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How does the network structure of standard-setters affect its standard-setting activity?

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Abstract: This article aims to explain the following question: how does the network structure of standard-setters affect their performance? This paper focuses on the activities and structures of FASB and IASB. It presumes that the standard-setters strategically alter the organizational structure and consequently change the activities. To identify the structures, this paper uses coreness analysis in network theory. According to the analyses, it follows as below. First, the FASB has recognized the survival-crisis due to the rise of IASB. Preventing from the crisis, the Board has sought to take alliances with the users and attempted to set lots of innovative standards. Second, to reinforce its position as a global ruler, the IASB has needed to acquire the trust of global and local regulators as well as the businesses. Then, the IASB has had to play as a coordinator with the preferences of broad constituencies and adopted the compromised standards slowly.

Keywords: accounting standard-setting, FASB, IASB, network theory

1 INTRODUCTION

The U. S. financial reporting standards setter, the Financial Accounting Standards Board (FASB) and the international counterpart, the International Accounting Standards Board (IASB) agreed upon the Norwalk Agreement, which both Boards decided to develop big projects, for examples, financial presentation, revenue recognition, financial instruments, fair value measurement, post-retirement benefits, lease, and business combinations, on September 2002. However, these projects except for business combinations project have been still under deliberation; furthermore each Board made different decisions in the business combinations project. The reason why both Boards couldn't obtain their consensus in developing these projects is thought that they should respectively have different preferences and ideas of accounting methods, and different standard-setting activities. How can we explain difference of the activities between FASB and IASB?

Throughout the history of FASB (Zeff [1]), it is founded that standard-setters could strategically alter the organizational structure by means of the shift of the member composition and the selection of members, in order to take care of problems which the Board faces. With this concept, it is thought that the difference of standard-setting activities between the FASB and the IASB could be explained on the difference of the facing issues and/or organizational structures. That is, the scheme is shown as follows: the facing issues affect the strategies of standard-setters; the strategies alter the organizational structures of the setters; and the structures change the activities of the setters. Following the premise, this paper aims to make clear what kinds of problems each Board face and what kinds of strategies they have respectively.

2 THE BEHABIOR MODEL OF THE STANDARD-SETTERS

2.1 The Characteristics of the Accounting Standard-Setting

Financial reporting standards are originally rules or guidelines which have to be followed when the management would prepare their financial statements for providing to various stakeholders and when the accountants audit these statements. Most importantly, these standards are thought to be necessary for the users of financial statements to help their making decisions on investment or credit. Therefore, the creation of new standards and the revisions or removals of existing standards can alter the quality and quantity of the accounting information; such information consequently make some kinds of stakeholders change their decision-makings and behaviors. Among these actors, the following two ones are significant: the public regulator and the business community.

2.2 The Behaviors of the Regulatory Agency and the Business Community

The regulatory agency delegates the authority of setting the standards to a specific standard-setter instead of providing them *per se*. In delegating the authority to the setter, the agency might usually be trust to the setters considerably; at the same time, the setter would develop the standards which are consistent with the agency's policy targets for the purpose of establishing its credibility. This mutual confidence consequently gives the setters discretion of setting standards (Büthe [2]). Obtaining the discretion, the setter comes to give considerations to the business community unduly and to establish the standards which are undesirable to the original policy targets and aims. With the frequent occurrence of such cases, the agency might make a judgment that the current setter could no longer fulfill their tasks, and decide to crate a new setter.

The accounting regulations are essentially meant to reduce discretion of companies on selecting accounting techniques in preparing their financial statements in order to increase the comparability among companies and to improve the companies' transparency. The business community is thus inclined to become opponents against the standard-setters. However, excessive opponents could not be rational to the business community, because these consequences replace the existing private-sector regulation with the public-sector to which the community can't easily access in developing standards (Kelly-Newton [3]; Mattli and Büthe [4]).

2.3 The Regulatory Behavioral Model of the Accounting Standard-Setter

Recognizing needs of certain standards, the setters would initially set the standards based on the fundamental theory or thought, i.e. the conceptual framework. In a large proportion of cases where the setters would establish significant standards, they face heavy oppositions from constituencies. Suppose that the setters would strategically take the most suitable action under every situation, it seems that they could change their behaviors depending on how they recognize the positions in which they are (see Figure 1).

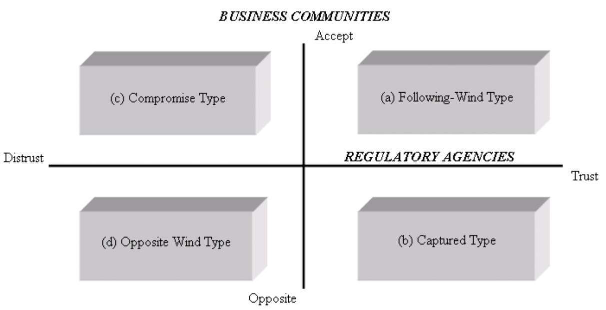


Figure 1: Behavioral Model of the Accounting Standard-Setters

Table 1 shows the behavioral model of standard-setter. This model illustrate as below: the setter at first recognizes the situation surrounding to it; based on the recognition, the setter prescribes its regulatory motivation; corresponding to the motivation, the setter strategically constructs the network; finally following the network, the setter sets the standards. Additionally, Figure 2 illustrates each network type in the behavioral model.

3. THE PERFORMANCES OF BOTH BOARDS

Table 2 shows the number of standards which each Board has respectively issued during 1991 to 2010. The FASB had issued 93 publications and the IASB had issued 98 standards during this term. The FASB had set less than 5 standards every year from 1991 to 2008; and thus it is hard to describe that the Board was the activist for setting accounting standards during this term. In contrast, the IASB had had two significant periods for actively issuing the standards: (a) from 1998 to 2000, for making ready to the completion of Core Standards, and (b) from 2003 to 2004, for providing the adoption of IASs/IFRSs in the EU jurisdiction.

Table 1: The Behavioral Model of Accounting Standard-Setter

	Following-Wind Type	Captured Type	Compromise Type	Opposite Wind Type
Situation	Regulatory agency trusts; Business community accepts.	Regulatory agency trusts; Business community opposites.	Regulatory agency distrusts; Business community accepts.	Regulatory agency distrusts; Business community opposites.
Regulatory Motivation	The setter would establish the standards, which it believes valid, based on the idea of investors' protection, because of growing its legitimacy. For the same reason, it would collect voices from some kinds of interested parties.	The setter would recover the acceptance from business leaders.	The setter would recover the trust from the regulatory agency. At the same time, it takes account of the business community for preserving the support from the community. Without its support, it might not set the standards.	The setter pursues to closely and directly formulate a new alliance with investors for keeping them on its side.
Network Structure	The setter attempts to build up the open network in order to easily gather the voices and ideas of various constituencies.	The setter would form the network with closer relations to business communities comparative to other stakeholders.	The setter would form the network with close relationship to business community as well as regulatory agency and investors.	The setter would form the network with closer and more directly relationships to investors rather than other stakeholders.
Activity of Setting Standards	The number of standards issued by the setter might be almost as same as the necessary number. Also, the contents can be similar to what it originally proposed to.	The number of standards issued by the setter would be less than what the setters need to establish. Also, in the case of being heavily criticized from the business leaders, the setter decides to cancel or postpone the projects or sets the standards which should have no real impacts.	The setter would establish the compromise standards which are incorporated into both preferences of the regulatory agency and the community at the same time. Also, the number of standards issued by the setter would be less than what the setter need to set because of spending considerable time and efforts for coordinating with some kinds of the interested parties.	The setter should establish the standards which it believes true. Therefore, the setter would establish standards as much as possible.

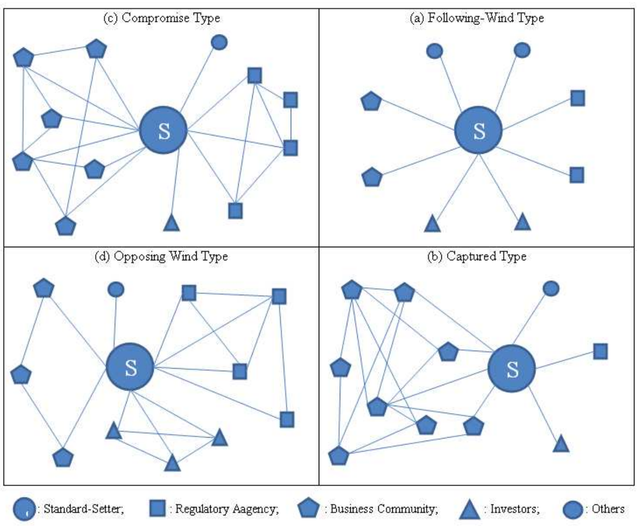
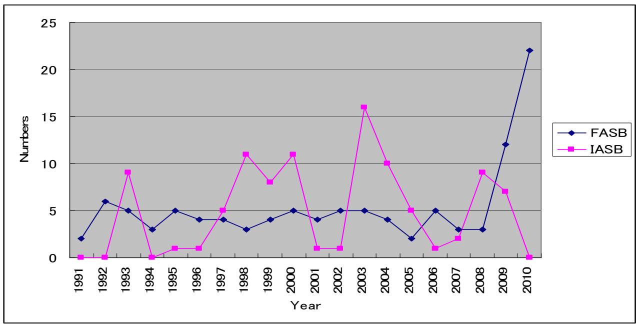


Figure 2: Four Types of Network Structures

Focus on the activity of each Board in the last two years, 2009 and 2010. While the FASB had issued 21 standards and published the most number of standards in last 20 years, the IASB had set mere seven standards and hardly published the ones. The composition is drawn that the FASB actively attempts to set the standards; on the other hand, the IASB takes a passive stance for setting standards

Table 2: The Number of the Standards Issued by FASB and IASB



Next, turn to the preference of each Board in the standard-setting. According to some projects which have already completed recent years and has deliberated at this moment, it is noted that the FASB strongly aims to adopt the innovative standards which have been rarely used at present or never done by now; in contrast, the IASB takes negative attitude for setting these standards and thus has a tendency for permitting the current practices as alternatives with the innovative techniques.

4. METHODOLOGY AND DATA

4.1 Analytical Method

To illustrate the network structure of standard-setters, this article uses graph theory or network theory for specifying the structure of standard-setters. The researches applying the network theory to the accounting arena are listed as below: Perry and Nöelke [5], Richardson [6], and Ogata [7]. Network theory usually quantifies the relations measured among actors in the network and provides descriptions of structural properties of actors, subgroups of actors, or groups (Wasserman and Faust [8]). In addition, the theory attempts to describe the network structure and the relationship using a graph shown by nodes and edges.

This paper applies the continuous coreness analysis to identify the network structure of each Board. Here, the "coreness" mentions that who have a high density of ties within the network by many events in common. The coreness analysis can capture a density continuously (Borgatti and Everett [9]).

4.2 Using Data

In analyzing the network structure respectively, this article focuses on the "career path" which means that each member who belongs to any organizations of each Board would arrive at the organization with his/her backgrounds on the basis of their previous jobs and extracts the organization-to-organization relationship from such a data. By manifesting such relationships, it could seem to be clear that what organizations could take on the central positions of and establish their influence on each Board.

As of January 2011, the FASB had four main organizations (FAF, FASB, FASAC, and EITF) and six advisory groups (ITF, ITAC, NAC, PCFRC, SBAC, and VRG); the IASB had four organizations (IFRS Foundation, IASB, Advisory Council, and Interpretations Committee) and five groups (ARG, GPF, EBWG, IWG, and FIWG); and both Boards had some joint advisory groups (FCAG, LAWG, JIG, and FIAG). This research traced the careers of all members in these organizations and groups through their curriculum vitae disclosed in their belonging organizations as of January 2011. As a result, this article could gain the following data: on the FASB, 208 members had gotten engaged in 540 organizations; for the IASB, 233 members had related to 496 organizations.

5. ANALYTICAL RESULTS

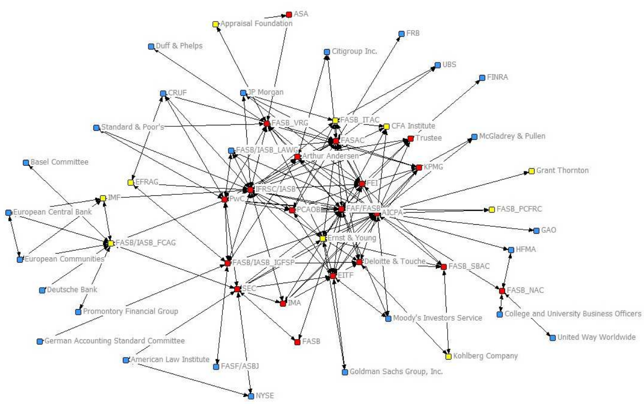
5.1 The Results on FASB

Table 3 shows the result of coreness analysis on FASB. The shaded parts on this table indicate organizations and groups relating to the FASB. Also, Graph 1 depicts the network of FASB.

Table 3: The Result of Coreness Analysis on FASB

1	AICPA	0.506	24	Not-for-Profit Advisory Committee (NAC)	0.067	47	Loews Corporation	0.027
2	FAF/FASB	0.412	25	Board member	0.066	48	LoopNet	0.027
3	IFRSF/IASB	0.282	26	JP Morgan	0.058	49	MacDonald Dettwiler	0.027
4	FASAC member	0.255	27	Goldman Sachs Group, Inc.	0.057	50	Maryland Association of CPAs	0.027
5	EITF member	0.219	28	Grant Thornton	0.055	51	Public Oversight Board (POB)	0.027
6	PwC	0.192	29	Financial Crisis Advisory Group (FCAG)	0.054	52	R.G. Associates, Inc.	0.027
7	FEI	0.167	30	Standard & Poor's	0.050	53	Sapient Corporation	0.027
8	Valuation Resource Group(VRG)	0.163	31	McGladrey & Pullen	0.049	54	Thomson Reuters	0.027
9	Arthur Andersen & Co	0.149	32	American Society of Appraisers (ASA)	0.048	55	American Arbitration Association	0.026
10	PCAOB	0.147	33	International Swaps and Derivatives Association	0.042	56	Appraisal Foundation	0.026
11	Ernst & Young	0.140	34	EFRAG	0.041	57	CitiGroup	0.026
12	SEC	0.133	35	U.S. Government Accountability Office (GAO)	0.041	58	Financial Consulting Group (FCG)	0.026
13	KPMG	0.130	36	Corporate Reporting Users' Forum (CRUF)	0.040	59	Financial Valuation Group	0.026
14	Deloitte	0.128	37	BDO International	0.036	60	Financial Valuation Group of Florida, Inc	0.026
15	IMA	0.124	38	Stanley Black & Decker	0.035	61	Florida Bar,	0.026
16	Trustee	0.105	39	A.C. Sondhi & Associates, LLC	0.034	62	Florida Institute of CPAs	0.026
17	Investors Technical Advisory Committee(ITAC)	0.103	40	UBS	0.034	63	Intellectual Property Owners Association	0.026
18	Joint International Group on Financial Statement Presentation(JIG)	0.100	41	Healthcare Financial Management Association	0.028	64	Licensing Executive Society	0.026
19	Small Business Advisory Committee(SBAC)	0.096	42	Career Education Corporation	0.027	65	Bank of America Corporation	0.025
20	CFA Institute	0.087	43	Chicago Mercantile Exchange	0.027	66	Deutsche Bank	0.025
21	Lease Accounting Working Group(LAWG)	0.086	44	GE Company	0.027	67	Duff & Phelps	0.025
22	Moody's Investors Service	0.076	45	IBM	0.027	68	University of North Carolina	0.025
23	Private Company Financial Reporting Committee(PCFRC)	0.072	46	Insweb Corporation	0.027			

Graph 1: The Network of FASB as of January 2011



According to the analysis and the graph, it follows that (1) the accounting professions like AICPA, PwC, Deloitte, KPMG and E &

Y are core actors; (2) the domestic actors like SEC, PCAOB, AICPA, FRB, and NYSE stand on core positions within the network; (3) the business community actors like FEI are core, while its range of network is restricted; and (4) although the user actors composed of (a) analyst groups like CFA Institute and CRUF, (b) the financial institutes, and (c) the credit rating agencies are less core, its range is broad.

5.2 The Results on IASB

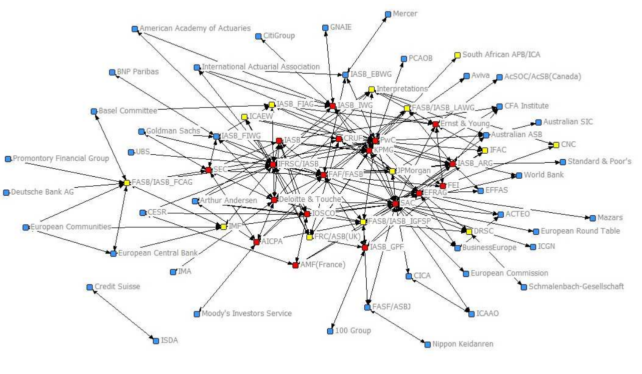
Table 4 shows the result of coreness analysis on IASB. The shaded parts on this table indicate organizations and groups within the IASB. Also, Graph 2 depicts the network of IASB at the same point.

Table 4: The Result of Coreness Analysis on IASB

1	SAC member	0.449	29	Financial Crisis Advisory Group (FCAG)	0.068	57	Goldman Sachs Group Inc.,	0.034
2	IFRSF/IASB	0.392	30	Australian Accounting Standards Board	0.066	58	International Swaps and Derivatives Association	0.034
3	PwC	0.313	31	World Bank Group	0.065	59	XL Capital Ltd.	0.034
4	EFRAG	0.232	32	Arthur Andersen & Co.	0.064	60	Australian Public Sector Accounting Standards Board	0.033
5	FAF/FASB	0.226	33	International Actuarial Association	0.062	61	Basel Committee on Banking Supervision	0.033
6	KPMG	0.185	34	Global Preparers Forum (GPF)	0.061	62	CICA	0.033
7	Insurance Working Group (IWG)	0.172	35	UBS	0.061	63	AIG	0.032
8	Deloitte	0.151	36	Standard & Poor's	0.060	64	Equitable Companies	0.032
9	Board member	0.149	37	IMF	0.056	65	Hudson International	0.032
10	Analyst Representative Group (ARG)	0.147	38	CFA Institute	0.055	66	Aviva	0.030
11	FRC/ASB (UK)	0.131	39	European Commission	0.051	67	IMA	0.030
12	IOSCO	0.124	40	CESR	0.050	68	CitiGroup	0.029
13	SEC	0.114	41	BUSINESSEUROPE	0.049	69	GE Company	0.028
14	Financial Institution Advisory Group on Financial Statement Presentation (FIAG)	0.112	42	FASF/ASBJ	0.049	70	Institutes of Chartered Accountants of Alberta and Ontario	0.028
15	Joint International Group on Financial Statement Presentation (JIG)	0.109	43	ACTEO (France)	0.046	71	Inter-American Investment Corporation	0.028
16	Corporate Reporting Users' Forum (CRUF)	0.106	44	Group of North American Insurance Enterprises (GNAIE)	0.045	72	Nippon Keidanren	0.028
17	IFAC	0.098	45	American Academy of Actuaries	0.041	73	Association of British Insurers	0.027
18	Financial Instruments Working Group (FIWG)	0.093	46	Merrill Lynch	0.041	74	Business Accounting Deliberation Council	0.027
19	Interpretations member	0.092	47	Australian Securities and Investments Commission	0.039	75	Institute of International Finance	0.026
20	JPMorgan Chase & Co.	0.092	48	CNC (France)	0.039	76	International Corporate Governance Network	0.026
21	AICPA	0.089	49	European Round Table of Industrialists	0.039	77	Ministry of Economy, Trade and Industry(Japan)	0.026
22	Ernst & Young	0.089	50	Trustees	0.038	78	Ceylon Electricity Board	0.025
23	AMF (Financial Market Authority, France)	0.084	51	ASOC/AcSB (Canada)	0.037	79	Independent Television Network (Sri Lanka)	0.025
24	FEI	0.084	52	Bear Stearns & Co	0.037	80	Institute of Chartered Accountants of Sri Lanka	0.025
25	Lease Accounting Working Group (LAWG)	0.080	53	Mazars	0.037	81	Post Graduate Institute of Management (Sri Lanka)	0.025
26	DRSC e.V(German Accounting Standard Committee)	0.078	54	South African APB/South African ICA	0.037	82	South Asian Federation of Accountants	0.025
27	Employee Benefits Working Group (EBWG)	0.076	55	PCAOB	0.036	83	Sumitomo Corporation	0.025
28	ICAEW	0.072	56	Credit Suisse First Boston	0.035	84	UK Financial Services Authority	0.025

By the analysis of the IASB, it follows that (1) similar to the case of FASB, the accounting professions are core actors within the IASB network; (2) the international authority actors like IOSCO, IMF, World Bank, and the Basel Committee naturally stand on core positions; (3) European actors comprised of (a) the administrative agencies and the corresponding bodies like EC, CESR, EFRAG,, and European Central Bank, and (b) the national standard-setters in the EU like ASB (U. K.), CNC (France), and DRSC (Germany); (4) the business community actors including FEI, BusinessEurope, European Round Table, and Nippon Keidanren construct a broad network; and (5) the user actors are not so core and shouldn't build up a broad network.

Graph 2: The Network of IASB as of January 2011



6. DISCUSSION

Above results suggests some following points. First, both Boards are in close contact with accounting professions. It means that, in the case of standard-setting called for high degree of expertise, accounting professions could play key roles. Second, the FASB of course makes tight relationship with the national actors; by contrast, the IASB establishes close ties to the European actors. It is generally predicted that local actors applying a specific set of standards which are endorsed in the jurisdiction stand on the central stances. In that case, with respect to the IASB, it is noted that European actors would be responsible for actively setting standards. Third, the IASB comes to formulate the tight relations with the international organizations, especially the international financial agencies. In fact, the IASB includes the representatives of IOSCO and Basel Committee as observers in the FIWG (IFRS Foundation 2011). Fourth, each Board constructs discrete relationship between the business community actors and the user actors. For the FASB, though being core, the business community actors have a closed network; being not so core, the user actors are created a broad network. For the IASB, the business community actors, especially European industrial associations establish a broad and close network; the user actors build up a coreless and closed network. From the viewpoint of the range of network, it can be stated as follows: the FASB seeks to formulate a more friendly relationship with investor actors in comparison with the business community actors; the IASB attempts to construct a more comfortable network for the business community actors than the user actors.

Such a structural outline is consistent with the description of performance of each Board from the quantitative and qualitative perspectives, as mentioned above: the FASB strongly proposes to adopt innovative techniques; the IASB develops a negative attitude for establishing such techniques. Although causing the businesses to impose heavy burdens including the increment of the amount of liabilities, the extreme volatility of earnings or losses, and the increasing costs of preparing for their financial statements, these techniques could provide the users with transparent and useful information.

In sum, it is noted as follows: for the FASB, putting weight on the user actors rather than the business community actors; the Board stands on the stage that it would issue a lot of innovative standards; in the case of the IASB, coordinating with the preferences of the European and the international actors as well as the business community actors, the Board couldn't positively develop so many standards and adopted the compromised standards allowing either the current practices or the innovative methods.

7. CONCLUSION

From the viewpoint of the behavioral model in this paper, the story of each Board is presumed as described below. First, the

FASB has recognized the crisis of its survival by itself due to the rise of IASB in the U. S. and global accounting standard-setting. To prevent from the survival-crisis, the Board has sought to take a new alliance with the users and consequently has tried to set lots of innovative standards. Second, having faced the endorsement problem, the IASB has needed to reinforce its position as a global ruler by means of acquiring the trust of international regulators and national and jurisdictional administrative agencies. In addition, on conducting its tasks, the Board can't afford to lose the support from the businesses, because the lost of their supports possibly causes these agencies to evaluate the inadequacy against the Board. Therefore, the IASB has had to play as a coordinator with the preferences of various kinds of the constituencies and has adopted the compromised standards at a slow pace.

There seem to be some implications of this paper. First, the behaviors of the accounting standard-setters have a possibility to depend on their network structures. Second, the networks have prospects of being strategically constructed by the standard-setters. And third, the strategies might be dependent on the situations with which the setters are facing. However, it is necessary to furthermore consider the validity of the model developed in this paper. To do so, we attempt to focus on the time-series transition of the network on the same organization.

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