

THE POTENTIAL EFFECTS OF DIFFERENT VOTING RULES ON THE FASB DUE PROCESS

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ABSTRACT

The institutional legitimacy of the FASB is dependent upon a substantive and procedural due process. A major step in the due process is the combination of individual Board members' preferences into an aggregate FASB decision on a statement of financial accounting standards. Different voting rules may have varying degrees of "success" in aggregating individual Board members' preferences. The purpose of this paper is to analyze four voting rules and to demonstrate that the ultimate FASB decision about a statement of financial accounting standards may be dependent upon

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which voting rule is used, even though each rule is based on the same set of Board member preferences.

I. INTRODUCTION

According to Johnson and Solomons [1984], the institutional legitimacy of the Financial Accounting Standards Board (FASB) is dependent upon a substantive and procedural due process. The existing literature about the FASB due process tends to concentrate on the analysis of individual Board members' preferences for an accounting issue and the political influences of constituent groups on the development of those individual preferences. In contrast, this paper extends the prior research and focuses on voting rules which may be used to aggregate those individual preferences into a composite FASB decision on an accounting issue.

The remainder of the paper is organized as follows. Section II discusses the FASB due process and the importance of a voting rule to this process. Section III examines four voting rules and their potential impact on the FASB's collective choice for an accounting standard. A summary and conclusion are provided in Section IV.

II. THE FASB DUE PROCESS

The mission of the FASB is to establish and improve standards of financial accounting and reporting. The Board's decisions are based on research conducted by the FASB staff and comments received from various constituent groups. Specifically, the Rules of Procedure of the FASB require that the Board follow an extensive "due process"—a series of steps which ensure that the views of all interested parties receive careful consideration before final standards are adopted [Johnson and Solomons, 1984]. This process is modeled on the Federal Administrative Procedure Act and in several respects is more demanding than that Act [FASB, 1988; and Van Riper, 1987].

In general, six basic steps constitute the overall due process [Miller and Redding, 1988]:

1. preliminary evaluation of the problem,
2. admission to the agenda,

- 3. early deliberations,
- 4. tentative resolution,
- 5. further deliberations, and
- 6. final resolution

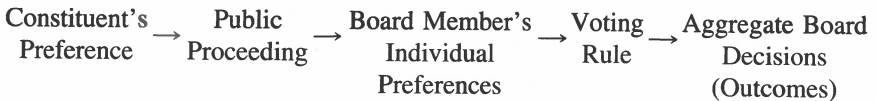
During steps 1, 2, and 3, the Board members attempt to form their individual positions on the issues. At that time the Board members are exposed to the views of the following groups: (a) the constituents (written comment letters and oral presentations at public hearing); (b) the FASB staff (research projects and drafts of proposed documents); and (c) other Board members (official Board meetings and informal discussions of issues). These interactions enable the individual Board members to identify their pre-existing preferences and to possibly develop new preferences.

The FASB staff plays a major role in the identification and development of individual Board members' preferences. Van Riper [1987, p.31] describes this role as follows:

The board members are the decision makers and they must make many decisions on each of several projects that are under consideration at any given time. The Board must rely on staff members to spend all or a large part of their time on the details of the individual projects, gathering and organizing the information on which board decisions can be based. Therefore staff project managers, not board members, conduct the day to day work on projects, always subject to review and challenge by the board. Informal discussions among board members and between board members and staff take place frequently throughout every phase of a project.

However, because the Board members are distinguished individuals from diverse backgrounds, each Board member may not develop the same preference for an accounting issue. During steps 4, 5, and 6 of the FASB's due process, the focus shifts from the formulation of individual Board members' preferences to the coalescence of individual preferences into a composite FASB position on an issue.

At the ultimate stage of the due process, the Board members must culminate their open decision-making process into a vote on a final standard. Newman [1981] suggests a framework which describes how this process may ensue. Notice that a major step in this process is the combination of individual Board members' preferences into aggregate FASB decisions by way of a voting rule:



Though the accounting literature gives little recognition to the importance of a voting rule, the above diagram and the political science literature suggest that different voting rules may have varying degrees of ‘success’ in aggregating individual Board members’ preferences. According to Solomons [1978] and Miller and Redding [1988], the accounting policy formulation process is as much political as logical. Thus, various voting rules may have differential effects on the FASB due process and, thereby, possess potential economic consequences [Zeff, 1978]. Four voting rules are discussed and illustrated in the next section of the paper.

III. THE POTENTIAL EFFECTS OF DIFFERENT VOTING RULES

The purpose of this section is to illustrate that even with a *constant set* of individual Board member preferences, different outcomes may result based upon the selection of a voting rule. Assume that four accounting alternatives have been identified during the due process as viable versions of a statement of financial accounting standards. The four alternatives are denoted respectively by a_1 , a_2 , a_3 , and a_4 . Also assume that each of the Board members ranks the four alternatives from most preferred to least preferred as depicted in Table 1. For example, Board Member No. 1 prefers a_1 to a_2 , a_2 to a_4 , and a_4 to a_3 , and so on. These preferences are utilized to illustrate the potential effects of four voting rules, namely plurality voting (PV), sequential binary voting (SBV), Borda rank-order voting (BROV), and approval voting (AV).

These voting rules are by no means an exhaustive list. Rather, they

Table 1. Rank Order Preferences of Seven Board Members for Four Accounting Alternatives

Board Member	Ranking (Most Preferred to Least Preferred)
#1	a_1, a_2, a_4, a_3
#2	a_1, a_4, a_3, a_2
#3	a_2, a_1, a_4, a_3
#4	a_2, a_4, a_1, a_3
#5	a_3, a_1, a_4, a_2
#6	a_3, a_2, a_1, a_4
#7	a_3, a_4, a_2, a_1

were chosen because they are used in political settings and because they demonstrate the potential ramifications of different voting rules. The process by which each Board member arrives at his individual preferences, prior to the application of an aggregate voting rule, is taken as a given (individual-specific) variable.

A. Plurality Voting (PV)

In this voting rule, all alternatives are considered simultaneously with each member voting for exactly one alternative. The alternative receiving the most votes is then chosen as the decision of the Board.

As shown in Table 2, a_1 would receive two votes, a_2 would receive two votes, a_3 would receive three votes, and a_4 would receive zero votes. Hence, alternative a_3 would be the Board's choice in this example based on the individual preferences in Table 1.

B. Sequential Binary Voting (SBV)

Alternatives are introduced pairwise in this voting rule so that in each round, one alternative is eliminated. The process continues until only one alternative remains, which then becomes the Board's choice.

For instance, suppose that the four alternatives are considered in the sequence a_1 , a_2 , a_3 , and a_4 (see Panel A of Table 3). In this scenario a_2 wins against a_1 , a_3 wins against a_2 and a_4 wins against a_3 . Hence, a_4 is the Board's choice (based upon the individual preferences in Table 1) even though it did not receive a single vote under PV above. However, if the sequence of alternatives considered is changed to a_3 , a_1 , a_2 , and a_4 , then a_2 would be selected (see Panel B of Table 3). Therefore, the ultimate FASB decision (even with constant preferences) may be dependent upon the sequence in which the alternatives are considered.

Table 2. Plurality Voting

<i>Alternative</i>	<i>Number of Votes</i>	<i>Board Members From Table 1</i>
a_1	2	#1, #2
a_2	2	#3, #4
a_3	3	#5, #6, #7
a_4	0	—

Table 3. Sequential Binary Voting

Panel A—Where Sequence of Evaluation is $a_1, a_2, a_3,$ and a_4			
<i>Round</i>	<i>Alternative</i>	<i>Number of Votes</i>	<i>Board Members from Table 1</i>
I	a_1	3	#1, #2, #5
	a_2	4	#3, #4, #6, #7
II	a_2	3	#1, #3, #4
	a_3	4	#2, #5, #6, #7
III	a_3	3	#5, #6, #7
	a_4	4	#1, #2, #3, #4
a_4 wins!			
Panel B—Where Sequence of Evaluation is $a_3, a_1, a_2,$ and a_4			
I	a_3	3	#5, #6, #7
	a_1	4	#1, #2, #3, #4
II	a_1	3	#1, #2, #5
	a_2	4	#3, #4, #6, #7
III	a_2	4	#1, #3, #4, #6
	a_4	3	#2, #5, #7
a_2 wins!			

C. Borda Rank Order Voting (BROV)

The Board members are asked to rank order all alternatives in this voting rule (based upon the individual preferences from Table 1). The lowest-ranked alternative is given one point, the next lowest ranked alternative is given two points and so on. The points scored by an alternative on each member’s ranking are then added together and the alternative receiving the most points would be the Board’s decision. Therefore, a_1 would be selected under this voting rule as illustrated in Table 4.

D. Approval Voting (AV)

In this voting rule, a member can vote for (approve of) as many alternatives as desired. The alternative that gets the most votes is then the Board’s choice. Note that in this voting rule, unlike the others, a member can express to a certain extent an intensity of preferences by partitioning the set of alternatives into two subsets: approval and disapproval.

For instance, suppose that the seven members’ intensities of preferences are as shown in Table 5. Assume that each member approves of all alternatives to the left of the vertical line. Then a_1 gets 4 votes (#1, #2, #3, #4), a_2 receives 3 votes (#1, #3, #4), a_3 gets 3 votes (#5, #6,

Table 4. Borda's Rank Order Voting

Board Member from Table 1	Rank Order Scores by Alternatives			
	a_1	a_2	a_3	a_4
#1	4	3	1	2
#2	4	1	2	3
#3	3	4	1	2
#4	2	4	1	3
#5	3	1	4	2
#6	2	3	4	1
#7	<u>1</u>	<u>2</u>	<u>4</u>	<u>3</u>
	<u>19</u>	<u>18</u>	<u>17</u>	<u>16</u>

#7), and a_4 receives 5 votes (#1, #2, #3, #4, #7). Therefore a_4 would be the FASB's collective choice under the AV rule.

IV. SUMMARY AND CONCLUSION

The purpose of this paper is to highlight the potential effects of different voting rules on the ultimate issuance of a FASB statement of financial

Table 5. Approval Voting

Intensity of Preferences of the Seven Board Members for the Four Alternatives

Board Member from Table 1	Approve				Disapprove						
	a_1	a_2	a_4							a_3	
#1	x	x	x							x	
#2				x			x				
#3	x	x	x							x	
#4				x						x	
#5										x	
#6										x	
#7										x	
Scale	10	9	8	7	6	5	4	3	2	1	0

accounting standards. The previous examples illustrate that a *constant set* of Board members' preferences (Table 1) can result in *different outcomes* under the four voting rules (Tables 2,3,4, and 5). Alternative a_1 would be the Board's choice with the Borda's Rank Order Voting Rule; a_2 would be the winner under the second scenario for the Sequential Binary Voting Rule; a_3 would prevail with the Plurality Voting Rule; and a_4 would dominate based on the Approval Voting Rule. Thus, the selection of a particular voting rule might affect the FASB due process in a significant fashion.

This research into the potential effects of different voting rules on the FASB due process is intended to be exploratory and not confirmatory in nature. Much additional research needs to be conducted before any generalization could be made about the "best" voting rule for the FASB due process.

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