

**Vincent C. Ross Institute of Accounting Research
New York University Stern School of Business**

Ross Roundtable on Politics and GAAP

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A distinguished panel of academics, professionals, journalists, and industry experts convened to discuss the impact of politics on the setting of accounting standards, and in particular, the impact of political pressures on the recent promulgation of the controversial Statement¹ expanding the requirements of fair-value measurements. Seymour Jones² (NYU) provided the introductory remarks, stating that deluge of front-page headlines provided the incentive to include *mark to market accounting* in the discussion of politics and GAAP.

As some of the discussants noted “yes, we know our history”, but it would be important to step back and lay the groundwork before proceeding with our discussion of the role of politics and GAAP.

- Congress created the SEC (1934). SEC commissioners are appointed by the President of the U.S. with the advice and consent of the Senate.
- The SEC delegated the authority³ to establish accounting standards to the private sector, subject to Commission oversight and approval of standards.
- The FASB is structured to be independent of business and professional organizations and not of Congress.
- Congress is not independent of the political pressures of business and professional organizations.
- Independence, as it relates to private-sector setting of accounting standards is, at best, a nebulous descriptive.

The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. It was designed to provide investors and the markets with more reliable information and clear rules of honest dealing.

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public. The information should be relevant, reliable, transparent (understandability), with full disclosure. Achieving neutrality has always been a primary objective of accounting standard setters.

¹ SFAS No. 157.

² Professor and Associate Director, Ross Institute

³ Establishing accounting standards is the mandate of the SEC.

Missions of these agencies do not include promulgating standards for the purpose of implementing public policy, in particular, policy targeted towards individual sectors of our economy, thus breaching the neutrality of accounting standards.

Although admittedly the setting of accounting standards is not entirely independent, Raymond Beier (PWC) asserted that it must be free of undue influence. He does not believe that the U.S. government wants to take over standard setting⁴. However, the financial crisis, its impact on the economy, and pressure-cooker media coverage, provided the steam for government intervention.

Karthik Ramanna and Abigail Allen (Harvard U) presented the results of their research on the correlation between political affiliations, past employment, and FASB-SEC relations and their effect on the nature of accounting standards. The instrument used to measure the significance of the relationships was “Big 8” comment letters stating their positions on the increased/decreased relevance and reliability of FASB proposals. The data suggests a correlation between Big 8 citations of increased relevance and decreased reliability of financial reporting as the proportion of investment bankers and republicans on the FASB and SEC increased.

Providing information to assist in the efficient allocation of resources, the responsibility of the FASB, should not be confused with social welfare, the domain of the government (Joshua Ronen, NYU). Professor Ronen asserts that the objective of “*predicting the amount, timing, and uncertainty of cash flows*” is not met with “mark to exit” valuation based on the assumptions of market participants. Disclosures of downside risk should be made; however, inducing honesty remains a corporate governance issue.

The creation of the FASB, which replaced the APB⁵, was structured to insure the independence and objectivity of the Board members. Board members must sever all ties to business entities. Mark Lilling (Lilling & Co.) noted that under the current regime, we have witnessed significant government ownership of private business entities. They are not independent. Thus, political pressures and intervention in the standard setting process is highly suspect.

GAAP ↔ PAAP--“Generally” accepted must ultimately be “Politically” accepted (Stephen Ryan, NYU). He reemphasized that accounting standards should not be used as a vehicle to achieve economic, social, or political goals. Professor Ryan is of the opinion that the Financial Staff Position on *Other Than Temporary Impairment* (April, 2009) exemplifies the violation of GAAP in both letter and principle. The FSP ignores changes in interest rates, term structure, or credit risk premia⁶ and is thus economically unsound. The rules provide an appearance of improved solvency enabling banks to meet current “stress tests”. Reduced transparency has exacerbated the already

⁴ However, he acknowledged that the Perlmutter Bill, Federal Accounting Oversight Board Act of 2009, was re-introduced in Congress.

⁵ Accounting Principles Board (1959-1973) part-time members retained positions with business and financial institutions.

⁶ To the extent that they are distinct from illiquidity risk premia.

existing problems related to *impairments*. He suggests using “fulfillment value”⁷, that in general, provides good measurement in a wide range of settings. He urges individuals to become proactive and publicize the effects of political influence on GAAP, and faults the FAF for not getting the message out.

Stanley Siegel (NYU Law) suggests that a multitude of valuation methods may be needed to disclose core information; replace reliable with adequate. James Ohlson (NYU) opined that an improved “sharper” Conceptual Framework would be less susceptible to interpretations, and thus reduce political interference. Much to the amusement of the participants, Professor Siegel commented that it is the politicians who need to be more transparent, and a principled process must take precedence over objectives.

John Biggs (NYU)⁸ who has worn many “hats” in his long and distinguished career, expressed deep concern about the future of voluntary contributions from business entities and other organizations that have supported e.g. the FAF and IASB. *Reciprocity* is an undeniable alter ego of *voluntary contribution*. Post-SOX congressional financing and convergence to global accounting standards have created influence- peddling alliances that do not bode well for the future. Of even greater concern to Mr. Biggs regarding convergence, is the fact that accounting standards cannot be passed without the approval of the leaders of the European Union. He warns we are going to be entering a world where the European Union is going to have a major role in standard setting, considerably stronger than Congress.

Bob Herz (FASB) strongly believes that discounted cash flows are generally a better measure than exit values. That said, the complexity of the financial instruments, some of which were backed by fraudulent loans, defied valuation by any conventional method. Our country has gone through its second major shock in three decades. Mr. Herz noted that the one common feature of the S & L debacle and the current crisis is that under both GAAP and regulatory accounting for loans, institutions appeared to be well capitalized. Loans are not marked to market. Improvements to the Conceptual Framework are underway, and measurement issues are a priority.

“A combination of bad accounting and regulators, who promoted leniency to improve capital ratios, led to the S & L debacle.” Lawrence White (NYU). Professor White opined that historical cost is a very valuable option. “Delay and pray” worked in favor of many financial institutions in the ‘80’s. Miklos Vasarhelyi (Rutgers) finds the obsession of obtaining one deterministic measure within a specified time frame both incomprehensible and detrimental. Reports can be prepared using multiples bases, thus finessing political pressure and improving disclosure.

Politics and GAAP are inseparable. When Congress intervenes in the setting of accounting standards, and the objectives of political powers are incongruent with the objectives of financial reporting, irreconcilable differences are created. “Politics and GAAP becomes politics versus GAAP” (Sy Jones). During the long history of the

⁷ <http://www.naylornetwork.com/cia-nwl/articles/?aid=31030&projid=2080>

⁸ Former Chairman and Chief Executive Officer TIAA-CREF

accounting profession, political pressure has resulted in the promulgation of standards that have had a huge impact on the market economy. Intense lobbying by banks in the late 70's resulted in rules for "troubled-debt" that eliminated the fundamental requirement of reporting long term receivables/payables at present value. The issue was not *mark to market*. Ultimately banks failed⁹, and taxpayers were burdened with a bailout of billions of dollars.

If independence is merited, how should the FASB be insulated from political pressure? The SEC Roadmap sets a target date of 2014 for adoption of International Accounting Standards.. Global accounting requires establishment of an international monitoring body. Political pressures and lack of independence will take on a whole new meaning. Some Europeans are hoping the international group will make the standard setters more accountable to government officials. In socialistic countries accountants are expected to implement the directives set forth by the political machinery. Will the accounting profession become accountable to foreign governments?

As noted above, there is increasing concern related to both the speed and direction of changes affecting the accounting profession. Academics and professionals urged individuals and groups to become proactive. Lessons should be learned from the unprecedented failures of our most prestigious financial institutions and our government becoming a stakeholder in private entities. *It can happen here*. They believe the time has come to put up a fight against undue influence of our government, and avoid the threat of foreign political intervention in the setting of GAAP.

“For a brief moment in our long history, our markets may not have been the most efficient and transparent markets in the world. IFRS has yet to withstand the test of time. We should fight to get back what we lost, maintain our autonomy, and our rightful place as the leader of world markets .” (Claire Eckstein)

⁹ As mentioned previously, the S & L debacle was a result of relaxation of both regulation and accounting rules.