that are independent of researcher judgment, we develop a new measure based on comment letters filed by the Big 8/6/5/4 auditors (hereafter, the “Big N auditors”). In particular, we analyze the Big N auditors' comment letters to determine whether they perceive the proposals as

increasing accounting “relevance” and/or decreasing accounting “reliability.” In addition, using tools from computational linguistics, we measure the auditors’ overall favorability towards the FASB proposals: doing so allows us to examine how auditor satisfaction on a given proposal varies with the background of the board that proposes it. Our use of auditor comment letters assumes, consistent with prior studies, that the comment-letter writers’ evaluations are truthful (i.e., an audit firm will not say they approve of a standard when in fact they do not); however, we make no assumption on the evaluations’ correctness (i.e., the auditors’ perceptions on a standard, being self-serving, may not be consistent with furthering economic efficiency). The Big N auditors’ comment letters represent time-series consistent and contemporaneous evaluations of FASB proposals from an important FASB constituency; thus, they provide a useful means to assess the impact of FASB members on standard setting.

We build a biographical database of all 39 FASB members appointed between 1973 (the board’s inception) and 2007. Drawing on empirical political-economy research that has examined the characteristics of regulators on regulation (see for example, Dal Bo, 2006 for a review), we focus on three biographical characteristics in particular: length of tenure on the FASB, past professional experience, and political contributions. On length of tenure, we examine whether longer tenures facilitate independence or capture. On one hand, long tenures can help standard setters develop the authority necessary to propose standards that are independent of special interests (e.g., Leaver, 2009); alternatively, long tenures can promote entrenchment, resulting in standards that cater to special interests (e.g., Stigler, 1971).<sup>3</sup> On FASB members’ past employment, we focus in particular on whether the members served in auditing or in investment banking/ investment management immediately prior to their appointment to the

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<sup>3</sup> “Special interest” is usually defined as an “organized group” with “similar preferences on a subset of policy issues” (Grossman and Helpman, 2001, p. 1). For example, the Big N auditors can be considered a special interest.

board. We expect members with prior careers in auditing to be more sympathetic to accounting verifiability (since verifiable accounting lowers auditors' litigation risk; e.g., Watts, 2003), and thus to be more likely to promote "reliability" in accounting standards (at the expense of "relevance"). In contrast, we expect members with prior careers in investment banking/investment management to be sympathetic to valuation-relevant accounting information, and thus more likely to promote "relevance" in accounting standards (at the expense of "reliability").

We also examine the influence of FASB members' political contributions on standard setting. Political contributions can be used to infer members' political sympathies. FASB members contributing to the Democratic Party are coded as Democrats, while those contributing to the Republican Party are coded Republicans; members not contributing to either party are not assigned a political identity. Prior literature has shown that Democratic regulators on the Federal Communications Commission are on average less sympathetic to corporate interests (e.g., Cohen, 1986). If this is also the case with Democratic FASB members, we expect such members to be more likely to propose standards that mitigate corporations' information advantage over outsiders. If, as the positive accounting literature argues, firms' information advantage is mitigated through conservative reporting,<sup>4</sup> we expect Democrats to be on average more likely to promote accounting standards that increase "reliability" (at the expense of "relevance").<sup>5</sup>

We find that standards proposed by FASB members with longer average tenures on the board are viewed more favorably by the Big N auditors. If the Big N auditors are self-serving in delivering favorable assessments of FASB proposals (e.g., Puro, 1984), this result is consistent

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<sup>4</sup> For example, Watts (2003) argues conservatism in accounting has evolved to mitigate managers' information asymmetry vis-à-vis corporate outsiders. Accounting conservatism results in the timely recognition of costs (including losses) in financial reports; benefits, however, are not recognized until they are earned and realizable.

<sup>5</sup> For example, Kothari, Ramanna, and Skinner (2010, p. 30) discuss how conservatism results in more "reliable" reporting (emphasis added): "Conditional and unconditional conservatism signify a trade-off under which relevant information about management achievements is deemphasized to provide a more prudent and *reliable* performance measure."

with long FASB tenures promoting capture by the Big N auditors. However, if the Big N auditors' evaluations are, on average, accurate indicators of accounting quality, the evidence suggests that standards proposed by FASB members with longer average tenures are of better quality (where quality refers to a standard's ability to facilitate efficient capital allocation). In separate tests, we find that longer average tenures are also associated with proposing standards perceived as decreasing accounting "reliability;" but, we find no evidence of an association between members' tenures and the standards' "relevance." If greater "reliability" is a desirable property of accounting (e.g., Watts, 2003), this result is consistent with longer tenures on the board compromising accounting quality.

There is also evidence that standards proposed by FASB members with prior experience in auditing are viewed less favorably by the Big N auditors; however, we find no evidence that board members' prior experience in auditing is associated with proposing standards that are perceived as increasing accounting "reliability." Thus, we cannot confirm the proposition that a career in auditing predisposes FASB members to be more sympathetic to accounting verifiability. In contrast, we do find evidence that standards proposed by FASB members with prior experience in investment banking/ investment management are perceived as decreasing accounting "reliability." This evidence is consistent with careers in finance predisposing FASB members towards "value-relevant" accounting standards.

On the role of personal politics, we find evidence that increased proportional membership of Democrats on the FASB is associated with proposed standards that are perceived by the Big N auditors as both increasing accounting "reliability" and decreasing accounting "relevance." These results are consistent with the proposition that Democrats are on average more likely to promote accounting conservatism because they are less sympathetic to corporate interests and

because they view conservative financial statements as mitigating corporations' information advantage over outsiders. We also find evidence that standards proposed by FASB boards with more Democratic donors are viewed less favorably by the Big N auditors. To the extent that Big N auditors reflect their clients' concerns in delivering favorable assessments on FASB proposals (e.g., Watts and Zimmerman, 1981), the auditors' low favorability of Democrat-proposed standards can also be explained by such standards being less sympathetic to corporate interests.

All of the results described above are robust to auditor fixed effects and to clustering standard errors by auditor and FASB proposal. Additionally, we conduct a number of sensitivity tests, including assigning greater weight to FASB chairmen when calculating the average background characteristics of an extant FASB (to assess if FASB chairmen are more important in standard setting). We also assess how the Big N auditors' perceptions of FASB proposals vary with the backgrounds of extant SEC commissioners, the political identity of the U.S. President, and the political composition of relevant Congresses. The SEC, the Presidency, and the Congress all enjoy some oversight of the FASB, and thus, can potentially influence standards proposed by the board. We find some systematic evidence relating standards proposed under certain SEC commissioners and members of Congress to more favorable assessments by the Big N auditors. These results are discussed in detail in Section 4.

The hypotheses and results presented in this paper are exploratory. Although there is a long history of political economy studies in accounting, our understanding of this field remains nascent. Kothari *et al.* (2010) lay out the capture and ideology theories of regulation as potential alternatives to explain standard setting behavior. The evidence in this paper is consistent with some "capture" of standard setting by the Big N auditors and their interests, but it also suggests, consistent with ideology theory, that standard-setters' prior experiences and personal politics

bear weight on the accounting standards they propose. With more research in the political economy of standard setting institutions, academics can develop a theory of accounting standard setting. Such a theory will be useful in designing and evaluating standard-setting institutions.

The remainder of the paper is organized as follows. Section 2 describes the data and discusses the various hypotheses being tested. Section 3 discusses descriptive statistics and the multivariate research design. Section 4 presents and interprets the multivariate results. Section 5 concludes with implications and suggestions for future research.

## **2. Data and hypotheses**

Our analysis of the influence of standard setters on standard setting focuses on members of the FASB. In particular, we are interested in whether the personal characteristics of FASB members can predict the “relevance” and “reliability” of the standards they produce. In addition, we test whether the members’ personal characteristics can explain variation in the Big N auditors’ favorability towards FASB accounting standards. We describe our comment-letter-based measures of the FASB proposals’ “relevance,” “reliability,” and favorability in Section 2.1. In Section 2.2., we describe the construction of our database of FASB members’ personal characteristics and discuss associated hypotheses. In the following sub-section (2.3.), we describe our data on the characteristics of the SEC commissioners, the U.S. President, and members of Congress who have overseen the FASB over the 1973–2007 period.

### *2.1. Evaluating proposed SFAS using Big N auditors’ comment letters*

There are 163 proposed SFAS in our sample period, 1973–2007. To evaluate these proposals objectively (i.e., independent of researcher judgment), we rely on relevant comment

letters filed by the Big N auditors. The Big N auditors' comment letters also provide a consistent and contemporaneous source of evaluations, i.e., the Big N auditors comment on nearly every proposed SFAS, their incentives are relatively consistent across the sample period, and their letters do not suffer from hindsight bias. In using the Big N auditors' comment letters, we do not assume that they are correct in their evaluations of the proposed standards; if the auditors are self-serving in their letters, their evaluations may not be consistent with a broader objective of furthering economic efficiency. As an important constituency of the FASB, however, the Big N auditors' letters are a useful means to assess the impact of FASB members on standard setting.

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. Table 1 provides a timeline of the changing dynamics of the U.S. audit industry. The absence of big auditor comments letters on 12 proposed SFAS over the 1973–2007 period decreases our sample size from 163 proposed SFAS to 151 proposed SFAS. Appendix A describes the details. There are collectively 892 unique comment letters by the Big N auditors on the 151 proposed SFAS. 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 analyzed to create our measures of the proposed SFAS' "relevance," "reliability," and favorability to auditors.

#### 2.1.1. Increased "relevance" (*inc\_relv*) and decreased "reliability" (*dec\_relb*)

We use a custom-designed Perl script to analyze the Big N auditors' comments letters for instances of concern over the proposed standards' impact on "relevance" and "reliability." 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 in Appendix B. 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.

Based on the information above, 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. We focus on increased “relevance” and decreased “reliability” because the FASB views “relevance” and “reliability” as trade-offs (e.g., Johnson, 2005): if this characterization is accurate, increases in “relevance” are expected to also result in decreases in “reliability,” which imply similar directional predictions on *inc\_relv* and *dec\_relb*

vis-à-vis our hypotheses. The variables *inc\_relv* and *dec\_relb* are defined as follows. For each big auditor comment letter “*i*” on a proposed SFAS “*j*”:

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

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

In the above equations,  $WC\_inc\_relv_{ij}$  is the word count of the first instance of the word stem “relevan” used in a positive context 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 a negative context 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.<sup>6</sup> By construction, *inc\_relv* and *dec\_relb* are confined to the range [0, 1] and are increasing in the strength of an auditor’s opinion of a proposed SFAS’ impact on increased “relevance” and decreased “reliability,” respectively. In tests described later, we examine the validity of *inc\_relv* and *dec\_relb* in a random sample of comment letters that are manually evaluated for auditor opinions on increased “relevance” and decreased “reliability.”

### 2.1.2. Favorability (*fav*)

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<sup>6</sup> 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” or “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 addition to computing *inc\_relv* and *dec\_relb*, we measure the Big N auditors' overall favorability towards a given proposed SFAS (*fav*). Specifically, we analyze our sample of comment letters using the Linguistic Inquiry and Word Count (LIWC) software to extract an objective measure of the letters' overall positivity (Pennebaker, Francis, and Booth, 2001). The measure in LIWC is denoted "posemo." LIWC has been used previously in computational linguistic analyses across the social and behavioral sciences (see Tausczik and Pennebaker, 2009, for a review), including accounting research (e.g., Li, 2008; Ramanna and Watts, 2010).

To compute "posemo" on a given comment letter, LIWC sequentially checks each word in the letter against entries in its predetermined dictionary of English words with positive emotion.<sup>7</sup> For a given comment letter "*i*" on a proposed SFAS "*j*,"  $fav_{ij}$  is the proportion of positive emotion words to total words.

## 2.2. Background and personal politics of FASB members

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 past professional experience, and their political contributions. We focus on these three characteristics because prior research on the role of individual regulators in regulation has identified the characteristics as influential in shaping policy (e.g., Gromley, 1979; Cohen, 1986). However, since these characteristics have not, to our knowledge, been systematically applied to evaluating accounting standard setters' influence on standard setting, the hypotheses we present below are more exploratory than motivated by a well-defined accounting theory.

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<sup>7</sup> Information about LIWC and its dictionary of positive emotive (posemo) words can be found at [www.liwc.net](http://www.liwc.net).

Data on the duration of service on the board and the most recent employer prior to appointment to the board 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.

In addition, we also build a database of the 39 members' political contributions. 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 affiliation 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.<sup>8</sup>

As previously noted, we investigate FASB members' influence on standard setting by analyzing the standards they propose. Accordingly, for each proposed SFAS, we average the personal characteristics of all board members in office at the time. That is, for example, on SFAS 123 (issued October 1995), we average across the seven FASB members in office as of October 1995 their length of service on the board (hereafter, *Tenure FASB*), and compute across the seven members, the proportion of members with prior employment in auditing (hereafter, %

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<sup>8</sup> 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.

*Auditor FASB*), the proportion of members with prior employment in investment banking/investment management (hereafter, % *Financial FASB*), the proportion of members contributing to the Democratic Party (hereafter, % *Dem Donor FASB*), and the proportion of members contributing to the Republican Party (hereafter, % *Rep Donor FASB*). The assumption implicit in averaging board members' characteristics by SFAS is that a proposed SFAS represents the average position of all FASB members in office at the time.<sup>9</sup> In sensitivity tests described later, we examine the robustness of our results to: (1) assigning greater weight to FASB chairmen when calculating the average background characteristics of an extant FASB; and (2) averaging board-member characteristics across only those members who assented to the eventual SFAS that emerged from the proposals we investigate.

*Tenure FASB* can be used to assess the impact of the average length of standard-setters' terms on special-interest capture. If the Big N auditors are considered a "special interest," their overall favorability assessments of standards proposed by the FASB can be used as an indicator of special-interest capture. In the classical economic theory of regulation (Stigler, 1971), longer regulatory terms (i.e., higher values of *Tenure FASB*) signify greater regulatory entrenchment (or "coziness"), which in turn facilitates special-interest capture. Thus, the classical theory prediction on *Tenure FASB* is a positive association with auditors' favorability scores. However, Leaver (2009) develops and tests a model of regulation where longer regulatory terms promote greater independence from special interests, suggesting that we cannot specify an ex ante directional prediction on the association between *Tenure FASB* and auditors' favorability of FASB standards.

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<sup>9</sup> The maximum number of FASB members at any given time during our sample period is seven. 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.

*Tenure FASB* can also be associated with assessments of a proposed standard's "relevance" and "reliability." If "relevance"/ "reliability" are desirable properties of accounting standards, a negative association between *Tenure FASB* and these properties is consistent with longer term-lengths decreasing standard-setting quality (as implied under Stigler's theory, assuming capture results in lower quality standards). In contrast, a positive association between *Tenure FASB* and "relevance"/ "reliability" is consistent with longer term lengths facilitating standards with desirable accounting properties (consistent with Leaver's model).

*% Auditor FASB* and *% Financial FASB* can be used to test the impact of FASB members' prior industry affiliations on the standards they propose. Prior research in political science has shown that Federal Communications Commission (FCC) regulators with broadcasting industry experience are more supportive of broadcasting industry interests (e.g., Cohen, 1986). In this vein, we first investigate whether FASB members with prior careers in auditing are more sympathetic to auditors' interests. We expect auditors are likely to be concerned about accounting verifiability since verifiable accounting lowers auditors' litigation risk (see for example, a discussion of the evidence in Kellogg, 1984, by Watts, 2003). Thus, if backgrounds in auditing predispose FASB members to support auditors' interests, we predict FASB members with careers in auditing are more likely to promote "reliability" in accounting standards (at the expense of "relevance"). We also examine whether FASB members with careers in investment banking/ investment management are more supportive of "value relevant" accounting standards. "Value relevance" is expected to improve accounting's usefulness in stock price valuation. If investment bankers and investment managers view this direct valuation role for accounting as desirable, we expect FASB members with careers in these industries to promote "relevance" in accounting standards (at the expense of "reliability").

The empirical literature in political science has also considered the implications of regulators' political affiliations on regulations. While summarizing the evidence as (p. 215) "well short of abundant," Dal Bo (2006) does underscore the persistent finding in the literature that Democratic regulators are less likely to be sympathetic to corporate interests. Drawing from these findings, we expect FASB memberships with higher proportions of Democrats (i.e., higher values of *% Dem Donor FASB*) to be more likely to propose standards that mitigate corporations' information advantage over outsiders. The positive accounting literature has argued that conservatism in financial reporting is a key feature in mitigating managers' information asymmetry vis-à-vis outsiders (e.g., Watts, 2003; LaFond and Roychowdhury, 2008; LaFond and Watts, 2008). Accounting conservatism results in the timely recognition of costs (including losses) in financial reports; benefits are not recognized until they are earned and realizable. Accounting conservatism is likely to result in more "reliable" reporting (e.g., Kothari *et al.*, 2010); accordingly, we expect Democrats to be more likely to promote "reliability" in accounting standards, at the expense of "relevance."<sup>10</sup>

Ex ante, we have no corollary 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 on the role of political affiliations on accounting standards.<sup>11</sup>

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<sup>10</sup> Of course, corporations' information advantage can also be mitigated by requiring managers to recognize more timely information about benefits (thus making accounting more "relevant"), but positive accounting theory predicts that such information cannot be credibly communicated in audited financial statements. "Relevant" information about benefits is usually communicated through extra-GAAP disclosures (including, the management discussion and analysis section of the firms' annual 10-K filings). Thus, under the hypothesis that Democratic regulators promote standards that mitigate corporations' information advantage, we can expect Democratic regulators (on the SEC) to encourage more of such extra-GAAP disclosures.

<sup>11</sup> 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). The closeness between Democrats and Republicans on the FASB can confound the prediction that Democratic regulators are less likely to be sympathetic to corporate interests.

### *2.3. Characteristics of SEC commissioners, the U.S. President, and members of Congress*

In addition to exploring the role of FASB members on the nature of FASB standards, we study the impact of extant SEC commissioners, the U.S. President, and the composition of relevant Congresses on accounting standard-setting. The FASB's derives its standard-setting mandate from the SEC, so SEC commissioners can plausibly exert influence over the nature of standards proposed by FASB members. Further, the U.S. President, through his power to name SEC commissioners, can also influence the FASB's activities. Finally, the literature has documented evidence of lobbying by members of Congress on accounting standards (e.g., Farber, Johnson, and Petroni, 2007; Ramanna, 2008), and of a role for accounting in congressional elections (Ramanna and Roychowdhury, 2010), so it is possible that the FASB anticipates congressional sentiments when proposing new standards.

Our variables on SEC commissioners' personal characteristics are similar to those on FASB members. Specifically, we gather data on the commissioners' length of tenure on the SEC, their political affiliation, and their prior professional background—in particular, whether they worked for an auditing firm or a financial services firm prior to appointment to the SEC. Our definition of “financial services” in classifying SEC commissioners' prior experience is broader than the investment banking and investment management criteria used with FASB members. Specifically, we also include two commissioners who worked for the NYSE and a financial industry association, respectively, under the SEC “financial services” classification. The data on the commissioners' personal characteristics are obtained from the SEC's historical archives, as well as from newspaper biographies of the commissioners (usually published upon the commissioners' initial appointment).

As with the variables on the FASB members, we average the variables on the commissioners' personal characteristics at the SFAS level. That is, for each proposed SFAS, we average the personal characteristics of all commissioners in office at the time. The variable denoting commissioners' average length of service is called *Tenure SEC*; the variable denoting the proportion of commissioners with prior employment in financial services is called *% Financial SEC*; and the variable denoting the proportion of commissioners who identify as Democrats is called *% Democrat SEC*. We do not include a variable for the proportion of commissioners with prior employment in auditing because only one of the 41 SEC commissioners that served during our sample period (1973–2007) worked for an audit firm prior to appointment to the commission.

In the case of SEC commissioners, political identities are not inferred from campaign contributions since the identities are known with certainty (commissioners declare a party affiliation at or prior to appointment). Further, the proportion of SEC commissioners identifying as Republicans and Democrats in our sample is collectively exhaustive, obviating the need for separate party identity variables (as is the case with FASB members).

On the role of the U.S. President and members of Congress, we test for an association between their political ideology and the nature of standards proposed under their watch. We measure political ideology using the first dimension of common space scores, as discussed in Poole (1998) and reported on Keith Poole's website, [www.voteview.com](http://www.voteview.com). The scores are constructed from spatial voting analysis of the politicians' voting records and are scaled between -1 (very Democratic) and +1 (very Republican). The scores have been used extensively in the political science literature to measure ideology (see Cox, 2001, for a recent discussion). We denote the score for each U.S. President during our sample period, *President Politics*. In

constructing the score for the Congress in session at the time of a proposed SFAS, we average the measure across all members of the majority party in the Senate and all members of the majority party in the House. The resulting average is called *Congress Politics*. There are two assumptions implicit in computing *Congress Politics*: that the ideology of a majority party is more dominant than that of a minority party, and that the ideology of a party in power in both chambers is more dominant than that of a party that has control over only one chamber.

### 3. Descriptive statistics and multivariate research design

In Section 3.1., we present and discuss descriptive statistics and univariate correlations for the variables in our study (see Appendix C for a summary of all variables and their definitions). Section 3.2. details the research design used in our regression-based tests of standard-setters' influence on standard setting.

#### 3.1. Descriptive statistics

Table 2, Panel A, reports summary statistics for our comment-letter-based measures of increased “relevance” (*inc\_relv*), decreased “reliability” (*dec\_relb*), and favorability (*fav*). The reported statistics are for the 892 big auditor comment letters received on the 151 proposed SFAS in our sample. The mean value of *inc\_relv* is 0.0359.<sup>12</sup> The median value of *inc\_relv* is 0, suggesting that at least 50% of comment letters do not include any instance of an assessment on increased accounting “relevance.” The standard deviation of *inc\_relv* is 0.17 (over four-and-a-half times the mean), suggesting 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*

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<sup>12</sup> The relatively low mean value for *inc\_relv* is driven by comment letters with no mention of “relevance.”

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, 2007), so the high *inc\_relv* score on this standard’s exposure draft is consistent with *inc\_relv* measuring increased “relevance.”

The mean value of *dec\_relb* is 0.0655 and its median value is 0. As with *inc\_relv*, there is considerable variation in *dec\_relb* (standard deviation is 0.21), 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 can introduce considerable subjectivity in financial reporting; thus it seems reasonable, that SFAS 141R’s exposure draft received a high score on *dec\_relb*.

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 892 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, our evaluation agreed with *inc\_relv* and *dec\_relb*. In all five exceptions, *inc\_relv* and *dec\_relb* were coded zero, while our manual assessment was that the letters did in fact express sentiments on increased relevance and/or decreased reliability. In all these cases, however, the actual word-stems “relevan” and “reliab” were never used, which explains why *inc\_relv* and *dec\_relb* were coded zero. Thus, the validity tests suggest *inc\_relv* and *dec\_relb* are good measures of increased “relevance” and decreased “reliability,” provided these sentiments are expressed using the word-stems “relevan” and “reliab.”

The mean value of *fav* across the 892 big auditor comment letters is 3.05%, suggesting just over three percent of words in the comment letters are associated with positive emotions, per the LIWC dictionary. Research by Pennebaker *et al.* (2007) is helpful in interpreting this measure. That study analyzes a composite sample of six classes of writing from over 24,000 individuals in 72 linguistic studies. Of particular interest to our analysis, Pennebaker *et al.* compare LIWC “posemo” scores (i.e., *fav*) from experimental analysis in which individuals were randomly assigned to write about either “deeply emotional topics” (average “posemo” = 3.28%) or relatively “trivial” topics (average “posemo” = 1.83%). In reference to these values, our observed sample mean for *fav* of 3.05% suggests that Big N auditors are “deeply” invested in the positions they take in comment letters. The sample median for *fav*, at 2.97%, is also closer to this “emotional writing” benchmark; the sample standard deviation for *fav* is 1.28%. The maximum average value of *fav* for any given proposed SFAS (6.66%) is observed on the exposure draft for SFAS 110, Reporting by Defined Benefit Pension Plans. This standard requires a defined benefit pension plan to report certain investments at fair value.

Panel B of Table 2 reports Pearson correlation coefficients between the three variables discussed above, i.e., *inc\_relv*, *dec\_relb*, and *fav*. The p-values on the correlation coefficients in Table 2 are based on clustering at the proposed SFAS level.<sup>13</sup> The variables *inc\_relv* and *dec\_relb* are significantly correlated at the 99% confidence level; the correlation coefficient is 0.212. This result is consistent with the FASB’s conception of “relevance” and “reliability” as trade-offs. Neither *inc\_relv* nor *dec\_relb* are significantly correlated with *fav*, suggesting the Big N auditors’ favorability assessments on a proposed SFAS are independent of their assessments on “relevance” and “reliability.” Figure 1 plots the time series of *inc\_relv*, *dec\_relb*, and *fav*.

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<sup>13</sup> 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  $\rho$  is the Pearson correlation coefficient and  $n$  is the number of clusters (i.e., proposed SFAS).

Overall, there appears to be an increasing time trend in all three variables (trend lines omitted), indicating the proposed standards' are becoming increasingly "relevant," decreasingly "reliable," and more agreeable to the Big N auditors.

Panel A of Table 3 reports summary statistics for the FASB members' and SEC commissioners' personal characteristics, as well as *Congress Politics* and *President Politics*. These measures constitute the set of explanatory variables in subsequent regression-based tests. The mean value of *Tenure FASB* is 4.25 and the median is 4.23, suggesting that, on average, a proposed SFAS is issued by a board with just over 4 years of individual service experience. In contrast, the mean and median values of *Tenure SEC* are 3.1 and 2.9, respectively, suggesting SEC commissioners are on average less experienced in their extant jobs. Figure 2 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.

On average, about 38.34% of FASB members have a prior background in auditing (*% Auditor FASB*), while about 5.12% of FASB members have a prior background in investment banking/ investment management (*% Financial FASB*). Figure 3 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 emergence of, and growth in, fair-value accounting since the mid-1990s can be associated with the increase in *% Financial FASB*. The average proportion of SEC commissioners with prior backgrounds in financial services (*% Financial SEC*) is higher than the corresponding FASB statistic at 12.24%. Figure 3 plots the secular trend in *% Financial SEC*, which appears to show considerable time series variation.

The average proportion of FASB members contributing to the Democratic Party, *% Dem Donor FASB*, is 16.24%. This statistic is lower than *% Rep Donor FASB* at 19.19%. The medians for these two variables show similar differences, although the maximum value of *% Dem Donor FASB* is higher than that of *% Rep Donor FASB*. Figure 4 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 43.93%, which indicates the average statistic for Republican SEC commissioners is just over 56%. 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 4) is predictable, given that SEC commissioners are appointed by the President.<sup>14</sup>

The average values of *Congress Politics* and *President Politics* in the sample are -0.029 and 0.172, respectively, indicating that the average congressional politics over our sample period is slightly Democratic, while the average presidential administration is Republican. There is considerable variation in these variables over time as can be expected from changing national politics over the sample period (standard deviations are 0.258 and 0.491, respectively; also see Figure 5). The most Democratic presidential administration in our sample period is that of President Carter, 1977–1981 (*President Politics* of -0.543), and the most Republican presidential administration is that of President Reagan, 1981–1989 (*President Politics* of 0.581).

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<sup>14</sup> No more than three of the five SEC commissioners at any given time can belong to the same party; so for example, a Democratic 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.

Panel A of Table 3 also reports summary statistics on two market-based variables that are included as control variables in regression tests. The variables measure the annual value-weighted market return (*VWRETD*) and the standard deviation of the daily value-weighted market return (*sd\_VWRETD*) in the twelve months leading up to the issuance of a proposed SFAS. The two market return variables are computed from data reported by CRSP. The market variables are included to account for overall macroeconomic conditions that may affect the Big N auditors' perceptions on FASB proposed standards.

Pearson correlations between the explanatory variables in Panel A, Table 3 are shown in Panel B, Table 3. Statistical inferences are based on clustering by year because some of the variables are measured yearly (e.g., *VWRETD* and *sd\_VWRETD*). 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* (0.410) and negatively associated with *% Dem Donor FASB* (-0.507); *% Auditor FASB* is positively associated with both *% Rep Donor FASB* (0.302) and *% Dem Donor FASB* (0.462). 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., Gromley, 1979; Cohen, 1986).

### *3.2. Multivariate research design*

We test several exploratory hypotheses on the role of standard setters in standard setting. We are interested in assessing how auditors' favorability of FASB proposed standards, and their perceptions on the proposals' impact on "relevance" and "reliability," vary with characteristics

of standard setters. Accordingly, the dependent variables in our regressions are variously, *inc\_relv*, *dec\_relb*, and *fav*.

In the first set of regressions, we include as explanatory variables, our measures of the FASB members' average service on the board, *Tenure FASB*, and their prior professional background, *% Auditor FASB* and *% Financial FASB*. Additionally, we include similar variables for the SEC commissioners, i.e., *Tenure SEC* and *% Financial SEC*. We include FASB and SEC background variables in the same regression for parsimony; all results are substantively similar when estimated on FASB or SEC characteristics only. We do not include our measures of the members' personal politics in these regressions because of the high observed correlations between the political and other variables. As previously discussed, these correlations are consistent with prior findings (see Dal Bo, 2006, p. 217, for a summary of those findings). The formal specification for our first set of regressions is given in equation (3).

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

In equation (3), “*i*” is a big auditor comment letter and “*j*” is a proposed SFAS and *DepVar<sub>ij</sub>* is variously *inc\_relv<sub>ij</sub>*, *dec\_relb<sub>ij</sub>*, and *fav<sub>ij</sub>*, as defined in Section 2. Standard errors in estimating equation (3) are clustered two-ways, by proposed SFAS and big auditor (using the method described in Petersen, 2009). We run two specifications of equation (3), one with big auditor fixed effects and one without. The big 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 members' personal politics (i.e., *% Dem Donor FASB* and *% Rep Donor FASB*) in a second set of

regressions. Consistent with the format in equation (3), these regressions also include the political identity of the SEC commissioners (i.e., *% Democrat SEC*). The formal specification for our second set of regressions is given in equation (4) below.

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

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 test for the association between the dependent variables and our measures of the politics of Congress and the Presidency (*Congress Politics* and *President Politics*). The formal specification for the third set of regressions is in equation (5).

$$DepVar_{ij} = f(Congress\ Politics_j, President\ Politics_j) \dots (5)$$

*DepVar* and the subscripts “*i*” and “*j*” are as defined in equations (3) and (4). Standard error clusters are also as described earlier.

All regressions described above are estimated using ordinary least squares (OLS). In all regressions, we include the two market-based variables, *VWRETD* and *sd\_VWRETD*, as economic controls; the results are substantively unchanged when these controls are excluded.

#### **4. Multivariate results**

Section 4.1. presents multivariate regression results on the tenure and prior employment characteristics of FASB members and SEC commissioners. In Section 4.2., we discuss results on the members’ and commissioners’ personal politics. In Section 4.3., we present our results on the impact of congressional and presidential politics on standard setting. Finally, in Section 4.4., we discuss the results of various robustness tests.

#### 4.1. Tenure and prior employment characteristics of FASB members and SEC commissioners

Table 4 reports OLS estimation results of equation (3), which test for association between the explanatory variables and the Big N auditors' perceptions of proposed SFAS' "relevance" (Panel A), "reliability" (Panel B), and overall favorability (Panel C). There are two columns to each panel: the first reports regression results without auditor fixed effects, the second with the fixed effects. All regressions use the sample of 892 comment letters. Standard errors in all regressions are clustered by big auditor and SFAS, and are robust to heteroskedasticity.

On the impact of tenure, we find no association between *Tenure FASB* and increased "relevance," *inc\_relv* (Panel A). However, the coefficients on *Tenure FASB* when regressed on decreased "reliability," *dec\_relb* (Panel B) are positive and statistically significant in columns (1) and (2) ( $p < .01$ ), suggesting that longer terms of service on the FASB are associated with a perception of decreased accounting "reliability." To put the coefficients' magnitudes in perspective, the implication from column (2) is that a one standard deviation increase in tenure (1.39 years) is associated with a decrease in "reliability" that is about 27% of the mean *dec\_relb* value. If the quality of financial statements is increasing in "reliability" (e.g., FASB, 1980), this finding suggests longer average board tenures are associated with diminished standards' quality.

Panel C shows that *Tenure FASB* is a positive and significant predictor of Big N auditors' favorability, *fav* ( $p < .05$ ), suggesting that standards produced by boards with longer individual tenures are on average viewed more favorably by the Big N auditors. To put the coefficients' magnitudes in perspective, the implication from column (2) is that a one standard deviation increase in tenure is associated with an increase in favorability that is about 8% of the mean *fav* value. If Big N auditors are self-serving in favorably assessing a proposed standard (Puro, 1984), this result is consistent with the proposition that increased tenure fosters regulatory capture. If

the Big N auditors' assessments are a signal of a standard's quality (vis-à-vis the standard's ability to facilitate efficient capital allocation), the same result suggests that longer average FASB tenures can be welfare increasing. This second explanation is, however, inconsistent with the finding in Panel B that longer tenures are associated with decreased standards' "reliability."

The coefficient on *Tenure SEC* is positive only in Panel A ( $p < .10$ ). Thus, there is some weak evidence to confirm that the tenure lengths of SEC commissioners influence the nature of proposed FASB standards.

When investigating the impact of prior employment, the regression coefficients on *% Auditor FASB* are significant ( $p < .05$ ) and negative only in the regression on *fav* (Panel C). Thus, while there is evidence that auditors' favorability of FASB proposals decline with the proportion of ex-auditors on the board, there is no evidence to confirm the proposition that greater auditor representation on the FASB results in standards that Big N auditors perceive as verifiable.

We find evidence that *% Financial FASB* is a positive and significant ( $p < .01$ ) predictor of FASB proposals perceived as decreasing accounting "reliability" (Panel B). To put the coefficients' magnitudes in perspective, the implication from column (2) is that a one standard deviation increase in *% Financial FASB* (9.10%) is associated with a decrease in "reliability" that is about 67% 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 more value-relevant (and thus, less "reliable") standards. In the multivariate regressions, however, we cannot corroborate this proposition with evidence of a direct association between *% Financial FASB* and our measure of increased "relevance," *inc\_relv*.

The coefficient on *% Financial SEC* is significantly positive ( $p < .05$ ) in Panel C, suggesting auditor favorability towards proposed standards is increasing in the proportion of

extant SEC commissioners with backgrounds in financial services. *% Financial SEC* is not statistically associated with either *inc\_relv* (Panel A) or *dec\_relb* (Panel B).

#### 4.2. Personal politics of FASB members and SEC commissioners

Table 5 reports OLS estimation results of equation (4). The regressions test for association between the personal politics of FASB members and SEC commissioners and the Big N auditors' perceptions of proposed SFAS' "relevance" (Panel A), "reliability" (Panel B), and overall favorability (Panel C). As in Table 4, two regression specifications, columns (1)–(2), are presented in each panel of Table 5, allowing for tests of the results' robustness to the inclusion of auditor fixed effects.

As shown in Table 5, the coefficient on *% Dem Donor FASB* is significant ( $p < .05$ ) and negative in explaining both *inc\_relv* (Panel A) and *dec\_relb* (Panel B). To put the coefficients' magnitudes in perspective, the implication from columns (2) is that a one standard deviation increase in *% Dem Donor FASB* (17.50%) is associated with a decrease in "relevance" that is about 63% of the mean *inc\_relv* value and an increase in "reliability" that is about 42% 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 both decreasing accounting "relevance" and increasing accounting "reliability." As proposed under positive accounting theory, this tendency towards "reliability" over "relevance" results in conservative accounting, which in turn, can mitigate corporations' information advantage over outsiders. We expect Democratic-leaning FASB members to be more likely to engage in standard setting that mitigates corporations' information advantages, consistent with findings in

the political economy literature that concludes Democratic regulators are on average less sympathetic to corporate interests (e.g., Cohen, 1986).

*% Dem Donor FASB* is also negatively associated ( $p < .05$ ) with auditors' favorability, *fav* (Panel C). That is, standards proposed by FASB boards with more Democratic donors are viewed less favorably by Big N auditors. When combined with the results in Panels A and B, and assuming audit firms' interests are aligned with those of their corporate clients (e.g., Watts and Zimmerman, 1981), this evidence is consistent with the proposition that Democratic FASB members are on average less sympathetic to corporate interests.

Table 5 also reveals a statistically negative association between *% Rep Donor FASB* and *inc\_relv* (Panel A); although this association does not carry through to the *dec\_relb* (Panel B) and *fav* (Panel C) regressions. The interpretation is that standards proposed by FASB boards with more Republican contributors are perceived as decreasing "relevance." We are not aware of a theory to interpret this result. Table 5 also reports no evidence of an association between the politics of SEC commissioners and Big N auditors' assessment of FASB proposed standards.

#### 4.3. Politics of Congress and the Presidency

Table 6 reports OLS estimation results of equation (5). The regressions test for association between congressional and presidential politics and the Big N auditors' perceptions of proposed SFAS' "relevance" (Panel A), "reliability" (Panel B), and overall favorability (Panel C). As in Tables 4 and 5, two regression specifications, (1)–(2), are presented in Table 6 to allow for robustness tests on the inclusion of auditor fixed effects. Direction and significance of coefficients in the table are robust across all specifications.

On the role of Congress, Table 6 provides evidence ( $p < .05$ ) that standards proposed under Democratic-controlled Congresses (*Congress Politics* < 0) are perceived by the Big N auditors as increasing accounting “reliability” (Panel B). To put the coefficients’ magnitudes in perspective, the implication from column (2) is that a one standard deviation change in *Congress Politics* towards Democratic politics (0.258) is associated with an increase in “reliability” that is about 44% of the mean *dec\_relb* value. There is also evidence in Table 6 that the Big N auditors’ favorability toward FASB proposals decreases when the Congress in existence is more Democratic (Panel C). These results corroborate the earlier findings on the role of Democrats in regulation: Democrats are on average less sympathetic to corporate interests.

There is no evidence in Table 6 to suggest that auditors’ perceptions of FASB proposals’ “relevance” are associated with congressional politics. Further, we find no evidence to suggest that the politics of the U.S. President is associated with the Big N auditors’ perceptions of FASB proposals’ “relevance,” “reliability,” and favorability.

#### 4.4. Robustness tests

In the tests thus far, we average the background characteristics of all FASB members in office at a given time, the implicit assumption being that a proposed SFAS represents the average position of all extant FASB members. In Table 7, we report the results of assigning greater weight to FASB chairmen when calculating the average background characteristics of an extant board. In particular, we assign the background characteristics of FASB chairmen twice the weight of non-chair members when computing *Tenure FASB*, *% Auditor FASB*, *% Financial FASB*, *% Dem Donor FASB*, and *% Rep Donor FASB*. 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.

Also in Table 7, we examine the sensitivity of our results to averaging board-member characteristics across only those members who assented to the final standards that emerged from the proposals we study. That is, we exclude from the averages those members who actively dissented in or abstained from the final approval vote on a standard. Members' final votes on standards can be influenced by changes induced by corporate lobbying, thus such votes are not perfect indicators of members' preferences on original proposals. However, to the extent such votes are reasonable approximations of members' positions on the proposals, this sensitivity test can exclude the possibility that our results are driven by dissenting and abstaining members.

There are two parts to Table 7: Part A is equivalent to the regression in Table 4 (i.e., tenure and experience are the explanatory variables); Part B to that in Table 5 (i.e., personal politics variables are the regressors). Each part is composed of three panels that are based on our three dependent variables, *inc\_relv*, *dec\_relb*, and *fav*. The first column of each panel reports the results from doubling the weight on FASB chairmen when computing average member characteristics. The second column of each panel reports the results of averaging board-member characteristics across only assenters. Overall, all of the inferences in Tables 4 and 5 can be made in Table 7 as well, with one exception: *Tenure SEC* is not a significant predictor of *inc\_relv* when board-member characteristics are averaged across only assenters.

## **5. Conclusion and directions for future research**

The positive literature on the political economy of accounting standard setting has examined the origins of accounting standards through an analysis of corporate lobbying on

FASB proposals. Corporate lobbying is, however, only part of the political economy that determines accounting standards: at the core of the standard setting process are the individuals that constitute the FASB. In this paper, we develop and test some exploratory hypotheses with a view towards building an understanding of the influence of FASB members on GAAP.

We examine how the backgrounds and personal politics of FASB members influence the nature of accounting standards proposed between 1973 and 2007. In particular, we investigate how members' length of tenure on the FASB, their past professional experience, and their political contributions vary with the degree to which the accounting standards they propose are perceived by the big audit firms as increasing accounting "relevance" and/or decreasing accounting "reliability." We also examine the variation in FASB members' backgrounds and personal politics with the Big N auditors' favorability towards FASB proposed standards. We find that length of service on the board is associated with proposing standards perceived both more favorably by Big N auditors and as decreasing accounting "reliability." The evidence is consistent with longer tenures on the board facilitating capture at the expense of standards quality. We also find that FASB members' affiliation with the Democratic Party is associated with proposing standards perceived both less favorably by Big N auditors and as increasing accounting "reliability." This evidence is consistent with prior literature that has shown Democratic regulators are on average less sympathetic to corporate interests.

The hypotheses and results presented in this paper can be viewed as a step towards developing a political-economic theory of standard setters in standard setting. Kothari *et al.* (2010) lay out two promising theories that have the potential to explain standard setting behavior: the capture and the ideology theories of regulation. The capture theory models regulators as self-interested and thus liable to "capture" by special-interest factions. By catering

to special interests, standard setters may be currying favor for potential future employment. One implication of this proposition is that there is a “revolving door” between standard setters and special-interests groups. The ideology theory, in contrast, offers a more nuanced view of regulators: in particular, it predicts regulators’ actions represent trade-offs between demands of special-interest lobbies and their own regulatory “ideologies.” The implication for standard setting is that GAAP rules can sometimes reflect standard setters’ idiosyncratic ideologies (e.g., a preference for “relevance” over “reliability”).

The evidence in this paper is consistent with some “capture” of standard setting by the Big N auditors and their interests, but it also suggests, consistent with ideology theory, that standard-setters’ personal characteristics bear weight on the accounting standards they propose. Of course, more research in the political economy of standard setting institutions is necessary before a well-developed theory of standard setting can be specified. For example, future research can investigate whether audit training and prior professional experience (such as government or academic service) explain standard setters’ preference for “reliability” over “relevance.” Also, in addition to “relevance” and “reliability,” research can explore how standard setters’ backgrounds predict other important accounting properties like “comparability,” “consistency,” and more topically, “harmonization” with international practices.

A theory of accounting standard setting can be helpful in informing future efforts at designing standard setting institutions, including considerations on term limits and prior work experience. As capital market institutions across the world adapt to the growing influence of International Financial Reporting Standards (IFRS), there have been several attempts at redesigning national standard setting institutions. For example, in the past five years, both

Canada and China have undertaken some revamping of their standard setting institutions.<sup>15</sup> Further, in the U.S., over the two years from 2008 to 2010, the FASB has pared down and then increased its membership from seven to five and back to seven members, in order to “protect and maintain its efficiency” (FAF, 2008, 2010). Given the paucity of theory and evidence to guide such structural changes, most, if not all of the institutional transformations have been *ad hoc*. There is also very little understanding of the design and operations of process at the International Accounting Standards Board.<sup>16</sup> We see this paper as a first response to the call in Kothari *et al.* (2010) for a broader research agenda in the political economy of accounting standards.

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<sup>15</sup> See for example, Ramanna and Cheng (2009) on Canada, and Ramanna, Donovan, and Dai (2010) on China.

<sup>16</sup> An exception is Camfferman and Zeff's (2007) account of the IASB's predecessor, the International Accounting Standards Committee, which offers some historical insights into the IASB's current structure.

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## **Appendix A**

### **Obtaining Big N auditors' comment letters on proposed SFAS from 1973 to 2007**

From 1973 through 1989 there are eight large audit firms, the Big 8, suggesting we can expect up to eight comment letters per proposed SFAS. There are 104 SFAS from this period (Table 1), indicating a maximum of 832 comment letters. Not every Big 8 auditor wrote a comment letter on each of the 104 SFAS proposals. In fact, on nine of these SFAS proposals, there are no comment letters from the Big 8.<sup>i</sup> Of the remaining 95 proposed SFAS, the average Big 8 comment rate is 78.29%.<sup>ii</sup>

The emergence of both Ernst & Young and Deloitte & Touche in 1989 results in a consolidation of the “Big 8” to the “Big 6.” Thus, from 1989 through 1998 (when the Big 6 became the Big 5), we can expect up to six comment letters per proposed SFAS. There are 30 SFAS proposed in this period; two without any Big 6 comment letters.<sup>iii</sup> On the remaining 28 proposed SFAS, the average Big 6 comment rate is 96.97% (Table 1), an increase over the earlier period.

In the sample period 1998 through 2002, when the U.S. auditing oligopoly operated as the Big 5, ten additional SFAS were proposed. All of the ten were commented on by the Big 5, with an average Big 5 comment rate of 90%. The demise of Arthur Andersen in 2002 lowers the number of potential comments per SFAS proposed between 2002 and 2007 to four. Of the 19 SFAS proposed in this period, all but one received comments from some members of the Big 4.<sup>iv</sup> The average Big 4 comment rate for 2002–2007 is 96.11%.

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<sup>i</sup> The nine proposed SFAS from 1973–1989 with no comment letters from the Big 8 are: SFAS 40 (re: accounting for timberlands); SFAS 51 (re: accounting by cable television companies); SFAS 53 (re: accounting in the motion picture industry); SFAS 67 (re: accounting for initial rental operations in real estate projects); SFAS 89 (which made supplementary information of price-level information voluntary); SFAS 92 (accounting for phase-in plans); SFAS 98 (accounting for sale-leasebacks); SFAS 101 (disclosure issues in certain regulated entities); and SFAS 103 (resetting the effective date of another standard).

<sup>ii</sup> The average comment rate is defined as the ratio of the actual number of “big auditor” comment letters received to the number of possible comment letters.

<sup>iii</sup> 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).

<sup>iv</sup> The proposed SFAS from 2002–2007 receiving no comment letters from the Big 4 is SFAS 146 (accounting for costs associated with exit or disposal activities).

## **Appendix B**

### **Examples from actual sentences in the comment letters of “relevance” and “reliability” being used in positive, negative, and irrelevant contexts**

- 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.

## Appendix C

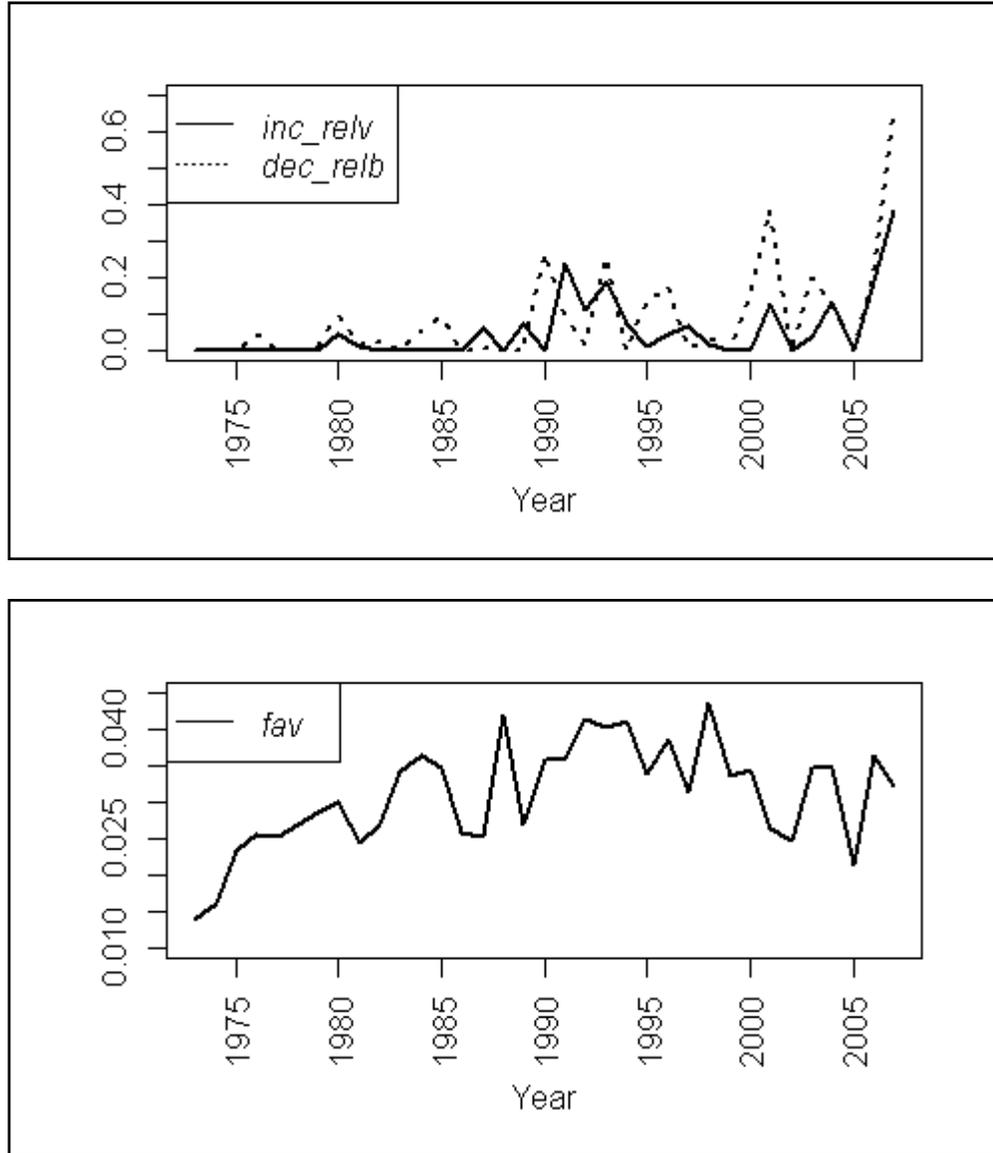
### Variable definitions

VARIABLE	DESCRIPTION
<b><i>Dependent variables</i></b>	
<i>inc_relv</i>	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 2.1.1. for details.
<i>dec_relb</i>	Assessment that a proposed SFAS will decrease accounting “reliability” as expressed by the Big N auditors in their comment letters. See Section 2.1.1. for details.
<i>fav</i>	A measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2.1.2. for details.
<b><i>FASB member characteristics</i></b>	
<i>Tenure FASB</i>	SFAS-level measure of the average tenure in years of all extant FASB members.
<i>% Auditor FASB</i>	SFAS-level measure of the proportion of extant FASB members with most recent former employ in auditing.
<i>% Financial FASB</i>	SFAS-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management.
<i>%Rep Donor FASB</i>	SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Republican party or candidates.
<i>% Dem Donor FASB</i>	SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Democratic party or candidates.
<b><i>SEC commissioner characteristics</i></b>	
<i>Tenure SEC</i>	SFAS-level measure of the average tenure in years of all extant SEC commissioners.
<i>% Financial SEC</i>	SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services.
<i>% Democrat SEC</i>	SFAS-level measure of the proportion of extant Democratic SEC commissioners.
<b><i>Other political variables</i></b>	
<i>Congress Politics</i>	Yearly measure of the conservatism/ liberalism of members of Congress. See Section 2.3. for details.
<i>President Politics</i>	Yearly measure of the conservatism/ liberalism of the U.S. President. See Section 2.3. for details.
<b><i>Market control variables</i></b>	
<i>VWRETD</i>	Annual value-weighted market return (from CRSP) for the 12 months directly preceding the month in which a proposed SFAS was issued.
<i>sd_VWRETD</i>	Standard deviation of daily <i>VWRETD</i> for the 12 months directly preceding the month in which a proposed SFAS was issued.

**Figure 1**

**Time series of increased “relevance,” decreased “reliability,” and favorability**

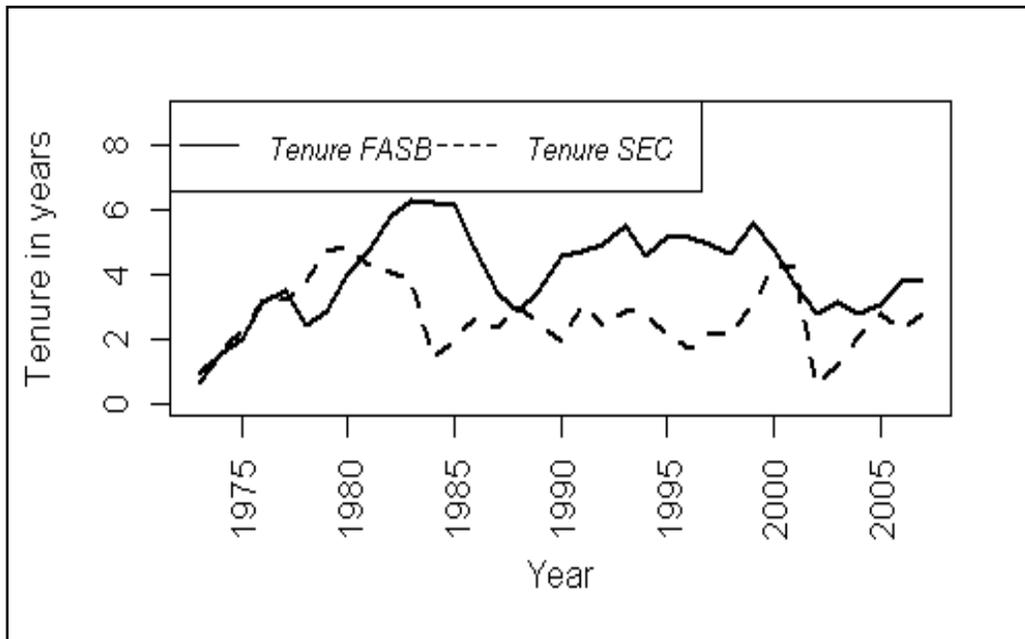
The sample is the 892 big auditor comment letters written on 151 proposed SFAS issued between 1973 and 2007. *inc\_relv* is an assessment that a proposed SFAS will increase accounting “relevance” as expressed by the Big 8/6/5/4 auditors (hereafter “Big N auditors”) in their comment letters. *dec\_relb* is an assessment that a proposed SFAS will decrease accounting “reliability” as expressed by the Big N auditors in their comment letters. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details.



**Figure 2**

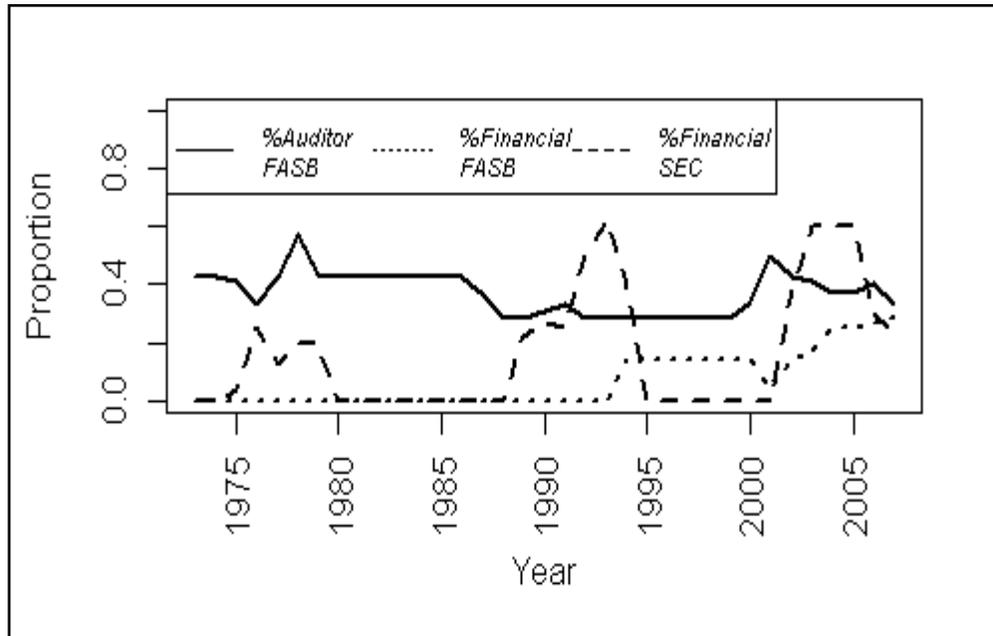
**Average tenure of FASB members and SEC commissioners by proposed SFAS, 1973–2007**

The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an SFAS-level measure of the average tenure in years of all extant FASB members. *Tenure SEC* is an SFAS-level measure of the average tenure in years of all extant SEC commissioners.



**Figure 3**  
**Proportion of FASB members and SEC commissioners with prior employment in auditing and financial services**

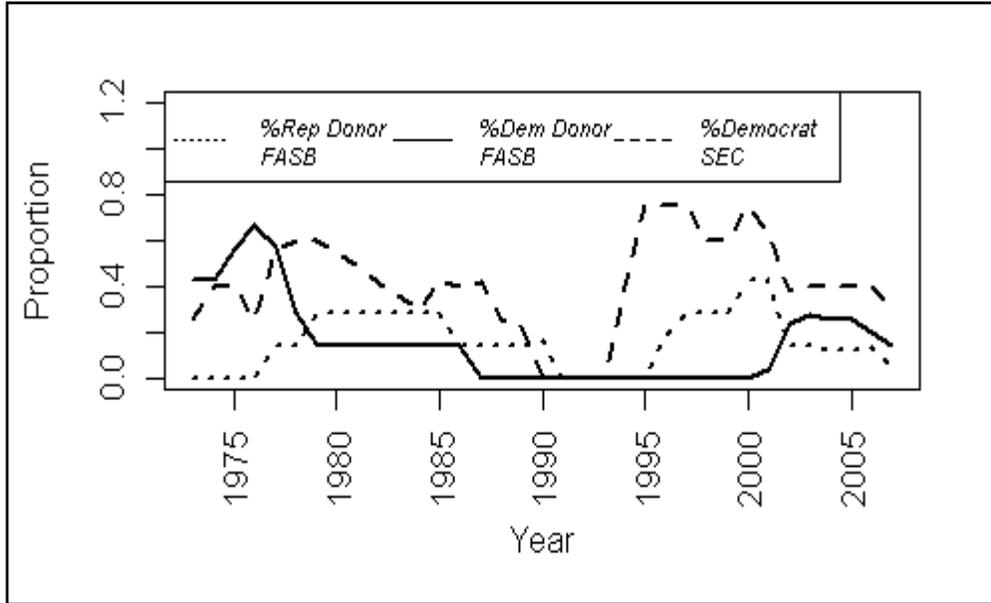
The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *% Auditor FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *% Financial SEC* is an SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services.



**Figure 4**

**Proportion of FASB members and SEC commissioners by political identity**

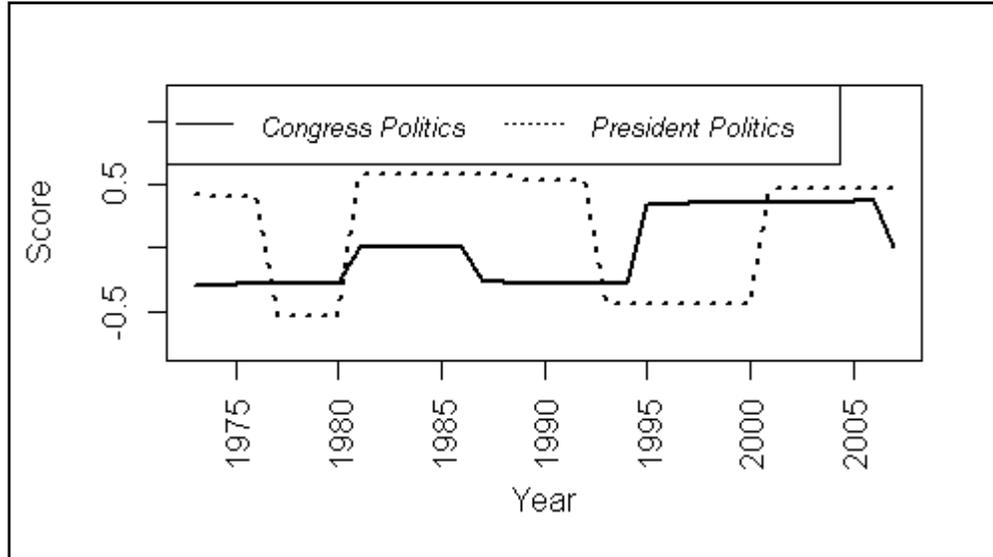
The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *%Rep Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *% Democrat SEC* is an SFAS-level measure of the proportion of extant Democratic SEC commissioners.



**Figure 5**

**Politics of the Congress and the Presidency in the sample period 1973–2007**

The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Congress Politics* is a yearly measure of the conservatism/ liberalism of members of Congress. See Section 2.3. for details. *President Politics* is a yearly measure of the conservatism/ liberalism of the U.S. President. See Section 2.3. for details. The y-axis score is scaled between -1 and +1 with negative values being Democratic and positive values being Republican.



**Table 1**  
**Sample construction**

The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters.

<b>Era</b>	<b>Big 8</b>	<b>Big 6</b>	<b>Big 5</b>	<b>Big 4</b>
<b>Period</b>	1973-1989	1989-1998	1998-2002	2002-2007
<b>Audit firms</b>	Arthur Anderson Arthur Young Ernst & Whinney/ Ernst & Ernst	Arthur Anderson  Ernst & Young	Arthur Anderson  Ernst & Young	Ernst & Young
	Touche Ross Deloitte, Haskin & Sells	Deloitte Touche	Deloitte Touche	Deloitte Touche
	Peat Marwick Coopers Lybrand Price Waterhouse	KPMG Coopers Lybrand Price Waterhouse	KPMG PWC	KPMG PWC
<b># of SFAS issued</b>	104	30	10	19
<b># SFAS with zero big auditor comment letters</b>	9 <i>SFAS 40, 51, 53, 67, 89, 92, 98, 101, 103</i>	2 <i>SFAS 109, 124</i>	0	1 <i>SFAS 146</i>
<b>Remaining SFAS</b>	95	28	10	18
<b>Avg. % response in remaining SFAS*</b>	0.7829	0.9697	0.9000	0.9611

\*Avg. is computed excluding zero response SFAS as: (Total # of big auditor comment letters received) / (# of remaining SFAS \* # of big auditor firms in the era).

**Table 2****Summary statistics and correlations between measures of increased “relevance,” decreased “reliability,” and favorability**

The sample is the 892 big auditor comment letters written on 151 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. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details.

**PANEL A: Summary statistics**

Variable	Mean	Median	S.D.	Maximum	Minimum
<i>inc_relv</i>	0.0359	0.00	0.17	0.98	0.00
<i>dec_relb</i>	0.0655	0.00	0.21	0.99	0.00
<i>fav</i>	3.05%	2.87%	1.28%	9.20%	0.00%

**PANEL B: Pearson Correlation Coefficients**

Variable	<i>inc_relv</i>	<i>dec_relb</i>	<i>fav</i>
<i>inc_relv</i>			
<i>dec_relb</i>	0.212 ***		
<i>fav</i>	0.079	0.077	

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

**Table 3 Panel A****Summary statistics on explanatory variables**

The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an SFAS-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an SFAS-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an SFAS-level measure of the proportion of extant Democratic SEC commissioners. *Congress Politics* is a yearly measure of the conservatism/ liberalism of members of Congress. See Section 2.3. for details. *President Politics* is a yearly measure of the conservatism/ liberalism of the U.S. President. See Section 2.3. for details. *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.

Variable	Mean	Median	S.D.	Maximum	Minimum
<b>FASB</b>					
<i>Tenure FASB</i>	4.25	4.23	1.39	6.55	0.58
<i>% Auditor FASB</i>	38.34%	42.86%	7.27%	57.14%	28.57%
<i>% Financial FASB</i>	5.12%	0.00%	9.10%	28.57%	0.00%
<i>% Rep Donor FASB</i>	19.19%	28.57%	12.62%	42.86%	0.00%
<i>% Dem Donor FASB</i>	16.24%	14.29%	17.50%	66.67%	0.00%
<b>SEC</b>					
<i>Tenure SEC</i>	3.1	2.9	1.2	6.1	0.4
<i>% Financial SEC</i>	12.24%	0.00%	19.05%	66.67%	0.00%
<i>% Democrat SEC</i>	43.93%	40.00%	19.46%	100.00%	0.00%
<b>Other politics</b>					
<i>Congress Politics</i>	-0.029	0.010	0.258	0.370	-0.289
<i>President Politics</i>	0.172	0.470	0.491	0.581	-0.543
<b>Market variables</b>					
<i>VWRETD</i>	12.37%	13.29%	18.11%	-31.33%	66.89%
<i>sd_VWRETD</i>	0.87%	0.83%	0.28%	0.47%	0.00%

**Table 3 Panel B**

**Pearson correlations between explanatory variables**

The sample is the 151 proposed SFAS issued between 1973 and 2007 on which the Big N auditors filed comment letters. *Tenure FASB* is an SFAS-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *%Rep Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *Tenure SEC* is an SFAS-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *% Democrat SEC* is an SFAS-level measure of the proportion of extant Democratic SEC commissioners. *Congress Politics* is a yearly measure of the conservatism/ liberalism of members of Congress. See Section 2.3. for details. *President Politics* is a yearly measure of the conservatism/ liberalism of the U.S. President. See Section 2.3. for details. *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.

		FASB characteristics			SEC characteristics		FASB politics		SEC politics	Other politics		Market vars.
		<i>Tenure FASB</i>	<i>% Auditor FASB</i>	<i>% Fin FASB</i>	<i>Tenure SEC</i>	<i>% Fin SEC</i>	<i>%Rep Donor FASB</i>	<i>%Dem Donor FASB</i>	<i>% Dem SEC</i>	<i>Cong Politics</i>	<i>Pres Politics</i>	<i>VWRETD</i>
FASB characteristics	<i>Tenure FASB</i>											
	<i>% Auditor FASB</i>	-0.231										
	<i>% Financial FASB</i>	-0.116	-0.228									
SEC characteristics	<i>Tenure SEC</i>	0.089	0.329**	-0.360**								
	<i>% Financial SEC</i>	-0.251	-0.124	0.392**	-0.276							
FASB politics	<i>% Rep Donor FASB</i>	0.410**	0.302*	-0.135	0.488***	-0.463***						
	<i>% Dem Donor FASB</i>	-0.507***	0.462***	-0.215	-0.070	-0.032	-0.344**					
SEC politics	<i>% Democrat SEC</i>	-0.076	0.193	0.180	0.210	-0.447***	0.462***	0.001				
Other politics	<i>Congress Politics</i>	0.291*	-0.099	0.708***	-0.288*	0.001	0.339**	-0.368**	0.387**			
	<i>President Politics</i>	0.171	0.137	-0.059	-0.261	-0.033	-0.050	0.040	-0.541***	0.077		
Market variables	<i>VWRETD</i>	0.108	-0.156	0.166	0.080	-0.025	0.226	-0.283*	0.181	0.140	-0.140	
	<i>sd_VWRETD</i>	-0.252	0.068	-0.024	-0.080	-0.038	-0.037	0.185	-0.185	0.069	0.374**	-0.259

Significance levels: (\*) 10% level, (\*\*) 5% level, (\*\*\*) 1% level using a two-tailed t-test with S.E. clustered by year.

**Table 4****OLS regression of increased “relevance,” decreased “reliability,” and favorability on the background characteristics of FASB members and SEC commissioners**

Sample is 892 big auditor comment letters written on 151 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. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details. *Tenure FASB* is an SFAS-level measure of the average tenure in years of all extant FASB members. *% Auditor FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an SFAS-level measure of the proportion of extant FASB members with most recent former employ in investment banking/ investment management. *Tenure SEC* is an SFAS-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. 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.

	[A] Dep. Var.= <i>inc_relv</i>		[B] Dep. Var.= <i>dec_relb</i>		[C] Dep. Var.= <i>fav</i>	
	(1)	(2)	(1)	(2)	(1)	(2)
<i>Tenure FASB</i>	-0.0001 (0.0040)	-0.0001 (0.0041)	0.0128 ** (0.0053)	0.0129 ** (0.0053)	0.0018 *** (0.0006)	0.0018 *** (0.0006)
<i>% Auditor FASB</i>	-0.1246 (0.1334)	-0.1249 (0.1338)	0.0724 (0.1618)	0.0686 (0.1603)	-0.0281 ** (0.0110)	-0.0279 ** (0.0111)
<i>% Financial FASB</i>	0.3033 (0.1867)	0.3141 * (0.1867)	0.5060 *** (0.1793)	0.4788 *** (0.1824)	0.0102 (0.0086)	0.0101 (0.0088)
<i>Tenure SEC</i>	0.0066 * (0.0037)	0.0065 * (0.0037)	0.0025 (0.0082)	0.0027 (0.0083)	0.0003 (0.0007)	0.0003 (0.0007)
<i>% Financial SEC</i>	0.1336 (0.1036)	0.1349 (0.1042)	0.0936 (0.0842)	0.0901 (0.0847)	0.0114 ** (0.0048)	0.0113 ** (0.0048)
Market Vars.	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects	No	Auditor	No	Auditor	No	Auditor
S.E Cluster	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor
Obs.	892	892	892	892	892	892
R-Sq	0.0690	0.0729	0.0562	0.0734	0.1144	0.1221

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

**Table 5**

**OLS regression of increased “relevance,” decreased “reliability,” and favorability on the personal politics of FASB members and SEC commissioners**

Sample is 892 big auditor comment letters written on 151 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. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details. *%Rep Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an SFAS-level measure of the proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *% Democrat SEC* is an SFAS-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.

	[A] Dep. Var.= <i>inc_relv</i>		[B] Dep. Var.= <i>dec_relb</i>		[C] Dep. Var.= <i>fav</i>	
	(1)	(2)	(1)	(2)	(1)	(2)
<i>% Rep Donor FASB</i>	-0.2278 *** (0.0766)	-0.2319 *** (0.0786)	-0.1324 (0.1477)	-0.1220 (0.1494)	-0.0089 (0.0065)	-0.0088 (0.0066)
<i>% Dem Donor FASB</i>	-0.1269 *** (0.0465)	-0.1290 *** (0.0473)	-0.1634 *** (0.0572)	-0.1582 *** (0.0570)	-0.0204 *** (0.0048)	-0.0203 *** (0.0049)
<i>% Democrat SEC</i>	-0.0864 (0.0737)	-0.0858 (0.0747)	-0.0245 (0.0848)	-0.0246 (0.0856)	-0.0031 (0.0051)	-0.0030 (0.0050)
Market Vars.	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects	No	Auditor	No	Auditor	No	Auditor
S.E. Cluster	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor
N Obs.	892	892	892	892	892	892
R-Sq	0.0679	0.0706	0.0281	0.0487	0.0870	0.0944

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

**Table 6****OLS regression of increased “relevance,” decreased “reliability,” and favorability on the politics of the Congress and the Presidency**

Sample is 892 big auditor comment letters written on 151 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. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details. *Congress Politics* is a yearly measure of the conservatism/ liberalism of members of Congress. See Section 2.3. for details. *President Politics* is a yearly measure of the conservatism/ liberalism of the U.S. President. See Section 2.3. for details. 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.

	<b>[A] Dep. Var.= <i>inc_relv</i></b>		<b>[B] Dep. Var.= <i>dec_relb</i></b>		<b>[C] Dep. Var.= <i>fav</i></b>	
	(1)	(2)	(1)	(2)	(1)	(2)
<i>Congress Politics</i>	0.0089 <i>(0.0392)</i>	0.0106 <i>(0.0401)</i>	0.1158 ** <i>(0.0469)</i>	0.1106 ** <i>(0.0466)</i>	0.0055 * <i>(0.0029)</i>	0.0055 * <i>(0.0029)</i>
<i>President Politics</i>	0.0221 <i>(0.0148)</i>	0.0222 <i>(0.0151)</i>	0.0082 <i>(0.0237)</i>	0.0074 <i>(0.0234)</i>	-0.0014 <i>(0.0017)</i>	-0.0015 <i>(0.0017)</i>
Market Vars.	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects	No	Auditor	No	Auditor	No	Auditor
S.E. Cluster	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor
N Obs.	892	892	892	892	892	892
R-Sq	0.0158	0.0177	0.0282	0.0484	0.028	0.0372

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

**Table 7****Robustness tests using alternate definitions of FASB-based explanatory variables**

Sample is 892 big auditor comment letters written on 151 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 N auditors” in their comment letters. *dec\_relv* is an assessment that a proposed SFAS will decrease accounting “reliability” as expressed by the Big N auditors in their comment letters. *fav* is a measure of the Big N auditors’ favorability towards a proposed SFAS. See Section 2 for details. *Tenure FASB* is an SFAS-level measure of the weighted average tenure in years of all extant FASB members. *% Auditor FASB* is an SFAS-level measure of the weighted proportion of extant FASB members with most recent former employ in auditing. *% Financial FASB* is an SFAS-level measure of the weighted proportion of extant FASB members with most recent former employ in investment banking/ investment management. *Tenure SEC* is an SFAS-level measure of the average tenure in years of all extant SEC commissioners. *% Financial SEC* is an SFAS-level measure of the proportion of extant SEC commissioners with most recent former employ in financial services. *%Rep Donor FASB* is an SFAS-level measure of the weighted proportion of extant FASB members making campaign contributions to the Republican Party or candidates. *% Dem Donor FASB* is an SFAS-level measure of the weighted proportion of extant FASB members making campaign contributions to the Democratic Party or candidates. *% Democrat SEC* is an SFAS-level measure of the weighted 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. In columns (1), all FASB variables are averaged using a double weighting for FASB chairpersons. In columns (2), FASB members who dissented on/abstained from the final vote on an SFAS are excluded in calculating average FASB characteristics. See section 4.4 for details. Figures in italics and parentheses are standard errors.

**PART A: Regressions on tenure and prior employment**

	<b>[A] Dep. Var.= <i>inc_relv</i></b>		<b>[B] Dep. Var.= <i>dec_relv</i></b>		<b>[C] Dep. Var.= <i>fav</i></b>	
	(1)	(2)	(1)	(2)	(1)	(2)
<i>Tenure FASB</i>	-0.0002 (0.0035)	-0.0039 (0.0043)	0.0092 * (0.0051)	0.0125 ** (0.0060)	0.0018 *** (0.0005)	0.0019 *** (0.0006)
<i>% Auditor FASB</i>	-0.1106 (0.1424)	0.0104 (0.0810)	0.0904 (0.1877)	0.1956 *** (0.0754)	-0.0289 ** (0.0114)	-0.0172 ** (0.0082)
<i>% Financial FASB</i>	0.3884 * (0.2069)	0.2481 * (0.1439)	0.5466 *** (0.2096)	0.3695 ** (0.1522)	-0.0150 (0.0098)	0.0166 * (0.0088)
<i>Tenure SEC</i>	0.0065 * (0.0037)	0.0024 (0.0046)	0.0016 (0.0085)	-0.0011 (0.0083)	0.0003 (0.0007)	0.0003 (0.0007)
<i>% Financial SEC</i>	0.1370 (0.1051)	0.1541 (0.1010)	0.0873 (0.0859)	0.1032 (0.0832)	0.0125 ** (0.0049)	0.0117 ** (0.0053)
Market Vars.	Yes	Yes	Yes	Yes	Yes	Yes
Fixed Effects	Auditor	Auditor	Auditor	Auditor	Auditor	Auditor
S.E. Cluster	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor	SFAS, Auditor
Obs.	892	892	892	892	892	892
R-Sq	0.0718	0.0637	0.0719	0.0724	0.1147	0.1187

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

**Table 7 (continued)**

**PART B: Regressions on political contributions**

	<b>[A] Dep. Var.= <i>inc_relv</i></b>		<b>[B] Dep. Var.= <i>dec_relb</i></b>		<b>[C] Dep. Var.= <i>fav</i></b>	
	(1)	(2)	(1)	(2)	(1)	(2)
<i>% Rep Donor FASB</i>	-0.2382 *** (0.0819)	-0.1559 *** (0.0588)	-0.1117 (0.1567)	-0.0656 (0.1124)	-0.0057 (0.0075)	-0.0075 (0.0056)
<i>% Dem Donor FASB</i>	-0.1047 ** (0.0447)	-0.0862 ** (0.0385)	-0.1304 ** (0.0523)	-0.1145 *** (0.0426)	-0.0168 *** (0.0043)	-0.0149 *** (0.0045)
<i>% Democrat SEC</i>	-0.0923 (0.0748)	0.1035 (0.0765)	-0.0307 (0.0846)	-0.0412 (0.0877)	-0.0039 (0.0051)	-0.0035 (0.0053)
Market Vars.	Yes	Yes	Yes	Yes	Yes	Yes
	Auditor	Auditor	Auditor	Auditor	Auditor	Auditor
S.E. Cluster	Auditor, SFAS	Auditor, SFAS	Auditor, SFAS	Auditor, SFAS	Auditor, SFAS	Auditor, SFAS
Obs.	892	892	892	892	892	892
R-Sq	0.0704	0.0614	0.0490	0.0442	0.0963	0.0763

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