

Lobbying accounting standards



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INTRODUCTION TO LOBBYING

Lobbying has long been the most persistent research themes for many years. Since the study by Watts and Zimmerman (1987), the motives of companies to lobby accounting standard setters have been examined in numerous studies. Though most initial study was done from one point of view and usually based on small samples, it cannot reveal any pattern in a company lobbying strategy since it only looks at a sole lobbying decision. Therefore, examining lobbying behaviour over a range of issues and period of time would reciprocate more advantages (Georgiou, 2005). Lobbying patterns varies across nations and regions due to factors that impact responsible lobbying by shaping relation between the state and firms such as type of government, government intervention, lobbying system and factors that have indirect effects by shaping the degree to which stakeholders such as employees, consumers and non-governmental organizations push responsible lobbying (Bauer, 2017)

In the modern day, whereby financial statement users often have diverse and conflicting interest, it is hard to achieve an accounting standard that is acceptable by all parties involved. The setting of accounting standards plays an important role in affecting how, when, and where corporate financial information is disclosed. The interplay of power and influence among many different groups makes up the complex process of accounting standard setting. Through lobbying, special interest groups are able to influence the setting of accounting standards whereby it can take on many different forms (Chung, 1999). Studying corporate lobbying on accounting issues is important because it gives us insights into understanding the unique

institutional features of the accounting standard setting process. It is generally believed that accounting standards are intended to enhance the quality of accounting information and to reduce information asymmetry among market participants (Scott 1997, pp. 368–370).

LOBBYING DETERMINANTS

Before further analysing the impact of lobbying on standard setting in accounting, multiple variable makes up on the reason why lobbying occurs within companies in the United Kingdom. To generalize a few is the companies particular size that might influence the lobbying activities whereby past studies have concluded that a firm's frequency of lobbying on ASB proposals is positively associated with the company's size and operation. Lobbying is costly, thus aside from having more resources available, larger companies are able to devote time and personnel to lobbying activities as the potential benefits favours larger companies and the impact can clearly be seen. Lobbyists make rational choices based on cost-benefit function. Larger companies has greater ability to influence a regulator and to benefit from the outcome as compared to smaller firms and thus they have greater incentive to lobby (Sutton, 1984). Another factor that can be taken into account is the management compensation effect whereby managers are likely to be more interested and consequently more involved in the standard-setting process when their compensation are dependant on the accounting numbers itself. To support this theory, studies has found that the existence of incentive management compensation schemes was found to be positively related to firm participation in the standard-setting process (Georgiou, 2008).

According to Watts and Zimmerman (1987) companies are more likely to lobby when regulatory changes might impact their reporting figures. If the proposed standard does not give any substantial impact on the accounts, firm will choose not to participate in the process. The new lease proposal intends to move towards a full capitalization model in which lessee companies would increase the amounts of assets and liabilities recognized as a result of capitalized operating leases, as a consequence financial ratios such as leverage would be affected. Managers will usually make accounting choices that would avoid debt covenants violations. Firms with higher financial constraints and leverage levels prefer to use leases instead of other methods of debt. Thus, it can be said that companies with high leverage ratios are more likely to lobby over the long term as compared to other companies.

Companies that generates more profit is said to be more likely to engage with lobbying activities since they have more resources to invest in lobbying activities. Similarly, income volatility and/or changes in profitability can explain the probability of submitting a comment letter to avoid adverse effects on markets and stakeholders. In terms of financial strategy, lease contracts in large companies is found to be positively correlated with profitability. Aside from profitability, firm's age is also another major determinant in lobbying whereby older firms are said to engage in lobbying activities more intensely as compared to younger firms. Reason may be due to their previous experience in lobbying activities within their operating period which supports the theory that firm age increases the likelihood that a firm will engage in lobbying activities. Thus, firms lobbying in the past might

experience economies of scale in terms of lobbying (Kosi and Reither, 2014, Morck et al., 2001) because they made considerable investments the first time they lobbied and will thus experience low marginal costs for further lobbying in subsequent periods. Similarly, Weymouth (2012) suggests that older firms have the advantage of repeated interactions during previous years with politicians and regulators and that the costs of monitoring may thus decrease with the age of the firm. <https://www.sciencedirect.com/science/article/pii/S1138489116300188>

Companies in the service industries such as air transport services, hotels, retails, restaurants, shipping and transport use operating leases more intensively. Thus, companies in these industries are more affected by any regulatory change and tend to lobby more than companies in other industries. (Adams & Hardwick, 1998). PwC (2013) believes that the oil industry will be particularly affected based on the definition of a lease because of the capital-intensive nature of the industry and because highly specialized equipment is not always owned. Therefore, we expect a positive relationship between industries that are traditionally more intensively involved in leases and lobbying in the long term.

The convergence project of the IASB and FASB has resulted in IFRS 16 (IASB, 2016) being introduced in 2016 with some new divergence regarding certain aspect of its content. The lease accounting proposal is highly controversial and has resulted in substantive differences of opinion among constituents. The ongoing debate over the pros and cons of the new lease accounting standard has become an important matter that has attracted the attention of accounting academia, professionals and the media (see, e. g., The <https://assignbuster.com/lobbying-accounting-standards/>

Economist, 2013, The New York Times, 2013). The new lease approach aims to help users' decision-making processes, but companies are concerned about its costs and consequences.

Third, the lease standard introduces important accounting modifications from a conceptual and practical perspective. The new approach might have significant economic consequences because it affects companies' financial statements across all sectors; however, industries with more intensive exposure to operating leases would naturally face greater consequences (e. g., Fito et al., 2013, Fülbier et al., 2008). Scholars such as Beattie, Edwards, and Goodacre (1998), Goodacre (2003), in addition to companies such as PwC (2010), have examined the impact of capitalized operating leases and have shown that some financial ratios would be substantially affected. However, other authors reveal that the amount of off-balance-sheet assets and liabilities resulting from operating leases have been adjusted by analysts and are already included in stock prices and interest rates (see, e. g., Altamuro et al., 2014, Krische et al., 2012), thus reducing concerns about the recognition of assets and liabilities from lease contracts. Nonetheless, transparency would increase if companies calculated the adjustments directly (Nailor & Lennard, 2000).

According to the economic theory of democracy, a rational entity assigns resources to lobbying only when benefits outweigh costs, which is similar to the process of allocating a vote in a political system (Sutton, 1984). This cost-benefit function, which has its origins in classical microeconomic theory and is usually represented by signalling models based on assumptions, also relies on agency theory (Jensen & Meckling, 1976).

Based on previous theories, we assume that companies who become involved in the lease standard-setting process by submitting comment letters have invested in transferring information to standard setters with the aim of ultimately influencing the outcome and reaping benefits. They are signalling themselves as lobbyists through a transactional information strategy based on corporate political activities theory. Independent of the corporate position described in the comment letter which may be interpreted subjectively, the investment is greater when the company is committed during all phases of the project.

Conclusions

The evidence shows that lobbying intensity is associated with firm characteristics such as firm size, profitability, age, whether the firm belongs to a lease-intensive industry, and insider ownership. Our results also reveal that the most powerful companies in terms of size and profitability lobby with more intensity, thus confirming the political cost hypothesis advocated by Watts and Zimmerman (1978) and the rational choice theories of Sutton (1984). The results for firm leverage are not statistically significant, which is in line with the debate on the relationship between debt and leases and also consistent with the argument that current adjustments made by analysts mitigate leverage effects. Firm age has been introduced as a proxy for experience in lobbying activities, which reduces the marginal costs of participation.

We also validate the hypothesis that those companies that are most intensively involved with leases and that are directly affected by the

proposal devote more resources to lobbying, thus supporting positive accounting theory. Our findings confirm this theory, which predicts that self-interested companies are incentivized to participate when they are considerably affected by the potential negative consequences of a proposed standard. Finally, the insiders variable, which represents managerial ownership, is negatively related to the intensity of lobbying. Although there is evidence to suggest that monitoring mechanisms and governance characteristics influence financial reporting, little research on this topic has been conducted in previous lobbying studies. Thus, introducing managerial ownership opens an interesting avenue for future research.

The corporate participants in the lease project demonstrate similar behaviours as shown by the evidence from other accounting projects, but the intensity of the lease accounting project is high because it is a highly controversial convergence project, and the boards delayed publishing the final standard until January 2016. Many large corporate groups have been involved throughout the process to protect their self-interest and to influence the outcome by protecting the status quo. These conclusions have implications for standard setters who wish to predict the intensity of lobbying depending on the degree of controversy of the standard discussed and the specific characteristics of the project.

These findings result in a number of possibilities for future research. One potential direction is to introduce more firm factors and qualitative factors to explore their incidence in the lease accounting project. Examining the effects of additional quantitative and qualitative factors on a particular accounting standard project may generate a complete picture of lobbying behaviour.

Specially, the analysis of comment letters' content might help to find more specific qualitative variables that increase explanations and predictions in lobbying behaviour. It might be interesting to deal with notes of financial statements and debt covenants, as a better proxy for balance sheet leverage, to test the impact of this variable in the participation on the lease accounting standards. These measures may clarify the association between liability and lobbying intensity when addressing lease accounting. Another future direction might expand the results using other accounting projects to provide a more complete picture of lobbying behaviour.

This study examines the determinants of lobbying and whether lobbying affects shareholder

wealth. We find that lobbying behavior is related to firm size, investment opportunities, and

industry affiliation. Lobbying is unrelated to cash flow, which is inconsistent with lobby

spending arising from agency problems, unlike other forms of political spending. Evidence

suggests corporate lobbying is lucrative on average. After controlling for factors known to

influence firm-value, results indicate the market value contribution of an additional dollar of

lobbying is roughly \$200.

Lobbying today is a multimillion pound business. Lobbyists are on hand to pursue the interests of individual corporations, industrial sectors and the generic interests of the corporations. Lobbying is clearly about more than sectional interests of particular capitalists and is also about the restructuring of the way in which capital is or is not regulated. The fact that big business was able to put in place the architecture of neoliberalism (through NAFTA, Maastricht, the final round of the GATT, the creation of the WTO etc) is an indication of the necessity of lobbying for the corporations, and of the inability of 'public choice' models to account for the lobbying of which the theorists of public choice approve.

25 The main issues relating to lobbying today relate to the structure of the public sphere – in particular transparency and accountability – and to the questions of hegemony and outcomes. This includes the narrow ambit of policy discussions, privileged access to decision makers for the corporations and their lobbyists and undue influence in decision making. Some examples follow to illustrate the British lobbying system in Westminster and Whitehall.

- <https://onlinelibrary-wiley-com.ezproxy.westminster.ac.uk/doi/full/10.1111/j.1467-6281.2005.00185.x#b1>
- <https://www-emeraldinsight-com.ezproxy.westminster.ac.uk/doi/full/10.1108/JGR-07-2015-0012>
- <https://link.springer.com/content/pdf/10.1023%2FA%3A1008374831913.pdf>

CONCLUSION

Responsible lobbying, understood as lobbying in line with a firm's overall responsibilities toward society, is essential, as it helps to prevent public criticism of political influence and reputational risks. Some firms now begin to recognize the need for an integrative approach and implement measures like lobbying code of ethics or disclosure of political activities in corporate responsibility reports

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