

**The implications of unverifiable fair-value accounting:
Evidence from the political economy of goodwill accounting***

Karthik Ramanna
Harvard University[†]

This Draft: August 13, 2007

Abstract

I study the evolution of SFAS 142, which uses unverifiable fair-value estimates to account for acquired goodwill. I find evidence consistent with the FASB issuing SFAS 142 in response to political pressure over its proposal to abolish pooling accounting. The result is interesting given this proposal was due in part to SEC concerns over pooling misuse. I also find evidence consistent with lobbying support for SFAS 142 increasing in firms' discretion under the standard. Agency theory predicts such unverifiable discretion can be used opportunistically.

JEL Classifications: D72, M41, M43, M44

Keywords: accounting standard setting, fair values, politics, SFAS 142

* For helpful comments, I thank Romana Autrey, Ray Ball, Mozaffar Khan, S. P. Kothari, Ryan LaFond, Thomas Lys (the editor), Joshua Ronen, Lawrence Rothenberg, Sugata Roychowdhury, James Snyder, Douglas Skinner (the discussant), Rodrigo Verdi, Charles Wasley, Joseph Weber, Joanna Wu, Jerold Zimmerman, an anonymous reviewer, and especially, Ross Watts. I also thank seminar participants at Columbia University, Dartmouth College, George Washington University, Harvard University, London Business School, Massachusetts Institute of Technology, New York University, University of Chicago, University of Pennsylvania, University of Rochester, Yale University, and the 2006 *Journal of Accounting and Economics* conference. Financial support was provided by Harvard University, Massachusetts Institute of Technology, and University of Rochester. Responsibility for any errors accrues solely to me.

[†] Email: kramanna@hbs.edu.

1. Introduction

“Fair-value accounting” is the practice of reporting assets and liabilities at estimates of their current values. It has been used in several GAAP (Generally Accepted Accounting Principles) standards in recent years.¹ Holthausen and Watts (2001) argue that fair values when not based on actively traded market prices, i.e., when unverifiable, can increase the likelihood of opportunistic disclosure. I test this argument by studying a recent standard that uses unverifiable fair values: Statement of Financial Accounting Standard (SFAS) # 142, accounting for acquired goodwill. I find evidence consistent with SFAS 142 being at least partly due to lobbying by firms that under the standard enjoy increased potential for opportunism.²

SFAS 142 resulted from the FASB’s (Financial Accounting Standards Board) project to revise business combinations accounting. The FASB (1998, pp. 5–6) cited “flaws,” “deficiencies,” and “abuses” of pooling accounting among its reasons for revising business combinations accounting. It also cited SEC (Securities and Exchange Commission) concerns about pooling misuse: SEC Chief Accountant Turner (1999) complained that he often saw pooling transactions that “clearly [did] not meet the spirit or the intention of [pooling rules].” Initially, the FASB proposed eliminating pooling accounting, and requiring all business combinations to be accounted for using the purchase method, with amortization required for all acquired goodwill (FASB 1999). This proposal met with strong opposition among lobbying firms: some members of Congress also joined the opposition (U.S. House 2000, U.S. Senate 2000). The FASB then revised its original proposal: it continued to advocate eliminating pooling and requiring purchase, but now proposed, in lieu of amortization, goodwill “impairment” based on unverifiable fair-value estimates of goodwill’s extant value (FASB 2001a). This revised proposal, with few changes, was quickly promulgated as the new business combinations standards: SFAS 141 and 142 (FASB 2001b, c).

I find that the congresspersons opposed to the FASB’s original proposal to abolish pooling can be linked—using political contributions—to firms opposed to that proposal,

¹ Examples of accounting standards that use fair values include: impairment of long-lived assets (SFAS 121 in 1995 and SFAS 144 in 2001), employee stock options (SFAS 123 in 1995 and SFAS 123R in 2005), derivatives and hedging (SFAS 133 in 1998), and acquired goodwill (SFAS 142 in 2001).

² Throughout the paper, I assume that managers are responsible for firm decisions: if managers’ incentives are not perfectly aligned with those of shareholders, firm decisions will reflect managers’ interests.

i.e., pro-poolers. I also find these pro poolers are among those who proposed the “revised” impairment rules now in SFAS 142. The evidence is consistent with pro-poolers being at least partly responsible for the outcome of the FASB’s business combinations project.

If the FASB and the SEC are correct about pooling being abused, and if abusers are among the pro-poolers, from the evidence above, it is likely that potential for opportunism has been retained in SFAS 142. To test this, I investigate whether discretion potential explains firms’ lobbying support for the SFAS 142 impairment rules. Agency theory suggests such unverifiable discretion can be used opportunistically.³ From the SFAS 142 impairment rules, I identify three firm characteristics that increase the probability of discretion: (1) larger and more numerous business segments; (2) higher market-to-book (MTB) ratios; and (3) higher proportions of net assets without observable market values.

- (1) Under SFAS 142, goodwill recognized in an acquisition must be allocated across the acquirer’s “reporting units” based on fair-value estimates of how that goodwill will be realized.⁴ Acquired goodwill usually represents rents expected by the acquirer. If such rents are generated by the acquirers’ units in common, their allocation across units involves separating joint benefits. Thus, the allocation is arbitrary and unverifiable (Watts 2003, Roychowdhury and Watts 2007). *Ceteris paribus*, the larger and more numerous an acquirer’s reporting units, the greater the acquirer’ flexibility in allocating goodwill, and thus, the greater its discretion in determining future impairments. Since data on “reporting units” (as defined in SFAS 142) are not available, I use data on “business segments” (as defined in, and reported under, SFAS 131) as a proxy (see §3 for details).
- (2) After acquired goodwill is allocated to reporting units, acquirers must periodically evaluate whether it is impaired. SFAS 142 requires such impairment testing only for reporting units with fair-value-to-book-value (FTB) ratios less than one. This rule implicitly assumes that all of the excess of a unit’s fair value over its book

³ Managers may avoid opportunism due to its reputational costs. Contracts are unlikely to prevent opportunism since unverifiable estimates are difficult to challenge *ex post*.

⁴ A reporting unit is part or all of an operating segment with discrete financial information that is regularly reviewed by management (FASB 2001a).

value is due to acquired goodwill: internally generated rents and the understatement of book value are not accounted for at this step. *Ceteris paribus*, units with high FTB ratios can absorb losses to acquired goodwill, giving them greater discretion to avoid future impairments. Since units' FTB ratios are unobservable, I use firm-wide MTB ratios as a proxy.

- (3) For units with FTB ratios less than one, SFAS 142 requires recording impairment losses when the extant value of goodwill is less than its historical book value. Since there is no observable market price for goodwill, the extant value of a unit's goodwill is calculated as the difference between the unit's total fair value and the fair value of its non-goodwill net assets. In a firm, fair values of some net assets (e.g., cash, investments, payables, etc.) can be verified more readily than the fair values of others (e.g., firm-specific assets such as specialized plant and equipment). *Ceteris paribus*, the greater the proportion of unverifiable net assets, the greater the flexibility in estimating the current value of net assets and goodwill, and thus, the greater the discretion in determining impairments.

I find that firms with the three financial characteristics above are more likely (than other firms) to lobby for impairment in SFAS 142. This result is consistent with discretion potential motivating firms' support for impairment. If lobbying motives indicate how firms will apply standards, then from agency theory we can expect at least some firms to use their discretion opportunistically. Thus, the result suggests that at least in some lobbying firms, unverifiable fair values in SFAS 142 impairment generate costs.

Two recent association studies on SFAS 142 (Chen, Kohlbeck, and Warfield 2004 and Li, Shroff, and Venkataraman 2005), however, conclude that the standard is "net beneficial" (thus potentially subsuming any evidence on the standard's costs). These association studies base their conclusions on finding negative correlations between SFAS 142 impairments and stock returns. The studies attribute the negative correlations to the standard's "effectiveness"—SFAS 142 provides managers with a framework to convey private future-cash-flow information to markets. This interpretation and the "net beneficial" conclusion are likely premature for at least two reasons.

First, negative correlations between impairments and market returns are also consistent with other plausible explanations. For example, markets can react negatively to impairments because: (a) impairments are “big baths,” or (b) impairments indicate management’s incompetence in avoiding losses despite SFAS 142’s discretion potential. In both cases, the impairments are informative to markets, but not because the standard has provided a framework for managers to reliably report private information. Second, the association studies do not explain the determinants of impairment *decisions*. The studies are focused on explaining *recorded* impairments; firms *avoiding* impairments are not considered. Without an investigation of the extent and causes of impairment avoidance, it is difficult to make conclusions on the “net benefits” of SFAS 142.⁵

Given the limitations of the above studies, I argue this paper generates *new* evidence on SFAS 142’s costs. There are, however, some alternate interpretations that must be addressed. *First*, it can be argued that pooling is the optimal method to account for business combinations, and so, on average, pro-poolers will not use SFAS 142 discretion opportunistically. Pooling’s long history as a method to account for acquisitions suggests there are efficiencies associated with the method (unless standard setting bodies have systematically suffered from special-interest capture). An argument for pooling is that it does not record acquired rents as assets: Ely and Waymire (1999) find evidence in pre-SEC accounting practices consistent with the non-capitalization of intangibles being optimal for financial reporting. However, under pooling, assets and liabilities with verifiable values are not written up to current values. This is inconsistent with common practice pre-SEC (Fabricant 1936), and assuming pre-regulation accounting practices evolved in equilibrium, is an argument against the method. Thus, it is not clear pooling is optimal. My results on pro-poolers’ association with congressional pressure on the FASB and on pro-poolers’ support for the unverifiable SFAS 142 standards are interesting *given* the FASB’s and SEC’s concerns over pooling abuse.

Second, one can argue that pro-pooling firms supported unverifiable fair-value impairment rules not for greater discretion, but because it offered an alternative to

⁵ For example, Ramanna and Watts (2007) find 189 firms with non-zero book goodwill that had $MTB > 1$ in 2001 (the year of SFAS 142) and $MTB < 1$ in 2002, but that took no write-offs in 2002. These 189 firms are over 60% of Li *et al.*’s (2005) entire association test sample of 313 firms. If $MTB < 1$ is an indication of impaired goodwill, this finding suggests firms are able to avoid write-offs post SFAS 142.

amortization (amortization is regarded as arbitrary and unreflective of the economics of goodwill depreciation). This argument cannot explain why firms' lobbying support for the impairment rules increases systematically in their discretion potential. Further, the *specific* discretion-granting impairment rules now in SFAS 142 closely resemble those advanced by pro-poolers lobbying on the revised proposal (details discussed in §3), a result not predicted by the opposition-to-amortization argument. Thus, while it is possible that opposition to amortization motivated firm support for impairment, evidence in this paper is consistent with the discretion motive. The two reasons can coexist.

Third, it can be argued that the unverifiable discretion firms sought in SFAS 142 impairment rules will, on average, improve financial reporting's usefulness. Although some managers will use unverifiable discretion opportunistically, other managers, disciplined by reputation costs, will avoid opportunism and use their discretion to make financial statements more informative. Since (non)impairment decisions are unverifiable at the time they are reported, the cost of potential opportunism is borne by all firms (i.e., opportunists free ride), and the benefits to a non-opportunistic manager from improved reporting under SFAS 142 must exceed these costs. I cannot rule out the claim that SFAS 142 impairment will, on average, improve financial reporting's usefulness, but I cannot test it either—because I am not aware of any method to measure of the benefits of improved financial reporting under SFAS 142.⁶

The rest of this paper is organized as follows. Section 2 describes the events leading up to SFAS 142. Section 3 develops two hypotheses: the first to test whether SFAS 142 goodwill impairment is due in part to pro-pooling firms; the second to test whether discretion potential explains firms' support for goodwill impairment. Section 3 also addresses alternate explanations. Section 4 describes the research design, univariate and multivariate tests of both hypotheses, and robustness results. Section 5 summarizes the study's findings and explores avenues for future research.

2. Background to SFAS 142

⁶ Developing such a method requires a theory of how unverifiable discretion improves financial reporting; developing such a theory is beyond the scope of this paper. Such a theory, however, must specify why pre-SFAS 142 goodwill accounting standards were not in equilibrium and/or why the old equilibrium changed.

Prior to SFAS 141 and 142, GAAP had two methods to account for business combinations: purchase and pooling. Purchase required capitalizing and then amortizing acquired goodwill; pooling required neither. Firms were expected to use purchase unless they met certain statutory criteria—established in APB Opinion 16—to qualify for pooling (AICPA 1970). Pooling’s more favorable impact on income statements meant that certain firms engineered deals to qualify for pooling.⁷ Firms unable or unwilling to engineer deals had to report amortization costs under the purchase method. This led to situations where “two transactions that [were] not significantly different [could] be accounted for by methods that produce[d] dramatically different financial statement results (FASB 1999, p. 34).” In the late 90’s, perhaps in response to increasing merger activity, the SEC openly expressed its concern on pooling abuse. SEC Chief Accountant Lynn Turner (1999) noted that he often saw pooling transactions that “clearly [did] not meet the spirit or the intention of [APB 16].” SEC Deputy Chief Accountant Jane Adams (1997) called the practice that had evolved around APB 16 a “quagmire,” and remarked that “[a]n incredible amount of resources of preparers, practitioners, standards setters and regulators [was] consumed daily by APB 16...”

Due in part to this SEC concern, in September 1999, the FASB issued Exposure Draft (ED) #201 on business combinations and intangibles.⁸ The ED proposed eliminating pooling, and requiring all business combinations to use the purchase method. Under purchase, acquired goodwill was to be amortized, with the maximum amortization period reduced from 40 to 20 years.

ED 201 provided for a 90-day comment period: over 200 comment letters were filed. About 60% of corporate respondents to the ED opposed abolishing pooling. The debate over pooling quickly reached Congress. In March and May of 2000, the Senate Banking Committee and the House Finance Subcommittee, respectively, held hearings on the issue. Many of the firms and industry associations that had already expressed their opposition to ED 201 (through comment letters and/or testimonies at FASB’s hearings) testified at the congressional hearings. In fact, apart from the FASB itself, there were no supporters of ED 201 at the Senate hearings. Most congresspersons at both hearings

⁷ For example, Lys and Vincent (1995) estimate that AT&T paid between \$50 million and \$500 million to qualify for pooling in its acquisition of NCR.

⁸ The FASB (1999) also cited “international convergence” as a reason for the ED.

urged the FASB to either reconsider its decision on pooling, or propose alternate ways to account for goodwill and intangibles. A few congresspersons, however, did express concerns over the hearings because they built precedent for future congressional intervention in accounting standards setting (U.S. House 2000, U.S. Senate 2000).

In October 2000, several members of the House introduced a bill, H.R. 5365, the “Financial Accounting for Intangibles Reexamination Act.” The stated purpose of the bill was to “impose a moratorium on the elimination of ... pooling” until a congressionally appointed commission reported on the economic impact of eliminating pooling and on methods to better account for intangible assets. Also in October 2000, a bipartisan group of thirteen U.S. Senators wrote the FASB expressing “reservations” over the FASB’s plan to eliminate pooling. The letter asked the FASB to “take no conclusive action” on the business combinations project until Congress “had the opportunity to review the economic impact of the FASB’s plans (Abraham 2000, pp. 1-2).”

Over this period, the idea of an impairment-only approach to goodwill was proposed to the FASB. First, in May 2000 (shortly after the House hearings), the FASB heard from representatives of Morgan Stanley Dean Witter, Goldman Sachs, Deloitte and Touche, PriceWaterhouseCoopers, Arthur Andersen, and Columbia Business School. Later, in September 2000, the FASB heard from another team from the American Business Conference, Cisco, Merrill Lynch, TechNet and UPS. Both groups discussed the merits of implementing an impairment-only test for goodwill. In February 2001, the FASB unanimously issued a revised ED (#201-R) that proposed replacing goodwill amortization with the impairment-only approach. Notably, however, ED 201-R did not change the FASB’s stance on abolishing pooling.

ED 201-R detailed the following procedure for goodwill accounting: (1) Goodwill from an acquisition is initially allocated among the “reporting units” of a firm based on fair-value estimates of how that goodwill will be realized across those units. Generally, a reporting unit is an operating segment or a component thereof if that component constitutes a business with discrete financial information that is regularly reviewed by management (FASB 2001a). (2) In subsequent periods, goodwill is tested for impairment at this reporting unit level. (3) A reporting unit’s goodwill is considered impaired if the goodwill’s “implied fair value” is less than the goodwill’s book value. (3) The goodwill’s

“implied fair value” is the excess of the reporting unit’s *total* fair value over the fair value of the unit’s non-goodwill net assets. (4) Goodwill impairment losses from various reporting units in a firm are aggregated and presented as a separate above-the-line item.

Over 200 comment letters were received on ED 201-R. This revised proposal (abolish pooling, impair goodwill) was considerably more popular than the original one (abolish pooling, amortize goodwill). About 70% of corporate respondents to ED 201-R supported the impairment-only approach. Although the FASB had left its decision on abolishing pooling intact, there was little mention of the pooling issue in firms’ comment letters (only 14% of corporate respondents on ED 201-R expressed support for pooling). Congressional interest in retaining pooling also waned: there were no comment letters by congresspersons on ED 201-R.

In June 2001, the board issued its final business combinations standards—SFAS 141 and 142. The former abolished pooling in favor of purchase. The latter introduced impairment-only accounting for goodwill. The goodwill impairment method in SFAS 142 adds an important *additional* step to the procedure detailed in ED 201-R. In the ED, a reporting unit’s goodwill is impaired if the goodwill’s implied fair value is less than the goodwill’s book value. In the final standard, this impairment test is performed only if the reporting unit’s total fair value is less than the reporting unit’s book value (i.e. only if the reporting unit’s fair-value to book-value ratio is less than one).

3. Hypotheses Development

Table 1 summarizes all hypotheses; Figure 1 locates them in the timeline of events leading to SFAS 142.

3.1. Is Goodwill Impairment in SFAS 142 due in part to Pro-Poolers?

The sequence of events leading up to SFAS 142 suggests unverifiable fair-value-based goodwill impairment is due, at least in part, to pro-poolers (i.e., supporters of pooling on the original ED).⁹ Almost all congressional pressure on the FASB over its

⁹ Pro-poolers' support for impairment could be motivated by seeking an alternative to pooling, by opposition to amortization, or by both. My hypotheses test and find evidence consistent with the first reason; however, as discussed earlier, this does not exclude the possibility of opposition to amortization *also* motivating firm support for impairment.

business-combinations ED was in support of pro-poolers' interests. Those few congresspersons who did not actively make the pro-poolers' case did not support the FASB's position either: they only expressed concern over the dangers of congressional involvement in accounting standard setting. That goodwill impairment is likely due to pressure on the FASB by pro-poolers has been suggested before (Michaels and Larsen, *Financial Times* 2000; Weil, *Wall Street Journal* 2000). However, no systematic evidence to this effect has been presented so far. In this sub-section, I develop two testable hypotheses to determine if there is a link between pro-poolers and goodwill impairment.

Congressional hearings on accounting standards are "relatively infrequent;" however, as former FASB Chair Dennis Beresford (2001, p. 74) notes, such hearings are taken "very seriously" by the board. If the FASB is concerned about its long-term survival, it likely heeds congressional pressure when exerted. There is precedent for the dissolution of accounting standard-setting bodies in the face of political pressure: Zeff (2005) notes how persistent industry lobbying against the APB eventually led to its demise. Thus, it is likely that the FASB took the pressure from congresspersons against its initial business-combinations proposal (abolish pooling, amortize goodwill) seriously.

The purpose of my first hypothesis is to test if there is a link between those congresspersons who became involved in the pooling issue and the firms and industry groups opposing abolishing pooling (i.e., pro-poolers). The idea is to test whether these pro-pooling firms and industry groups used their allies in Congress to pressure the FASB to rethink its original proposal (abolish pooling, amortize goodwill). Congresspersons pressuring the FASB over pooling are defined as those involved against the board in at least one of the following events: (1) the March 2000 Senate hearings; (2) the May 2000 House hearings; (3) the October 2000 House bill to create a federal commission on intangibles accounting; and (4) the October 2000 Senate letter seeking a moratorium on the FASB's original proposal.

I use PAC (Political Action Committee) contributions to link congresspersons to pro-pooling firms and industry groups. I use PAC money although it represents only one component of congresspersons' total political receipts because the other major sources of money (viz., soft money and direct lobbying money) cannot be directly traced from

source firms/organizations to congresspersons. Moreover, Ansolabehere, Snyder, and Tripathi (2002) show that PAC money from non-ideological PACs (like corporations) is likely followed up by direct lobbying money. Further, as Snyder (1992) points out, virtually all scholarly work relating corporations with congressional decisions focuses on PAC contributions.

I hypothesize that PAC contributions received from firms and industry groups opposed to the FASB's pooling decision increase the likelihood of a congressperson self-selecting into the set pressuring the FASB over pooling. It is important to note that this does not suggest that PAC contributions were used to buy congressional positions *solely* on pooling. It is widely held in political science that firms' relations with congresspersons are developed over long periods, and that firms likely give to congresspersons who are already predisposed to supporting them (i.e., PAC giving is likely endogenous).¹⁰ Thus, PAC contributions can be used to establish donors' *association* with, but not *causality* of, specific congressional decisions.

[H1a] The probability of a congressperson pressuring the FASB over pooling is increasing in PAC contributions received from firms and industry groups that opposed the FASB's original proposal (abolish pooling and require goodwill amortization).

While the null to H1a may seem benign at first, establishing this result is an important step in tracing the political history of SFAS 142 goodwill impairment. Every member of Congress could potentially have become involved in the pooling debate; however, only certain members did. While the news media has suggested that these members did so at the behest of pro-pooling groups, it is also possible that these members did so solely due to their ideology and/or their memberships on relevant congressional committees (i.e., House Finance Subcommittee and Senate Banking Committee). Multivariate tests of H1a control for these alternate possibilities.

Evidence consistent with the H1a will suggest that pro-poolers were associated with congressional pressure against the FASB's original proposal. This proposal was replaced by one requiring unverifiable fair-value-based goodwill impairment in lieu of goodwill amortization. The revised proposal, with few changes, quickly became the final

¹⁰ For empirical work, see for example, Snyder (1992), Kroszner and Stratmann (2005), and Stratmann (2005). For theoretical work, see for example, Austen-Smith (1995) and Grossman and Helpman (2001).

standard. Given Congress' support for pro-poolers, and assuming the FASB heeds congressional pressure (Beresford 2001), it is likely that the final standard reflected pro-poolers' interests. In other words, the politically connected pro-poolers are unlikely to have let a proposal become the final standard if they did not support it. H1b tests this proposition. Together, H1a and H1b provide evidence as to whether pro-poolers are at least partly responsible for goodwill impairment in SFAS 142.

[H1b] Firms opposing the FASB's original proposal (abolish pooling and require goodwill amortization) are more likely to support the final impairment standards in SFAS 142.

3.2. Does Discretion Potential Explain Firms' Support for Goodwill Impairment?

As noted earlier, the proposal to abolish pooling and require purchase was due in part to FASB and SEC concerns over pooling abuse. If the FASB and SEC are correct about pooling being abused, and if abusers are among the pro-poolers predicted in H1 to have influenced the final impairment rules in SFAS 142, it is likely that potential for abuse has been retained in those rules. To test this, I test whether discretion potential explains firms' lobbying support for the SFAS 142 impairment rules. The discretion potential arises due to the rules' reliance on unverifiable fair-value estimates. Agency theory suggests such discretion potential can be used opportunistically.

The significance of discretion potential under SFAS 142 impairment rules increases in both the probability of managing impairments and the magnitude of impairments that can be managed. I identify three firm characteristics that increase the probability of managing impairments (developed in H2a–H2c) and one firm characteristic that measures the magnitude of impairments that can be managed (H2d). I test whether lobbying positions on the FASB's revised ED (201-R, which proposed the impairment-only approach to goodwill) vary with these four firm characteristics.

There are three firm lobbying positions on ED 201-R. The first position is anti-impairment: I call this the *Amortization Position* since firms supporting this position (about 28% of lobbyists) wanted the practice of amortization to continue. The other two positions are both pro-impairment. The first, the *Revised ED Position* (supported by about 38% of lobbyists) is that adopted by pro-impairment firms who also supported the impairment rules as proposed in ED 201-R. The second, the *Comment Letter Position*

(supported by about 34% of lobbyists) is that adopted by pro-impairment firms proposing an alternate impairment test to that in ED 201-R. This is explained below.

In ED 201-R, impairments are recognized when the “implied fair value” of a reporting unit’s goodwill is less than its book value. The ED defines the “implied fair value” of goodwill the excess of the unit’s total fair value over the fair value of its constituent net assets. Comment Letter Position firms objected to the costs of assessing the *fair values* of reporting units’ net assets each time an impairment test was necessitated. As an alternative, they proposed tests based on the *book values* of those net assets (see Figure 2 to contrast the Revised ED and Comment Letter Positions).

Note that in the final standard, goodwill impairment is recognized only when the total fair value of a reporting unit is less than its *book value*. Thus, the Comment Letter Position (so named because it originated in firms’ comment letters) most closely resembles the final impairment rules in SFAS 142 (see also Appendix 1). Accordingly, the hypotheses that follow are structured to test whether discretion-measuring firm characteristics determine a firm’s choice of the Comment Letter Position over the two other positions. This arrangement facilitates interpretation of the results.

3.2.1. The Number and Size of Reporting Units

Under SFAS 142, a firm recognizing goodwill in an acquisition must allocate that goodwill among its reporting units based on fair-value estimates of how that goodwill will be realized. Assuming appropriate valuation of an acquired firm and its net assets, goodwill from an acquisition represents rents expected by the acquiring firm. If such rents are generated by the acquiring firm’s units in common, their allocation across units involves separating joint benefits: any allocation is arbitrary and unverifiable (Watts 2003, Roychowdhury and Watts 2007). For an acquiring firm, the larger the number of reporting units, the greater the flexibility in initially allocating goodwill; also, the larger the size of a unit relative to acquired goodwill, the more likely subsequent values of acquired goodwill will be masked by the unit’s internally generated gains/losses. Acquiring firms with several large reporting units can choose to allocate goodwill either to low growth units to accelerate impairment (big bath), or to high growth units (with existing unrecorded internally generated growth options) to delay impairment.

If this ability to manage future impairments motivated lobbying, I expect firms with several large reporting units to support the Comment Letter Position over the other positions. The Amortization Position does not afford such firms comparable flexibility, while the Revised ED Position will be costlier for such firms to implement. The Revised ED Position requires firms to calculate fair values of all their units' net assets each time impairment reviews are necessitated; this is likely to be more costly for firms with several large reporting units.

[H2a] The probability that a firm supports the Comment Letter Position over both the Amortization Position and the Revised ED Position increases with the number and size of its reporting-units.

Empirical data on “the number and size of reporting units” are not available. SFAS 131, however, requires firms to disclose data on business segments. I use the number of business segments to proxy for the number of reporting units, and the sales of business segments (which when aggregated is the sales of the firm) to proxy for the size of reporting units. I use one combined variable to represent the flexibility given by “the number and size of reporting units,” viz., $Ln(Seg)*Ln(Sales)$, where $Ln(Seg)$ is log of the number of segments and $Ln(Sales)$ is log of firm sales. Holding the number of segments constant, increasing total sales increases the average segment size (and flexibility to hide impairments in a segment). Holding the total sales constant, increasing the number of segments gives more choice of units to allocate acquired goodwill.

In addition to $Ln(Seg)*Ln(Sales)$, I also use the number of segments alone as an H2a proxy. It is possible that $Ln(Seg)*Ln(Sales)$ is only capturing the size of the firm, i.e., not the size *and* complexity of its business segments. Since $Ln(Seg)$ cannot directly proxy for the size of business segments, using $Ln(Seg)$ mitigates the possibility that results from using $Ln(Seg)*Ln(Sales)$ are driven only by firm size. Using $Ln(Seg)$ to proxy for the number of reporting units can bias against finding results consistent with H2a since the number of segments is always weakly smaller than number of units.

3.2.2. Reporting-Units' Fair-Value-to-Book-Value (FTB) Ratios

After acquired goodwill is allocated to reporting units, firms must periodically evaluate whether it is impaired. SFAS 142 requires such impairment testing only for units

with fair-value-to-book-value (FTB) ratios less than one (implicitly assigning, at this step, all of the excess of a unit's fair value over book value to acquired goodwill). While this requirement was not part of ED 201-R, supporters of the Comment Letter Position did lobby for a similar requirement. To see this note that under the Comment Letter Position, the fair value of acquired goodwill is defined as the excess of a unit's total fair value over its book value (excluding goodwill). It is unlikely, however, that all of this excess is due to acquired goodwill: internally generated rents and the understatement of book values likely account for some of the excess. *Ceteris paribus*, the higher a unit's FTB ratio, the more likely the Comment Letter Position will overstate the fair value of acquired goodwill, and thus the more likely losses to acquired goodwill can be avoided. Thus, I expect lobbying firms with high unit-FTB ratios to support the Comment Letter Position (see also Appendix 2).

Lobbying firms with low unit-FTB ratios are more likely to support the Amortization Position: impairment testing is likely to result in immediate loss recognition for such firms; but under amortization, the cost of impairment for low FTB ratio firms can be spread over several years.

I do not, however, expect reporting-unit FTB ratios to explain firms' choice of the Revised ED Position. The Revised ED Position imposes costs on both units with high and low FTB ratios. Units with low FTB ratios will, by definition, have low fair-value estimates of goodwill under the Revised ED Position, making management of impairment less likely. Units with high FTB ratios are more likely to generate higher fair-value estimates of goodwill under the Comment Letter Position than under the Revised ED Position (see Figure 2).¹¹

[H2b] The probability that a firm supports the Comment Letter Position over the Amortization Position increases with its reporting-units' FTB ratios.

Reporting-unit FTB (fair-value-to-book-value) ratios are unobservable. A simple proxy is firm-wide MTB (market-to-book). Another proxy is abnormal MTB, *Abn.MtB*.

¹¹ The claim is made *ceteris paribus*—i.e., after controlling for flexibility in estimating the fair values of non-goodwill net assets (tested in H2c).

Abn.MtB is the excess of firm-wide MTB over size-industry average MTB.¹² If firm-wide MTB is affected by industry-wide growth options that are not reflected at the reporting-unit level, then *Abn.MtB* is a cleaner measure of reporting-unit FTB.

3.2.3. *The Unverifiability of Net Assets*

For units with FTB ratios less than one, SFAS 142 requires recording impairment losses when the “implied fair value” of goodwill is less than its historical book value. ED 201-R had a similar requirement for recording impairment losses, except that losses were not conditional on FTB being less than one. In both ED 201-R and SFAS 142, the “implied fair value” of a unit’s goodwill is difference between the unit’s total fair-value and the fair value of its non-goodwill net assets. In a firm, fair values of some net assets (e.g., cash, investments, payables, etc.) can be verified more readily than the fair values of others (e.g., firm-specific assets such as specialized plant and equipment). *Ceteris paribus*, the greater the proportion of unverifiable net assets, the greater the flexibility in estimating the fair value of net assets and goodwill, and thus, the greater the discretion in determining impairments.

The impairment flexibility associated with a high proportion of unverifiable net assets is not afforded under the Comment Letter Position because here book values of net assets are used in calculating the “implied fair value” of goodwill. Under the Revised ED Position, however, fair values of net assets are used in the “implied fair value” of goodwill calculation. Thus, firms with more unverifiable net assets are likely to support the Revised ED Position over the Comment Letter Position. Assuming discretion motivated lobbying positions, the unverifiability of net assets cannot *ex ante* differentiate a firm’s choice between the Comment Letter Position and the Amortization Position.

[H2c] The probability that a firm supports the Comment Letter Position over the Revised ED Position increases with the verifiability of net assets.

I define the ratio of [Cash + Investments – Debt – Preferred Equity] to [Assets – Liabilities] as the verifiable-net-assets ratio (VNA). The denominator in VNA is total net

¹² In my main tests, I define a firm’s size-industry as all companies within the same sales quartile of its two-digit NAICS code. For robustness, I show that results hold under alternate definitions of size-industry.

assets, while the numerator is net-asset items with more readily verifiable fair values (Richardson, Sloan, Soliman, Tuna, 2005). Items excluded from the numerator include plant, equipment, receivables, payables, etc. These items are less likely to have actively traded market prices, so fair-value estimates of these items likely more subjective. Thus, as VNA increases, subjectivity in estimating the “implied fair value” of goodwill decreases. To get a variable that *increases* in subjectivity, I multiply the VNA ratio by -1, and call the result the unverifiable-net-assets ratio, *UNA*.

When the numerator in VNA is greater than the denominator, *UNA* will be low, indicating that the firm has a lower ability to manage fair-value goodwill estimates. However, a higher proportion of verifiable *net* assets to total *net* assets can be the result of fewer verifiable liabilities compared to total liabilities.¹³ By overstating (understating) unverifiable liabilities, firms can understate (overstate) their non-goodwill net assets, and thus overstate (understate) implied goodwill. Thus, firms with above-one VNA (i.e., low *UNA*) can still manage goodwill write-offs by opportunistically valuing certain unverifiable liabilities. In such cases, a better measure of the verifiability of net assets can be the closeness of VNA to one. If all net assets are “verifiable net assets,” the VNA ratio will be one; deviations of the ratio from one indicate that some assets and/or liabilities have been excluded from “verifiable net assets.”¹⁴ Thus, as an alternative proxy to *UNA*, I compute a variable that captures the absolute distance of VNA from one and call this variable *Mod.UNA* (for modified *UNA*). *Mod.UNA* is defined as $|1 - \text{VNA}|$. Larger values of *Mod.UNA* correspond to larger absolute distances from one, and thus more flexibility in estimating the fair value of goodwill. On average, I expect *Mod.UNA* to be positively correlated with *UNA* and thus, a firm’s ability to manage impairment losses to increase in *Mod.UNA* as well.

Ramanna and Watts (2007) recognize the restrictiveness of the assumption in *UNA* and *Mod.UNA*—that cash and investments are the only verifiable assets. As an

¹³ For example, consider a firm with \$100 in assets and \$60 in liabilities. All of the assets are verifiable, but only \$20 of the liabilities are verifiable. Thus, verifiable net assets are \$80, total net assets are \$40, and the VNA ratio is 2.

¹⁴ Note that the VNA ratio can be one even if all net assets are not “verifiable net assets.” In the example above, if \$60 of the assets are verifiable and \$20 of the liabilities are verifiable, the VNA ratio is 1 although there is still potential to manage fair value estimates. This example highlights the need to use *UNA* and *Mod.UNA* as complements.

alternate proxy, they suggest *Ind.Lev*, the ranked mean leverage of the firm's industry (where industry is defined using 2-digit NAICS codes). Leverage can be a good proxy for non-firm-specific assets (Myers 1977, Smith and Watts 1992), which are more likely to have verifiable fair-value estimates. At the firm level, leverage is a noisy measure of assets-in-place because it also proxies for distress. Industry mean leverage, however, can average out the firm-specific distress component of leverage, resulting in a proxy for assets-in-place. The higher the industry's average leverage, the more likely assets in a firm can be reliably valued, and the less likely the unverifiability of net assets. In the subsection on robustness tests, I report the results of using *Ind.Lev* as an alternate proxy for the unverifiability of net assets.

3.2.4. *The Magnitude of Impairment Charges that can be Managed*

The previous three hypotheses (H2a, H2b, and H2c) describe characteristics that give firms a higher *probability* of managing impairment. The significance of impairment discretion is also likely increasing in the *magnitude* of write-offs that can be managed. I call this magnitude the standard's "wealth effect" on a lobbyist. The wealth effect includes the standard's absolute (i.e., dollar) effect, its effect relative to one's total wealth, and its effect relative to peer-effects. The own-wealth relative effect is due to the opportunity cost of lobbying: although a standard has a high dollar effect on a firm, the firm will not lobby if this dollar effect represents an insignificant portion of its total wealth. The description of peer-relative effects is motivated from Stigler (1971) who notes that firms in an industry have heterogeneous interests: firms can lobby against collective goods even if it benefits them, provided it benefits their competitors more (see Ramanna 2007a for a fuller description of how lobbyists can measure standards' wealth effects).

I propose that wealth effects of impairment discretion can be measured by firms' *abnormal* goodwill-to-assets. I define abnormal goodwill as the deviation in a firm's book goodwill-to-assets from its size-industry's average goodwill-to-assets. For firms with positive (negative) abnormal goodwill-to-assets, the standard has positive (negative) wealth effects. I use abnormal goodwill-to-assets in lieu of just goodwill-to-assets or unscaled goodwill because the former likely better captures all three elements of the

wealth effect. Empirical proxies for abnormal goodwill-to-assets, just goodwill-to-assets, and unscaled goodwill are correlated; but unscaled goodwill likely captures only the dollar effect, while just goodwill-to-assets is unlikely to capture peer effects. In empirical tests, I use abnormal intangibles-to-assets (*Abn.ItA*) to proxy for abnormal goodwill-to-assets because more than half of the lobbying firms do not separately list goodwill.

I expect that lobbying firms' support for pro-impairment positions over the Amortization Position increases in abnormal goodwill-to-assets, i.e., in the standard's positive wealth effects. This is because pro-impairment positions offer greater probability of managing impairments, and such probability only assumes significance if the wealth-effects from impairment management are positive. I do not expect abnormal goodwill-to-assets to distinguish firm-support between the two impairment positions.

[H2d] The probability that a firm supports the Comment Letter Position over the Amortization Position increases with abnormal goodwill.

3.3. Implications and Alternate Explanations

Hypothesis 1 tests whether goodwill impairment in SFAS 142 is due in part to pro-pooling firms. To do this, H1a tests whether congressional pressure on the FASB over its original proposal (abolish pooling and require goodwill amortization under purchase) is linked to pro-pooling firms; and H1b tests whether pro-pooling firms then backed goodwill impairment as now seen in SFAS 142. Linking H1a and H1b is the assumption that goodwill impairment was offered by the FASB to assuage political pressure over its proposal to abolish pooling. It is possible that the FASB was determined to eliminate pooling (consistent with its stated goal of "international convergence"), and offering impairment in lieu of amortization was its way of achieving this goal (given the political pressure). My tests cannot rule out this possibility, but doing so is not required to interpret the evidence on Hypothesis 1. Evidence consistent with H1a and H1b is interesting *given* the FASB and SEC cited concerns of pooling abuse as a reason for changing business combinations accounting.

Hypothesis 2 (i.e., H2a–H2d) tests whether support for unverifiable fair-value-based impairment in SFAS 142 increases in firms' discretion potential. To a firm, there are benefits and costs associated with this discretion. The benefits are the increased potential to manage financials; the costs can include a higher cost-of-capital due to the

risk opportunistic management (by the firm in question or by other firms). Hypothesis 2 assumes that for supporters (opponents) of impairment, the benefits from greater discretion exceed (are exceeded by) its possible costs. Thus, tests of hypothesis 2 also implicitly test this assumption.

Conditional on rational lobbying, understanding *why* firms lobby for a standard indicates *how* they intend to use that standard. Thus, finding that discretion motivates firms' support for goodwill impairment, suggests that at least some management of impairment decisions is occurring post SFAS 142. Further, agency theory predicts that at least some of this impairment management is opportunistic.¹⁵ The unverifiable discretion in impairment rules allows firms to either delay write-offs (resulting in overstated assets and earnings) or accelerate write-offs (resulting in understated assets and earnings).

There are reasons other than discretion for firms to support goodwill impairment. (1) Impairment was offered under purchase accounting, which, because it requires all acquired assets and liabilities to be recorded at fair values, can make financial statements more informative. Thus, observed "support" for impairment may simply be support for purchase. (2) Impairment was offered as an alternative to amortization. Thus, observed "support" for impairment may simply be opposition to amortization.

If either of these above reasons *alone* motivated firm support for impairment, then such support is unlikely to increase in firms' discretion potential under the impairment standards (as predicted by Hypothesis 2). However, evidence consistent with Hypothesis 2 cannot rule out that firms' were *also* motivated by either or both of the above reasons (in other words, the above are not alternate explanations, but can be complementary to Hypothesis 2).

4. Empirical Analysis

4.1. Research Design for H1a

I identify 43 distinct congresspersons who took active pro-pooling positions at the Senate/House hearings and/or one of the two other events identified in §3.1. I compare these pro-pooling congresspersons to all other members of the 106th Congress (1999–

¹⁵ Consistent with this prediction, Ramanna and Watts (2007) find that in a sample of firms with market indications of impairment ($MTB < 1$), firms with greater discretion are more likely to avoid write-offs.

2000).¹⁶ For this combined set of congresspersons (pro-pooling and others), I obtain data on contributions made by the PACs of all firms and industry associations that lobbied on the original FASB proposal (ED 201, abolish pooling, amortize goodwill).¹⁷

For each congressperson, I aggregate PAC contributions from firms and associations by lobbying position. Thus, I obtain two data points for each member of Congress: PAC contributions from the pro-pooling group and PAC contributions from the anti-pooling group. For each congressperson, I scale total group-contributions by total PAC receipts. From H1a, the probability that a congressperson took a pro-pooling stance is increasing in contributions from the pro-pooling lobbying group. Accordingly, I run a probit regression on the combined sample of congresspersons, where the dependent variable coded as “1” for pro-pooling congresspersons and “0” for all other congresspersons. As explanatory variables, I include scaled contributions from the pro- and anti-pooling lobbying groups. In addition, I include controls for congresspersons’ ideologies and a committee-membership dummy (dummy indicates if congresspersons are members of House Finance Subcommittee/ Senate Banking Committee).

The control variables help address alternate hypotheses. The committee-membership dummy controls for the possibility that only congresspersons with relevant finance expertise became interested in pooling. If this variable explains congressional positions on pooling to the exclusion of pro-pooling PAC money, then H1a will be rejected. The ideology variables similarly control for the possibility that congressional positions on pooling can be explained by political beliefs. The ideology variables are “Common Space Scores,” commonly used in political science (obtained from Keith Poole’s website, VoteView.com). The scores are obtained from a spatial voting analysis of congresspersons’ roll-call records, a procedure fully described by Poole (1998).

¹⁶ The group of all other congresspersons includes six members who participated in the hearings, but whose positions on pooling are ambiguous. An example of an ambiguous position is that of Sen. Sarbanes who participated in the Senate hearings on pooling, but cautioned that “Congress would be entering into very dangerous ground” by legislating on accounting standards (U.S. Senate 2000, p.9). Results are invariant to including these six as pro-pooling congresspersons, or excluding them from the sample altogether. Note that while these congresspersons were supportive of FASB independence, none of them actively supported the anti-pooling (i.e., original FASB) position.

¹⁷ I identify 102 distinct US firms and 21 industry associations lobbying on ED 201. PAC data were obtained from the Federal Election Commission and the Center for Responsive Politics. Not all lobbying firms have PACs, and not all PACs made contributions to all congresspersons. Thus, for the 535 members of Congress and the 123 lobbying firms/associations, I found data on about eleven thousand distinct firm-congressperson contributions of a possible sixty-five thousand pairs.

Intuitively, Common Space Scores are much like “factors” in a factor analysis. These scores are the result of explaining, on two dimensions, congresspersons’ votes over their congressional life. Like factors, the scores have no *ex-ante* interpretation, although *ex post* the first dimension has been interpreted as party identity, while the second dimension has typically captured non-partisan voting trends.

Because of the possible endogeneity of PAC contributions (see §3.1), the probit model of congressional positions is estimated simultaneously with a model for pro-pooling PAC contributions received by each congressperson. The explanatory variables in this latter model are the ideology controls and committee-membership dummy described above, together with the following additional controls: a control for whether the congressperson is a Senator or House member; a control for the congressperson’s seniority in her/his respective chamber; and a control for the size of the state the congressperson represents. The Senator/House member indicator controls for the possibility that Senators receive on average more PAC money (because they have larger constituencies). The seniority variable is the natural log of the number of years the congressperson has served in her current chamber; this controls for the possibility that more senior members of Congress receive more PAC money (e.g., Kroszner and Stratmann 2005). The state size variable is the ratio of the congressperson’s state GDP to U.S. GDP; this variable controls for the possibility that representatives of larger states receive more PAC money. All data are for year 2000.

4.2. Results for H1a

Table 2 reports mean and median PAC contributions from lobbying groups to congresspersons. The mean (median) PAC contribution from pro-pooling groups to pro-pooling congresspersons was 13.36% (14.47%) of those congresspersons’ total PAC receipts. Consistent with H1a, this number is statistically greater than the mean (median) PAC contribution from pro-pooling groups to *other* congresspersons—8.86% (8.28%). The number is also greater than (i) the mean (median) PAC contribution from anti-pooling groups to pro-pooling congresspersons, and (ii) the mean (median) PAC contribution from anti-pooling groups to other congresspersons. On average, PAC contributions from pro-pooling groups are greater than PAC contributions from anti-

pooling groups, suggesting that pro-pooling groups are more politically active. This result reiterates the importance of testing H1a in a multivariate setting that controls for the endogeneity of PAC contributions.

Table 3 reports the results of the probit model of congressional positions (i.e., pro-pooling or not), estimated in the simultaneous system described above. I run three specifications. In the first (second), I exclude the seniority and state size controls (state size control only) from the equation explaining pro-pooling PAC contributions. In the third, I include all controls. The results are similar across all specifications, so I discuss the third specification only. As predicted by H1a, the probit-model coefficient on PAC contributions from pro-pooling groups is positive and significant. The marginal effect of this variable is 29.5%, suggesting that a two-standard-deviation change in pro-pooling PAC money about its mean value increases the probability that a congressperson is pro-pooling by 29.5%. As noted earlier, I do not interpret this result as PAC money was used to buy congressional positions *solely* on pooling. Relations with congresspersons are likely developed over long periods, and firms likely give money to their friends in Congress. Thus, consistent with H1a, the results suggest that congresspersons pressuring the FASB over pooling are likely allies of pro-pooling firms and associations.

Among, the control variables in the probit equation, the ideology variables are significant. The first of the two ideology variables captures partisan voting (with Democrats having negative values). The negative coefficient on this variable suggests that Democrats are more likely to be pro-pooling, consistent with strong Democratic representation in more industrialized states (e.g., California, Connecticut, Massachusetts, and New York).

In the model explaining congresspersons' pro-pooling PAC receipts, the first ideology variable, the committee-membership dummy, and the Senator indicator dummy are statistically significant. This is, respectively, consistent with Republicans, finance committee members, and Senators receiving on average more PAC money.

4.3. Research Design for H1b and H2

H1b predicts that after successfully generating congressional pressure against the FASB's original proposal, pro-poolers lobbied for the goodwill impairment rules now

seen in SFAS 142. As described in §3.2, the Comment Letter Position (of firms lobbying on the revised ED) most closely resembles the goodwill impairment rules in SFAS 142. Thus, H1b can be tested by checking if support for the Comment Letter Position (as compared to the two other firm positions) is higher among pro-pooling firms. In other words, H1b can be tested by examining if a firm's support for pooling on the original ED is a determinant of support for the Comment Letter Position in the revised ED. Since H2 also examines the determinants of firms' support for the Comment Letter Position (over other firm positions), tests of H1b are reported with tests of H2.

4.3.1. Jointly Modeling H2 (i.e., Lobbying Positions) and the Lobbying Decision

H2 makes predictions on how firms' lobbying *positions* on the revised ED vary with characteristics measuring discretion. Managers' lobbying positions can be related to their *decision* to lobby in the first place. For example, if discretion potential explains lobbying positions, firms that did not lobby likely expected lower net benefits from discretion. Thus, I control for the self-selection of firms into the set of lobbyists. Prior accounting research has found that lobbying *decisions* can be explained by: (1) size (Watts and Zimmerman 1978); (2) other cash-flow effects not captured by size (Francis 1987); and (3) contracting effects (Deakin 1989).

Apropos (1), I expect larger firms with greater expected benefits from lobbying are more likely to lobby. To see this note that: (a) larger firms likely have larger absolute stakes in the outcome of proposed standards; (b) larger firms are more visible and likely have larger influence with the FASB; and (c) if there are scale economies in the costs of lobbying, then larger firms with more accounting staff and better expertise likely have lower costs. I measure firm size using $\ln(\text{Sales})$. Apropos (2), I expect the significance of lobbying on goodwill impairment to increase in the absolute value of abnormal goodwill-to-assets. In §3.2.4, I argue that the standard's "wealth effects" are increasing in abnormal goodwill-to-assets, and that firms with positive (negative) wealth effects lobby for pro-impairment positions (amortization). Thus, I expect that the *decision* to lobby likely increases in the absolute value of wealth effects, measured as $|Abn.ItA|$.¹⁸

¹⁸ As an additional control for (2), I include proxies for firms' past M&A activity (e.g., market value of acquisitions from 1995–2000, market value of pooling acquisitions from 1995–2000, and ratio of pooling

Apropos (3), I consider the standard's potential impact on debt contracts, compensation contracts, and stock prices. Debt contracts can be asset-based and/or income-based, but frequently exclude the effects of goodwill and other intangibles.¹⁹ Firms with goodwill-based debt contracts that also include the effects of mandatory GAAP changes²⁰ are likely concerned with goodwill impairment's potential impact. I use the firm's debt-to-assets to proxy for debt contracting concerns. Dichev and Skinner (2002) find that debt-to-assets is a relatively noisy proxy for the *probability* of debt covenant violation; however, holding constant this probability, debt-to-assets is likely a good proxy for the *cost* of debt covenant violation (the more leverage a firm has, the more costly it will be to renegotiate contracts once covenants are violated). Ideally, debt-to-assets should be interacted with a dummy that indicates whether a firm has goodwill-based covenants and whether those covenants include the effects of mandatory GAAP changes. Unfortunately, I cannot observe this information for most lobbying firms because lobbying firms tend to be large, and so are unlikely to have covenants that meet the materiality threshold for disclosure.

Compensation contracts are usually written on net income, and thus *do* include the effects of goodwill and other intangibles (Murphy 1999). Firms that expect to be affected by impairment's impact on net income are more likely to lobby if their managers are compensated on net income. The larger the proportion of net-income-based managerial pay, the more likely such firms will lobby (assuming that managers are responsible for lobbying decisions). I use the ratio of a CEO's Bonus to Total Cash Compensation to measure compensation contracting concerns (assuming that CEO bonus is based on net income, Murphy 1999).

Finally, to the extent that managers believe that accounting numbers directly map into stock prices, they should be concerned with the effects of impairment on their stock price. The more correlated price is to accounting income, the more likely a manager is concerned about the price impact of goodwill impairment. In the ED, goodwill

to total acquisitions). These data are not available for all sample firms. To the extent that it is, these acquisition variables do not add explanatory power over abnormal goodwill-to-assets.

¹⁹ Of a sample of 503 firms with available covenant data and $MTB < 1$, Beatty and Weber (2006) find that 288 (57%) had covenants that were unlikely to be affected by goodwill.

²⁰ In a sample of 206 firms, Beatty, Ramesh, and Weber (2002) find that about 25% have covenants that include the effects of mandatory accounting changes in calculations. If lobbying positions are influenced by covenant implications, then presumably covenants of lobbying firms include the effect of GAAP changes.

impairment loss is recognized above-the-line. Thus, the more correlated a firm's price is to its *operating* income, the more likely its manager will lobby. I measure stock pricing concerns using *ERC*, the coefficient from regressing a firm's price on its operating income using at least 16 and up to 20 quarters prior to ED 201-R.²¹

To summarize, I expect that the *decision* to lobby is increasing in (1) firm size, (2) absolute value of abnormal goodwill, and (3) contracting effects (i.e., debt, compensation and stock pricing concerns). To control for the self-selection of lobbyists, I jointly model the decision to lobby and positions upon lobbying using a two-level nested multinomial logit model. The first level models the probability that firms lobby: this is a binary choice (i.e., lobby or not). For those firms that lobby, the second level models the probability of lobbying *positions*: this is a multinomial choice (i.e., Comment Letter Position v. Revised ED Position v. Amortization Position). The nested model has an "inclusive value" parameter to capture correlation between the two levels (see Appendix 3 for details).

4.4. Distribution of Firms Lobbying on the Original and Revised EDs

Before presenting the results for H2, in Table 4, I discuss the distribution of firms across lobbying positions in both the original and revised EDs (i.e., pro-pooling v. anti-pooling on the original ED; Amortization Position v. Revised ED Position v. Comment Letter Position on the revised ED). I identified 186 distinct firms lobbying on either of the two proposals: of these, 52 firms lobbied on both. Thirty-one pro-pooling firms from the original ED also lobbied on the revised ED: of these, only five supported the Amortization Position, while 18 supported the Comment Letter Position (consistent with H1b). Twenty-one anti-pooling firms from the original ED also lobbied on the revised ED: of these eight supported the Comment Letter Position. Table 4 also reports that half of all lobbyists from the original ED did not lobby on the revised ED. Increased certainty about the project's outcome following congressional intervention may have made it cost ineffective for these firms to lobby. Eighty-two firms lobbying on the revised ED did not lobby on the original ED, but these new lobbyists supported goodwill impairment over amortization by nearly a two-to-one margin.

²¹ Following Beatty and Weber (2006), if the coefficient from the regression is less than zero, I set it to zero. This is because negative ERCs have little meaning in this context.

Since the bottom right cell in Table 4 is non-reportable (the population of all firms that did not lobby on both the original and revised EDs is not known with certainty), I cannot perform a chi-square significance test on the entire table. Instead, I report chi-square tests from two sub-samples of Table 4. The first sub-sample is all firms lobbying on the original ED (i.e., the sub-sample excludes the 28+35+19 firms that did not lobby on ED 201). The chi-square for this sample is not significant (p-value is 0.57), consistent with a random clustering of lobbying decisions and positions among original ED lobbyists. The second sub-sample is all firms lobbying on the revised ED (i.e., the sub-sample excludes the 21+31 firms that did not lobby on ED 201R). The chi-square for this sample is statistically significant (p-value is 0.01), consistent with a non-random clustering of lobbying decisions and positions among revised ED lobbyists.

4.5. Univariate Results for H1b and H2

Table 5A presents univariate comparisons of the discretion proxies used to test H2, viz., *Abn.MtB* and *MtB* for H2a; $\ln(\text{Seg}) * \ln(\text{Sales})$ and $\ln(\text{Seg})$ for H2b; *UNA* and *Mod.UNA* for H2c; and *Abn.ItA* for H2d. In the definitions of *Abn.MtB* and *Abn.ItA*, a firm's "size-industry" is all companies within the same sales quartile of its two-digit NAICS code.²² All data are from the most recent fiscal year prior to ED 201-R, and all ratios are winsorized at the 1st and 99th percentile of size-industries.²³ I use the t test (Wilcoxon test) to compare means (medians).

Consistent with H2a, the mean and median values of proxies for the number and size of reporting units, viz., $\ln(\text{Seg}) * \ln(\text{Sales})$ and $\ln(\text{Seg})$, are larger for Comment Letter Position firms than for Amortization Position and Revised ED Position firms (the comparison between Comment Letter Position and Amortization Position firms is not statistically significant). Consistent with H2b, the mean and median values of proxies for reporting-unit FTB ratios, viz., *Abn.MtB* and *MtB*, are larger for Comment Letter Position firms than for Amortization Position firms. Consistent with H2c, the mean and median

²² Using two-digit over three-digit NAICS is likely more informative for lobbying studies, given that lobbying firms tend to be large multi-sector firms.

²³ In the sample of lobbying firms, the unwinsorized mean values of *MtB*, *UNA*, and *ItA* are nearly three times their median values. First and 99th percentile winsorization of these ratios mitigates the large mean-median differences, suggesting that near-zero denominators for a few observations were skewing the mean values of these ratios. Hence, I use 1st and 99th percentile winsorization.

values of proxies for the unverifiability of net assets, viz., *UNA* and *Mod.UNA*, are larger for Revised ED Position firms than for Comment Letter Position firms (the comparisons using *Mod.UNA* are not statistically significant). Consistent with H2d, the mean and median values of the proxy for impairment's wealth effects on a firm, viz., *Abn.ItA*, are larger for Comment Letter Position firms than for Amortization Position firms (the comparisons using means is statistically significant at the 90% confidence level). Except as otherwise noted, all of the above comparisons are statistically significant at the 95% confidence level.

As preliminary evidence supporting H1b, Table 5A also reports that 40% of Comment Letter Position firms supported pooling in the original ED compared to 13% and 17% of Amortization Position and Revised ED Position firms, respectively.

As a control variable in the H2 regressions, I add a dummy variable for the lobbying positions of firms' industry associations. This variable is set to "1" if a firm's industry association lobbied against it and "0" otherwise. Since most industry groups lobbying on ED 201-R supported the Revised ED Position, this control variable helps ensure that the multivariate results are not driven by an omitted variable. Table 5A reports that 87% of Amortization Position firms, 63% of Comment Letter Position firms, and only 2% of Revised ED Position firms were opposed by their industry association.

Table 5B presents univariate comparisons for lobbying-*decision* variables. The mean and median size of firms lobbying on the revised ED is significantly larger than that of non-lobbying firms. Non-lobbying firms are all FY 2000 firms in the COMPUSTAT universe subject to data availability. The mean and median absolute abnormal intangibles-to-assets are also larger for lobbying firms than for non-lobbying firms, although the differences are not significant. Finally, median values of debt/assets, mean and median values of bonus/compensation, and mean and median values of ERC are significantly larger for lobbying firms than non-lobbying firms.

Table 5B also reports that 42% of firms lobbying on the revised ED also lobbied on the original ED. I create a dummy variable (*Lobb.Orig.ED*) set to "1" for firms lobbying on the original ED, "0" otherwise. I include this dummy as a control variable in modeling the determinants of firms' decision to lobby on the revised ED. This dummy performs an important control function in multivariate tests of H1b. Recall that H1b is

tested with H2 in a nested logit structure where the decision to lobby on the revised ED and positions upon lobbying are jointly modeled. To test H1b, I use a pro-pooling indicator variable in the lobbying-positions' regression. This pro-pooling indicator can take the value "1" only if the firm lobbied on the original ED in the first place. Without *Lobb.Orig.ED* a significant coefficient on the pro-pooling indicator could be simply due to the firm lobbying on the original ED and not due to the *direction* of that lobbying. In other words, *Lobb.Orig.ED* mitigates the possibility that the pro-pooling indicator is statistically significant due to an omitted variable.

In H2, I suggest that impairment testing favors firms with several large reporting units and high FTB ratios. To the extent that such firms are systematically clustered in a few industries, controlling for industry-specific effects is necessary. Table 5C presents the distribution of lobbying positions on the revised ED by industry. Industry is defined by first two digits of the firms' NAICS codes. I run a Freeman-Halton (Fisher's Exact) test to check for systematic relations in the table. The p-value from this test is 0.62, failing to reject the null hypothesis of no industry-wide-clustering across positions.

4.6. Multivariate Results for H1b and H2

Table 6A presents results of multivariate tests of H1b and H2 using the two-level nested multinomial logit model described earlier. Level one is the binary decision to lobby on the revised ED. Level two is the multinomial decision to choose one of the three lobbying positions on the revised ED. The explanatory variables in level one are size, abnormal-goodwill-to-assets, the contracting variables, and a dummy for whether the firm lobbied on the original ED. The explanatory variables in level two are the discretion proxies from H2, a dummy to indicate whether the firm was pro-pooling on the original ED (to test H1b), and a dummy to control for the lobbying positions of firms' industry associations. For the multinomial logit in level two, I use the Comment Letter Position as the base case: this follows from §3.2 where I discuss how the Comment Letter Position most closely resembles the final standard. Thus, parameter estimates from level two should be interpreted as the effect of explanatory variables on the choice of the Amortization Position or Revised ED Position over the Comment Letter Position. Accordingly, the parameter estimates are prefixed by "AM - CL" and "Rev - CL."

Requiring contracting variables in level one severely limits the sample size: the available sample drops from 8912 level-one firms and 115 level-two firms to 1435 level-one firms and 86 level-two firms. Since these variables are included as controls, in specifications (1) through (4) of the model, I omit them and avail of the larger number of observations. Even without these contracting variables, data requirements for the discretion proxies in H2 reduce the population of 134 listed firms that lobbied on the revised ED to 115 firms.

Since parameter estimates from the nested model cannot be directly interpreted, in Table 6A, I only report t-statistics (later I report marginal effects). In specification (1), I use $\ln(\text{Seg}) * \ln(\text{Sales})$ to proxy for the number and size of reporting units (H2a), Abn.MtB to proxy for fair-value-to-book-value ratios (H2b), UNA to proxy for the proportion of unverifiable fair values (H2c), Abn.ItA to proxy for wealth effects (H2d), and a dummy to indicate whether the firm was pro-pooling on the original ED (H1b). Specification (2) is similar to (1) except that I use $\ln(\text{Seg})$ to proxy for the number and size of reporting units. Specification (3) is similar to (1) except that I use MtB to proxy for fair-value-to-book-value ratios. Specification (4) is similar to (1) except that I use Mod.UNA to proxy for the ratio of unverifiable fair values. In specifications (1) through (4), all proxies for H2 and H1b have their predicted sign and statistical significance with one exception: in specification (4), Mod.UNA is not statistically significant. In general, the evidence is consistent with (a) lobbying support for SFAS 142 goodwill impairment increasing in discretion potential, and (b) pro-poolers supporting the impairment rules now in SFAS 142.

When the contracting variables are included, specifications (5) and (6) of Table 6A, all previous results hold. However, in specification (6), where nearly 35% of level-two observations are lost due to data requirements, the coefficient on Abn.MtB (H2b) loses statistical significance. Among the contracting variables, debt-to-assets is not significant, likely due to noise in this variable from omitting the covenant dummy described earlier; bonus-to-compensation is significantly positive, consistent with the hypothesis that managers lobbying on impairment were concerned about its effect on their own compensation (through accounting income); ERC is not significant, despite managers' claims that they were concerned about the standard's effect on stock prices.

The “inclusive value” parameter that captures the correlation between the two levels of the nested model is close to one in all specifications, i.e., (1) through (6), suggesting that the error terms from the two levels are independent (see Appendix 3).

Since the parameter estimates in Table 6A cannot be directly interpreted for economic significance, Table 6B reports their marginal effects. The columns in Table 6B are identical to Table 6A (except that marginal effects are reported instead of t-statistics). The marginal effect of a continuous variable in Table 6B is the change in outcome probability when the continuous variable is increased from one standard deviation below its mean value to one standard deviation above its mean value. The marginal effect of a dummy variable is the change in outcome probability when the dummy variable is increased from zero to one. When calculating the marginal effect of a given explanatory variable, all other level-two variables are set to their mean values, while all other level-one variables are set to their 90th percentile value. This is because consistent with prior studies on lobbying in accounting, I find the firm size in level-one is a very important determinant of lobbying decisions, and that all other variables are economically unimportant in explaining lobbying unless firm size is large.

Specification (1) of Table 6B reports that a standard deviation increase in $\ln(\text{Seg}) * \ln(\text{Sales})$ about its mean decreases the probability of supporting the Amortization Position (Revised ED Position) over the Comment Letter Position by 18.8% (29%). These results are consistent with H2a: firms with several large reporting units have a higher potential to manage impairments under the Comment Letter Position than under the two other positions. A standard-deviation increase in Abn.MTB about its mean decreases the probability of supporting the Amortization Position over the Comment Letter Position by 21.1%. This result is consistent with H2b: firms with high FTB units have a higher potential to manage impairments under the Comment Letter Position than under the Amortization Position. A standard deviation increase in UNA about its mean increases the probability of supporting the Revised ED Position over the Comment Letter Position by 52.6%. This result is consistent with H2c: firms with less verifiable net assets have a higher potential to manage impairments under the Revised ED Position.

Consistent with H2d, I also find in Table 6B (1) that a standard deviation increase in *Abn.ItA* about its mean decreases the probability of supporting the Amortization Position over the Comment Letter Position by 11.3%. *Abn.ItA* proxies for the “wealth effects” of the standard, including peer-relative effects. Firms with low (high) *Abn.ItA* are less (more) likely to benefit from impairment management than their peers, and are thus more likely to choose amortization (impairment). The finding that peer effects motivate lobbying is consistent with Stigler’s (1971) theory of regulation of collective goods. To my knowledge, it has not been previously documented in accounting lobbying.

Table 6B (1) also reports that the probability that a firm supports the Amortization Position (Revised ED Position) over the Comment Letter Position in the revised ED is 9% (11.3%) lower if the firm supported pooling in the original ED. This result is consistent with H1b—i.e., the hypothesis that the unverifiable fair-value-based impairment test in SFAS 142 (represented by the Comment Letter Position) is partially the outcome of pressure by pro-pooling firms.

Marginal effects from other specifications, i.e., (2) through (6), in Table 6B are generally similar to those reported above.

4.7. Robustness of Multivariate Results for H1b and H2

The economic significance of *Abn.ItA* suggests that, consistent with H2d, firms are strategic in their lobbying decisions and positions (i.e., firms consider the effect of accounting standards on peers when lobbying). This result depends on the appropriateness of size-industry-differencing. To ensure that my definitions of size-industry (i.e., size quartiles within two-digit NAICS codes) do not drive these results, I rerun the Table 6A regressions using the following alternate definitions: (1) size industry is defined using size quartiles within three-digit NAICS codes; (2) size industry is defined using size quartiles within two-digit SIC codes. I also test if results hold without any size-industry differencing, i.e., I use just intangibles-to-assets for H2d. In all these robustness tests, all parameters retain their predicted sign and significance.

The multivariate results for H2 and H1b are also robust to using in lieu of the nested multinomial logit model: (a) a bivariate probit selection model, where I collapse the second level into a binary choice (i.e., impairment v. amortization), and (b) a bivariate

ordered probit model, where I model the second level as an ordered choice (with order decreasing from Comment Letter Position to Revised ED Position to Amortization Position). Other robustness tests include: (1) using assets, in lieu of sales, to define size-industries; (2) using un-weighted averages, in lieu of sales-weighted averages, to calculate industry means; and (3) using *Ind.Lev* in lieu of *UNA* or *Mod.UNA* as a proxy for the unverifiability of net assets. In case of (1), results are similar, although some variables lose statistical significance. In case of (2) and (3), results are similar in sign and significance to those reported in Table 6A. Results to some of the robustness tests described above are available in Ramanna (2007b).

To mitigate concerns about the effects of extreme observations, I also obtain jackknifed parameter estimates for the nested multinomial logit model. The jackknife estimates closely resemble their MLE counterparts.

5. Conclusion

5.1. Summary of Findings

Several accounting standards in recent years have used fair values.²⁴ Holthausen and Watts (2001) argue that such fair values, when not based on actively traded market prices, i.e., when unverifiable, can increase opportunism. I test this argument through a political-economy study of a recent prominent standard that uses unverifiable fair values: SFAS 142, accounting for acquired goodwill.

SFAS 142 was part of the FASB's project to revamp business combinations accounting. This project was taken on in part due to FASB and SEC concerns over pooling misuse (Adams 1997, Turner 1999, FASB 1999). The project resulted in the elimination of pooling; all business combinations must now use the purchase method. Acquired goodwill recognized under purchase is subject to periodic impairment tests based on unverifiable fair-value estimates of goodwill.

Results in this paper are consistent with SFAS 142 impairment tests being due in part to firms opposed to abolishing pooling (pro-poolers). If the FASB and SEC are correct about pooling abuse, and if such abusers are among pro-poolers, it is likely that

²⁴ Examples include: impairment of long-lived assets (SFAS 121 in 1995 and SFAS 144 in 2001), employee stock options (SFAS 123 in 1995 and SFAS 123R in 2005), derivatives and hedging (SFAS 133 in 1998), and acquired goodwill (SFAS 142 in 2001).

some potential for opportunism has been retained in SFAS 142 impairment tests. I find that firms' lobbying support for SFAS 142 impairment tests increases in their discretion potential under the tests. Agency theory suggests such discretion potential can be used opportunistically. Thus, the results are consistent with unverifiable fair values in SFAS 142 impairment generating costs, at least among some lobbying firms.

5.2. Avenues for Future Research

Notwithstanding the evidence in this paper, it is possible that impairment management following SFAS 142 is *net* beneficial. Although some managers will use unverifiable discretion opportunistically, other managers, disciplined by reputation costs or increased monitoring, will avoid opportunism and use their discretion to make financial statements more informative. For SFAS 142 to be net beneficial to the economy, the costs of opportunistic discretion must be exceeded by the benefits of improved financial reporting. Since (non)impairment decisions are unverifiable at the time they are reported, the costs of potential opportunism are borne by all firms. Thus, at the firm level, the benefits to a non-opportunistic manager from improved reporting under SFAS 142 must exceed the costs imposed by free-riding opportunists. Future work can test these propositions, but doing so requires a theory to specify how the benefits of improved financial reporting under SFAS 142 can be measured.

Future work can also investigate the behavior of lobbying firms (and firms in general) post-SFAS 142. Figure 3 provides some preliminary evidence to this effect. The figure shows that although pro-unverifiable-fair-value firms have seen declines in *Abn.MTB* through 2004, their intangibles have continued to rise. If declining *Abn.MTB* indicates declining growth options and rising intangibles indicate new acquisitions, the evidence suggests that pro-unverifiable-fair-value firms are making poor acquisitions. Despite this, the figure shows that (with the exception of transition-period write-offs) impairments by these firms are rare. This result is consistent with pro-unverifiable-fair-value firms successfully managing impairments post-SFAS 142.

Another avenue for future research is to look at political events prior to the issuance of the FASB's first ED on business combinations (where I begin my study). This original ED (#201), issued in September 1999, was predated by a December 1998

G4+1 position paper.²⁵ Like ED 201, the G4+1 position paper proposed purchase with amortization as the only allowable business-combinations method. The position paper was exposed to comment in the US. An FASB analysis of these comments concluded that while academics, public accountants, and some industrial firms supported the G4+1 conclusions, banks, securities firms, and other industrial firms opposed the conclusions. Future work can analyze firm responses to the G4+1 paper for their effect on the FASB. Since ED 201 is similar in substance to the G4+1 paper, it does not appear that opposition to the position paper substantially changed the FASB's position (the change only came in the FASB's second exposure draft, after Congress became involved). Nevertheless, a study of the G4+1 comments can shed light on the FASB's agenda-setting process. Further, such a study can test whether firms discouraged by the FASB's non-responsiveness on the G4+1 lobbying chose not to lobby on ED 201.

Studying the agenda-setting process can help us understand why the FASB decided to take on a hot-button issue like pooling. Zeff (2005) reports that both of the FASB's predecessor bodies (i.e., the Committee on Accounting Procedure and the Accounting Principles Board) suffered considerable political damage over pooling, and that both bodies were disbanded within two years of this damage. Business combinations had topped the Financial Accounting Standards Advisory Council's list of potential FASB projects for nearly six years before the FASB added it to its agenda (Leftwich 1995). What forces influenced the FASB's initial thinking on business combinations accounting, and why did the FASB choose to ignore pooling's turbulent political history?

²⁵ The G4+1 is a working group of standard setters from Canada, New Zealand, the UK, the US, and the IASC. Its position papers are not binding on its members.

References:

- Abraham, S. 2000. Comment Letter to the FASB on ED 201. Norwalk, CT: FASB.
- Adams, J. 1997. "Current Accounting Projects," Remarks of the Deputy Chief Accountant at the Twenty-Fifth Annual National Conference on Current SEC Developments. Washington, DC: U.S. Securities and Exchange Commission.
- American Institute of Certified Public Accountants (AICPA). 1970. Accounting Principles Board Opinion No. 16 *Business Combinations*. New York: AICPA.
- Ansolabehere, S., J. Snyder, and M. Tripathi. 2002. Are PAC Contributions and Lobbying Linked? New Evidence from the 1995 Lobby Disclosure Act. *Business and Politics* 4(2): 131-155
- Austen-Smith, D. 1995. Campaign Contributions and Access. *American Political Science Review* 89(3): 566-581.
- Beatty, A., K. Ramesh, and J. Weber. 2002. The importance of accounting changes in debt contracts: the cost of flexibility in covenant calculations. *Journal of Accounting and Economics* 33: 205-227
- Beatty, A. and J. Weber. 2006. Accounting Discretion in Fair Value Estimates: An Examination of SFAS 142 Goodwill Impairments. *Journal of Accounting Research* 44: 257-288.
- Beresford, D. 2001. Congress Looks at Accounting for Business Combinations. *Accounting Horizons* 15 (March): 73-86.
- Chen, C., M. Kohlbeck, and T. Warfield. 2004. Goodwill Valuation Effects of the Initial Adoption of SFAS 142. Working Paper—University of Wisconsin at Madison.
- Deakin, E. 1989. Rational Economic Behavior and Lobbying on Accounting Issues: Evidence from the Oil and Gas Industry. *The Accounting Review* 64 (January): 137-151.
- Dichev, I. and D. Skinner. 2002. Large Sample Evidence on the Debt Covenant Hypothesis. *Journal of Accounting Research* 40: 1091-1123.
- Ely, K. and G. Waymire. 1999. Intangible Assets and Stock Prices in the Pre-SEC Era. *Journal of Accounting Research* 37 (Supplement): 17-44.
- Fabricant, S. 1936. Revaluations of fixed assets, 1925-1934. *National Bureau of Economic Research* December.

- Financial Accounting Standards Board (FASB). 1998. Invitation to Comment 192-A: *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for Achieving Convergence*. Norwalk, CT: FASB.
- Financial Accounting Standards Board (FASB). 1999. Exposure Draft 201-A: *Business Combinations and Intangible Assets*. Norwalk, CT: FASB.
- Financial Accounting Standards Board (FASB). 2001a. Exposure Draft 201-R: *Business Combinations and Intangible Assets—Accounting for Goodwill*. Norwalk, CT: FASB.
- Financial Accounting Standards Board (FASB). 2001b. Statement of Financial Accounting Standards No. 141 *Business Combinations*. Norwalk, CT: FASB.
- Financial Accounting Standards Board (FASB). 2001c. Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets*. Norwalk, CT: FASB.
- Francis, J. 1987. Lobbying Against Proposed Accounting Standards: The Case of Employer's Pension Accounting. *Journal of Accounting and Public Policy* 6: 35-57.
- Grossman, G. and E. Helpman. 2001. *Special Interest Politics*. Cambridge, Mass: MIT Press.
- Holthausen, R. and R. Watts. 2001. The relevance of the value-relevance literature for financial accounting standard setting. *Journal of Accounting and Economics* 31: 3-75.
- Kroszner, R. and T. Stratmann. 2005. Corporate Campaign Contributions, Repeat Giving, and the Rewards to Legislator Reputation. *Journal of Law and Economics* 48: 41-71.
- Leftwich, R. 1995. The agenda of the financial accounting standards board. Working Paper—University of Chicago.
- Li, Z., P. Shroff, and R. Venkataraman. 2005. Goodwill Impairment Loss: Causes and Consequences. Working Paper—University of Minnesota.
- Lys, T. and L. Vincent. 1995. An analysis of value destruction in AT&T's acquisition of NCR. *Journal of Financial Economics* 39: 353-378.
- Michaels, A. and P. Larsen. 2000. Fresh Rules Planned for M&A. *Financial Times*, December 7, 2000, Print and Online Editions.
- Murphy, K. 1999. Executive Compensation, in: Ashenfelter, O. and D. Carl (eds) *Handbook of Labor Economics* Vol. 1. Amsterdam: North Holland, pp. 2485-2563.
- Myers, S. 1977. Determinants of corporate borrowing. *Journal of Financial Economics* 5: 147-175.

- Poole, K. 1998. Recovering a Basic Space From a Set of Issue Scales. *American Journal of Political Science* 42 (July): 954-993.
- Richardson, S., R. Sloan, M. Soliman, and I. Tuna. 2005. Accrual Reliability, Earnings Persistence and Stock Prices. *Journal of Accounting and Economics* 39: 437-485.
- Ramanna, K. 2007a. A Strategic Model and Estimation Procedure for Lobbying on Accounting Standards Changes. Working Paper—Harvard University.
- Ramanna, K. 2007b. The implications of unverifiable fair-value accounting: Evidence from the political economy of goodwill accounting. Ph.D. Thesis—Massachusetts Institute of Technology.
- Ramanna, K. and R. Watts. 2007. Evidence on the Effects of Unverifiable Fair-Value Accounting. Working Paper—Harvard University and Massachusetts Institute of Technology.
- Roychowdhury, S. and R. Watts. 2007. Asymmetric timeliness of earnings, market-to-book, and conservatism in financial reporting. *Journal of Accounting and Economics* 44: 2-31.
- Smith, C. and R. Watts. 1992. The investment opportunity set and corporate financing, dividend, and compensation policies. *Journal of Financial Economics* 32: 263-292.
- Snyder, J. 1992. Long-term investing in politicians; or, give early, give often. *Journal of Law and Economics* 35 No.1: 15-43.
- Stigler, G. 1971. The Theory of Economic Regulation. *Bell Journal of Economics and Management Science* 2: 3-21.
- Stratmann, T. 2005. Some talk: Money in politics: A (partial) review of the literature. *Public Choice* 124: 135-156.
- Turner, L. 1999. “Initiatives for Improving the Quality of Financial Reporting,” Remarks of the Chief Accountant to the New York Society of Security Analysts. Washington, DC: U.S. Securities and Exchange Commission.
- U.S. House. 2000. Accounting for Business Combinations: Should Pooling be Eliminated? Hearing Before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce. Serial No. 106-100. Washington, DC: G.P.O.
- U.S. Senate. 2000. Pooling Accounting. Hearing Before the Committee on Banking, Housing and Urban Affairs. S. Hrg. 106-1035. Washington, DC: G.P.O.

- Watts, R. 2003. Conservatism in Accounting Part I: Explanations and Implications. *Accounting Horizons* 17 (September): 207-221.
- Watts, R. and J. Zimmerman. 1978. Towards a Positive Theory of the Determination of Accounting Standards. *The Accounting Review* 53 (January) 112-134.
- Weil, J. 2000. FASB Backs Down on Goodwill-Accounting Rules. *The Wall Street Journal*, December 7, 2000, Page A2.
- Zeff, S. 2005. The Evolution of US GAAP: The Political Forces Behind Professional Standards Part 1. *CPA Journal* 75 (January) 18-27

Appendix 1 Comparison of Impairment Proposals

Definitions:

“BV(.)” is book value. “FV(.)” is fair value. “GW” is goodwill. “NA” is net of all assets and liabilities excluding goodwill. “U” is the reporting unit (level at which goodwill impairment is calculated). “I(.)” is the indicator function.

Amortization Position

No Impairment Testing

Revised ED Position: Impairment test proposed by FASB in ED 201-R

Impairment = $\text{Max} \{ 0, (\text{BV}(\text{GW}) - [\text{FV}(\text{U}) - \text{FV}(\text{NA})]) \}$

Comment Letter Position: Impairment test proposed by certain firms in response to ED 201-R

Impairment = $\text{Max} \{ 0, (\text{BV}(\text{GW}) - [\text{FV}(\text{U}) - \text{BV}(\text{NA})]) \}$

Impairment test in SFAS 142

Impairment = $\text{Max} \{ 0, (\text{BV}(\text{GW}) - [\text{FV}(\text{U}) - \text{FV}(\text{NA})]) * \text{I}(\text{FV}(\text{U}) < \text{BV}(\text{U})) \}$
= $\text{Max} \{ 0, (\text{BV}(\text{GW}) - [\text{FV}(\text{U}) - \text{FV}(\text{NA})]) * \text{I}(\text{BV}(\text{GW}) > [\text{FV}(\text{U}) - \text{BV}(\text{NA})]) \}$

To see how the Comment Letter Position most closely resembles the impairment test in SFAS 142, note that the condition for impairment in SFAS 142 [i.e., the term in I(.)] is similar to the impairment loss formula under the Comment Letter Position.

Appendix 2

High Reporting-Unit FTB ratios and the Comment Letter Position

Supporters of the Comment Letter Position advocated using book values in impairment tests in either of two ways: (1) defining the fair value of a unit's goodwill as the difference between the unit's total fair value and the *book value* of its net assets (excluding goodwill); (2) recognizing an impairment loss in a unit only when the undiscounted sum of its future cash flows is less than the *book value* of its net assets.

Note that alternative (1) likely overstates the fair value of goodwill for units with high Fair-value-to-Book-value (FTB) ratios (particularly when the book values of assets other than goodwill are understated). Since impairment losses are recognized only when the fair value of goodwill is less than book goodwill, this proposal makes timely impairment losses less likely for units with high FTB ratios. Alternative (2) also makes timely impairment losses less likely for high FTB ratio units. To see this, simply note that if a unit's *undiscounted* future cash-flows is less than its book value (the condition for an impairment loss), then its *discounted* future cash flows (i.e. market value) will also be less than its book value. Alternatives (1) and (2) taken together, suggest that the Comment Letter Position makes timely impairment losses less likely for units with high FTB ratios.

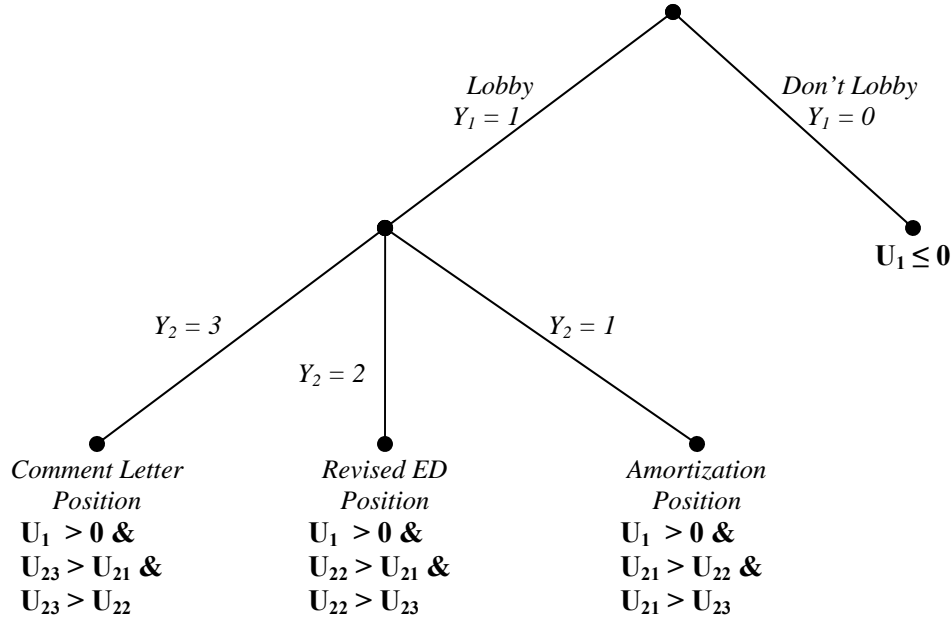
To see this with an example, consider a single reporting-unit firm (company T) that advanced proposal (1). Let T's market value be \$100. Let the book value of its net assets (excluding goodwill) be \$40, and the market value of these assets be \$75. Goodwill is recorded on the books at \$35. Under ED 201-R, the firm's implied fair value of goodwill is $\$100 - \75 , or \$25. Impairment loss is $\$35 - \25 , or \$10. Under the method proposed by company T, however, implied fair value of goodwill is $\$100 - \40 , or \$60. There is no impairment loss because this implied goodwill value is greater than its book value (\$35). Now assume that company T advanced proposal (2). T's market value (\$100) is the *discounted* sum of its FCF, thus the undiscounted sum can only be greater than \$100. T would not face an impairment loss because its book value is \$75 (i.e. $\$40 + \35).

Thus, I expect lobbying firms with high reporting-unit FTB ratios are more likely to support the Comment Letter Position.

Appendix 3

Two-Level Multinomial Logit for the Decision to Lobby and Lobbying Positions

The two sets of decisions firms face on ED 201-R are represented in the tree below.



Level 1 (the higher level) is the decision made by all firms on whether to lobby or not. The utility from lobbying is represented as U_1 , while the utility from not lobbying is normalized to zero. Thus, a firm chooses to lobby, i.e., $Y_1 = 1$, when $U_1 > 0$.

Level 2 (the lower level) is the position adopted by those firms that lobby. Firms support either (1) the Amortization Position ($Y_2 = 1$), (2) the Revised ED Position ($Y_2 = 2$), or (3) the Comment Letter Position ($Y_2 = 3$). U_{21} , U_{22} , and U_{23} represent the utilities to firms from lobbying on these three positions, respectively. Thus, for example, a firm lobbies for amortization, i.e., $Y_2 = 1$, when $U_1 > 0$, $U_{21} > U_{22}$, and $U_{21} > U_{23}$.

I model the decision in level 1 using binary logit, and the decision in level 2 using three-choice multinomial logit. In level 2, I use the Comment Letter Position as the base position. Thus, parameter estimates in level 2 must be interpreted as affecting the choice of Revised ED Position / Amortization Position over Comment Letter Position. I use a nested logit structure to link the two levels.

Thus, for example,

$$\Pr[Y_1 = 1] = \frac{\exp(X_1 * \beta_L + I_L * \alpha_L)}{1 + \exp(X_1 * \beta_L + I_L * \alpha_L)},$$

$$\Pr[Y_2 = 1 | Y_1 = 1] = \frac{\exp(X_2 * \beta_{AM-CL})}{1 + \exp(X_2 * \beta_{AM-CL}) + \exp(X_2 * \beta_{Rev-CL})}, \text{ and}$$

$$\Pr[Y_1 = 1 \ \& \ Y_2 = 1] = \Pr[Y_1 = 1] * \Pr[Y_2 = 1 | Y_1 = 1].$$

Where,

(1) α_L is the Inclusive Value Parameter in level 1 to account for the correlation between decisions: $\alpha_L = 1 \Leftrightarrow$ no correlation, and $\alpha_L = 0 \Leftrightarrow$ perfect correlation;

(2) $I_L = \ln[1 + \exp(X_2 * \beta_{AM-CL}) + \exp(X_2 * \beta_{Rev-CL})]$; and

(3) for each lobbying firm, X_2 and X_1 are vectors of explanatory variables for lobbying positions and decisions, respectively.

For the two-level multinomial logit described above, I use full-information maximum likelihood estimation to recover parameter values, while standard errors are the roots of diagonal elements of the inverse Hessian.

Table 1: Summary of Hypotheses

Motivation	No.	Hypothesis	Empirical Proxies	Pred. Sign
<i>Is goodwill impairment in SFAS 142 due in part to pro-poolers?</i>	H1a	Prob. that a congressperson selects into the set pressuring the FASB over pooling increases in <i>PAC contributions received from pro-pooling firms and industry groups.</i>	<i>\$ from pro-pooling PACs / Total PAC receipts & \$ from pro-pooling PACs / Total receipts</i>	+
	H1b	Prob. that a firm supports the Comment Letter Position over the Amortization Position/ Revised ED Position increases with <i>the firm's support for pooling.</i>	AM - CL <i>Pro-Pooling</i> Rev - CL <i>Pro-Pooling</i>	-
<i>Does discretion potential explain firms' support for goodwill impairment?</i>	H2a	Prob. that a firm supports the Comment Letter Position over the Amortization Position/ Revised ED Position increases with <i>the number and size of its reporting-units.</i>	AM - CL <i>Ln(Seg)*Ln(Sales) & Ln(Seg)</i> Rev - CL <i>Ln(Seg)*Ln(Sales) & Ln(Seg)</i>	-
	H2b	Prob. that a firm supports the Comment Letter Position over the Amortization Position increases with <i>its reporting-units' FTB ratios.</i>	AM - CL <i>Abn.MtB & MtB</i>	-
	H2c	Prob. that a firm supports the Comment Letter Position over the Revised ED Position increases with <i>the verifiability of its net assets.</i>	Rev - CL <i>UNA & Mod.UNA.</i>	+
	H2d	Prob. that a firm supports the Comment Letter Position over the Amortization Position increases with <i>its abnormal goodwill-to-assets.</i>	AM - CL <i>Abn.ItA</i>	-
<i>Controls for the self-selection of lobbying firms</i>		Prob. that a firm lobbies increases with firm size	<i>Ln(Sales)</i>	+
		Prob. that a firm lobbies increases with the absolute value of abnormal goodwill-to-assets	<i>|Abn.ItA|</i>	+
		Prob. that a firm lobbies increases with debt contract, compensation contract, and stock pricing concerns	<i>Debt/Asst. & Bonus/Comp. & ERC</i>	+

Variable Definitions

PAC is Political Action Committee. “ $\$ \text{ from pro-pooling PACs} / \text{Total PAC receipts}$ ” is the ratio of a congressperson’s PAC receipts from pro-pooling PACs to her/his receipts from all PACs. “ $\$ \text{ from pro-pooling PACs} / \text{Total receipts}$ ” is the ratio of a congressperson’s PAC receipts from pro-pooling PACs to her/his receipts from all sources (including PACs). AM, Rev and CL refer to the Amortization Position, Revised ED Position, and Comment Letter Position, respectively. When a variable is prefixed with AM - CL (Rev - CL), then the effect of that variable on the choice of Amortization Position (Revised ED Position) over Comment Letter Position is being measured. *Pro-Pooling* is a dummy set to “1” if the firm lobbied for pooling on ED 201 (Original Proposal), “0” otherwise. $\ln(\text{Seg}) * \ln(\text{Sales})$ is the product of the natural logs of the number of business segments in a firm and the firm’s sales. $\ln(\text{Seg})$ is the natural log of the number of business segments in a firm. *Abn.MtB* is the excess of a firm’s Market-to-Book over its size-industry’s average Market-to-Book. *MtB* is the firm’s Market-to-Book ratio. *UNA* is a measure of the unverifiability of net assets, calculated as $-1 * [\text{Cash} + \text{Investments} - \text{Debt} - \text{Preferred Equity}] / [\text{Assets} - \text{Liabilities}]$. *Mod.UNA* is a modified measure of the unverifiability of net assets, calculated as $| (1 - |\text{UNA}|) |$. *Abn.ItA* is the excess of a firm’s Intangibles-to-Assets over its size-industry’s average Intangibles-to-Assets. $\ln(\text{Sales})$ is the log of a firm’s sales. $|\text{Abn.ItA}|$ is the absolute value of *Abn.ItA*. *Debt/Asst.* is the ratio of debt to assets. *Bonus/Comp.* is the ratio of CEO Bonus to total Cash Compensation. *ERC* is the coefficient from regressing a firm’s price on its operating income using at least 16 and up to 20 quarters of data prior to ED 201-R (Revised Proposal). In the definitions above, a firm’s “size-industry” peer-group is all COMPUSTAT observations sharing its sales-quartile rank and its two-digit NAICS code. For a firm, the “size-industry average” value of a given variable is the sales-weighted mean value of that variable within the firm’s “size-industry.” Results are robust to various alternate definitions of “size-industry” and “size-industry average:” see the text.

Table 2
Univariate Test of H1a: Benchmarking Contributions from Pro-Pooling PACs to Pro-Pooling Congresspersons

	Mean		Median	
	Pro-Pooling Congresspersons	Other Congresspersons	Pro-Pooling Congresspersons	Other Congresspersons
<i>\$ from anti-pooling PACs / Total PAC receipts</i>	4.84 % ⁺	3.43 % [#]	4.39 % ⁺	3.00 % [#]
<i>\$ from pro-pooling PACs / Total PAC receipts</i>	13.36 %	8.86 % [*]	14.47 %	8.28 % [*]

For means (medians), *, +, and # indicate that contributions from pro-pooling PACs to pro-pooling congresspersons are statistically greater at the 95% confidence level than contributions from: (i) pro-pooling PACs to other congresspersons; (ii) anti-pooling PACs to pro-pooling congresspersons; and (iii) anti-pooling PACs to other congresspersons, respectively, using a two-sided t test (Wilcoxon two-sample test).

Pro-Pooling Congresspersons are those congresspersons who took a pro-pooling position in at least one of the political events identified in the text. Other Congresspersons are all other members of the 106th Congress (1999-2000). PAC is Political Action Committee. Pro- and anti-pooling PACs are the PACs of firms and industry groups taking pro- and anti-pooling positions, respectively, on ED 201 (Original Proposal). “*\$ from pro-pooling PACs / Total PAC receipts*” is the ratio of a congressperson’s PAC receipts from pro-pooling PACs to her/his receipts from all PACs. A similar definition applies to “*\$ from anti-pooling PACs / Total PAC receipts*.”

Table 3
Multivariate Test of H1a: Probit Regression to Explain Congresspersons' Pro-Pooling Activity with Contributions from Pro-Pooling PACs

	Pred. Sign	(A)		(B)		(C)	
		t-Stat.	Marginal Effect	t-Stat.	Marginal Effect	t-Stat.	Marginal Effect
Control Equation: Dependent Variable for A (B) is: \$ from pro-pooling PACs / Total PAC receipts (Total receipts)							
<i>Intercept</i>		7.84		4.58		4.49	
<i>Ideology1</i>		7.48	6.7%	7.51	6.7%	7.45	6.7%
<i>Ideology2</i>		0.14	0.1%	0.12	0.1%	0.06	0.1%
<i>Committee Membership Dummy</i>		4.72	5.7%	4.74	5.7%	4.74	5.7%
<i>Senator Dummy</i>		2.88	2.9%	3.04	3.0%	2.96	2.9%
<i>Seniority</i>		.	.	0.70	0.5%	0.73	0.6%
<i>State Size</i>		-0.33	-0.3%
<i>Sigma</i>		0.07		0.07		0.07	
Probit Equation: Dependent Variable is "1" if Congressperson supported pooling, "0" otherwise							
<i>Intercept</i>		-6.28		-6.85		-7.08	
<i>\$ from anti-pooling PACs / Total PAC receipts</i>		0.88	2.9%	0.86	2.8%	0.87	2.8%
<i>\$ from pro-pooling PACs / Total PAC receipts</i>	+	3.86	35.3%	3.21	31.3%	2.91	29.5%
<i>Ideology1</i>		-3.16	-19.7%	-2.71	-17.3%	-2.49	-16.2%
<i>Ideology2</i>		-1.99	-9.3%	-2.05	-8.9%	-2.07	-8.6%
<i>Committee Membership Dummy</i>		0.92	16.1%	1.05	18.9%	1.10	19.8%
<i>Rho</i>		-0.68		-0.63		-0.61	
Log likelihood		686		686		686	
No. of Observations		498		498		498	

Values for Sigma and Rho are parameter estimates; these estimates are statistically significant at the 95% confidence level in all specifications.

Variable Definitions

Pro-Pooling Congresspersons (Dependent Variable = 1 in the Probit Regression) are those congresspersons who took a pro-pooling position in at least one of the political events identified in the text. Other Congresspersons are all other members of the 106th Congress (1999-2000). PAC is Political Action Committee. Pro- and anti-pooling PACs are the PACs of firms and industry groups taking pro- and anti-pooling positions, respectively, on ED 201 (Original Proposal). “*\$ from pro-pooling PACs / Total PAC receipts*” is the ratio of a congressperson’s PAC receipts from pro-pooling PACs to her/his receipts from all PACs. A similar definition applies to “*\$ from anti-pooling PACs / Total PAC receipts*.” Ideology1 and Ideology2 are the two dimensions of congresspersons’ ideologies (Common Space Scores) described in Poole (1998). Committee Membership Dummy is “1” for congresspersons who are members of the House Finance Subcommittee/ Senate Banking Committee. Senator Dummy is “1” for congresspersons who are members of the Senate, “0” for members of the House. Seniority is the natural log of the number of years the congressperson has spent in her/his current chamber. State Size is the ratio of the congressperson’s state GDP to U.S. GDP. Sigma is the estimated standard deviation of the error term in the control equation (required for identification because the dependent variable in this equation is truncated). Rho is the estimated correlation between the error terms of the control and probit equations. The marginal effect of a continuous variable is the change in outcome probability when the continuous variable is increased from one standard deviation below its mean value to one standard deviation above its mean value. The marginal effect of a dummy variable is the change in outcome probability when the dummy variable is increased from zero to one. When calculating the marginal effect of a given variable, all other variables are set to their mean values.

Table 4
Distribution of Firms across Lobbying Positions

		Original Proposal (201)			Total
		Anti-Pooling	Pro-Pooling	Didn't Lobby	
Revised Proposal (201-R)	Amortization Position	5	5	28	38
	Revised ED Position	8	8	35	51
	Comment Letter Position	8	18	19	45
	Didn't Lobby	21	31		
Total		42	62		

Support for the Amortization Position indicates support for continued goodwill amortization (i.e. opposition to the ED's impairment approach). Support for the Revised ED Position indicates support for both goodwill impairment and the ED's testing method. Under this method, a reporting-units' fair value of goodwill is the difference between the unit's total fair value and the fair value of its net assets. Support for the Comment Letter Position indicates support for goodwill impairment, but opposition to the testing method. Instead, these managers proposed tests based on the book values of net assets in reporting units.

Table 5A
Univariate Test of H1b and H2: Discretion Proxies across Lobbying Positions on ED 201-R (Revised Proposal)

		Means			Medians		
		Amortization Position <i>N=30</i>	Revised ED Position <i>N=42</i>	Comment Letter Position <i>N=43</i>	Amortization Position <i>N=30</i>	Revised ED Position <i>N=42</i>	Comment Letter Position <i>N=43</i>
H2a	<i>Ln(Seg)*Ln(Sales)</i>	15.781	13.789	17.030	15.688	12.804	17.562
	<i>Ln(Seg)</i>	1.722	1.544	1.775	1.792	1.609	1.792
H2b	<i>Abn.MtB</i>	0.019	2.484	3.374	-1.081	-0.097	0.984
	<i>MtB</i>	3.147	5.569	6.360	2.195	2.874	3.715
H2c	<i>UNA</i>	0.454	2.417	0.221	0.352	0.769	0.447
	<i>Mod.UNA</i>	0.690	2.847	0.970	0.753	<u>0.816</u>	0.535
H2d	<i>Abn.ItA</i>	<u>-0.018</u>	0.062	0.046	-0.040	0.020	0.003
H1b	<i>Pro-Pooling</i>	13%	17%	40%			
	<i>Oppsd.Ind.Assn.</i>	87%	2%	63%			

For means (medians), boldface and underlined figures in the Amortization Position and Revised ED Position columns are significantly different at the 95% and 90% confidence levels, respectively, from corresponding figures in the Comment Letter Position column using a one-sided t test (Wilcoxon two-sample test).

Variable Definitions

Support for the Amortization Position indicates support for continued goodwill amortization (i.e. opposition to the ED's impairment approach). Support for the Revised ED Position indicates support for both goodwill impairment and the ED's testing method. Under this method, a reporting-units' fair value of goodwill is the difference between the unit's total fair value and the fair value of its net assets. Support for the Comment Letter Position indicates support for goodwill impairment, but opposition to the testing method. Instead, these managers proposed tests based on the book values of net assets in reporting units. $Ln(Seg)*Ln(Sales)$ is the product of the natural logs of the number of business segments in a firm and the firm's sales. $Ln(Seg)$ is the natural log of the number of business segments in a firm. $Abn.MtB$ is the excess of a firm's Market-to-Book over its size-industry's average Market-to-Book. MtB is the firm's Market-to-Book ratio. UNA is a measure of the unverifiability of net assets, calculated as $-1*[Cash + Investments - Debt - Preferred Equity] / [Assets - Liabilities]$. $Mod.UNA$ is a modified measure of the unverifiability of net assets, calculated as $|(1 - |UNA|)|$. $Abn.ItA$ is the excess of a firm's Intangibles-to-Assets over its size-industry's average Intangibles-to-Assets. $Pro-Pooling$ is a dummy set to "1" if the firm lobbied for pooling on ED 201 (Original Proposal), "0" otherwise. $Oppsd.Ind.Assn$ is a dummy set to "1" if the firm's industry association took a position different from that of the firm, "0" otherwise. In the definitions above, a firm's "size-industry" peer-group is all COMPUSTAT observations sharing its sales-quartile rank and its two-digit NAICS code. For a firm, the "size-industry average" value of a given variable is the sales-weighted mean value of that variable within the firm's "size-industry." All ratios are winsorized at the 1st and 99th percentile of size-industry values. Results are robust to various alternate definitions of "size-industry" and "size-industry average:" see the text.

Table 5B
Descriptive Statistics for Lobbyists v. Non-Lobbyists on ED 201-R (Revised Proposal)

	Mean		Median		N	
	Non-Lobbying Firms	Lobbying Firms	Non-Lobbying Firms	Lobbying Firms	Non-Lobbying Firms	Lobbying Firms
<i>Ln(Sales)</i>	4.403	9.079	4.393	9.262	8797	115
<i>|Abn.ItA|</i>	0.103	0.109	0.071	0.077	8797	115
<i>Debt/Asst.</i>	0.408	0.391	0.279	0.286	8797	113
<i>Bonus/Comp.</i>	0.362	0.532	0.395	0.560	1658	98
<i>ERC</i>	17.979	25.079	9.186	18.960	3743	94
<i>Lobb.Orig.ED</i>	<1%	42%			8797	115

For means (medians), boldface figures in the Non-Lobbying Firms column are significantly different at the 95% confidence level from corresponding figures in the Lobbying Firms column using a one-sided t test (Wilcoxon two-sample test).

Ln(Sales) is the log of a firm's sales. *|Abn.ItA|* is absolute value of the excess of a firm's Intangibles-to-Assets over its size-industry's Intangibles-to-Assets. *Debt/Asst.* is the ratio of debt to assets. *Bonus/Comp.* is the ratio of CEO Bonus to total Cash Compensation. *ERC* is the coefficient from regressing a firm's price on its operating income using at least 16 and up to 20 quarters of data prior to ED 201-R. *Lobb.Orig.ED* is a dummy set to "1" if the firm filed a comment letter on ED 201, "0" otherwise. In the definitions above, a firm's "size-industry" peer-group is all COMPUSTAT observations sharing its sales-quartile rank and its two-digit NAICS code. For a firm, the "size-industry average" value of a given variable is the sales-weighted mean value of that variable within the firm's "size-industry." All ratios are winsorized at the 1st and 99th percentile of size-industry values. Results are robust to various alternate definitions of "size-industry" and "size-industry average:" see the text.

Table 5C
Distribution of Firms by Industry and Lobbying Positions on ED 201-R (Revised Proposal)

	Revised ED (201-R)			Total
	Amortization Position	Revised ED Position	Comment Letter Position	
Finance and Insurance	8	15	12	35
Information	3	4	3	10
Manufacturing	19	18	21	58
Trade	3	3	1	7
Transport and Storage	0	4	0	4
Utilities	2	1	4	7
Other Services	3	4	3	10
All Other	0	2	1	3
Total	38	51	45	134
Fisher's Exact Test (Freeman-Halton)	Table P 9.16E-10	Prob. <= P 0.6209		

Smaller p-values support the alternative hypothesis of association between row and column variables.

See Table 5A for a description of the positions.

Table 6A
Multivariate Test of H1b and H2: Two-Level Nested Multinomial Logit to Explain Firms' Lobbying Decisions and Lobbying Positions

Figures in the table are t-statistics.

	Predicted	(1)	(2)	(3)	(4)	(5)	(6)	
Level 1	<i>Intercept</i>		-12.741	-13.487	-12.760	-12.923	-9.970	-8.566
	<i>Ln(Sales)</i> +		8.408	8.040	8.405	8.519	7.726	5.722
	<i>|Abn.ItA|</i> +		1.295	1.079	1.270	1.527	0.062	-0.322
	<i>Debt/Asst.</i> +		.	.	.	.	-0.693	-0.700
	<i>Bonus/Comp.</i> +		.	.	.	.	.	2.124
	<i>ERC</i> +		.	.	.	.	0.631	0.480
	<i>Lobb.Orig.ED</i>		8.922	9.221	8.912	8.543	8.113	7.664
Level 2: AM – CL	<i>Intercept</i>		5.564	3.564	5.814	6.031	4.407	3.540
	<i>Ln(Seg)*Ln(Sales)</i> -	H2a	-4.564	.	-4.478	-4.369	-4.425	-3.442
	<i>Ln(Seg)</i> -		.	-2.563	.	.	.	.
	<i>Abn.MtB</i> -	H2b	-2.714	-2.790	.	-2.940	-2.293	-1.329
	<i>MtB</i> -		.	.	-2.611	.	.	.
	<i>UNA</i>		1.011	0.462	0.971	.	1.241	1.565
	<i>Mod.UNA</i>		.	.	.	-0.783	.	.
	<i>Abn.ItA</i> -	H2d	-2.307	-1.796	-2.295	-2.213	-3.175	-2.073
	<i>Pro-Pooling</i> -	H1b	-3.960	-4.181	-4.067	-3.566	-2.601	-2.464
	<i>Oppsd.Ind.Assn</i>		2.134	2.224	2.276	2.115	1.276	0.816
Level 2: Rev – CL	<i>Intercept</i>		7.390	5.106	7.047	7.559	7.086	6.153
	<i>Ln(Seg)*Ln(Sales)</i> -	H2a	-4.624	.	-4.563	-4.311	-5.102	-4.029
	<i>Ln(Seg)</i> -		.	-2.914	.	.	.	.
	<i>Abn.MtB</i>		0.105	0.104	.	-0.614	0.018	0.237
	<i>MtB</i>		.	.	0.594	.	.	.
	<i>UNA</i> +	H2c	3.539	3.034	3.539	.	3.866	3.718
	<i>Mod.UNA</i> +		.	.	.	0.700	.	.
	<i>Abn.ItA</i>		-0.641	0.661	-0.470	-0.083	-0.540	-0.099
	<i>Pro-Pooling</i> -	H1b	-3.344	-3.829	-3.617	-2.800	-3.018	-3.040
<i>Oppsd.Ind.Assn</i>		-4.160	-4.245	-4.123	-3.887	-4.613	-4.455	
Inclusive Value Estimate		1.000	1.000	1.000	1.000	1.000	1.000	
Pseudo R2		0.705	0.689	0.705	0.696	0.684	0.625	
Level 1 No. of Obs.		8912	8912	8912	8912	3835	1435	
Level 2 No. of Obs.		115	115	115	115	92	86	

This table presents the results of tests of H1b and H2. The determinants of firms' lobbying positions (level 2) are modeled using a multinomial logit, while firms' lobbying decisions (level 1) are modeled using a binary logit. Y1, the dependent variable in level 1, is "1" if a firm lobbies on the ED 201-R (revised proposal), and "0" if it does not. Y2, the dependent variable in H2 is "1" if the firm supports the Amortization Position, "2" if the firm supports the Revised ED Position, and "3" if the firm supports the Comment Letter Position.

Variable Definitions

Level 1: $\ln(\text{Sales})$ is the log of a firm's sales. $|\text{Abn.ItA}|$ is absolute value of the excess of a firm's Intangibles-to-Assets over its size-industry's Intangibles-to-Assets. Debt/Asst. is the ratio of debt to assets. Bonus/Comp. is the ratio of CEO Bonus to total Cash Compensation. ERC is the coefficient from regressing a firm's price on its operating income using at least 16 and up to 20 quarters of data prior to ED 201-R. Lobb.Orig.ED is a dummy set to "1" if the firm filed a comment letter on ED 201, "0" otherwise.

Level 2: AM, Rev, and CL refer to the Amortization Position, Revised ED Position, and Comment Letter Position, respectively. When a variable is prefixed with AM - CL (Rev - CL), then the effect of that variable on the choice of Amortization Position (Revised ED Position) over Comment Letter Position is being measured. $\ln(\text{Seg}) * \ln(\text{Sales})$ is the product of the natural logs of the number of business segments in a firm and the firm's sales. $\ln(\text{Seg})$ is the natural log of the number of business segments in a firm. Abn.MtB is the excess of a firm's Market-to-Book over its size-industry's average Market-to-Book. MtB is the firm's Market-to-Book ratio. UNA is a measure of the unverifiability of net assets, calculated as $-1 * [\text{Cash} + \text{Investments} - \text{Debt} - \text{Preferred Equity}] / [\text{Assets} - \text{Liabilities}]$. Mod.UNA is a modified measure of the unverifiability of net assets, calculated as $| (1 - |\text{UNA}|) |$. Abn.ItA is the excess of a firm's Intangibles-to-Assets over its size-industry's average Intangibles-to-Assets. Pro-Pooling is a dummy set to "1" if the firm lobbied for pooling on ED 201 (Original Proposal), "0" otherwise. Oppsd.Ind.Assn is a dummy set to "1" if the firm's industry association took a position different from that of the firm, "0" otherwise.

In the definitions above, a firm's "size-industry" peer-group is all COMPUSTAT observations sharing its sales-quartile rank and its two-digit NAICS code. For a firm, the "size-industry average" value of a given variable is the sales-weighted mean value of that variable within the firm's "size-industry." All ratios are winsorized at the 1st and 99th percentile of size-industry values. Results are robust to various alternate definitions of "size-industry" and "size-industry average:" see the text. *Inclusive Value* accounts for the correlation between the two levels: see Appendix 3.

Table 6B
Marginal Effects of Independent Variables in Table 6A

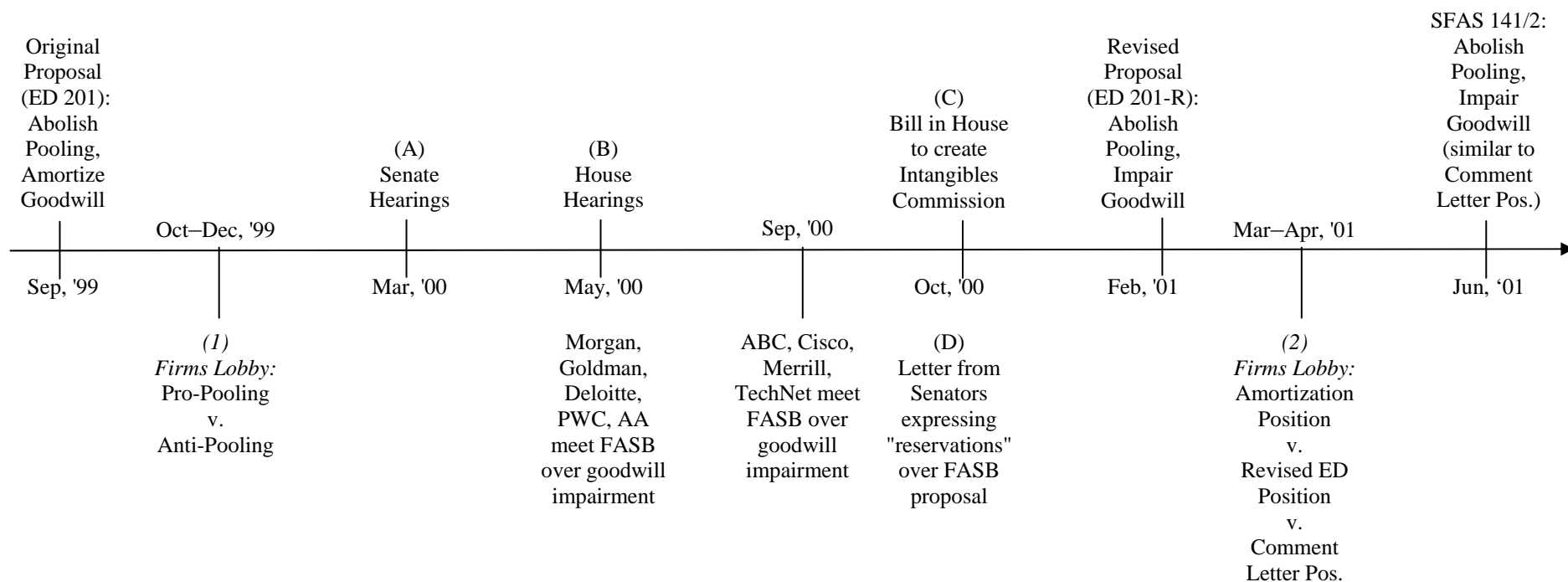
Figures in the table are percentage changes in outcome probabilities.

		Predicted	(1)	(2)	(3)	(4)	(5)	(6)	
Δ Pr[Y1 = 0]; independent variables at 90th percentile									
Level 1	<i>Ln(Sales)</i>	-	-6.6	-7.0	-6.4	-6.0	-5.6	-17.5	
	<i>|Abn.ItA|</i>	-	-3.8	-3.1	-3.6	-3.8	-0.2	2.3	
	<i>Debt/Asst.</i>	-	.	.	.	.	3.3	5.7
	<i>Bonus/Comp.</i>	-	.	.	.	.	.	-12.3
	<i>ERC</i>	-	.	.	.	.	-1.5	-3.1
	<i>Lobb.Orig.ED</i>	-	-67.1	-68.4	-66.9	-64.2	-64.4	-62.7	
Δ Pr[Y1 = 1, Y2 = 1]; independent variables at means									
Level 2: AM - CL	<i>Ln(Seg)*Ln(Sales)</i>	-	-18.8	.	-17.7	-15.8	-10.9	-14.4	
	<i>Ln(Seg)</i>	-	H2a	.	-9.0	.	.	.	
	<i>Abn.MtB</i>	-	-21.1	-22.2	.	-20.4	-9.2	-13.7	
	<i>MtB</i>	-	H2b	.	.	-20.0	.	.	
	<i>UNA</i>		2.2	0.0	1.8	.	1.1	3.7	
	<i>Mod.UNA</i>		.	.	.	-12.1	.	.	
	<i>Abn.ItA</i>	-	H2d	-11.3	-8.1	-11.0	-9.2	-10.7	-15.5
	<i>Pro-Pooling</i>	-	H1b	-9.0	-8.4	-9.0	-7.6	-3.2	-9.6
	<i>Oppsd.Ind.Assn</i>		10.4	10.3	10.8	8.3	4.4	10.5	
	Δ Pr[Y1 = 1, Y2 = 2]; independent variables at means								
Level 2: Rev - CL	<i>Ln(Seg)*Ln(Sales)</i>	-	-29.0	.	-28.0	-20.5	-41.9	-44.9	
	<i>Ln(Seg)</i>	-	H2a	.	-18.1	.	.	.	
	<i>Abn.MtB</i>		2.2	2.4	.	-2.5	0.8	7.1	
	<i>MtB</i>		.	.	5.5	.	.	.	
	<i>UNA</i>	+	52.6	47.9	53.6	.	75.7	81.5	
	<i>Mod.UNA</i>	+	H2c	.	.	.	7.5	.	
	<i>Abn.ItA</i>		-2.4	3.8	-1.5	-0.2	2.2	1.7	
	<i>Pro-Pooling</i>	-	H1b	-11.3	-12.9	-11.4	-8.4	-12.3	-26.3
	<i>Oppsd.Ind.Assn</i>		-43.1	-44.9	-44.4	-32.3	-47.1	-69.3	

Marginal effects in boldface are statistically significant at the 95% confidence level (one tail test). The marginal effect of a continuous variable is the change in outcome probability when the continuous variable is increased from one standard deviation below its mean value to one standard deviation above its mean value. The marginal effect of a dummy variable is the change in outcome probability when the dummy variable is increased from zero to one. When calculating the marginal effect of a given variable, all other level 2 variables are set to their mean values, while all other level 1 variables are set to their 90th percentile value.

See Table 6A for variable definitions.

Figure 1: Hypotheses in the Timeline of Events Leading Up To SFAS 142



H1a: Are congressional positions in (A)–(D) associated with PAC money from pro-poolers in (1)?

H1b: Are pro-pooling firms from (1) among supporters of the Comment Letter Position in (2)?

H2a-d: Can lobbying positions in (2) be explained by discretion proxies?

See Table 1 for variable definitions.

Figure 2
Implied Fair Value of Goodwill Under the Revised ED Position and the Comment Letter Position

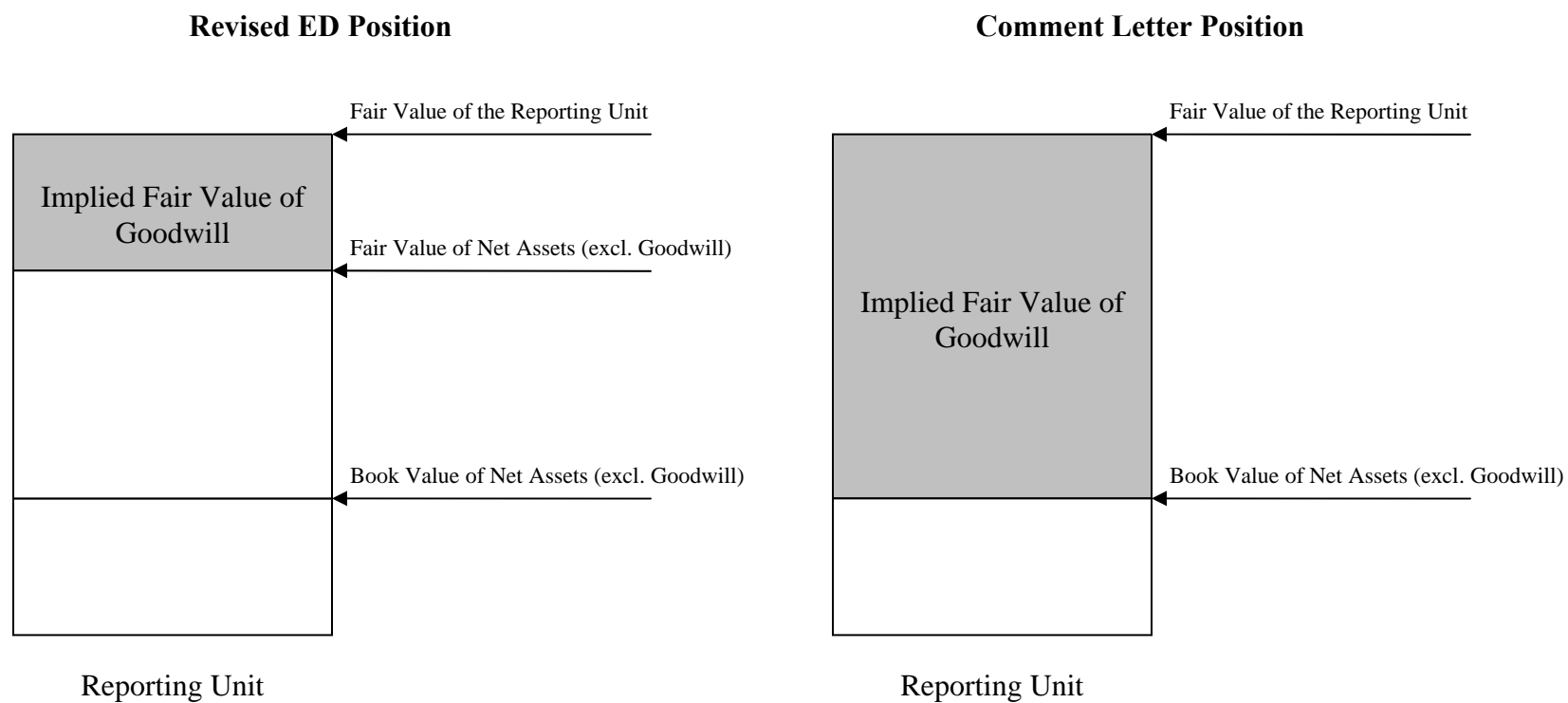


Figure 3
Abnormal MTB, Intangibles, and Impairments post SFAS 142

