Macro and Micro Earnings Manipulation: The Role of Accounting Standard Setting Process

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***Abstract*—Preparers of financial statements are in a position to influence the view of economic reality presented in those statements to interested parties. The term 'macro-manipulation' is used to describe the lobbying of preparers against regulators (accounting standards setters) to persuade them to produce regulation that is more favorable to the interests of preparers. The aime of this paper is to introduce a suggested tool that could be used to ascertain why some financial accounting standards turn out to the benefit of one of the stakeholders involved in the process of accounting standards setting. This paper utilizes the construct of power to reveal the influences from parties involved in the process of accounting standards setting. The comprehensive income reporting standard is used in this paper as an example of these types of standard that may involve 'macro-manipulation'.**

***Index Terms*—Comprehensive Income; Statement of Financial Accounting Standards No. 130; Macro Earnings Manipulation; Micro Earnings Manipulation; Accounting Standard Setting Process.**

I. INTRODUCTION

To give interested parties a chance to convey their opinions, the Financial Accounting Standards Board **(FASB)** follows certain procedures when setting an accounting standard. These procedures start with placing the new standard project on the FASB's agenda, and then a discussion memorandum on the project is prepared by a task force consisting of technical staff members of the FASB. After at least 60 days have passed since the release of the discussion memorandum a public hearing of the content of it is held. Following the public hearing and after considering the responses for discussing the memorandum, an exposure draft of the standard is prepared. A second public hearing is held (if necessary) after 30 days (at least) of releasing the exposure draft and after that the standard proposal may be revised according to the responses during the public hearing period. The last step is voting on the final draft of the standard proposal, and if the majority of the FASB members agreed then the standard is released [1].

The above mentioned procedures followed by the FASB may be viewed as a transcendental scheme of constructs to make the process of accounting standard development notified by the actors who represent the sub-worlds of the accounting world [2]. Thus, the exposure draft is an important tool for carrying accounting meaning among these sub-worlds whose members are not considered as a homogeneous group [2].

The process of setting accounting standards is not a pure technical matter, it also involves political substances. Putting this into consideration, one can look at the accounting standards as a compromise between the different views of financial reports preparers; users of these financial reports; and accounting standards setting bodies such as the FASB. These groups hold conflict interests. For example, users usually ask for more financial disclosures while preparers may resist extending these disclosures due to the expected cost of the increased disclosure and other reasons. This compromising process does not guarantee that the accounting standards developed through accounting standard setting give the right answer(s), because a process of standard setting where feedback is required from interested groups before standards are issued makes different groups think that their interests would be taken into account by the FASB if they were able to influence or exercise power in the process [3]. Determining whether an accounting standard is considered as an acceptable standard or not is extremely depending upon the support of an authoritative group supported by a considerable type of power [1].

II. CONCEPTUAL FRAMEWORK

The construct of power originally was introduced within political science and sociology. There is no one definite definition of power, but there are many themes related to the meaning of power in the work of many modern philosophers. In one of these works Lukes (1977) referred to power as "the capacity to bring about consequences" (cited in [3]). The idea of capacity can be credited to what political scientists call actors in presses [3].

In the case of accounting standard setting two main types of actors can be recognized. The first type is the internal actors which represent the standards setting body members (FASB members) that have direct influence on the process of standard setting through the voting process. The other type of actors is the external actors which include all other related actors such as users and preparers that may have an influence on the process although they don't have the right to vote for the standard issuance. So, these group of actors have indirect influence on the process [3].

The term "bring about" mentioned in the definition introduced by Lukes (1977) considered by many researchers as a reference to "influence" which refers to the ability of an individual or a group to change the behavior of

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another individual or group. The way in which influence would work can take one of many forms. These forms are: force; coercion; inducement; persuasion, manipulation; and authority [3]. Force is related to the ability of the power holder to influence the subject's body or physical environment. Coerciveness exists when the power holder's commands are obeyed by the subject as a result of the threat of negative sanctions for the rejection of complying. Inducement exists when the power holder's commands are obeyed by the subject as a result of the promise of positive reward for compliance. The source of persuasion power is the argument used by power holder to achieve compliance with their wishes on subjects. Under manipulation power, the power holder can influence subjects' actions and beliefs without making explicit declaration about the behavior or attitudes expected from them. Authority exists where power relations are structured into models of command and obedience [3].

Reviewing the historical back ground of the emergence of the FASB and its procedures in setting accounting standard might suggest that the process of standard setting and the relations among actors related to this activity involves mixed mechanisms of power. Some researchers think that coercive power and inducement power are not considerably different enough to be dealt with separately. Thus, they merge them under a combined title called sanctions [3]. We think that the mixed mechanisms of power that might be related to the standards setting processes are sanctions, persuasion and authority. The power of the FASB is driven from the Securities and Exchange Commission's support that has the authority to take corrective actions against any firm that doesn't comply with the standards issued by the FASB. These corrective actions could be described as threats of negative sanctions for the rejection of complying with the requested requirements which in turn means that there is some kind of coercive power. Procedures of issuing a new standard should include the discussion memorandum, the public hearing, responses for the discussion memorandum, and the exposure draft. The possibility that standard proposals could be revised according to the responses during the public hearing period also suggests that the power of persuasion may exist in the accounting standard setting process. Finally, the relationship between the Securities and Exchange Commission, the public companies, and the FASB is set by law. Therefore, the authority of power somehow exists. This is because after a standard is officially released the public company should obey the standard for which it calls.

III. THE CASE OF STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 130

Since the 1930s, the fair determination of income has been of primary importance to financial statement users. It is reasonable to connect the change in reporting emphasis from the balance sheet to the income statement with the change in the requirements of the primary financial reporting users group(s). During the 1930s, financial reporting changed from providing information principally to managers and creditors to providing information to investors and stockholders. The latter group was more interested in returns than it was in liquidity. The investment community's focus on earnings per share has lead accountants efforts toward defining and describing earnings for accounting purposes [4].

Two approaches for measuring income are commonly discussed in accounting literature. These approaches are the transaction approach (some call it revenue-expense approach) and the capital maintenance approach (some call it asset-liability approach). Under the transaction approach, income is calculated by analyzing the effects of revenue and expense transactions during a period of time. Any change in the value of the firm that is not a result of a transaction is not reflected in the firm's net income. Income from continuing operations under current Generally Accepted Accounting Principles **(GAAP)** is based on the transaction approach [5]. The transaction approach depends on definitions of revenues and expenses and matching them to determine earnings [4]. Under capital maintenance approach, net income is defined as the difference between net assets (assets minus liabilities) at the beginning of a period and net assets at the end of that period, excluding the owners' contributions and distributions during that period. Capital maintenance approach captures all changes in the firm's value during a period, regardless of whether or not the change resulted from a transaction [5]. Capital maintenance approach depends on definitions of assets and liabilities to define earnings [4].

Economists use the capital maintenance approach when considering the concept of income. According to this concept, income is the maximum amount that can be consumed within a certain period while maintaining the same amount of a firm's capital at the end of the period not different from the capital at the beginning of that period. Therefore, capital can be identified with reference to current market values of the net assets at the beginning and the end of a period. Thus, when defining income, economists fully take into account market changes when measuring income. Accountants, on the other hand, usually exclude many changes in the market values of the assets, on purpose, when measuring accounting income. Because many of the fluctuations in the market values of assets are subject to personal judgements, accountants have used historical cost models which do not recognize any change in market value unless it is realized through a transaction.

Another reason for the difference between accounting and economic measurement of income is due to the fact that the economic measurement is based upon computing the difference between a firm's wealth at the ending point of its life and its wealth at the beginning of that life; adding drawings or distributions to the owners and deducting the additional investments made by them over that life. This method of measuring income is difficult to be applied by accountants who are required to provide periodical financial

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reports, at least annually, during a firm's life span. Thus, accountants can not postpone measuring income until the end of the firm's life span [6].

The FASB states that financial reports should supply information to assist both current and potential investors and creditors as well as other users to rationalize investment decisions and the granting of credit and other similar decisions. Financial reports should help users to estimate the amount and timing of cash flows resulting from distributions of profits, payment of interest, the sale of products, and the recovery or maturity of securities or loans. In addition to this, the financial reports must provide information on the economic resources of the business, the obligations and restrictions on the ownership, the transactions performed by the firm on these resources, the impact of processes and events, the different circumstances that lead to the change in the resources, as well as the commitments and the constrains on the firm or business [7]. The FASB indicates that the information reported in financial reports must be relevant and reliable. Relevant information is information which leads to decisions that are different from decisions that are not based on knowledge of this information. Therefore, the elimination of some of this information would make the financial report lacking or misleading. Information that can be relied upon, however, is information that is free of errors, is not biased and is presented fairly [7]. Accounting standards and rules should reflect how to disclose income in such a way that fulfils the underlying purposes of financial reporting.

Institutes involved in organizing the accounting profession in the United States of America (USA) were concerned about reporting financial performance of public firms, which are publicly traded in the stock market. These institutes have paid attention, in particular, on how to identify the results of a firms' performance and the components or details of these results. The development of reporting results of firms' financial performance in the USA can be divided into two perods, the Period around Mid 1960's and the Period from Mid 1960's to 1997.

Before the mid 1960's there was a wide debate on the concept of income which should be measured and reported in the income statement. At this stage, one was able to distinguish between two points of view in this regard. The first point of view adopted the concept of income from recurring operations while the other adopted the concept of the all-inclusive income. According to the first point of view, income statements should include only items related to the regular recurrent activity of the firm during the current accounting period. The statement of retained earnings, according to this point of view, includes any unusual items and items that are non-recurring or related to prior periods. Proponents of the income from recurring operations base their point of view on the belief that income from recurring operations is more useful in the evaluation of management's performance and in predicting the performance of the coming years.

On the other hand, proponents of the all-inclusive income concept think that income statements should include all the effects of events and processes that led to the change of the owners' equity during the year except for investments carried out by owners and profits distributions to them. Proponents of this view have criticized the income from recurrent operations concept as management may have the right to determine the amount of profit from recurring operations because it determines the classification of items. In addition, the concept of income from recurrent operations can be used to mislead users of financial statements who may not realize that there are important gains or losses have been moved directly to the statement of retained earnings without passing through income statement. During this period the American Accounting Association (AAA) supported the all-inclusive concept of income, while the American Institute of Certified Public Accountants (AICPA) supported the concept of income from recurring operations [8].

The second period has been recognized by the shift toward the concept of all-inclusive (comprehensive) income. During that period an income statement was divided into three main parts. The first part reports the results of the regular and recurring (continuing) activities, this parts ends with profit from recurring (continuing) operations. The second part reports the results of the discontinuing activities, extraordinary items, and the cumulative effect of change in certain accounting principles, this part determines comprehensive income. The third part reports profit per share.

Despite the fact that the FASB has adopted the concept of all-inlusive (comprehensive) income, some standards that were issued during that period included accounting treatments that represent a violation of this concept. Examples of such treatments are those mentioned in Statement of Financial Accounting Standards **(SFAS)** 52 regarding accounting for the translation of foreign currencies, SFAS 80 regarding accounting for future contracts, SFAS 87 regarding accounting for retirement plans, and SFAS 115 regarding accounting for some of the investment in securities representing debts and ownership rights. The application of each of these standards resulted in gains or losses that were recognized but not included in the income statement; alternatively they were moved directly as components of owners' equity, a treatment that is considered a violation from the concept of comprehensive income. This violation has led many users of financial reports to demand from firms to include comprehensive income on their reports and to separate realized and unrealized gains and losses. Some of those users have suggested a number of other items that must be reported within the comprehensive income, such as the reduction of goodwill, and gains or losses from the translation of foreign financial statements [8]. Users believe that allowing firms to include some of the recognized gains and losses items during the period directly within the owners' equity without passing through the income statement could increase the load on them when searching for elements that could help

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in judging the financial performance of firms. There is a need to study the impact of applying the concept of comprehensive income on the usefulness of financial reporting.

The term comprehensive income was first introduced in Statements of Financial Accounting Concepts **(SFAC)** 3. In this statement comprehensive income was defined as "the change in equity (net assets) of an entity during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners" [9], Para. 56). The FASB decided to use comprehensive income rather than earnings in SFAC 3 because it wanted to preserve earnings for a probable use to designate a different concept that was narrower than comprehensive income [9], Para. 58).

In 1984 the FASB issued SFAC 5 (Recognition and Measurement in Financial Statements of Business Enterprises). In that statement the FASB stated that "The amount and variety of information that financial reporting should provide about an entity require several financial statements. A full set of financial statements for a period should show: the financial position at the end of the period, the earnings (net income) for the period, a comprehensive income (total of non-owner changes in equity) for the period, the cash flows during the period, the investments made by the owners, and the distributions to them during th period [10], Para. 13).

In SFAC 5, the FASB describes earnings as part of comprehensive income indicating that earnings are narrower than comprehensive income. The FASB provides examples of possible differences between earnings and comprehensive income. Earnings are illustrated as being similar to net income except for cumulative effects of changes in accounting principles. These effects are included in net income but are excluded from the earnings [11], Para 37).

In December 1985, SFAC 6 superseded SFAC 3 by expanding the scope to include not for profit organizations. SFAC 6 does not change the definition of comprehensive income introduced in SFAC 3 [11], Para 38). The FASB explains in SFAC 6 that comprehensive income of a business enterprise results from (i) exchange transactions and other transfers between the enterprise and other entities that are not its owners, (ii) the enterprise's productive efforts, and (iii) price changes, casualties, and other effects of interactions between the enterprise and the economic, legal, social, political, and physical environment of which it is a part. That is, the characteristics of various sources of comprehensive income may differ significantly from one to another, indicating a need for information about various components of comprehensive income. That need underlies the distinctions between revenues and gains, between expenses and losses, between various kinds of gains and losses, and between measures found in present practice such as income from continuing operations and income after extraordinary items and the cumulative effect of change in accounting principle [12], Para 74-76).

The FASB defines comprehensive income in a manner consistent with the all-inclusive income concept as comprehensive income represents the difference between a firm's opening and closing net worth, excluding investments by and distributions to the owners of the firm. This approach of measuring income is consistent with capital maintenance approach viewpoint under which assets are regarded as probable future economic benefits while liabilities are considered to be probable future sacrifices of economic benefits. In addition, revenues and expenses are defined in terms of gains (losses) of economic benefits arising from increases (decreases) in the assets and liabilities of the entity (other than from transactions with owners). Therefore, under the asset and liability viewpoint, revenues less the expenses represents comprehensive income [13].

While the FASB generally has followed the all-inclusive income concept, it occasionally has made exceptions to it by requiring certain items to bypass the income statement and be taken directly to the equity section of the balance sheet [14]. Examples of these items are:

- Foreign currency translation adjustments [15], Para.13).
- Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date [15], Para. 20 a).
- Gains and losses on inter-company foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting enterprise's financial statements [15], Para. 20 b).
- A change in the market value of a futures contract that qualifies as a hedge of an asset reported at fair value pursuant to SFAS 115 [16], Para. 5).
- A net loss recognized according to SFAS 87 as an additional pension liability not yet recognized as net periodic pension cost [17], Para. 37).
- Unrealized holding gains and losses on available-for-sale securities [18], Para. 13).
- Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category [18], Para. 15 c).
- Subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of available-for-sale securities previously written down as impaired [18], Para. 16).

Several factors urged the FASB to issue a standard

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requiring reporting comprehensive income. For example, the Association for Investment Management and Research **(AIMR)** and the Robert Morris Associates **(RMA)**, both very influential user groups, urged the FASB in the early 1990's to require the reporting of comprehensive income and its components [19]. The AIMR has expressed concern over the deviation from the all-inclusive concept. For example, the AIMR report (Financial Reporting in the 1990s and Beyond) noted that considerable effort is necessary to locate all income items that may be relevant to the valuation of a firm [20]. Also, there was a notable diversity in the display of these items in owners' equity. For example, there was a wide variation among firms in the presentation of the cumulative holding gains and losses related to available for sale securities [21]. Because of the effort necessary to locate these items, that might be relevant for performance evaluation, the AIMR suggested that users of financial statements need all the data reporting a firm's economic activity in one place. The AIMR suggested that users want a clear display of the comprehensive income and its components. The AIMR thought that this requires a different way of reporting which may help users to sort out the data that fits their own purposes [20]. Because the FASB expects an expanded fair market value reporting for financial instruments and in response to the concerns expressed by the AIMR and others, it has added the comprehensive income project to its technical agenda [22].

In June 1996 the FASB issued the exposure draft (Reporting Comprehensive Income). The exposure draft proposed that changes in the accumulated balances of income items required to be reported directly in a separate component of equity in a statement of financial position (unrealized gains and losses on available-for-sale-securities, minimum pension liability adjustments, and translation gains and losses) should be reported in a statement of financial performance. The FASB noted that those items would be included in a statement of financial performance under the all inclusive income concept [11], Para. 58). The FASB received 281 comment letters on the exposure draft, and 22 individuals and organizations presented their opinions at a public hearing held in November 1996. In addition, the FASB discussed the exposure draft in meetings with the Financial Instruments Task Force, and the Financial Accounting Standards Advisory Council [11], Para. 50).

Some respondents to the exposure draft stated that information about the components of other comprehensive income **(OCI)** was already available somewhere else in the financial statements and that it was pointless for the FASB to require that information to be reported into a measure of comprehensive income. Other respondents agreed that the components of OCI should be reported in a more transparent manner [11], Para. 59).

Most respondents to the exposure draft declared that the requirement to report comprehensive income and its components in a statement of financial performance would result in confusion. Much of that confusion would result from reporting two financial performance measures (net income and comprehensive income) and users' failure to decide which measure was the appropriate one for investment decisions, credit decisions, or capital resource allocation. Many of those respondents argued that the items identified as OCI were not performance related and that it would be confusing to require those items to be included in a performance statement. Some respondents pointed out that comprehensive income would be unstable from period to period and that instability would be linked to market factors beyond the control of management. They thought that it would be unsuitable to emphasize that instability in a statement of financial performance [20]. For example, General Electric's comment letter to the FASB maintained that comprehensive income "in stark contrast to the promise of its name, corresponds more closely to a random number than to enterprise performance. But we believe equally strongly that, for a while at least, 'comprehensive' income is looked to as a performance indicator, to the detriment of other measures in financial statements that actually do reflect performance of the enterprise and its management". Because of the instability inherent in the items that compose OCI, critics of the standard suggest that its display will lead to increased insight of a firm's risk. A number of comment letters to the FASB suggested that the components of comprehensive income are already available in the annual report and would be redundant if presented among the basic financial statements [20].

Many respondents suggested that the FASB could achieve the desired transparency for the components of OCI by requiring reporting them in an expanded statement of changes in equity or in a note to the financial statements. Respondents said that either of those types of display would be more suitable than the reporting in a performance statement because the components of OCI would not be characterized as being performance related [11], Para. 61). The FASB decided against allowing a firm to report comprehensive income and its components in a note to the financial statements. The FASB thought that such reporting would be inconsistent with the concepts statements, which both define comprehensive income and require the reporting of it as part of a full set of financial statements. The FASB also agreed on the reporting of the comprehensive income and its components in a financial statement [11], Para. 63).

In June 1997, the FASB issued SFAS 130 (Reporting Comprehensive Income) which requires firms presenting a full set of financial statements to report comprehensive income. The standard became effective in 1998. This standard has a limited scope in that it deals only with the reporting and displaying of comprehensive income components and does not address issues of when they should be recognized or how they should be measured [23]. Prior to SFAS 130, many gain and loss items bypassed income and were carried directly to owners' equity. The three main items included unrealized gains and losses on available for sale securities, foreign currency translation

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adjustments, and minimum pension liability adjustments. SFAS 130 requires that firms with any of these three items, as well as reclassification adjustments for both unrealized gains and losses on available for sale securities and foreign currency translation adjustments, report comprehensive income and its components. Basically, comprehensive income includes traditional net income plus or minus these special components affecting owners' equity but not net income. These components are commonly referred to as items of OCI. We think that the OCI items stated in SFAS 130 are not all the components of comprehensive income but were stated as examples of these components. The FASB will continue to make changes to the current standards or issuing new standards, adding more components, in line with the philosophy it follows, which is based on the concept of the all-inclusive (comprehensive) income.

The FASB stated that although total comprehensive income is a useful measure, information about the components that make up comprehensive income is also needed. The FASB explained that a single focus on total comprehensive income is likely to result in a limited understanding of a firm’s activities. Information about the components of comprehensive income may be more important than the total amount of comprehensive income [11], Para. 13). In this regard, the final standard of reporting the comprehensive income and its components contained a major change from its exposure draft. Under the exposure draft the FASB was requiring firms to report the comprehensive income and its components as a part of the income statement, but under the final standard firms have the option to report comprehensive income and its components either as a part of the income statement or as a part of the statement of owners’ equity which is believed by most users and researchers to be a non-performance statement [24].

The FASB allows that reporting comprehensive income and its components may be shown in the financial statements in any of the following formats:

- In a combined statement of net income and comprehensive income.
- In a separate statement of comprehensive income.
- In a statement of changes in the stockholders' equity.

Table 1, Table 2 and Table 3 show illustrations of the different reporting formats allowed by the FASB [23].

TABLE 1
OCI REPORTED IN INCOME STATEMENT

Wilson Company
Statement of Income and Comprehensive Income
For the Year Ended December 2006

sales	1000000		
Cost of sales	550000		
Gross profit		450000	
Operating expenses		(200000)	
Operating income		250000	
Other expenses		(33000)	
Income before tax		217000	
Tax expense		65100	
Net income			151900
Other comprehensive income:			
Unrealized gains (losses) on securities:			
Unrealized gains arising during period (net of tax)	2100		
Less: reclassification for gain in net income	(3500)		
		(1400)	
Foreign currency translation adjustment (net of tax)		(14000)	
Minimum pension liability adjustment (net of tax)		10500	
Other comprehensive income			(4900)
Comprehensive income			147000

Source (Wilson and Waters 1998)

TABLE 2
OCI REPORTED IN A SEPARATE STATEMENT OF COMPREHENSIVE INCOME

Wilson Company
Statement of Comprehensive Income
For the Year Ended December 2006

Net income			151900
Other comprehensive income:			
Unrealized gains (losses) on securities:			
Unrealized gains arising during period (net of tax)	2100		
Less: reclassification for gain in net income	(3500)		
		(1400)	
Foreign currency translation adjustment (net of tax)		(14000)	
Minimum pension liability adjustment (net of tax)		10500	
Other comprehensive income			(4900)
Comprehensive income			147000

Source (Wilson and Waters 1998)

TABLE 3
OCI REPORTED AS A CHANGE IN EQUITY

Wilson Company
Statement of Changes in Equity
For the Year Ended December 2006

Item	Common stock	Retained earnings	Unrealized gains (losses) on securities	Foreign currency item	Min. pension liability adjustment	Total comprehensive income	Total equity
Beginning balance	1000000	300000	6300	(21000)	(42000)		1243300
Net income		151900				151900	151900
Other comprehensive income:							
Changes arising during period			2100	(14000)	10500	(1400)	(1400)
Reclassifications (net of tax)			(3500)			(3500)	(3500)
Total comprehensive income						147000	
Ending balance	1000000	451900	4900	(35000)	(31500)		1390300

Source (Wilson and Waters 1998)

The FASB decided to convince firms to report comprehensive income and the components of OCI in an income statement below the figure of net income or in a separate statement of comprehensive income that begins with net income, as originally proposed by the exposure draft. The FASB believes that displaying comprehensive income in an income statement type format is more consistent with the concepts statements and therefore is conceptually better than displaying it in a statement of changes in equity. That type of display is also considered by the FASB to be consistent with the all-inclusive income concept. The FASB believes that the display of comprehensive income in an income statement type format provides the most transparency for its components. Also, it may be more practical for a firm that has several items of

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OCI to display them outside a statement of changes in equity. The FASB thinks that the display in an income statement type format is consistent with its desire to implement a broader scope project on comprehensive income that ultimately could move toward reporting comprehensive income and its components in a statement of financial performance [11], Para. 67).

The change of the final standard from the exposure draft raises a question about the reasons and events that made the FASB change its original plans about the required reporting format.

After the issuance of the final standard of reporting the comprehensive income and its components many studies were performed to survey the type of the statement in which comprehensive income and its components were reported. Thompson, et al. [25] conducted a survey of Fortune 500 firms' reporting of comprehensive income and found that 3.6% of these firms used combined statement of net income and comprehensive income, 14.4% used separate statement of comprehensive income, and 68.2% reported the comprehensive income and its components as a part of the statement of changes in stockholders’ equity.

Pandit and Phillips [26] examined the presentation of comprehensive income in the financial statements of a sample of 100 annual reports of the New York Stock Exchange (NYSE) firms five years after the release of the comprehensive income reporting standard. The study showed that 89 of the 100 firms included OCI and a total comprehensive income in the statement of change in the stockholders’ equity. Only 9 firms of the sample presented a separate statement of comprehensive income. The two remaining firms presented the comprehensive income as a component of their income statement. A significant percentage (65%) of the firms in the sample that chose to include OCI and total comprehensive income in the statement of change in stockholders’ equity had other negative comprehensive income.

Lee, et al. [27] investigated the comprehensive income reporting decisions of 82 publicly traded property liability insurers in 1998. They found that insurers who do not have the tendency to manage earnings using the realization of investment gains and losses and, at the same time, enjoy a reputation for high quality financial reporting tend to choose reporting comprehensive income in a performance statement. On the other hand, the results showed that insurers with a tendency towards earning management avoid reporting comprehensive income in a performance statement. The later result suggests that managers of these firms implicitly agree with the belief that the display of comprehensive income in an income statement type format provides the most transparency of its components.

Thus, almost all of these researches found that the majority of preparers have chosen to report comprehensive income in the statement of owners’ equity (the statement that was not favored by the investors). Other researches used psychological experiments [20, 28]. The results of these researches supported the notion that reporting the comprehensive income in the income statement is more effective in enhancing the transparency of the firms’ earnings management activities. The results also suggest that reporting the comprehensive income in the statement of owners’ equity was not as effective as an income statement in revealing earnings management activities.

Although financial reports users (represented by the AIMR) have supported the issuance of a standard for reporting comprehensive income and its components separately, many preparers were not supporting this standard [20]. The FASB found itself in a situation between the power of the users on one side and the power of the preparers on the other, meanwhile the FASB has its own power.

IV. Conclusions

The external actors recognize that after the standard is issued they will have no power to refuse it. Thus, the only chance for them to use their own power in the face of the FASB is during the standard setting process. This process applied during standard setting process is a situation in which the external actors can feel that they have had a chance to influence the result of this process [29]. During the standard setting process period the FASB tries to use its persuasion power to achieve external actors’ compliance with their wishes through arguments, but it is face to face with the power of the external agents. Also, within this process the external actors could be divided into different subgroups with different attitudes. In the example of the comprehensive income standard, two main groups of external actors are obviously seen (managers and investors represented by the AIMR). Although the FASB thought of issuing a standard for reporting the comprehensive income as a response to the calls of the AIMR, the final standard was not exactly what the AIMR expected. The final standard allows financial reports preparers (managers) to report comprehensive income and its components either in the income statement or in the statement of owners’ equity; the later statement was not favored by the AIMR. This bias of the FASB toward the benefit of the preparers suggests that although the steps followed in accounting standard setting gives a practical starting point, the political nature of accounting standards setting is such that a merely technical solution that may be undesirable [30].

The shift of the comprehensive income reporting standard toward preparers’ wishes also reveals that the power of the preparers managed to outperform the power of the investors. The dominant of preparers’ power highlights the importance of having the financial resources to respond to groups and individuals (other actors) that threaten the benefits of the preparers. These financial resources made the prepares to have access to the media [31] and influence, indirectly, the direction of the FASB’s standards.

As suggested by Burchell et al. (1980) “corporate annual reports are seen to contribute to the maintenance of an ideology of oppression. As an ideological weapon, an annual report is viewed as a proactive tool by which

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corporate management influences and shapes what is important in society" (cited in [32]). This statement might explain why managers (preparers) used their power to direct the FASB to change the way of reporting the comprehensive income to be either in the income statement or in the statement of owners' equity; in spite of the FASB's plan to recommend the income statement as the only statement to report the comprehensive income.

Results of these researches suggests that managers used their power to change the original idea of reporting the comprehensive income standard toward their own benefit, as reporting comprehensive income in the income statement would reveal some undesired accounting practices. Reporting comprehensive income in the statement of owners' equity will not reveal such practices because this statement, contrary to the income statement, is seen by investors as a statement of minor benefit. Bearing in mind that preparers of financial statements are in a position to influence the view of economic reality presented in those statements to interested parties, the large number of firms that have chosen to report comprehensive income and its components as a part of statement of changes in stockholders' equity and the characteristics of these firms may refer to some kind of a manipulative behavior. Some studies suggest that there are two principal categories of manipulative behavior. The term "macro-manipulation" is used to describe the lobbying of preparers against regulators (accounting standards setters) to persuade them to produce regulation that is more favorable to the interests of preparers. "Micro-manipulation" describes the management of accounting figures to produce a biased view at the entity level. Both categories of manipulation can be viewed as attempts at creativity by financial statement preparers. In both cases, prepares are not fair to users. They involve an unjust exercise of power, and they tend to weaken the authority of the accounting regulators [33].

A study could be performed in an attempt to confirm or disconfirm the presence or absence of a relation between both types of manipulative behaviors. That study could be performed by listing some accounting items (innovations) that are used by managers to perform earnings management. Then, studying the events and processes accompanied the issuance of the accounting standards related to these items (i.e. discussion memorandum, the public hearing, responses for the discussion memorandum, the exposure draft, and the possibility that standards proposals could be revised according to the responses during the public hearing period). If it is found that the standard that involves items used by managers to perform earnings management was revised in favor of financial statement preparers, evidence on "macro-manipulation" would be inferred. Comprehensive income standard can be used as an example of these standards that involve "macro-manipulation".

Hence, the idea of power mechanisms could be used is explaining many market based accounting research. An obstacle of using this idea in market based accounting research may by the reliance of this kind of research on the efficient market hypotheses. One of the efficient market hypotheses implications is the note that changing the reporting format will have no effect on stock prices. Thus, reporting the comprehensive income in the income statement or in the statement of owners' equity will make no difference.

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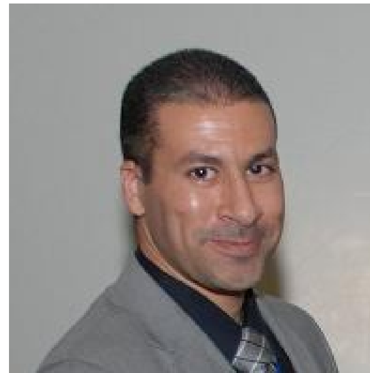

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