

GLOBAL PRIVATE GOVERNANCE: LESSONS FROM A NATIONAL MODEL OF SETTING STANDARDS IN ACCOUNTING

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I

INTRODUCTION

Numerous recent studies have documented the increase of global governance by international organizations, formal and informal transgovernmental networks, hybrid public-private institutional arrangements, and entirely private transnational institutions.¹ These bodies establish general rules and make specific decisions with which other actors comply, based on the recognition by the latter of the authority of the former.² In the domestic context, such rule- and decisionmaking authority is embedded in a system of administrative law, that is, a system of institutionalized procedural and substantive norms. It assures those

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1. See, e.g., Tim Büthe, *Governance through Private Authority? Non-State Actors in World Politics*, 58 J. INT'L AFF. 281 (2004); GOVERNANCE IN A GLOBAL ECONOMY: POLITICAL AUTHORITY IN TRANSITION (Miles Kahler & David A. Lake eds., 2003); TRANSATLANTIC GOVERNANCE IN THE GLOBAL ECONOMY (Mark A. Pollack & Gregory C. Shaffer eds., 2001); ANNE-MARIE SLAUGHTER, A NEW WORLD ORDER (2004). While most of these studies focus on the increased demand for global governance, the supply of governance institutions must also be explained. See WALTER MATTLI, THE LOGIC OF REGIONAL INTEGRATION: EUROPE AND BEYOND (1999); DOUGLASS C. NORTH, STRUCTURE AND CHANGE IN ECONOMIC HISTORY (1981); MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965). For a discussion of internationalization or transnationalization versus "globalization," see DAVID HELD ET AL, GLOBAL TRANSFORMATIONS: POLITICS, ECONOMICS AND CULTURE (1999). For notational simplicity we will use "global" in this article even when social exchange or institutions may, strictly speaking, "only" be international or transnational.

2. Miles Kahler & David A. Lake, *Globalization and Governance*, in : GOVERNANCE IN A GLOBAL ECONOMY, *supra* note 1, 1, at 7. We concur with Kahler and Lake that recognition of authority may be based on coercive power, but that "governance" connotes compliance as such as being voluntary. For a discussion of alternative notions of "governance," see GOVERNANCE WITHOUT GOVERNMENT: ORDER AND CHANGE IN WORLD POLITICS (James N. Rosenau & Ernst-Otto Czempiel eds., 1992).

who are affected by the regulator's decisions that they will enjoy "procedural participation" (that is, that their views will be heard and considered, for instance through notice-and-comment procedures); that decisions will be taken in a transparent manner on the basis of disclosed reasons and in compliance with norms of proportionality, means-end rationality, and the like; and that the decisions are subject to review by a judicial or another independent body on request.³ In short, administrative law mechanisms ensure accountability. They have a long history and tradition at the domestic level without an apparent counterpart at the international or global level.⁴ Yet, globalization of rulemaking need not necessarily entail losing such safeguards: based on an extensive and detailed mapping of current administrative practice of global governance organizations and networks, Kingsbury, Krisch, and Stewart suggest that a *global* administrative law is not only possible but in the process of being created, and they open a normative-prescriptive debate over the forms that global administrative law might take.

We seek to contribute to this timely debate by presenting a positive political analysis of global governance, both theoretically and in a particular empirical context. Such a positive analysis, we submit, should precede deliberation about which administrative norms and mechanisms can and should be instituted, because a discussion of effective remedies presupposes a clear understanding of actual deficiencies and their causes. To gain such an understanding, we ask a series of analytical questions: Why is rulemaking authority implicitly granted or explicitly delegated to an international or transnational body? What are the consequences of such a delegation of authority for the domestic and international distribution of power and resources (including information and expertise)? Why do some actors rather than others supply such governance? Do all those who are affected in a given realm have a voice in the governance institution (and if not, why not)? And what are the prospects for the comprehensive adoption and the likely effectiveness of administrative law procedures?

Scholars of administrative law have tended to shy away from such questions, preferring detailed accounts of administrative procedures and normative discourse over positive political analysis. Positive analysis, however, is very much needed: lack of participation and accountability may be caused not just by exclusion or non-transparent procedures, but also by ignorance, information deficits, erroneous beliefs, or collective action dilemmas. The creation of notice-and-comment procedures, for example, will achieve little when the problem is ignorance or a lack of technical expertise by the subjects of a particular govern-

3. Benedict Kingsbury, Nico Krisch, & Richard B. Stewart, *The Emergence of Global Administrative Law*, 68 L. & CONTEMP. PROBS. 13 (Summer/Autumn 2005). "Disclosed reasons" may of course be merely rationalizations.

4. Many of these core principles of administrative law seem to be grounded in democratic theory. See, e.g., ROBERT A. DAHL, A PREFACE TO ECONOMIC DEMOCRACY (1985). Therefore, they might only be found in full in democracies. Yet, compare the distinction between participation-based and delegation-based notions of accountability in Ruth Grant & Robert O. Keohane, *Accountability and Abuses of Power in World Politics*, 99 AM. POL. SCI. REV. 29 (2005).

ance arrangement. Greater procedural transparency and formal rules guaranteeing procedural inclusion of all affected parties may be in vain if those parties' participation is in fact prevented by collective action problems. Positive analysis of new or changing administrative law mechanisms and procedures at both the national and global levels therefore also offers tools for assessing the effectiveness and desirability of competing institutional designs for administrative law.

Such an analysis and the above questions seem especially important when global governance is carried out by private regulatory bodies—because the “relatively effective means of intervention,” used domestically by democratically legitimated public bodies “to control or correct private governance,” are absent at the global level.⁵ Accountability has therefore been rightly noted as “the most difficult issue” when governance is provided by private actors.⁶ We consequently focus in this paper exclusively on the potential for administrative law to enhance transparency, access, and accountability in the realm of private transnational regulatory arrangements. Deductively, we draw on a modified principal-agent theory, which we have developed in greater detail elsewhere,⁷ to offer an analytical account of private global governance that emphasizes principals, agents, as well as the macro-political context in which any particular principal-agent relationship is embedded. To examine global private governance empirically, we focus on the little known but highly influential non-governmental organization responsible for setting global accounting or “financial reporting” standards, the International Accounting Standards Board (IASB).⁸

Accounting standards regulate how research and development expenses, performance incentives for managers such as stock options, assets in an employee pension fund, and other particular types of transactions and events may be reflected in corporate financial statements. The standards are supposed to result in statements of a firm's value and financial position, which are accurate and easily comparable across firms. Seemingly technical, these standards create incentives for firms to engage in some activities and to avoid others, as well as

5. Kingsbury et al, *supra* note 3, at 34.

6. VIRGINIA HAUFLE, A PUBLIC ROLE FOR THE PRIVATE SECTOR: INDUSTRY SELF-REGULATION IN A GLOBAL ECONOMY 118 (2001). For a broader discussion of issues of accountability in global governance, see Robert O. Keohane & Joseph S. Nye, *Redefining Accountability for Global Governance*, in GOVERNANCE IN A GLOBAL ECONOMY, *supra* note 1, at 386-411.

7. Walter Mattli & Tim Büthe, *Accountability in Accounting? The Politics of Private Rule-making in the Public Interest*, 18 GOVERNANCE 399 (July 2005); Tim Büthe, *The Dynamics of Principals and Agents: Institutional Change and Persistence in Setting U.S. Accounting Standards*, Mimeo (Duke University, 2005).

8. For an analysis of other major private-sector regulatory institutional bodies, namely the International Organization of Standardization (ISO) and the International Electrotechnical Commission (IEC), see Walter Mattli & Tim Büthe, *Setting International Standards: Technological Rationality or Primacy of Power?*, 56 WORLD POL. 1 (2003). For general discussions of the choice of various public, private, or hybrid governance arrangements, see Walter Mattli, *Public and Private Governance in Setting International Standards*, in GOVERNANCE IN A GLOBAL ECONOMY, *supra* note 1, at 199-225; Daniel Drezner, *Who Rules? The Regulation of Globalization* (2005) (unpublished manuscript).

to choose particular means in pursuit of a given goal; they thus shape the behavior of firms and consequently important aspects of a country's political economy. For various reasons discussed below, firms follow these rules in calculating and disclosing information like profits, costs, assets, liabilities, and revenues to their shareholders and to the general public.⁹

The growth of stock ownership, transnational stock market listings, and more generally the increasing integration of financial markets over the last decade or two have intensified demands from firms and investors for the international harmonization of divergent national accounting standards. The growing demand for global accounting rules has led to a delegation of rulemaking authority in accounting to a non-governmental body of technical experts, the IASB, funded by the business firms that "prepare" and "issue" financial statements and by the accountancy profession. IASB began operating in April 2001.¹⁰ It was modeled on a homologous national private institution, the American Financial Accounting Standards Board (FASB), which has been in charge of producing "generally accepted accounting principles" (GAAP) for the U.S. market for over thirty years.¹¹

Regulatory institutions like IASB and FASB, however, are not fixed structures. They undergo and have undergone changes over time. We focus here on an important dimension of change: change in the extent to which these bodies have embraced, resisted, instituted, or rejected mechanisms of administrative law, such as transparency, participation, and the proclamation of reasons for their decisions. We seek to explain such changes as well as the general operation of private-sector accounting governance as a function of political and structural factors, such as power, control, dependency, and knowledge asymmetries.

Part II elaborates the analytical framework and makes the case for its applicability to the realm of accounting standards-setting. Parts III and IV apply the framework of private-sector governance to the American and global cases respectively. In part III we draw on the relatively long history of private rulemaking in accounting in the United States to test a set of hypotheses about private-sector governance. Part IV turns to global private governance. Since the IASB experience is too recent for comparable in-depth analysis, we consider the implications of the preceding analysis for global private governance in accounting, based on the strong institutional affinity between FASB and IASB. Part V concludes by considering some of the implications of our analysis for attempts to improve transnational regulatory governance through administrative law procedures at the global level.

9. For a concise discussion of the key reasons for having standards for financial reporting, see David Solomons, *The Political Implications of Accounting and Accounting Standards Setting*, 13 ACCT. BUS. RES. 107f (1983).

10. IASB replaced an institutionally weaker predecessor hailing back to the early 1970s, the International Accounting Standards Committee (IASC).

11. Domestically, FASB accounting standards are binding based on the regulatory authority delegated to the SEC by Congress.

II

PRINCIPAL-AGENT THEORY AND PRIVATE REGULATORY GOVERNANCE¹²

Principal-Agent Theory (P-A) is a fruitful starting point for an analysis of private governance, because it was developed for the very purpose of capturing essential characteristics of situations in which rule- or decisionmaking authority in a specified domain is conditionally granted by one actor (the “principal”) to another (the “agent”).¹³ P-A adopts the core assumptions of rational choice (RC) theory,¹⁴ but differs from most RC approaches in that its *starting* assumption is that *information is neither complete nor perfect* because transactions—including the writing of detailed contracts and the monitoring of agents—are costly.¹⁵ Delegation thus inevitably creates some discretion for the agent, which gives rise to the “agency problem” of “shirking” when the principal’s and the agent’s interests do not coincide, and the agent therefore acts contrary to the principal’s interests after authority has been delegated to the agent. Accountability is therefore a central issue for P-A.

P-A also is a promising starting point for our analysis because delegation of regulatory authority has been the focus of much of the P-A literature. While the initial delegation of authority from citizens to legislators and governments surely warrants critical analysis,¹⁶ most of this literature has focused on delegation from legislatures to specialized bureaucracies, mostly in the United States¹⁷ but recently also comparatively,¹⁸ and from domestic elected officials to international governmental organizations.¹⁹ While this literature has yielded numerous

12. Parts II and III draw in large part on Mattli and Bütke, *supra* note 7.

13. For a recent review of the literature, see Jonathan Bendor et al, *Theories of Delegation*, 4 ANN. REV. POL. SCI. 235 (2001); see also DARREN HAWKINS ET AL, DELEGATION UNDER ANARCHY: STATES, INTERNATIONAL ORGANIZATIONS, AND PRINCIPAL-AGENT THEORY (forthcoming 2006).

14. See Barry R. Weingast, *Political Institutions: Rational Choice Perspectives*, in A NEW HANDBOOK OF POLITICAL SCIENCE 167 (Robert E. Goodin & Hans-Dieter Klingemann eds., 1996).

15. See, e.g., OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING (1985).

16. See generally Torbjörn Bergman et al, *Parliamentary Democracy and the Chain of Delegation*, 37 EUR. JOUR. POL. RES. 255, 255-429 (2000). There is also, of course, an extensive literature on delegation within legislatures. E.g., Kenneth A. Shepsle & Barry Weingast, *The Institutional Foundations of Committee Power*, 81 AM. POL. SCI. REV. 86 (1988); Kenneth A. Shepsle & Barry Weingast, *Positive Theories of Congressional Institutions*, 19 LEG. STUD. Q. 145 (1994).

17. E.g., Thomas H. Hammond & Jack H. Knott, *Who Controls the Bureaucracy? Presidential Power, Congressional Dominance, Legal Constraints, and Bureaucratic Autonomy in a Model of Multi-Institutional Policy-Making*, 12 JOUR. L. ECON. ORG. 119 (1996); Mathew D. McCubbins et al, *Administrative Procedures as Instruments of Political Control*, 3 JOUR. L. ECON. ORG. 243 (1987); see also Terry M. Moe, *Control and Feedback in Economic Regulation: The Case of the NLRB*, 79 AM. POL. SCI. REV. 1094 (1985).

18. E.g., JOHN D. HUBER & CHARLES R. SHIPAN, DELIBERATE DISCRETION? THE INSTITUTIONAL FOUNDATIONS OF BUREAUCRATIC AUTONOMY (2002); MARK POLLACK, ENGINES OF EUROPEAN INTEGRATION: DELEGATION, AGENCY AND AGENDA-SETTING IN THE EUROPEAN UNION (2003); Mark Thatcher & Alec Stone Sweet, *Theory and Practice of Delegation to Non-Majoritarian Institutions*, 25 W. EUR. POL. 1 (2002).

19. E.g., Erica R. Gould, *Money Talks: Supplementary Financiers and International Monetary Fund Conditionality*, 57 INT’L ORG. 551 (2003); Daniel L. Nielson & Michael J. Tierney, *Delegation to Inter-*

insightful analyses of delegation of governance authority to public bureaucracies and regulatory agencies, the delegation of governance functions to *private* agents has so far largely been overlooked by P-A. Yet, in recent years states have increasingly delegated domestic and international governance functions to private (non-governmental) actors, as novel forms of economic activities arose (e.g., internet commerce), increasing technical complexity required technical expertise that states found too costly to acquire and maintain (e.g., new financial instruments, bond ratings), and neoliberal ideas undercut the presumption of, and normative justification for, public provision of governance.²⁰ We therefore focus our analysis on the delegation of governance authority to private agents.

A. Why Delegate Authority to a *Private* Agent?

The P-A literature has identified several reasons for political principals to delegate rule- and decisionmaking authority to agents. The probably most general and common reason for delegation is to reduce the principal's workload and enable greater efficiency through specialization.²¹ This logic is at the heart of almost any employer-employee relationship. It plays some role in most delegation of regulatory authority, domestically and globally, but at this general level that role is relatively uninteresting for the present analysis. Three more specific reasons for delegation, however, warrant closer examination, because each of them may make delegation of governance functions to a *private* agent particularly attractive, and because they have important implications for (the feasibility of) administrative law mechanisms.

One specific reason for delegating authority is the desire to benefit from existing specialization and expertise as a substitute for acquiring such expertise through lengthy and costly training.²² Such delegation to an agent with prior specialized expertise is particularly common in highly technical and complex issue areas, for instance in the fields of science policy and space technology.²³ In such technical fields, regulatory authority may be established more cost-effectively by delegating authority to a private expert-agent insofar as it is private actors who have the requisite expertise *ex ante*.

Second, and more generally, the *maintenance* of specialized expertise may make delegation to a private agent more efficient and therefore more desirable

national Organizations: Agency Theory and World Bank Environmental Reform, 57 INT'L ORG. 241 (2003).

20. See, e.g., Susan Strange, *THE RETREAT OF THE STATE: THE DIFFUSION OF POWER IN THE WORLD ECONOMY* (1996); Alfred C. Aman, *Administrative Law for a New Century*, in *GLOBALIZATION AND GOVERNANCE*, 267, 272ff (Aseem Prakash & Jeffrey A. Hart eds., 1999); *PRIVATE AUTHORITY AND INTERNATIONAL AFFAIRS* (A. Claire Cutler et al. eds., 1999); see also Bütthe, *supra* note 1.

21. DAVID EPSTEIN & SHARYN O'HALLORAN, *DELEGATING POWERS: A TRANSACTION COST POLITICS APPROACH TO POLICY MAKING UNDER SEPARATE POWERS* 48 (1999).

22. James E. Alt & Alberto Alesina, *Political Economy: An Overview*, in *A NEW HANDBOOK OF POLITICAL SCIENCE* 645, 658 (Robert E. Goodin & Hans-Dieter Klingemann eds. 1996).

23. EPSTEIN & O'HALLORAN, *supra* note 21, at 5, 196.

than delegation to a public agent. Governments and public agencies, which can use the specialized expertise solely for the purpose of regulation, will find maintaining such expertise more costly than will private actors, who can derive positive externalities from this expertise by also using it to improve products, processes, and so forth. This economic rationale underpins the efficiency arguments for industry self-regulation.²⁴

Expertise-based motivations for delegation have direct implications for the effectiveness of administrative law mechanisms to ensure participation and accountability. If the public principal lacks the technical expertise that would be required to provide governance we might expect it to be also poorly positioned to exercise oversight and to correct private regulatory decisions when they are not in the public interest.²⁵ Moreover, we should expect the establishment of provisions for broad participation in the governance process, such as notice-and-comment procedures, to have limited effectiveness if the technical expertise is unevenly distributed across those with a stake in (that is, those affected by) the regulatory agent's rule- and decisionmaking.

Among the general reasons for delegation, the third reason that creates particular incentives for delegating governance functions to *private* agents, is "blame avoidance" or "shifting responsibility."²⁶ From the perspective of a political actor who may provide or delegate regulatory governance, we can distinguish between the benefits that arise from satisfied stakeholders giving him credit for the positive effects of regulation and, conversely, the costs that arise from dissatisfied stakeholders blaming him for the negative effects. Delegation creates a perceptual political "distance" between the political actor and the apparent exercise of regulatory authority, which may be expected to reduce both benefits and costs for the political actor. Delegation becomes attractive for the political actor if the political costs decline faster with distance than the political benefits, such that the *net* benefit increases with distance. Under these conditions, delegation to a *private* agent should be especially appealing because private agents are (or at least appear) more clearly separate from the public principal than public agents.²⁷

24. See, e.g., HAUFLER, *supra* note 6, at 3, 10f, 20ff.

25. We will discuss this issue in more detail below.

26. Morris P. Fiorina, *Legislative Choice of Regulatory Forms: Legal Process or Administrative Process?*, 39 PUB. CHOICE 33, 46ff (1982).

27. For clarification, these conditions may be formally summarized as follows:

$$\frac{\partial B_{R,P}(\chi)}{\partial \chi} < 0 ; \frac{\partial C_{R,P}(\chi)}{\partial \chi} < 0$$

$$U_{R,P} = (B_{R,P} - C_{R,P}) = f(\chi, \cdot) ; \frac{\partial U_{R,P}(\chi)}{\partial \chi} > 0$$

where χ is the distance between the political actor and the exercise of regulatory authority. $B_{R,P}(\chi)$ is the (expected) benefit of regulation to the political actor, that is, the benefit of gratitude from satisfied

This has important implications for administrative law. When shifting responsibility is an important motivation for delegation, procedures that enhance agent accountability to the principal—or ensure easy review and revision of the agent's decisions—actually diminish the desired effect of delegation by diminishing the perceived political distance between the principal and the exercise of regulatory authority. The implementation of such procedures should therefore be of little interest to the principal, and might even be resisted by her.

B. Governance and Accountability After the Initial Delegation

We have so far focused on some of the key reasons for delegating governance functions to a private actor in the first place. But how do such private regulators differ from public ones in how they operate and evolve institutionally after authority has been delegated to them?

The key difference between delegation to public agents and delegation to private agents is that delegation to private agents creates a multiple-principals problem. Potential private agents are almost always collective actors—firms, private associations, maybe the science and technology advisory committees of labor unions or environmental groups—that have an immediate and prior principal in their owners, members, or funders. When public regulatory authority is delegated to such a private actor, then this agent has at least two principals, one public and one private.

The P-A literature traditionally treats the multiple principals problem as a problem of collective action or free riding: Since monitoring is costly and any principal would have to share at least part of the benefits of her efforts with others, close monitoring is less likely when the agent has multiple principals than when the agent has only a single principal. The agent thus attains a higher level of discretion and will work less hard—what Wolfgang Müller calls “leisure shirking.”²⁸ When the private principal, however, pursues the interests of only one segment of the general public and only one group of stakeholders, then we should expect “dissent shirking” of the agent vis-à-vis the public principal because the private principal induces a systematic divergence of the agent's substantive preferences from the public principal's preferences.

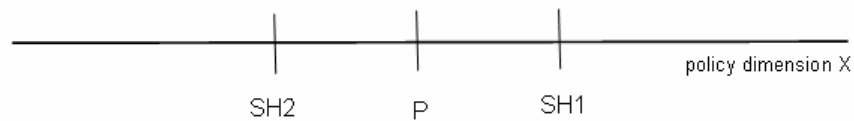
This qualitatively different type of multiple principals problem, which arises from the delegation to a private agent, may be brought out most clearly in a very simple spatial model. Assume that the public principal (P) seeks to balance the interests of two groups of stakeholders (SH1 and SH2), so P's ideal

stakeholders, which is a function of the distance χ (and other variables). $C_{R,P}(\chi)$ is the (expected) cost of regulation to the political actor, that is, the cost of being blamed by dissatisfied stakeholders, which also is a function of χ (and other variables). $B_{(\chi=0)}$ and $C_{(\chi=0)}$ are assumed to be greater than zero. $U_{R,P}(\chi)$ is the overall utility (net benefit) derived from regulatory governance by the political actor (public principal). This logic motivates delegation *inter alia* in politically charged contexts, in which regulatory activity may be more palatable for the regulated when carried out by an agent who is clearly separate from the principal, rather than being carried out directly by the principal.

28. Wolfgang C. Müller, *Political Parties in Parliamentary Democracies: Making Delegation and Accountability Work*, 37 EUR. JOUR. POL. RES. 309, 320f (2000).

point is somewhere between the ideal points of the stakeholders on any particular regulatory or institutional issue (see Figure 1). Unless we assume uneven distribution of political lobbying resources between the two stakeholders, we have no reason to expect a public agent to take a position on either side of the public principal (leisure shirking as such is random with respect to X). But if a private agent has one—but not the other— stakeholder as an additional principal (for instance, SH1), then we would expect regulatory policy or governance decisions by the agent to favor this stakeholder systematically (i.e., they will tend to fall between P and SH1). This model of delegation to a private agent therefore implies that one group of stakeholders will benefit from private governance at another group's expense.²⁹

Figure 1



Ideal Points for Simple Regulatory Delegation Scenario

29. We do not mean to make too much of this difference: in the real world, public regulatory agencies can get captured by those whom they are supposed to regulate. See George Stigler, *The Theory of Economic Regulation*, 2 BELL JOUR. ECON. MGMT. SCI. 3 (1971). And as Epstein and O'Halloran point out, legislators (as the public principals of the regulatory agencies) themselves may also be very receptive to special interest lobbying when making regulatory decisions. EPSTEIN & O'HALLORAN, *supra* note 21, at 10; see also Terry M. Moe, *Political Institutions: The Neglected Side of the Story*, 6 JOUR. L. ECON. ORG. 213 (1990). When any one group has privileged access, we would expect the regulatory activity to favor the interests of that group, regardless of whether this was the intention of the institutional arrangement or an unintentional by-product. See McCubbins et al, *supra* note 17, at 261; see also Matthew D. McCubbins et al, *Structure and Process, Politics and Policy: Administrative Arrangements and the Political Control of Agencies*, 75 VA. L. REV. 431 (1989); Glen O. Robinson, *Commentary on "Administrative Arrangements and the Political Control of Agencies": Political Uses of Structure and Process*, 75 VA. L. REV. 483 (1989). Note also that we do not argue that the involvement of non-governmental principals inherently diminishes the effectiveness or efficiency of regulation. Not all public policy decisions significantly affect everyone. If the private principals reflect without bias the balance of interests among those who have a stake in the regulatory matter, public and private benefits should coincide (though there might be less need for regulation under these circumstances). Moreover, with the right socio-political incentives, a high degree of independence seems to be quite possible: Highly institutionalized professional norms appear to provide effective incentives, for instance, for former senior partners in corporate law firms to become quite independent judges after appointment, or for national policy experts to largely disregard their own countries' policy preference after joining the European Commission bureaucracy. Finally, a full analysis of outcomes (rather than preferences) might require additional contextual information.

But where should we expect the outcome to fall between P and SH1 when the two principals' preferences diverge? The assumption of instrumental rationality on the part of the agent leads us to expect that this will be a function of the relative tightness of the P-A relationships between each of the principals and the agent, which in turn is a function of the relative importance of the principals for the agent's financial and operational viability as well as for its effectiveness in rulemaking.

Financial viability refers to the availability of the financial resources required for the agent to fund its operations. Unless the agent is funded entirely out of an endowment it controls itself the agent will have strong incentives to take the interests of its funders into account. The more the agent depends on its private principal for its financial viability, *ceteris paribus*, the tighter should be the P-A relationship between the agent and the private principal. In terms of Figure 1, the outcome would be expected to be closer to SH1. Conversely, the more the agent depends on a periodic discretionary allocation of resources from the public principal for its financial viability, the tighter should be the P-A relationship between the agent and the public principal (outcome closer to P).

Operational viability refers to the availability of the technical expertise required for the agent to carry out the governance tasks delegated to it. The World Anti-Doping Agency, for instance, requires medical and bio-chemical scientific expertise and instruments (as well as expertise for making ethical judgments and improving education about prohibited substances) to carry out the governance of the "fair play" provisions of the World Anti-Doping Code, including monitoring compliance by all athletes in the Olympics and other sports that have adopted the code.³⁰ How do regulatory agents acquire the needed expertise and technical support? As we suggested above, the prior existence of the requisite expertise among private actors is likely to be a key reason for having delegated to a *private* agent in the first place.³¹ If private provision of such expertise is crucial to the agent's operational viability, outcomes favoring those providing this crucial resource should be expected. Specifically, the more the agent depends on the private principal for the provision of such expertise, the closer should the outcome be to SH1.

While ensuring its own financial and operational viability may be the agent's first concern, effectiveness as a regulator also needs to be of central importance. Effectiveness here refers foremost to gaining acceptance for, and compliance with, the rules and decisions it issues. To gain an analytical handle on the issue of effectiveness, we depart from traditional P-A by recognizing explic-

30. See <http://www.wada-ama.org> (last visited Apr. 10, 2005); Kingsbury et al, *supra* note 3, at 46.

31. See *supra* text accompanying notes 23-24.

itly that any particular principal-agent relationship is “embedded” in a broader context of norms and ideas³²—the “macro-political” climate or “mood.”³³

The macro-political climate defines *inter alia* the “proper” relationship between public authority and private actors, which appears to have undergone several changes over the course of the twentieth century in the advanced capitalist democracies.³⁴ In the United States, for instance, there have been extended periods of an exuberantly pro-business macro-political climate that rendered any increase in regulation and even the then-current levels of government regulation of the private sector virtually illegitimate (most notably in the 1920s, 1950s, 1980s, and 1990s). Each of these periods was followed by a period during which the mood was almost hostile to business and during which it was seen as nearly unacceptable for business to regulate itself.³⁵ Such swings in the public mood make a private principal who appears to have notably diverged from the public preference vulnerable to challenges. It also opens opportunities for institutional change,³⁶ maybe even a revision of the principal-agent relationship, forced on the agent by the public principal. More likely, though, a private agent who values his discretion will react to such a change in the macro-political climate by modifying its procedures before being forced to do so by a public principal. Change in the macro-political climate thus creates an opening for the introduction or strengthening of administrative law procedures, such as greater transparency, the establishment of public comment-and-notice periods, and the like.³⁷

C. Applicability of P-A to Governance in Accounting

Before turning to the question whether the hypotheses developed above are empirically supported in the realm of accounting governance, it is worth exam-

32. See MARK BLYTH, *GREAT TRANSFORMATIONS: ECONOMIC IDEAS AND INSTITUTIONAL CHANGE IN THE TWENTIETH CENTURY* (2002); KARL POLANYI, *THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME* (1957); John Gerard Ruggie, *International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order*, in *INTERNATIONAL REGIMES* 195 (Stephen D. Krasner ed., 1983); Kathleen R. McNamara, *Rational Fictions: Central Bank Independence and the Social Logic of Delegation*, 25 *W. EUR. POL.* 47 (2002).

33. See, e.g., ROBERT S. ERIKSON ET AL., *THE MACRO POLITY* 325ff (2002).

34. See, e.g., David Vogel, *The Hare and the Tortoise Revisited: The New Politics of Consumer and Environmental Regulation in Europe*, 33 *BRIT. JOUR. POL. SCI.* 557 (2003).

35. See DAVID VOGEL, *FLUCTUATING FORTUNES: THE POLITICAL POWER OF BUSINESS IN AMERICA* (1989).

36. See PAUL PIERSON, *POLITICS IN TIME: HISTORY, INSTITUTIONS, AND SOCIAL ANALYSIS* (2004); Büthe, *supra* note 7; see also Kingsbury et al., *supra* note 3, at 35-40.

37. Substantial rather than merely cosmetic institutional or behavioral change in response to changes in the macro-climate, however, should not be expected to be automatic. As Wood and Waterman note, when signals from principals or the political environment conflict with the interests of a bureaucracy, “it is natural for bureaucracies to react slowly.” Dan B. Wood & Richard W. Waterman, *The Dynamics of Political-Bureaucratic Adaptation*, 37 *AM. JOUR. POL. SCI.* 497 (1993). This expectation should apply to private as well as public bureaucracies. Regulatory agents may react to such changes in the political macro-climate in recognition that it changes their constraints, but we should expect to see far-reaching changes in the formal institutions or regularized behavior of regulatory agents only when public principals translate the change in the macro climate into specific incentives for agent adaptation.

ining whether this issue area is suitable for an application of the analytical framework developed above. Indeed, the specific reasons for delegating governance to a private actor apply in the realm of accounting. Accounting standards are complex, technical, and have been fast-changing in recent decades, as new financial instruments were invented and their accounting treatment needed to be clarified. While there are public demands for the regulation of financial reporting, very few if any government employees have the requisite technical expertise. And while experts might be trained or hired, it would be very costly for career public servants (necessary if government bureaucracies were to carry out the standards-setting functions) to maintain such expertise, because they would not be participants in the private financial markets in which innovation in financial instruments is taking place. Expertise-based incentives for delegation to a private regulatory agent thus clearly exist. Moreover, disagreements over accounting standards appear to be grounded often in conflicts of interests with little room for mutually beneficial solutions,³⁸ such that the regulator is bound to leave some groups and individuals with a stake in the regulatory matter dissatisfied with the outcome.³⁹ It thus appears to be an area in which blame from dissatisfied stakeholders is likely to exceed the gratitude from satisfied ones, at least for those directly exercising regulatory authority. As the *Financial Times* recently observed: "Setting accounting standards is no way to make friends."⁴⁰

These characteristics of accounting governance create strong incentives to delegate governance to private agents at both the domestic and the global level. And indeed, accounting standards-setting is one of the governance functions that has been delegated to private agents within several countries as well as internationally. Our analytical framework also seems suitable in that the public agencies that are charged with regulating stock markets and financial reporting (be they central banks, securities commissions, or other agencies) may be seen as constituting an explicit or implicit public principal to the private agent at the domestic level, though who constitutes the public principal at the international or global level warrants separate analysis.⁴¹ We have also suggested above that expertise-based private agents should be expected to have, by design, a prior private principal; we will examine this proposition below.⁴²

Finally, mapping preferences in a space populated by several stakeholders also seems appropriate for the analysis of accounting standards-setting. The content of these standards matters to the firms that issue financial securities and therefore prepare financial statements (the "preparers"), but several other groups also have a stake in what these standards prescribe: Investors seeking information about alternative investment opportunities are probably the most

38. See ROGER FISHER ET AL, *GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN* 56ff (2d ed. 1991).

39. See *infra* text accompanying notes 56.

40. Barney Jopson, *Key Performance Ratio Finds that Its Numbers May Be Up*, *FINANCIAL TIMES*, Feb. 1, 2005, at 16.

41. See *infra* Part IV.

42. See *infra* text accompanying notes 55-57, 92-95, 103.

important type of “users” of financial statements, and accounting professionals must keep up with the latest developments both for keeping and for auditing the books of firms.

We have suggested that the tightness of a P-A relationship is a function of the relative importance of the principal for the agent’s financial viability and operational viability, as well as (indirectly) a function of what we have called the macro-political climate. Financial viability is straightforward and should be applicable in the analysis of any regulatory agent. Operational viability, in the realm of setting accounting standards, refers to having (or lacking) general accounting expertise, familiarity with existing financial instruments, and knowledge of current practices. The regulatory agent needs this expertise to write accounting standards that are feasible in implementation as well as effective in achieving the goals of completeness and comparability of financial reporting. Finally, changes in the macro-political climate should be expected to bear on attitudes toward the regulation of financial reporting, not just because it is an instance of the more general phenomenon of government regulation of private actors, but also because accounting fraud and—maybe more importantly—technically legal but fundamentally misleading accounting practices have been seen as essential components of the spectacular corporate wrongdoing at Enron and some other major corporations, contributing to the perception of a failure of the self-governing market. In sum, the analytical framework developed above seems suitable for a positive political analysis of accounting standards-setting.

III

PRINCIPALS AND AGENTS IN U.S. ACCOUNTING GOVERNANCE

The setting of accounting standards in the United States provides an opportunity to analyze empirically the delegation of governance functions to private actors in one of the few cases in which such delegation has a long history. To hold the institutional context broadly constant,⁴³ we focus on the period after the 1972/73 reforms of U.S. accounting standards-setting and on episodes in which divergent interests of the stakeholders can be well established, based on existing sources and on interviews that we have conducted with individuals involved with accounting standards issues in American corporations, at the FASB, and at the SEC.

A. The Structure of Private-Sector Accounting Standardization

While some individual states had regulated the issuance and trading of financial securities already in the late 1700s, Congress asserted the authority of the federal government to regulate financial securities only in the 1930s. It did so in response to the stock market crash that saw the Dow Jones Industrial Av-

43. Cf. Tim Büthe, *Taking Temporality Seriously: Modeling History and the Use of Narratives as Evidence*, 96 AM. POL. SCI. REV. 481 (2002).

erage lose ninety percent of its October 1929 valuation—attributed in part to “trick money” and “shenanigan” accounting, and more generally to misleading and “deceptive” financial reporting practices, facilitated by the “extraordinary diversity [of the] appearance, size, content, and intent” of financial statements.⁴⁴ More generally, Congress hereby reacted to the Depression-induced swing in the macro-political climate, reflected in the election of 1932. The Securities Act of 1933 and the Securities Exchange Act of 1934 mandated “full and fair disclosure” in the flotation of financial securities, required that periodic financial statements be filed by the issuers of publicly traded securities, and created the Securities and Exchange Commission (SEC), to which it delegated the task of specifying and enforcing all obligations arising from these two acts. Starting in 1938, the SEC—itself a public agency—further delegated the authority “to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed”⁴⁵ to a *private* body. This delegation of authority was controversial at the time, but it persisted, with the SEC itself retaining an oversight function and final authority, which makes it the direct public principal for the private agent. The first and second such private accounting standards-setting bodies—the Committee on Accounting Procedure (1934-1959) and the Accounting Principles Board (1959-1973)⁴⁶—were replaced in 1973 by a novel institutional structure that is largely in place to this day and provided the model for the global private regulator. This structure consists of three bodies: the Financial Accounting Foundation (FAF), the Financial Accounting Standards Board (FASB), and the Financial Accounting Standards Advisory Council (FASAC).⁴⁷

The FAF is composed of trustees whose task it is to appoint the members of FASB and to exercise general oversight. They are also responsible for raising funds—until recently primarily from business—to pay for FASB salaries and expenditures. Trustees are elected for three-year terms and are eligible for re-election to one additional term.⁴⁸

44. WILLIAM Z. RIPLEY, *MAIN STREET AND WALL STREET* 198, 216, 162 (1927).

45. Accounting Series Release No.150 (Dec. 20, 1973) (reprinted in, for example, Douglas C. Michael, *LEGAL ACCOUNTING: PRINCIPLES AND APPLICATIONS* 41-43 (1997)).

46. The institutional evolution of U.S. accounting standards-setting, which we examine in greater detail elsewhere, is beyond the scope of this article. See also PAUL B. W. MILLER ET AL., *THE FASB: THE PEOPLE, THE PROCESS, AND THE POLITICS* 55-58 (4th ed. 1998).

47. A fourth institutional body, the Governmental Accounting Standards Board (GASB), was added in 1984. GASB sets standards of financial accounting and reporting for state and local governmental units.

48. Each of the five original sponsoring organizations of the new standard-setting structure nominated one or more of the nine trustees of the Foundation. Besides the AICPA, these organizations included the American Accounting Association (AAA), the professional organization of accounting educators; the Financial Executives Institute (FEI); the Financial Analysts Federation (FAF, now the Association for Investment Management and Research, or AIMR); and the National Association of Accountants (NAA, now the Institute of Management Accountants, IMA). In 1976, the Securities Industry Association (SIA) joined this group of sponsoring organizations. The latest additions are the National Association of State Auditors, Comptrollers and Treasurers as well as the Government Finance Officers Associations. The Foundation's original trustees were the heads of three large national public accounting firms, two regional accounting firms, an investment banker, an accounting professor,

The central operating body of the new standard-setting system is FASB. Its seven members are all salaried and serve full-time for five-year terms with possible reappointment for a second term.⁴⁹ FASB's members usually are certified public accountants (CPAs) or experts from other relevant disciplines "who in the judgment of the trustees are well versed in problems of financial reporting."⁵⁰ They work with task forces of FASB employees and outside experts to draft standards.

FASB's mission, structure, operations, and relations with external groups are reviewed by the FAF every three to five years, typically generating recommendations for institutional and procedural changes. In response to such recommendations and to earlier complaints about a lack of transparency and accountability, FASB has developed rules of procedure that are supposed to guarantee to all stakeholders an opportunity for participation and to ensure due process for any proposals or objections they submit.⁵¹ So-called "sunshine" reforms in 1977 increased public access to deliberations and to the records of FASB and its task forces and set up the regular publication of plans for technical projects.⁵² Later changes in FASB's procedures have further enshrined many of the norms and practices of administrative law within this body of private governance, albeit sometimes against resistance.⁵³ Among these procedures are provisions for the publication of "discussion memoranda" and "exposure drafts" for comment before FASB's vote on the "final draft" proposals.

The third institutional pillar of the new standard-setting scheme is the FASAC, designed to be broadly representative of groups interested in or affected by accounting standards.⁵⁴ Meeting on a quarterly basis, its members—

and two executives from large U.S. corporations. By the mid-1990s, the number of trustees had risen to sixteen. Trustees have tended to represent and promote the interests of their sponsors.

49. Each member has to sever all connections with prior employers and to divest him- or herself of all investments or other financial arrangements that might create conflicts of interest.

50. FINANCIAL ACCOUNTING FOUNDATION, BYLAWS, chpt. A, art. II-A, section 2 (1973). The members of the first Board included the president of AICPA and three senior accountants from Haskins & Sells (now part of Deloitte & Touche), Price Waterhouse, and Peat, Marwick, Mitchell & Co. The other three members were a former chief of the office of Accounting and Finance of the Federal Power Commission, a comptroller of Exxon Corporation, and an accounting professor. The current board consists of five accountants (including one with past positions in investment banking and as a business school professor of accounting), one former comptroller of a major oil corporation, and one accounting professor. See http://www.fasb.org/facts/bd_members_staff.shtml (last visited Aug. 26, 2004).

51. STEPHEN MEZIAS & SEUNGWHA CHUNG, THE PROCESS AND PARTICIPATION AT FASB: A STUDY OF THE COMMENT PERIOD (1989); MILLER ET AL, *supra* note 46, at 59ff.

52. Other changes included changing the voting rule for adoption of FASB standards from a supermajority of at least 5-2 to a simple majority of 4-3 (requirements for passing proposals changed several times over the last three decades; see note 70 and accompanying text below), placing a limit on annual contributions from any given firm, doubling the technical staff, and consolidating the staff in a single Research and Technical Activities Division.

53. See *infra* text accompanying notes 84-90.

54. See MILLER ET AL, *supra* note 46, at 43. FASAC was originally comprised in 1973 of some twenty experts from the fields of finance, accounting, industry, education, banking, and the legal profession. By the 1990s, FASAC counted about thirty members, about half of which were representatives of "preparers" (that is, publicly listed companies). See <http://www.fasb.org/fasac/fasacmem.shtml> (last visited Apr. 10, 2005).

also selected by the FAF—liaise with FASB on technical issues. The FASAC has to be heard, but its requests and recommendations need not be taken into account, and—in contrast to the procedural standards of contemporary administrative law—FASB need not explain any decision not to take them into account.

The post-1972 structure of U.S. accounting standards-setting was, in effect, a bold experiment in self-regulation, which—like any form of administrative governance—has both legislative and judicial qualities.⁵⁵ It also closely resembles the principal-agent model developed above. The key body of the new scheme, FASB, may be understood as an agent with two principals: on the one hand, the FAF, which funds FASB and selects its members, and, on the other, the SEC, a public regulator whose grant of authority confers the weight of federal law on FASB standards. FASB (and its public principal, the SEC) operates in an issue-space populated by three main groups of stakeholders: business, accountants, and investors.⁵⁶ Each group is bound to be divided over some issues, but on many other aspects of accounting standards the members of each group have a coherent ordering of preferences, which allows us to treat each group analytically as a single actor.

We derived three key hypotheses from our theoretical model of delegation to a private agent in part II: that the agent will seek regulatory outcomes that favor the interests of the stakeholders represented by the private principal over the interests of stakeholders only represented by the public principal; that specific outcomes will be a function of the relative tightness of the competing P-A relationships; and that the likelihood of adoption of administrative law procedures, as well as their effectiveness if adopted, will be limited in this kind of multiple principals setting, as a function of the initial reasons for delegation to a private agent. All of this should be most apparent when the major groups have diametrically opposed preferences over a particular issue in accounting standards and standardization, leading to tensions and sometimes open conflicts over the control of private-sector rulemaking. To the extent that its members are able to overcome their collective action problems, any group should be expected to push its agenda by using its available means to pressure the agent, FASB, as well as the principals. Yet, we should see the business constituency—that is, corporations preparing and issuing financial statements—be more influential than the other groups because it is business that provides financial and operational viability to the agent, FASB, via FASB's private principal, FAF. Business thus resembles SH1 in the Figure 1 above.

55. See Kingsbury et al, *supra* note 3, at 3. The accounting standards-setting process is legislative in that it "establishes authoritative rules consistent with a legislative mandate; it is judicial because it interprets its own rules." Don Kirk in ROBERT VAN RIPER, *SETTING STANDARDS FOR FINANCIAL REPORTING: FASB AND THE STRUGGLE FOR CONTROL OF A CRITICAL PROCESS* 178 (1994).

56. Donald Kirk, *Address at the Business Council*, FASB VIEWPOINT at 2 (Nov. 9, 1979); see also MILLER ET AL, *supra* note 46, at 16.

How do FASB's dual loyalties affect its operation and institutional structure? The remainder of section III will address this question by examining the competing pressures on FASB and the principals, including changes in the specific preferences of FASB and its principals, and the relationship between agent and principals.

B. FASB and Business Groups

The viability of FASB depends foremost on continuing support from business groups—especially large companies with the requisite resources and expertise available within the firm. These groups willingly support FASB as long as it is effective in keeping government regulation at bay and as long as they feel that their preferences are understood and acted upon by the agent.⁵⁷

When business feels that FASB is out of step with its preferences, it criticizes FASB for allegedly being overly committed to theory at the expense of practicality and ease of implementation, working too slowly and on the wrong projects, producing rules that are too complex, or being insufficiently sensitive to the cost of new standards to business.⁵⁸

Business can resort to a variety of strategies to push its demands. For thirty years, the funding of FASB was raised by the FAF from voluntary donations. The bulk of the funding for FASB therefore has until recently come from business groups. When dissatisfied with FASB decisions, business has often reminded the agent that its continued financial viability depended on business's continuing contributions.⁵⁹ However, this financing arrangement has now changed. In the wake of recent accounting scandals, questions were raised in Congress and beyond about the impact of the funding structure on the independence of FASB as a regulatory agent. In August 2003, a new funding structure, initiated under the Sarbanes-Oxley Act, was implemented.⁶⁰ Under the new scheme, FASB's budget is paid by mandatory contributions of some 7,500 publicly listed companies. This change from voluntary to mandated funding has removed one important means of pressure from business.⁶¹

The business constituency also relies on the services of groups such as the Business Roundtable, an influential and by-invitation-only lobby group whose members are about 150 (current and some former) chief executives of the largest U.S. companies across industries and geographic regions. The Roundtable,

57. MILLER ET AL, *supra* note 46; Laurence Minard, *Lower the Red Flag?*, FORBES, June 12, 1978, at 95; Paulette R. Tandy and Nancy L. Wilburn, *Constituent Participation in Standard-Setting: The FASB's First 100 Statements*, 6 ACCT. HORIZONS 47 (June 1992) 47f.

58. MILLER ET AL, *supra* note 46; VAN RIPER, *supra* note 55; Randy Howard, *Kudos for the FASB*, 169 J OF ACCOUNTANCY (May 1990) at 15f.

59. This risk was noted early on. See, e.g., Stephen A. Zeff, *The Rise of "Economic Consequences,"* 146 JOUR. ACCT. 60 n. 25 (1978).

60. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, Title 1, §109 (codified as amended in scattered sections of 15 U.S.C.).

61. Several private-sector players interviewed have expressed concern that the new funding structure may move FASB closer to government and make it more susceptible to political interference.

founded in 1972, established in the late 1970s an Accounting Principles Task Force (APTF, today part of the Roundtable's Corporate Governance Task Force), made up of heads of major companies with a special interest in accounting matters. APTF has sought to influence the work of FASB through the business representatives among the trustees of the FAF—FASB's private principal. In theory, the bylaws of the FAF prohibit trustee interference in technical and agenda decisions of the standards-setters; in practice, however, such influence attempts do happen and tend to be successful.⁶² APTF may also air its views in meetings with the SEC or push its agenda on Capitol Hill in the hope that concerted political action may sway reluctant FASB members.⁶³

Finally, besides lobbying and threat strategies, business can seek to influence the making of standards via the normal due process, in particular through input in the public hearings or consultations that are part of the standardization process.⁶⁴ In fact, the FASB relies on expert input for its operational viability in developing standards. Large corporations have the necessary resources, including technical expertise and organizational structure to be actively involved, and industry groups contribute an average of sixty to sixty-five percent of responses to FASB discussion memoranda and exposure drafts. On certain projects more than eighty percent of the submissions at the consultation phase come from large firms and industry associations. Their representation at public hearings is also in the sixty to seventy percent range.⁶⁵

Considering the special importance of the resources and expertise of the issuers of financial statements for the financial and operational viability of FASB, as well as the privileged access of business to FASB via FAF, it is not surprising that this group of stakeholders has been quite successful over the years in influencing the procedures and substantive output of the standards-setter. Industry groups have succeeded, for example, in having standards cancelled or restated. A case in point is an FASB accounting rule for the translation of foreign currency transactions and foreign currency financial statements, which came into effect in 1976. Siding with the clearly stated preferences of investors and financial analysts, the new FASB standard required that exchange gains and losses resulting from translation be taken into income in the current period and not be deferred. Monetary assets and liabilities such as cash, receivables, and payables would be translated at the foreign exchange rate in effect when balance sheets

62. VAN RIPER, *supra* note 55, at 169f; *see also* Wayne Baliga et al, *News Report: Closer FAF Involvement Urged in FASB Standard-Setting*, 167 J. OF ACCOUNTANCY 18 (June 1989); Robert G. Walker and Peter Robinson, *A Critical Assessment of the Literature on Political Activity and Accounting Regulation*, 7 RESEARCH IN ACCT. REG. 3, 28, 37n5 (1993).

63. MILLER ET AL, *supra* note 46.

64. MILLER ET AL, *supra* note 46, at 67; Zeff, *supra* note 59, at 57, 60.

65. Timothy G. Sutton, *Lobbying of Accounting Standard-Setting Bodies in the U.K. and the U.S.A.: A Downsian Analysis*, 9 ACCT. ORG. AND SOC'Y 81, 85f (1984); STEPHEN MEZIAS & SEUNGWHA CHUNG, *THE PROCESS AND PARTICIPATION AT FASB: A STUDY OF THE COMMENT PERIOD* (1989), Clarence Sampson, *The "Process" in Due Process: A Behind-the-Scenes Look at Standards Setting*, FASB VIEWPOINT, at 4-6 (Oct. 14, 1991); Tandy & Wilburn, *supra* note 57, at 51; *see also* Walter & Robinson's excellent critique of this literature, *supra* note 62.

were prepared, and other assets and liabilities would be translated at the rate in effect when the assets were acquired or the liabilities incurred.⁶⁶ Firms with high levels of foreign market exposure strongly opposed this standard because it introduced what they considered excessive earnings volatility. Large firms were united in their position on this issue, and smaller listed firms with no foreign exchange exposure were indifferent, allowing business opponents of the new standards to forge a unified “business” position on this issue. Working through FAF and through lobbying groups, they put pressure on FASB to withdraw or change the standard until FASB announced in 1979 that it was working on a new standard that later replaced the 1976 rule.

Business groups have been successful not only in shaping the content of accounting rules; they also have left their imprint on the institutional structure and mode of operation of standard-setting in accounting. Several examples are noteworthy: 1) In response to business’s complaints that it was working on the wrong projects, and at the urging of FAF, FASB established the Emerging Issues Task Force (EITF) in 1984 to help it identify new trends and address new problems, providing firms greater influence on FASB’s agenda. 2) Under pressure from business for more “pragmatism” and “practicality” on the part of FASB, the FAF trustees agreed in the 1990s to increase from one to two FASB members who are direct representatives from the corporate world. Business also secured an additional place among the Foundation trustees. 3) Similarly, when a FASB member was up for re-election in 1990, business lobbied successfully to prevent his reappointment.⁶⁷ 4) The original bylaws of the FAF explicitly prohibited interference with FASB technical or agenda decisions. A 1991 revision, however, allowed the possibility that the trustees may “provide advice and counsel” to FASB on specific items. The trustees exercised this provision, for example, in a 1992 meeting, in response to fierce opposition by the Business Roundtable and other business organizations to FASB’s proposal for the expensing of stock options. In view of a unified position of the business community, the trustees urged members of FASB to drop their proposal—successfully.⁶⁸ 5) Finally, in the mid-1980s, a period of general deregulation,

66. VAN RIPER, *supra* note 55, at 32.

67. The name of the Board member was Arthur Northrop. Miller, Redding, and Bahnson sum up the episode as follows: “Northrop’s reappointment was not supported by the Financial Executives Institute because he had gravely disappointed leaders of the preparer constituency by not always taking positions on the issues that they expected, despite the fact that he had spent more than 40 years with IBM. This decision is significant because it shows that the trustees were again willing to use their appointment powers to try to shape the outcome of the Board’s process to meet their own needs.” MILLER ET AL., *supra* note 46, at 183.

68. Ten years later, after the Enron debacle, FASB felt that the time was right for resuscitating its stock options project, resulting in the December 16, 2004 revision of the U.S. accounting standard for “Share-Based Payments” (Statement 123(R)), *available at* http://www.fasb.org/news/nr121604_ebc.shtml (last visited Apr. 10, 2005), which requires the expensing of stock options. This time, business was less unanimous in opposing the project. Nevertheless, IT firms in particular have mounted a strong lobbying campaign against the project. As a result, the House of Representatives passed in July 2004 the Stock Options Accounting Reform Act (H.R. 3574) that would override the standard-setter by limiting options expensing to the five most highly paid executives. The Senate referred the

corporate America felt it was high time to curb what it viewed as rampant standard-setting⁶⁹ by changing the voting rule in FASB from simple majority back to supermajority to make it more difficult to adopt new standards. The trustees complied and voted 11-5 to change the voting requirement.⁷⁰

Notwithstanding all these episodes in which business succeeded in getting its way at FASB, it would be wrong to jump to the conclusion that accounting standards-setting simply boils down to business capture of a private-sector regulator. As argued in Part II.B, the delegation relationship is embedded in a broader political and economic context that affects and shapes this relationship. Changes in this macro-political context may change perceptions of the proper balance of interest representation and thus the urgency of weighing competing interests differentially in the process of rulemaking and improving the effectiveness of mechanisms of administrative law in private governance. This logic is illustrated in the following two sections, where we first describe the relationship between FASB and its public principal, the SEC, then consider the effect of the macro-political context on this relationship.

C. FASB and SEC

As the public-sector principal of FASB, the SEC is charged with overseeing private-sector standards-setting activity. Legally, it has the power to revoke FASB's mandate or override its standards and replace them with its own rules. The SEC also monitors compliance with FASB standards and is responsible for their enforcement. The close working relationship between the SEC (primarily

bill to the Committee on Banking Housing, and Urban Affairs, where it "died" when the committee did not take any action before the 108th Congress ended. H.R. Res. 3574, 108th Cong. (2004). However, upon heavy lobbying of the SEC by opponents of expensing, with support from a bipartisan group of members of Congress, FASB agreed to a six- to twelve-months delay before issuers of financial statements have to comply with the new standard. The political battle over stock option expensing in the United States may therefore be expected to continue for most of 2005. See Floyd Norris, *Audit Board Delays Rule on Options As Expenses*, N.Y. TIMES, Oct. 14, 2004, at C1; Gary Rivlin, *Senators Lobby S.E.C. Chief to Delay New Options Rule*, N.Y. TIMES, Oct. 8, 2004, at C3; Gary Rivlin, *Regulators Adopt Tighter Rules on Accounting for Stock Options*, NEW YORK TIMES, Dec. 17, 2004, at C5.

69. Not-for-attribution interviews with two former FASB officials, July 29, 2004 and August 3, 2004.

70. The rule had been changed in 1977 from supermajority to simple majority. See *supra* note 52. The supermajority requirement had been recommended by the 1972 Wheat Committee, which was the origin of the new institutional arrangement for accounting standard-setting, on grounds that it would reduce the likelihood of controversial rulings which may not enjoy wide support. The change to simple majority in 1977 was justified in terms of speeding up the process of establishing standards and creating less scope for compromising on the substance of a standard. See FINANCIAL ACCOUNTING FOUNDATION, *THE STRUCTURE OF ESTABLISHING FINANCIAL ACCOUNTING STANDARDS* 8 (Jan 26, 1989); *News Report: FASB "Supermajority" Voting Stirs Controversy*, 169 J. OF ACCOUNTANCY at 13f (April 1990); *News Report: Supermajority Approved for New FASB Standards* 170 J. OF ACCOUNTANCY at 18 (August 1990). Revealingly, in the wake of the Enron scandal of 2001 the FAF decided to move back to simple majority, after FASB had come under heavy criticism for being slow to act and failing to adopt rules that would have tightened the criteria for keeping so-called special purpose entities off corporate financial statements.

the Office of its Chief Accountant) and FASB has been described by a long-time FASB staff member as follows:

[A] close liaison was maintained between the two organizations [T]heir staffs were in almost daily contact by telephone on a wide range of matters [T]he [SEC] chief accountant participated in meetings of the Advisory Council . . . and [FASB] and the Commission held periodic joint meetings . . . to discuss matters of mutual concern. In addition, the respective chairmen met informally as circumstances required.⁷¹

Operationally, however, FASB depends little on the SEC. The FASB staff grew from a mere eight in 1973 to about eighty-five by the mid-1990s. Over the same period—a period of greatly increased complexity of accounting matters—the staff in the Office of the SEC’s Chief Accountant remained more or less steady, fluctuating around twenty-five. The staff of FASB is thus more than three times as large as the staff of the SEC Chief Accountant’s Office, making any suggestion by the SEC that it might re-appropriate standards-setting (beyond the details of a particular measure) an empty threat. At current levels of Congressional funding for the SEC, it has neither the expertise nor the capacity to take on standards-setting, as it is hardly able to fulfill its monitoring and enforcement mission.⁷²

Further, FASB pays private-sector salaries that are much higher than those offered to SEC staff.⁷³ The considerably better pay has tended to attract more accounting talent to FASB than to the SEC. As Miller, Redding, and Bahnson put it:

Although working at the SEC may provide an intangible benefit from performing a public service, it seems unlikely that the [SEC] would be able to consistently locate, hire, train, and retain people whose talents and backgrounds are equal to those of the people at the FASB and who are also willing to make a long-term commitment.⁷⁴

The higher level of expertise at FASB should objectively improve the technical quality of the standards and the efficiency of standards-setting, as argued in Part II. Yet, it also has the effect that SEC employees at the highest level on occasion encounter their superiors from former private-sector jobs as the FASB members or FASB senior staff whose work they are now supposed to oversee.⁷⁵

Arguably the most important role performed by the SEC staff is to feed back to FASB systematic data on enforcement problems with existing accounting standards or to report difficulties that SEC registrants may experience in implementing specific FASB rules.⁷⁶ Such information assists the agent in revis-

71. VAN RIPER, *supra* note 55, at 144. Van Riper worked for the FASB from 1973 to 1991.

72. Interviews with current and former SEC staff.

73. For example, in 1997, the SEC chief accountant earned \$123,000 while Board members or FASB’s director of research and technical activities earned \$345,000. The salaries of the SEC Chief Accountant’s professional staff ranged from \$47,180 to \$99,250, whereas FASB project managers earned between \$80,000 and \$125,000. MILLER ET AL, *supra* note 46, at 158.

74. MILLER ET AL, *supra* note 46, at 158.

75. Interviews at SEC and FASB.

76. FASB staff may of course also learn of enforcement and implementation problems directly from interactions with its constituents.

ing and improving its standards. The SEC, however, rarely tells FASB what items to work on. For the most part, the flow of information is from FASB to the SEC. FASB keeps the SEC informed of new projects, but it depends on the SEC for neither guidance nor expertise. Whereas the early and untested FASB still had to fight turf battles with the SEC, it has over time established itself quite unambiguously as the focal U.S. institution for rulemaking in accounting.⁷⁷

D. FASB, SEC, and the Accounting Standards Stakeholders in the Macro-Political Context

This account of the relationship between FASB and the SEC would be incomplete, however, without considering the role of exogenous analytical factors, chiefly the macro-political context. Three main groups have a stake in accounting standards: the business firms that prepare and issue financial statements, the users of such statements (mostly investors), and the accountants. All three groups operate within a broader macro-political context, which affects their relative power. The weight given to the concerns of the first group of stakeholders (that is, business) vis-à-vis the concerns of the second group (that is, investors), for instance, is partly a function of more general politically salient attitudes toward regulation.

The SEC as a politicized regulatory agent is bound to be attentive to this broader political context. The President appoints the five Commissioners (subject to Senate confirmation and the restriction that no more than three of them be of the same political party). At least three of the Commissioners therefore tend to share the policy views of the current administration (though they may differ on specifics), and Congress oversees the SEC, holding it accountable as it sees fit.⁷⁸ The SEC's approach to regulatory matters, including accounting standards-setting, is therefore very much a function of the mood of a period reflected in specific political and economic realities. As a result, SEC demands and expectations of FASB are likely to vary over time. The election of President Ronald Reagan, for instance, institutionalized a change in the macro-political climate in favor of deregulation and economic laissez-faire. Among Reagan's first appointments was a new SEC chairman, John Shad, who had a far less activist attitude than his predecessor Harold Williams. Shad, in turn, filled the chief accountant's position with Clarence Sampson, who largely left FASB to its own devices.⁷⁹ Unsurprisingly, it was especially during the Reagan and Bush (Sr.) presidencies that business solidified its control over FASB. Such influence is not undisputed: Dennis Beresford, FASB chairman from 1987 until

77. WALTER SCHUETZE, REFLECTIONS OF A FORMER MEMBER OF THE FASB 7 (1978).

78. See, e.g., ANNE M. KHADEMIAN, THE SEC AND CAPITAL MARKET REGULATION 35f (1992); THE ECONOMIC REGULATION OF BUSINESS AND INDUSTRY: A LEGISLATIVE HISTORY OF U.S. REGULATORY AGENCIES 2679ff (Bernard Schwartz ed., 1973); BARRY WEINGAST, *The Congressional-Bureaucratic System: A Principal Agent Perspective (with Applications to the SEC)*, 44 PUB. CHOICE 147, 160ff (1984).

79. MILLER ET AL, *supra* note 46, at 102.

1997, steadfastly denied that the corporate community had gained influence over FASB's deliberations on technical issues. An FASB insider, however, commented in 1994:

In a literal sense, in terms of the Board's painstaking consideration of the details of any given issue, [Beresford] is right. But in terms of the *overall balance of power* in the standard-setting structure, the atmosphere in which the standard setters work, and the trend lines and fault lines that are developing, he is overlooking some stark realities.⁸⁰

Occasionally, individual members of Congress have criticized what they perceived as excessive business influence in private rulemaking. Representative John Dingell (D-MI), for example, former chairman of both the House Committee on Energy and Commerce and its Subcommittee on Oversight and Investigations, wrote in the mid-1980s to the SEC chairman, advising him of the subcommittee's expectation that the SEC use its power to shield FASB from what he called "improper influence" by the business community. A few years later, during the (first) battle over how to account for stock options, the chairman of the House Subcommittee on Telecommunications and Finance, Representative Edward Markey (D-MA), deplored business's "ferocious hardball tactics and not-so-subtle threats" to FASB and went on to note:

The federal government allows the accounting profession to establish its own rules and standards, with limited federal oversight, because it has been promised that the profession can do so objectively and responsibly. . . . The . . . reported threats raise serious doubts about the wisdom of delegating such broad and important responsibilities to the accounting profession in the first place.⁸¹

More generally, Dingell, Markey, and a few others felt that the interests of users of financial information (investors, creditors, and others) were being overlooked. Such users typically want a maximum of detailed, reliable, and relevant information. From their perspective, standards should achieve maximum disclosure of firms' assets and liabilities and present them in a consistent, easily accessible format. Users also favor a transparent and broadly inclusive process of standardization. Investors and other users, however, are disadvantaged vis-à-vis reporting business firms not only because they have fewer resources and tend to be less well organized as a group, but also because the delegation to a private agent puts them in a less favorable position to influence the process of standardization.

Accountants responsible for auditing the books of firms are the third main group with a stake in standardization. Generally, they are inclined to want more, and more specific, standards, which will defuse differences of opinion with clients. At the same time, however, accountants depend on firms for audit engagements and, until recently, increasingly also for various forms of consult-

80. VAN RIPER, *supra* note 55, at 170 (emphasis added); see also Dale Gerboth, *Research, Intuition, and Politics in Accounting Inquiry*, 48 ACCT. REV. 475 (1973).

81. Press Release, Office of Representative Edward Markey (Apr. 7, 1993) as quoted in VAN RIPER, *supra* note 55, at 155.

ing work.⁸² Though they pride themselves on their analytical abilities and professional objectivity, accountants may be tempted to take a less stringent and more compromising approach, especially in a highly competitive environment. And there is little doubt that the environment for consulting became markedly more competitive in the second half of the 1980s and throughout the 1990s, making auditors much more pliant to the wishes and demands of business firms.⁸³

For all these reasons, politicians such as Dingell and Markey have at times demanded that standardization be taken over by the SEC or by a congressionally mandated “self-regulatory organization” under the control of the SEC, for example, along the lines of the municipal Securities Rule-making Board, whose rules covering municipal bond trading are subject to formal approval by the SEC and official review by the three federal bank regulatory agencies prior to becoming effective.

These demands, however, fell on deaf ears in a macro-political climate of deregulation and unbridled faith in market forces—until a series of major corporate accounting scandals, coupled with a marked cooling of the economy, dramatically changed the macro-political climate, invigorating the SEC to take on a more activist role.⁸⁴ Scholars and journalists writing about the politics of regulation often speak of this latest pro-regulatory political climate for financial markets as the “post-Enron” mood, in which tighter regulation is seen as necessary even by principled free-market advocates “to rebuild confidence after egregious scandals.”⁸⁵ The name of the former energy conglomerate has particular symbolic relevance for accounting standards-setting since its collapse was attributed in part to ambiguities and loopholes in accounting standards, which made many of Enron’s accounting practices questionable but arguably not illegal.⁸⁶ In a speech notable for its directness and forceful tone, SEC Chief Accountant Robert Herdman noted in 2002,

82. The Sarbanes-Oxley Act restricted the kinds and amounts of non-audit work that can be done by the accountants who work as auditors for a given firm. Sarbanes-Oxley Act § 210 and Regulation S-X, 17 C.F.R. § 210 (2002), as updated by SEC Release No. 33-8183 (May 6, 2003); (current version available at <http://www.sec.gov/divisions/corpfin/forms/regsx.htm> (last visited Apr. 10, 2005)).

83. MARK STEVENS, *THE ACCOUNTING WARS* (1985); MARK STEVENS, *THE BIG EIGHT* (1981); MARK STEVENS & CAROL BLOOM STEVENS, *THE BIG SIX: THE SELLING OUT OF AMERICA’S TOP ACCOUNTING FIRMS* (1991).

84. JOSEPH STIGLITZ, *THE ROARING NINETIES: A NEW HISTORY OF THE WORLD’S MOST PROSPEROUS DECADE* 115ff, 241ff (2003).

85. John Plender, *Too Many Watchdogs Barking*, *FINANCIAL TIMES*, Jan. 24, 2005, at 16.

86. This assessment was not limited to the Enron Board’s investigative report by William C. Powers et al (REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF ENRON CORP. (2002) available at <http://news.findlaw.com/hdocs/docs/enron/sicreport/> (last visited Apr. 10, 2005)). The Special Investigative Committee acknowledged false accounting (POWERS ET AL at 58, 198f), but blamed FASB standards for “little guidance” and “no clear answers” on how to treat special purpose entities in the company’s financial statements (*Id.*, at 37f, 180). The assessment was shared by later, outside observers. *E.g.*, HOWARD SCHILIT, *As Bad as It Gets, FINANCIAL SHENANIGANS: HOW TO DETECT ACCOUNTING GIMMICKS & FRAUD IN FINANCIAL REPORTS* 259ff (2nd ed. 2002); Ian P. Dewing & Peter O. Russell, *Accounting, Auditing and Corporate*

[E]ven before Enron's collapse, we called upon the FASB to work with us to address concerns about timeliness, transparency, and complexity. . . . Going forward, we plan to make some *changes to the historical way in which we have delegated our authority to oversee the standard-setting process*. . . . We plan to 1) broaden funding sources and make the funding involuntary, 2) meaningfully participate in selecting the members of FASB and setting the FASB agenda, 3) exercise our authority to review standards actually adopted, and 4) ensure that the FASB promulgates principle-based standards, which adapt faster to changing business environment and emphasize overall accuracy and completeness.⁸⁷

The SEC's first new objective has been attained. Under the Sarbanes-Oxley Act, FASB now receives mandated funding from public companies.⁸⁸ Commenting on the funding change, Robert Herz, FASB chairman since 2002, spoke words that in the pre-Enron era would have struck many within the private-sector standards community as pure heresy:

[W]e need the support, understanding, and partnership of politicians and government officials in helping [to] ensure that accounting standard setting is not subject to inappropriate constituent influence. And indeed, I believe that a clear aim of Sarbanes-Oxley in trying to bolster the financial security of the FASB through the mandated funding was to help ensure that our standard setting is carried out in an independent, objective, and neutral way. That's a tough one for some people to understand and even tougher for some to accept.⁸⁹

Progress on Herdman's other objectives is less certain. In particular, it is unlikely that much will change in the scope and intensity of SEC oversight, given the continuing asymmetry of resources and staff between FASB and the Office of the SEC Chief Accountant. While the staff of the latter has increased since the passage of the Sarbanes-Oxley Act, so have the tasks the Office is asked to tackle. They include not only keeping an eye on private-sector standards-setting, but also working to improve the implementation, auditing, and enforcement of accounting standards.

Nonetheless, the change in the macro-political climate post-Enron has triggered a series of notable additional institutional changes at FASB, aimed at improving its due process. All of these changes may be seen as adopting or improving administrative law procedures. In the summer of 2002, for example, FASB sent letters to chief executive officers of mutual funds, investment and commercial banks, rating agencies, and other user groups, inviting them to join

Governance of European Listed Countries: EU Policy Developments Before and After Enron, 42 JOUR. COMMON MKT. STUD. 289, 301 (2004).

87. Robert Herdman, Address delivered at the Schmalenbach Institute for Business Administration, Cologne, Germany, (Apr. 18, 2002), available at <http://www.sec.gov/news/speech/spch554.htm> (last visited Apr. 10, 2005) (emphasis added). Herdman reiterated the main points in congressional testimony. *Are Current Financial Accounting Standards Protecting Investors? Hearing Before the Subcomm. on Commerce, Trade, and Consumer Protection of the House Comm. on Energy and Commerce*, 107th Cong. 2nd Session (2002) (testimony of Robert Herdman), available at <http://www.sec.gov/news/testimony/021402srkh.htm> (last visited Apr. 10, 2005).

88. A similar arrangement exists in Britain, where the Financial Reporting Council, responsible for setting and enforcing accounting rules, draws its corporate funding from a levy applied by the Financial Services Authority, the main financial regulator.

89. Robert Herz, Address to the American Institute of Certified Public Accountants, (Dec. 12, 2003) (on file with authors).

the newly-created User Advisory Council (UAC). The UAC, whose purpose is to offer user groups a direct channel of communication with the Board, has now about forty members. It meets twice a year with the Board. Another outreach initiative is the creation in 2004 of the Small Business Advisory Committee (SBAC). Participation of small business firms has traditionally been rare, either because of the costs of having an employee monitor FASB activities, attend hearings, etc., or because of weak organizational support structures and collective action problems plaguing small firms. The SBAC, which meets twice yearly with FASB, is meant to overcome some of these difficulties and give small business a voice in the process of rulemaking in accounting. Finally, it also is notable that the FASB has agreed to return to the majority decision rule to improve the speed with which accounting standards are adopted. Further institutional changes, however, appear unlikely, not least because the anti-regulatory counter-trend against the 2001-2002 change in macro-political climate is by now well underway.⁹⁰

IV

IMPLICATIONS FOR GLOBAL PRIVATE GOVERNANCE IN ACCOUNTING

The International Accounting Standards Board (IASB) has been in existence for four years now—too short a period for systematic study. It is nevertheless worthwhile to examine the implications of the preceding analysis for the international experiment in private rulemaking in accounting. To do so, we first clarify the identity of both agent and principals at the global level, analyze how and to what extent differences in P-A relationships between the United States and the international cases are likely to affect the conclusions reached in the preceding section.

A. An International Private-Sector Institution for Setting Standards in Accounting

The international institutional structure for setting accounting standards closely follows the structure of the American model. It comprises four major bodies: the trustees, the IASB, the Standards Advisory Council (SAC), and the International Financial Reporting Interpretations Committee (IFRIC).⁹¹

90. See, *inter alia*, the Jan. 21, 2005, report on the increasing corporate pushback against post-Enron accounting and corporate governance regulation, at <http://marketplace.publicradio.org/shows/2005/01/21/PM200501211.html>; and the publications discussed in Samuel Brittan, *The Rising Spectre of Intrusive Regulation*, FINANCIAL TIMES, Feb. 18, 2005, at 13.

91. See <http://www.iasb.org>; see also KRISTINA TAMM HALLSTRÖM, ORGANIZING INTERNATIONAL STANDARDIZATION (2004); HENNIE VAN GREUNING & MARIUS KOEN, INTERNATIONAL FINANCIAL REPORTING STANDARDS: A PRACTICAL GUIDE (rev. 2004). On international accounting standards see BARRY EPSTEIN & ABBAS ALI MIRZA, IFRS 2005: INTERPRETATION AND APPLICATION OF INTERNATIONAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS (2005); CLARE ROBERTS, INTERNATIONAL FINANCIAL REPORTING: A COMPARATIVE APPROACH (2005).

Ensuring the viability and providing general oversight of the international private accounting-standards-setter is the responsibility of the nineteen trustees of the International Accounting Standards Committee Foundation (IASCF).⁹² They appoint the members of the IASB, SAC, and IFRIC. They also monitor the IASB's effectiveness, raise funds for it, approve its budget and have responsibility for constitutional changes. The International Federation of Accountants nominates candidates to fill five of the nineteen trustee seats; international organizations of preparers, users, and academics may each select one representative.⁹³ The remaining eleven trustees are "at-large," that is, they are not selected through a constituency nominating process but are chosen based on recommendations of individual trustees.

IASB has fourteen members (twelve full-time and two part-time members), appointed by the IASCF trustees. The Board has sole responsibility for setting accounting standards. At least five Board members must have a background as practicing auditors, three as preparers of financial statements, and another three as users of financial statements. One Board member hails from academia. Seven of the full-time members have formal liaison responsibilities with national standard-setters in order to promote the convergence between national and international accounting standards (though they must not be voting members of the national standard-setting bodies).⁹⁴ Each IASB member has one vote, and a simple majority of eight votes is required for the adoption of a standard.⁹⁵

The Standards Advisory Council is formally charged with commenting on IASB projects and giving advice to both trustees and Board members. The SAC is geographically diverse and has about fifty members, predominantly from industry and the accountancy profession. Its members are appointed by the trustees for a renewable term of three years. The SAC meets three times a year.

The IFRIC, finally, is responsible for reviewing accounting issues that are likely to receive divergent treatment in the absence of authoritative guidance. It has twelve voting members and a non-voting chairman. IFRIC interpretations are valid only if approved by IASB.

The process of developing standards typically occurs in four steps. First, during the early stage of a standard project, IASB may establish an advisory committee headed by a Board member, to advise on the issues arising in the project. The SAC may also be invited to offer comments. Second, on major

92. The foundation is a not-for-profit corporation registered in Delaware.

93. These organizations include the International Association of Financial Executives Institutes, the International Council of Investment Association, and the International Association for Accounting Education and Research.

94. The national standard-setters are FASB, the British Accounting Standards Board (ASB), the Canadian Accounting Standards Board (AcSB), the Australian Accounting Standards Board (AASB), the French Conseil Nationale de la Comptabilité (CNC), the German Accounting Standards Committee (DRSC), and the Accounting Standards Board of Japan (ASBJ).

95. IASB is currently undergoing a review of its governance structure.

projects, IASB publishes an initial discussion paper for public comment. Third, upon reviewing the comments, IASB issues an “exposure draft” for public comment. Fourth, after considering the comments, IASB publishes the final standard.

In sum, the key institution of the new international accounting standards-setting system is IASB; it is the agent in charge of setting the international standards known as the International Financial Reporting Standards (IFRSs; its predecessor, the old IASC, produced the International Accounting Standards (IASs)). Its private-sector principal is the board of trustees of the IASC Foundation whose membership comprises mostly representatives from the accounting profession and industry.

B. Endorsement by Public-Sector Principals

Who are the public-sector principals of IASB? Unlike in the United States, where the SEC is the sole public-sector principal of the private standards-setter (and has conferred public regulatory authority on FASB), no single international governmental or trans-governmental organization possesses exclusive jurisdiction in accounting. Instead, several major international organizations claim interest and authority in the area of financial reporting; and over the past ten years, many of these public principals have come to endorse IASB (and its predecessor, the IASC), thereby committing themselves to accept international accounting standards as authoritative rules.

Maybe most importantly, the International Organization of Securities Commissions (IOSCO)—the trans-governmental organization of financial market supervisory institutions from 105 countries, regulating ninety percent of the world’s financial securities markets—reached an agreement with the IASC in 1995, committing stock market regulators to endorse a set of “core standards” when completed in 1999.⁹⁶ In 2000, IOSCO endorsed thirty extant international accounting standards and generally recommended the use of IASs for cross-border offerings and listings.⁹⁷

Similarly, the WTO stated at the conclusion of the Singapore Ministerial Meeting of 1996 that “[w]e encourage the successful completion of international accounting standards . . . by the International Federation of Accountancy (IFAC) . . . [and] the International Accounting Standards Committee.”⁹⁸ Joel Trachtman has argued that this statement signals the WTO’s deference and in

96. See <http://www.iosco.org> (last visited Apr. 10, 2005). Under the agreement, IOSCO was allowed to monitor the IASC standard-setting process as a non-voting observer at both steering committee and Board meetings.

97. Press Release, IOSCO, *IOSCO Announces Completion of Its Assessment of the Accounting Standards Issued by the International Accounting Standards Committee (IASC)* (May 2000) at <http://www.iosco.org/news/pdf/IOSCONEWS26.pdf> (on file with authors). Agreement on matters of international standards in IOSCO is far from guaranteed. See David A. Singer, *Capital Rules: The Domestic Politics of International Regulatory Harmonization*, 58 INT’L ORG. 531, 546ff (2004).

98. Singapore Ministerial Declaration, WTO, § 17 (1996). The IFAC develops auditing standards only.

effect delegation (at least in part and in political terms, as opposed to legal terms) to these non-governmental organizations.

The WTO thus has . . . ‘delegated’ to specific functional organizations the task of establishing standards to facilitate the free movement of accountancy services. This particular delegation is not inconsistent with prior practice in other areas, such as food safety standards (Codex Alimentarius Commission) and general product standards (ISO). We begin to see some evidence of a common institutional solution to [trade problems] utilizing informational ‘delegation’ to specialized functional organizations. The further question, however, is how will the WTO [and its member states] ensure that these organizations reflect appropriately the trade perspective that concern the WTO? This is an agency problem . . . [H]ow can the WTO ensure that [these functional organizations] are faithful and diligent agents?⁹⁹

In 1998, the G-7 Finance Ministers and Central Bank Governors issued a declaration similarly endorsing the work of the IASC and calling on it to “finalize by early 1999 a proposal for a full range of internationally agreed accounting standards.”¹⁰⁰ This and other statements by institutions such as the World Bank, the IMF, and the Basle Committee on Banking Supervision (BCBS),¹⁰¹ as well as endorsing legislation by powerful groups such as the European Union,¹⁰² have provided the IASC (now IASB) with an implicit but nevertheless firm mandate to produce global financial reporting rules. As a result, not only has the pace of standards production increased rapidly, but the number of countries with stock listing requirements or national securities legislation permitting foreign companies to prepare their consolidated financial statements using these standards has also grown steadily.

C. Principal-Agent Relationships in the International Context

Faced on the one hand with multiple public-sector principals, and on the other with a private-sector principal (the trustees of the IASC Foundation), to whom will the IASB listen most closely? Our theoretical model predicts—and our analysis of accounting standards-setting in the United States shows—that

99. Joel Trachtman, *A Sectoral Analysis of Disciplines on Domestic Regulation and International Standard-Setting in Financial Services* (2002), Mimeo. See also *World Trade Organization supports IASC standards*, MANAGEMENT ACCOUNTING: MAGAZINE FOR CHARTERED MANAGEMENT ACCOUNTANTS, at 3 (Feb. 2, 1997).

100. *Declaration of G-7 Finance Ministers and Central Bank Governors*, G-7 (Oct. 30, 1998); see also *Final Report to the G-7 Heads of State and Government on Promoting Financial Stability*, G-7, (June 21, 1997); *Strengthening the Architecture of the Global Financial System: Report of the G-7 Finance Ministers to G-7 Heads of State or Government for their meeting in Birmingham, May 1998*, G-7 (May 15, 1998).

101. See THE WORLD BANK, FINANCIAL ACCOUNTING, REPORTING AND AUDITING HANDBOOK (1995); *Report of the Management Director to the Interim Committee on Progress in Strengthening the Architecture of the International Financial System*, IMF (Apr. 26, 1999); James Wolfensohn, Address to the World Congress of Accountants, Paris, France (Oct. 26, 1997); *Report to G-7 Finance Ministers and Central Bank Governors on International Accounting Standards*, Basle Committee on Banking Supervision (Apr. 2000); *Issues Paper of the Task Force on Implementation of Standards*, Financial Stability Forum (Mar. 25-26, 2000). The World Bank now includes the use of IASs/IFRSs as a condition of its loan agreements.

102. The EU has adopted regulations requiring listed companies to prepare consolidated accounts in accordance with IASs starting in 2005. See *infra* note 112 and accompanying text.

the agent's behavior will diverge from the principals' preferences as a function of the relative tightness of each of the P-A relationships. Specifically, the influence of each principal will depend on its relative importance for the agent's financial and operational viability as well as on the agent's effectiveness in rule-making, given the macro-political context. How does this hypothesis translate in the international context?

Funding for IASB comes largely from voluntary business contributions, which is similar to the situation in the United States prior to the Sarbanes-Oxley Act of 2002. IASB reported receiving in 2001 about \$11 million from 125 companies, \$5 million from the 'Big Five' accounting firms, and between \$1 million and \$2 million from central banks and bodies such as development banks. In theory, IASB's independence is ensured by its separation from the fundraising. The FASB case suggests, however, that such separation fails to shield standard-setters in practice from considerable business pressure. Indeed, the chairman of IASB, David Tweedie, complained only one year after it was launched that certain powerful donors were threatening to withdraw their financial support and "perhaps [even] destroy the organization" if IASB failed to show greater sensitivity to their policy preferences.¹⁰³ It thus appears that powerful firms will seek to trade cash for favors as long as IASB funding is voluntary. This may come at the expense of the interests of investors and other stakeholders who favor detailed and transparent financial reporting. The U.S. case suggests that alternative sources of funding are required to guarantee effective independence. One possible arrangement would be for securities regulators in countries subscribing to IASB rules to add a levy to their listing fees; another is for IASB to be funded via contributions from central banks, financial services regulators, and governments. The latter option creates the risk, however, of exposing IASB to political pressure.

The viability of IASB, like that of FASB, is not simply a function of financial resources; it also involves *operational* viability for which the agent needs to rely on specialized expertise. As in the United States, technical expertise at the international level resides primarily in the private sector. Consequently, preparers and large multinational accounting firms are the largest and most influential groups in the international standards-setting process, thanks to their ability to provide substantive input, both formally and informally. Large firms acting individually and business associations are also the most active lobbyists once an item is on the international standard-setting agenda, notably by submitting the bulk of comment letters in response to draft IASs.¹⁰⁴

103. Andrew Hill & Andrew Parker, *Standard-Setters Are Targeting Stock Options Again*, FINANCIAL TIMES, Nov. 11, 2002, at 21.

104. Sara York Kenny and Robert L. Larson, *The Development of International Accounting Standards: An Analysis of Constituent Participation in Standard-Setting*, 30 INT'L J. OF ACCT. 283 (1995); Robert K. Larson, Corporate Lobbying in the International Accounting Standards Committee, 8 J. INT'L FIN. MNGMT & ACCT. 175 (Autumn 1997).

In contrast to the domestic level, however, international accounting expertise is unevenly distributed geographically, which introduces a new dimension into the analysis: a regional-cultural bias. At the global level, it is the Americans and British who arguably have the most extensive experience writing rules for national capital markets—the world's largest such markets.¹⁰⁵ Indeed, the U.S. capital market alone accounts for half of the world's capitalization. Unsurprisingly, accounting expertise for writing standards for corporate financial statements is heavily concentrated in the Anglo-Saxon world.¹⁰⁶

This striking regional asymmetry in expertise and resources is, in part, the consequence of fundamental differences between the Anglo-Saxon model of accounting and the continental European tradition. They reflect differences in the legal system, the relative importance of capital markets, and the role of government in capital and other markets. In the United States and United Kingdom, where stock markets have long been the main source of capital for firms, the needs of investors have been a main consideration in the development of accounting standards. The elaboration of standards has been delegated by public regulators to the private sector, specifically, the accountancy profession. In most continental European countries, the main purpose of statements of accounts has been tax assessment and the protection of creditors. The basis of accounting thus tends to be highly legalistic. Private shareholding has long been much less widespread than in the Anglo-Saxon world; individual investors traditionally have preferred bonds to equity. The key providers of capital have traditionally been banks. These financial institutions are often represented on the boards of companies in which they are significant investors. As such they are assumed to be privy to inside information; legal disclosure requirements are therefore of less importance to them than to American or British holders of financial securities.¹⁰⁷

In short, in the continental European tradition the dominant concern is taxation and the protection of credit institutions, not the provision of information for investors. Accounting principles are enshrined in tax laws that are the products of democratic political processes; by contrast, in the Anglo-Saxon

105. See, e.g., Beth A. Simmons, *The International Politics of Harmonization: The Case of Capital Market Regulation*, 55 INT'L ORG. 589, 592ff (2001).

106. The concentration is partly due to the history of the accountancy profession, which in the United Kingdom dates back to 1854 (when the Society of Accountants was founded) and in the United States to 1887 (when the American Institute of Accountants was established), whereas for instance the German profession dates only from 1932, and the French from 1942. According to Stewart Hamilton, the United States counted in the early 1990s over 260,000 certified public accountants and the UK some 100,000 chartered members of accountancy bodies (Stewart Hamilton, *Accountants Gather Round Different Standards*, FINANCIAL TIMES, Mar. 20, 1998, at 12). The corresponding figures for France and Germany, according to Hamilton, were 11,000 and 5,000 respectively—though these figures seem to exaggerate the skew of the distribution of accounting expertise by not considering that the various functions of accountants in the U.S. are fulfilled by several different professions in some other countries (such as *Wirtschaftsprüfer*, *Steuerberater*, and tax lawyers in the German context). There is no doubt, however, that the distribution of financial reporting standards expertise is skewed.

107. CHRISTOPHER NOBES & ROBERT PARKER, *COMPARATIVE INTERNATIONAL ACCOUNTING* 15ff (5th ed. 1998).

model, accounting rules result from private-sector processes funded by industry.¹⁰⁸

The contest between these two models (which incidentally is also a contest for international relevance and salience of the technical expertise that supports the competing models) seems to have been decided in favor of market-oriented reporting. This is in no small part due to major European corporations, who, in order to tap into the vast U.S. capital market, have accepted listing requirements of the New York Stock Exchange (NYSE), most notably compliance with the U.S. Generally Accepted Accounting Practices (GAAP) produced by FASB. The motivation for cross-border listings is straightforward: such listings broaden a firm's financial options, often allowing it to raise more capital and on better terms than in the home market; they also broaden the shareholder base, spreading financial risk for firms; last but not least, they add an element of prestige and recognition to a firm's name.¹⁰⁹ The first major European corporation to embrace U.S. accounting rules and list on the NYSE was Daimler-Benz in 1993. When it broke ranks, many Europeans regarded the move as treachery.¹¹⁰ The lure of the U.S. capital market, however, seemed irresistible, and soon other major European firms jumped on the U.S. GAAP bandwagon, including Nestlé, Unilever, VEBA, Hoechst, Rhone-Poulenc, Olivetti, Peugeot, Citroën, and Volkswagen.¹¹¹

Given the dominance and attraction of the American and British capital markets for global business, it is not surprising that Anglo-Saxon experts are central in shaping international accounting rules. One measure of Anglo-Saxon influence can be gleaned from the composition of the IASB in 2001.¹¹² Five of

108. Inevitably, differences in philosophies and general principles underlying accounting standards lead to fundamental substantive differences in the treatment of many economic activities (such as mergers, pensions, leases, and changes in the value of financial instruments). Consider the following example: Income taxes in Germany are based primarily on externally reported accounting profit, so there are strong legal and economic pressures to report income and asset values conservatively. Consequently, German accounting standards allow management considerable flexibility in determining the appropriate allowance for all possible losses. Specifically, transfers to and from reserves need not even be disclosed. Thus if a firm wants to report an increase in income it can charge some expenses against reserves instead of against income without having to disclose such charges in the financial statements. Such practices are expressly prohibited in the United States and United Kingdom where reserves can be set aside for identifiable probable losses but where transfers to and from reserves must be disclosed in the financial statements.

109. Leonardo Martinez, *Private Expertise and Global Economic Governance: The Case of International Accounting Standards*, 54-56 (2001) (unpublished M.Phil thesis, Oxford University).

110. Lee H. Radebaugh et al, *Foreign Exchange Listings: A Case Study of Daimler-Benz*, 6 JOUR. INT'L FIN. MGMT ACCT. 158 (1995). Not only were other German and European business leaders incensed by Daimler-Benz's willingness to adopt U.S. GAAP, they were also troubled by its acceptance of the requirement to publish quarterly results; few Germans understood the American fixation on earnings per share as a performance measure.

111. In 1990, foreign companies raised \$8 billion in the United States; by 1998 the number had shot up to \$170 billion. Franck Bancel & Usha Mittoo, *European Managerial Perceptions of the Net Benefits of Foreign Stock Listings*, 7 EUR. FIN. MGMT. 213 (2001).

112. The nationality of IASB members should matter, given the difference in approaches to accounting as well as the empirical finding that substantive accounting standards preferences tend to be very similar among firms from the same countries but differ among firms from different countries, with firms from Anglo-Saxon countries often showing similar preference; see Robert K. Larson and Karen

the fourteen Board members were U.S. citizens. The United States, the United Kingdom, Canada, South Africa, and Australia together accounted for no fewer than ten members.¹¹³ Considering that under IASB rules the adoption of a standard requires approval by eight of the Board's fourteen members, Anglo-Saxon influence is guaranteed.

Finally, while ensuring operational viability may be the agent's first concern, effectiveness as a regulator also needs to be a centrally important concern for the agent, that is, the regulator's ability to gain acceptance for and compliance with its standards. Attaining this objective does not seem to have been overly difficult for IASB—despite its strong regional bias. IASB regulatory effectiveness has been boosted by an overriding preference of global firms for a single set of accounting rules. The European case is particularly instructive: In adopting Regulation 1606/2002, which requires European firms to prepare consolidated accounts in accordance with international accounting standards, the EU reserved the right to review all IASB standards and to correct any perceived material deficiencies or concerns regarding IASs or IFRSs.¹¹⁴ This was presented as retaining the authority to exercise necessary regulatory oversight, seen as needed due to the perceived Anglo-Saxon bias of IASB.¹¹⁵ It is questionable, however, whether such conditionality can be effective. In theory, it seems to be a reasonable way of ensuring that any new standard passes a minimum legitimacy threshold. In practice, though, it may well turn out to be an ineffective policy, because European multinationals have a strong preference for common global standards and are therefore likely to oppose any review decision that "Europeanizes" IASs, resulting in two sets of rules.

L. Brown, *Lobbying of the International Accounting Standards Committee: The Case of Construction Contracts*, 14 *ADVANCES IN INT'L ACCT.* 62 (2001).

113. David Tweedie, former head of the British Accounting Standards Board was appointed as chairman when IASB was formed in 2001; the vice chairman of the new Board was Thomas Jones, a British national who formerly had been chief financial officer of Citicorp. The Board included two accountants with long-time experience at FASB: Anthony Cope and James Leisenring (a former FASB vice chairman, who was the official liaison Board member to FASB). The other liaison members to their respective national organizations were Tricia O'Malley, former chairwoman of the Canadian Accounting Standards Board and KPMG partner; Hans-Georg Bruns of Germany, an official of Daimler Chrysler; Gilbert Gélard, a French partner of KPMG and former IASC Board member; Warren McGregor, a former chief executive of the Australian Standards Board (also liaison to New Zealand); Geoffrey Whittington, an accounting professor at Cambridge University; and Tatsumi Yamada, a partner at the Japanese affiliate of Price Waterhouse Coopers. The remaining full-time Board members were Robert Garnett, a South African and an executive of the minerals giant Anglo American, and Harry Schmid, a Swiss executive of Nestle. The two part-time members were Mary Barth, a Stanford University professor and former partner of Arthur Andersen, and Robert Herz, a partner at Price Waterhouse Cooper in New York. Some of these individuals have in the meantime been replaced, but the Anglo-Saxon group remains dominant. Anglo-Saxon dominance also has a long tradition in IASB's predecessor, the IASC, where even the few participating developing countries were almost all former British colonies or protectorates. See Kenny and Larson, *supra* note 104; Robert K. Larson and Sara York Kenny, *Research Note: Developing Countries' Involvement in the IASC's Standard-Setting Process*, 11 *sup.* 1 *ADVANCES IN INT'L ACCT.* 17 (1998).

114. Council Regulation 1606/2002, art. 3, 2002 O.J. (L 243).

115. For this purpose the Commission promoted the creation of a review body named the European Financial Reporting Advisory Group, incorporating expert users, accountancy professionals, and regulators.

Consequently, IASB seems unlikely to change a standard to accommodate European preference or governance needs, as EU threats to review and “Europeanize” a particular IAS or IFRS is credible only if large segments of corporate Europe oppose the draft of that particular international standard or if IASB is fundamentally at odds with the macro-political climate. This seems to have been the case recently in the row over rules regarding the financial reporting of derivatives and other financial instruments. Two IASB proposals (known as IAS 32 and IAS 39) require companies to report on derivatives and certain other instruments at market values rather than historic costs and to place restrictions on the use of these instruments in hedge accounting. Many European banks and insurance companies oppose such proposals, arguing that the new rules would inject heavy volatility into profits and balance sheets. The final outcome is uncertain.¹¹⁶

The macro-political context also affects IASB more broadly and has recently led it to consider instituting administrative law procedures. Some critics oppose IASB standards not only on substantive but also on procedural grounds. They argue that the IASB due process is faulty and insist that IASB improve it by making deliberations more transparent and getting more input from companies and investors. These demands have become much more salient and pressing since Enron and a series of other corporate scandals that have ushered in a new macro-political climate affecting private rulemaking in accounting.¹¹⁷

Similarly to FASB post-Enron, IASB has been bowing to this mounting pressure for institutional change and has agreed to strengthen some of its procedures to comply more fully with basic principles of administrative law. For example, IASB has recently agreed to publish near final versions of accounting standards so that companies and investors can get an early warning about their content. IASB previously released draft standards for comment, and then simply put out the final version several months later. The new arrangements will ensure that standards are released in several draft versions, so companies and investors can watch the rules as they develop. IASB will also look at issuing discussion papers on controversial accounting issues and do more field testing of its proposed standards.¹¹⁸ Further, the IASC Foundation trustees have pledged to play a greater role in ensuring that IASB follows due process and improves its deliberative procedures. Such improvements will include measures to reduce the cost of involvement in IASB proceedings (e.g., by broadcasting IASB meetings over the internet and posting observer notes on the IASB website in advance of Board meetings). The IASB has also promised to draw more

116. On Nov. 19, 2004, the European Commission endorsed “95%” of IAS 39 subject to IASB review of the “current full fair value option.” After extensive consultation with the EU Commission, IASB published an amended version of IAS 39 on June 16, 2005, which was endorsed by the EU’s Accounting Regulatory Committee, but formal adoption by the EU has yet to take place. The current position of the Commission toward IASs/IFRSs is available at http://europa.eu.int/comm/internal_market/accounting/ias_en.htm (last visited Aug. 10, 2005).

117. See Dewing and Russell, *supra* note 86.

118. Andrew Parker, *IASB to Improve Consultation Procedures*, FIN. TIMES, Mar. 24, 2004, at 29.

extensively on a wide range of advisory and user groups in the discussions of near-final exposure drafts and standards drafts. Finally, the trustees have also agreed to expand their number by offering two more seats to Asian countries.¹¹⁹

More far-reaching changes are unlikely, however, as a result of structural difficulties, that is, the multitude of public-sector principals of the IASB. Lack of a single or primary public principal who could threaten IASB with renegotiating the grant of authority (as the SEC can do domestically in the United States), leaves the agent with greater freedom of action for at least two reasons: First, a setting with many public principals allows the agent to play off one principal against another. Second, such a setting gives rise to the kinds of collective action problems that are familiar from the literature on multiple principals. Who will engage in proper monitoring of the agent when each principal can free-ride on the monitoring performed by others? Such monitoring would be costly, taxing already scarce resources, and requires technical expertise that IGOs and transgovernmental organizations may simply not possess. Maybe even more importantly, who can effectively reprimand or punish the agent? Any credible threat of taking governance functions away from the agent would, at a minimum, require collective action by several international or transgovernmental bodies and would therefore also require a compromise that is costly to forge, which only seems likely if the agent greatly diverges from several principals' preferences. In other words, the structure of multiple principals (exacerbated by the sometimes conflicting political agendas among those principals) translates into soft constraints on IASB, unless it exercises its power in ways that are substantially at odds with the macro-political climate.

V

CONCLUSION

We have sought to advance the debate about global governance and, specifically, about the potential for a global system of administrative law to ensure accountability, transparency, as well as access for those affected by the new international and transnational rule- and decisionmaking. To do so, we have conducted a positive political analysis of the delegation of regulatory authority to private agents—an issue largely neglected by social scientists but increasingly important in the international political economy. We have focused empirically on global governance in accounting, which as of 2001 is the task of the International Accounting Standards Board, IASB—a private agent, modelled after the national accounting standards-setter of the United States, the Financial Accounting Standards Board, FASB.

Our analysis contributes to several ongoing debates about power, institutions, and governance in world politics. We have found that, when governance functions are delegated to private bodies, material resources and technical ex-

119. See INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE FOUNDATION, REVIEW OF THE CONSTITUTION: PROPOSALS FOR CHANGE (2004).

expertise are crucial. Yet, an analysis of differences in material resources alone is not sufficient to understand private governance. Rather, specific institutional arrangements determine which resources give how much power over which issues to a given actor (and vis-à-vis whom). Consequently, solving any perceived problems of accountability, transparency, or access requires understanding these institutional arrangements.

In addition, our research contributes to the burgeoning literature on delegation. Social scientists who view delegation of public authority as a principal-agent relationship mostly assume that agents are all alike; the existing literature has therefore not systematically examined private agents. We have shown, however, that delegation to private agents is systematically different from delegation to public agents. We have asked, first, why rulemaking authority may be granted or delegated to a private body. We have found that the general reasons for delegating may also motivate delegation to a private agent, but three of them provide special incentives for delegating to a private rather than public agent: benefiting from prior expertise, maintaining expertise in a complex and fast-changing issue area—and shifting responsibility (blame avoidance). In that context, we have formalized with greater precision the conditions under which delegation for purposes of blame avoidance is attractive to a political principal, refining Morris Fiorina's well-known work on this issue. Turning to the practice of governance once authority is delegated, we have found that, especially when delegation of governance functions is motivated by wanting to benefit from the agent's prior expertise, delegation to private agents creates a *particular kind of multiple principals problem*, where the agent ends up with at least two principals—one public and one private. We have stipulated that this arrangement will advantage the stakeholder group that constitutes the private principal over other groups with a stake in the regulatory matter whenever those who constitute the private principal are cohesive amongst themselves yet differ in their preferences from the other groups. The agent's actions under these conditions should be a function of what we call the relative tightness of the competing P-A relationships. This tightness of a P-A relationship depends, in turn, on the extent to which the agent's financial and operational viability is dependent on each of the principals, as well as on the extent to which the macro-political climate demands or permits private regulatory authority to be relatively independent of public oversight.¹²⁰ Changes in this broader context, in which any particular P-A governance relationship is embedded, can deeply affect the nature of the relationship, not least by creating strong incentives for the adoption of administrative law procedures to address concerns about, for instance, unequal participation or bias.

We have examined these issues empirically in an analysis of FASB and a briefer analysis of IASB. Given the novelty of the IASB process, a firm ana-

120. It also is a function of the principals' monitoring capabilities, which, however, again turns on the distribution of technical expertise.

lytical grasp of the FASB process is helpful in pondering the trends and challenges that we may soon observe at the international or transnational level, since IASB is modelled after FASB. Moreover, as we have seen, Anglo-Saxon accounting standards experts are particularly influential at the transnational level, due to the domestic institutional structure and high concentration of accounting standards expertise in Anglo-Saxon countries; FASB is a central player in this world. This analysis of FASB and IASB, which supports our more general theoretical arguments, has a number of important implications for global governance and administrative law.

Self-regulation of socio-economic actors—which is at the heart of delegation of regulatory authority to private agents—has a number of advantages. It ensures that the regulated themselves have a voice in drawing up the regulation (which, *ceteris paribus*, should raise compliance), and it may allow them to establish the most economically efficient means to achieve the regulatory objective. These reasons also motivate the private sector to voluntarily supply (resources for) regulatory governance.¹²¹ Moreover, private regulatory governance makes such governance less costly for the general public, in part because the regulated economic actors will themselves provide the expertise that would otherwise have to be acquired and maintained by government employees.

At the same time, private regulatory governance also creates challenges for equal access for, and accountability to, all who have a stake in the regulation—and it may make administrative law procedures less effective than usually presumed. When technical expertise is required for effective participation but is unevenly distributed across those with a stake in the resulting rules and decisions, those stakeholders will have similarly uneven power in governance unless specific steps are taken to institutionally safeguard the interests of those with less technical expertise. We have found that those with the least technical expertise—namely the users of financial statements (mostly investors, who additionally face collective action problems)—play hardly any role in the domestic and global governance on accounting standards. This is particularly striking since, at least in the United States, public regulatory authority over financial reporting was established in the 1930s precisely to safeguard the interests of investors. In such situations, some of the procedures of administrative law—such as openness of the standards-setting process to input from all interested parties during notice-and-comment periods—will, by themselves, do little to improve the governance output for the previously disadvantaged group. Such administrative law procedures might be instituted with great fanfare in response to a shift in what we have called the macro-political climate, but they may be quite ineffective.

121. In addition, suppliers of governance may here, as always, be motivated by a quest for power, and private sector providers of governance also seem motivated by the opportunity to keep government regulation at bay. See Tandy and Wilburn, *supra* note 57, at 48. Minimizing government involvement appears to be particularly important to the business community in the liberal market economy of the United States. See Tim Büthe, *The Political Sources of Business Confidence* (2002; unpublished Ph.D. dissertation, Columbia University).

In sum, global governance can surely be improved through administrative law. Our findings suggest, however, that an assessment of the likely effectiveness of specific administrative law measures—that is, their effectiveness in solving perceived problems rather than in offering symbolic satisfaction to momentary critics—requires careful empirical analysis of the causes of those problems in the particular realm of governance that is at stake. The influence of the stakeholders in transnational regulation, for instance, may well be institutionally balanced by ensuring effective input from all stakeholders; yet, we caution that the nominal establishment of some of the standard procedures to achieve such greater balance by itself may not be suitable in the global governance of complex, technical issue areas. At the same time, a number of institutional changes and incentives might be quite effective, such as creating an independent source of information about the private agent's work, or changing the agent's funding structure.