

A CRITICAL ANALYSIS OF THE USE OF ACCOUNTING
STANDARDS' COMMENT LETTERS AS LOBBYING TOOLS
BY EXTRACTIVE INDUSTRY FIRMS

AYODELE OSHOKAMERE ASEKOMEH
GLASGOW CALEDONIAN UNIVERSITY
GLASGOW, SCOTLAND

ALEX RUSSELL
GLASGOW CALEDONIAN UNIVERSITY
GLASGOW, SCOTLAND

HEATHER TARBERT
GLASGOW CALEDONIAN UNIVERSITY
GLASGOW, SCOTLAND

Accounting scandals associated with Enron and Shell (see Largay, 2002; Healy and Palepu, 2003; Hoyos *et al.*, 2004; and Bickerton *et al.*, 2004) have brought the reporting practices of the international oil and gas industry into the public arena. Current international GAAP allows companies to choose either the full cost (FC) or the successful efforts (SE) method to report the results of their exploration and production activities. These methods are conceptually different and produce radically divergent reported results. Consequently, it is not surprising that recently the predecessor of the International Accounting Standards Board (IASB), the IASC, published an issues paper (IASC, 2000) that highlighted matters requiring resolution in order to develop a substantive accounting standard for the extractive industries. Its main purpose was to encourage convergence on a single historical cost accounting method for the extractive industries. Since the accounting method adopted determines the timing, recognition, and amortization of exploration and development costs, it follows that method choice inherently confers some discretionary control over capitalized expenditures and thereby empowers managers to engage in income management. This research does not attempt to judge whether this empowerment is beneficial for the industry or for society. Its importance is that it formally tests for lobbying behavior that maintains this empowerment. Standard setters and the market must then consider the consequences of this result. In addition, it provides a basis for further research into the income management practices of the industry.

A similar attempt¹ by the U.S.'s Financial Accounting Standards Board (FASB) had failed some thirty years previously and it is not surprising that history has, temporarily at least, repeated itself; IFRS 6, the eventual interim accounting standard issued by the IASB, has opted to retain both methods.² IFRS 6 (IASB, 2004) requires an entity to determine a policy for consistently specifying those expenditures to be recognized as exploration and evaluation (E&E) assets. Current acceptable policies include recognizing all such costs (FC) or only costs associated with specific discovery of "commercial" reserves (SE). The accounting policy adopted by entities for treating E&E expenditure will help determine the magnitude of reported current and future period earnings. Thus, choice of policy may be used to manage income.

This paper argues that the extractive industry used comment letters as lobbying tools as a means of postponing the development of a substantive standard and that the motivation for the lobbying was to maintain the ability to manage reported income figures.³ There is a burgeoning literature on income management practices of companies. For example, income smoothing as one form of systematic income management that has been intensively, if not conclusively, researched (see for instance, Ronen and Sadan, 1981; Schipper, 1989; Beattie *et al.*, 1994; Fudenberg and Tirole, 1995; Healy and Wahlen, 1999; Dechow and Skinner, 2000; McNichols, 2000; and Bao and Bao, 2004).

¹ This unsuccessful attempt by the FASB spawned a series of research studies on the full cost versus successful efforts methods issue. These studies have been well documented and commented upon (see Dyckman and Smith, 1979; Collins and Dent, 1979; Lev, 1979; Deakin, 1979; Collins *et al.*, 1982; Doran *et al.*, 1988; Clinch and Magliolo, 1992; Alciatore, 1993; Bandyopadhyay, 1994; and Bryant 2003). One possible summary of the outcome of the research is that the extant research, on balance, supports the use of the SE method for producing market relevant information. Proponents of the FC method can, however, draw comfort from the inconclusive nature of the evidence. The case for requiring a single method to be used throughout the industry then seems to rest on the desirability of having a consistent accounting practice throughout the extractive industry.

² In its defense the IASB has stated that IFRS 6 is an interim standard and that a more comprehensive project has to be undertaken before a definitive standard can be issued to cover all the accounting issues that face the extractive industries. However, since the development of such a standard has been on the agenda since 1998, it may be a long time before IFRS 6 is updated.

³ The phrase income management is not used in a pejorative manner but is to be interpreted as management using their legitimate discretionary powers over accounting decisions to present their accounts in a favorable light.

Accounting Standards Lobbying Literature

Accounting standard setting processes, to the extent that they would evolve a pseudo-prescriptive set of accounting rules, bring changes (including costs and/or benefits) to stakeholders. The benefits or costs that are perceived to be associated with a proposed accounting standard provide a rationale for stakeholders to participate in the standard setting process by, *inter alia*, commenting on the exposure drafts of standards; participants see this participation as a political lobbying tool that can influence the economic impact of the accounting rules (Sutton, 1984).

Deakin (1989) chronicled the controversies surrounding the earlier proposal to eliminate the FC method and the impact lobbying had on the FASB's pronouncements on the issues. Watts and Zimmerman (1978) advanced a positive accounting theory in which stakeholders attempted to influence regulatory pronouncements through lobbying behavior. This approach is consistent with agency theory (see Jensen and Meckling, 1976 and Fama, 1980) and the theory of rational behavior (see Klein, 1946), which suggest that each stakeholder group would attempt to influence the standard setter's decisions in a way that maximises its own interests relative to those of other stakeholders.

Georgiou (2004) noted that lobbyists could employ direct means, such as comment letters or speaking at public hearings, or indirect means, such as soliciting media/auditor support or sponsoring research studies for a particular point of view. He criticized the over-dependence on comment letters in previous research, choosing to use a questionnaire to reveal usually undisclosed or unobservable indirect lobbying methods. However, it is doubtful, as pointed out in the study, that responses to questions on covert lobbying would not be biased; respondents are likely to give answers that show them as acting in the public interest (*ibid*, 220). This observation supports the view that comment letters and transcripts of public hearings provide one of the most reliable forms of evidence for lobbying studies. Many academics researching into the issue proceed by examining hypotheses or developing models that explore a dimension of interest or a particular feature of the lobbying process. For example, Sutton (1984) hypothesized about the characteristics of lobbyists; Georgiou (2004) tested the methods, timing, and perceived effectiveness of lobbying; Larson (1997) crafted hypotheses to explore the characteristics of corporations that lobby the IASC, while Chung (1999) formulated a game-theoretic model to investigate the potential for lobbying itself to reveal useful information about the lobbying organization. Several major studies have attempted to apply the knowledge gained from observing features of the

lobbying process and the characteristics of lobbyists to obtain a better understanding of the ramifications of lobbying. Thus, O'Keefe and Soloman (1985), MacArthur (1988), Tutticci *et al.* (1994), and Weetman *et al.* (1996) have employed methods that examine the form and meaning of comment letters as a means of understanding how the dialectic is deemed to advance the course of the method being supported.

Empirical Approach

The extractive industries issues paper (IASB, 2000) sought to elicit comments that would facilitate the issuance of a substantive accounting standard. The Steering Committee held a tentative view that favored adoption of a method more consistent with the SE concept. Four years of uncertainty passed before the IASB decided it needed more time to develop the substantive standard. Their interim solution was to issue IFRS 6, a standard restricted to considering the accounting treatment of exploration and evaluation expenditure, and which essentially allows companies to continue with their current policies. Basically, the IASB invited comments on a proposal to limit the income management possibilities of the extractive industries. Logically, one would expect the industry to react in a way that preserves their discretionary powers to manage their income. This paper proceeds on the perception that comments during public hearings or reactions to accounting standard issues papers and exposure drafts are likely to convey companies' interpretations of how the issues paper's proposals might restrict their existing income management strategies. So long as reasons for lobbying are not camouflaged or withheld for other considerations (MacArthur, 1985) lobbyists' comments may reveal their accounting policy preferences (Chung, 1999).

Consequently, it seemed appropriate to perform a methodological *content analysis* of the comment letters to test the available evidence for income management intentions.⁴ This examination of indirect expressions of accounting choice preferences as a proxy for income management intent is likely to complement existing research approaches, improve understanding of

⁴ Schipper (1989) notes that empirical evidence in prior research on "whether earnings are managed is suggestive but not conclusive." However, she speculates that "if a set of regulations leads to a particular form of earnings management, changes in regulations should lead to predictable changes in earnings management behavior." To help users of reports converge on the true economic income, the subject area is likely to continue to profit from studies into better ways of segregating the income management impact of price and accounting regulation changes.

the standard-setting process and extend the literature on income management. The absence of, or difficulty of confirming, management's *a priori* intentions to serve as a benchmark for assessing income management limits the scope for employing accruals-based modelling research methods using historical data (de Albornoz and Alcarria, 2003). Models may be improved by incorporating the most pertinent indicators of management intent to manage income streams.

Fifty-two comment letters were received on the extractive industries issues paper. These are publicly available on the IASB's website (www.iasb.org). There is a strong case for the use of comment letters in this kind of research in that the data are obtained unobtrusively, and there is a high likelihood of the letters conveying actual management behavior. However, the problem of sampling imperfection (only entities that responded to the issues paper are captured) and measurement errors arising from interpretation of non-standard responses in comment letters must be considered.⁵

In line with the approach of prior studies (O'Keefe and Soloman 1985, MacArthur, 1988, Tutticci *et al*, 1994 and Weetman *et al* 1996) a review of the issues paper was carried out to provide themes for performing a content analysis of the comment letters. The research calculus adopted was to compare responses against the Steering Committee's (benchmark) tentative views on key accounting issues, using the degree of support for or objection to the proposals as an indication of the lobbying effort.

Due to the size⁶ of the issues paper, the review was restricted to issues that were deemed to have a bearing on income management, i.e., matters relating to historical cost method choice, method of depreciation of E&E assets, and the impairment test to be performed on such assets. "Extractive industries" as used in the issues paper encompassed the mining and petroleum (oil and gas) industries, which were considered to involve the same set of considerations to warrant treatment in a single accounting standard.

⁵ Although the use of questionnaires would provide an alternative approach that obviates the above shortcomings of comment letters, it is possible that the resultant analysis would capture "altered" management behavior where responses are given to convey a socially responsible outlook (Georgiou, 2004).

⁶ The issues paper (IASB, 2000) consists of 16 chapters dealing with a wide range of issues, from E&E terminologies to measurement units and from asset recognition to reserves disclosures and provision for future site clean-up costs.

The historical cost accounting concepts and the discretionary accrual implications of each were discussed in Chapters 4, 6, 7, and 9 of the issues paper. The differences in selecting among historical cost accounting methods can be summed up in five fundamental issues (IASB, 2000, 76):

1. The degree of relationship that should exist between a specific cost and specific mineral reserves to warrant treating the cost as an asset (Chapter 4).
2. The categorization scheme (cost centers) for pooling costs and for matching the results of extractive industries activities to costs expended in the relevant cost centers (Chapter 6).
3. Types of costs that should be capitalized at each phase of activity of the extractive industries (Chapter 6).
4. The method of depreciation to be applied to capitalized costs (Chapter 7).
5. The modality for measuring impairment of capitalized costs (Chapter 9). This relates to managerial judgment about recoverability of investment from assets and the ability (and timeframes) to reinstate previous impairments when new facts emerge about the nature of E&E assets.

Content analysis facilitates inferential interpretation of a communication or message (textual in this case) following an objective and systematic (often quantitative) identification of specified characteristics of the message (Berelson, 1952; Holsti, 1969). Building on approaches previously adopted in lobbying research by O'Keefe and Soloman (1985), MacArthur (1988), Tutticci *et al.* (1994), and Weetman *et al.* (1996), the extent and intensity of lobbying, defined as the level of objection to particular aspects of the issues paper, were used as indicators of the perceived importance attached to the income management potentials of the issues.

The comment letters were catalogued into country, sub-sector (mining or oil and gas), and type (companies, audit firms, umbrella organizations, etc.) of respondent. This analysis, in line with previous studies (Sutton, 1984; Larson, 1997; and Georgiou, 2004), provides a background of the characteristics of the respondents. Of the 52 replies received (from national accounting bodies, professional accounting firms, and individuals), 23 responses were from extractive industries firms. The relatively small number of responses available for analysis means that there are limitations as to the generalization of findings. However, this limitation is offset by the fact that the data were obtained unobtrusively, which eliminates management gaming bias that would lead to a distorted view of the distribution (Chung, 1999 and Georgiou, 2004).

Specification and Test of Research Hypothesis

The paper addressed the question of whether the intensity of lobbying (L) could be explained by managerial intent to manage income either by maintaining current strategies or seeking to protect future income management possibilities. If the assumption that the proposed standard would eliminate or minimize income management is valid, then it may follow that severe opposition to the issues paper proposals would imply a high propensity to manage income. If L is a proxy for the entire lobbying effort, the relative support or opposition by respondents to each of the identified issues can be classified using a subjective evaluation scale of one to five (developed by Weetman *et al*, 1996) relative to the Steering Committee's views:

1. Support for principles, with few minor comments or additional suggestions.
2. Support for principles, but reservations with particular aspect.
3. Broad support for principles, but substantial reservations.
4. Severe reservations with major aspects of the proposals.
5. Fundamental objections to proposals.

However, since comments agreeing [disagreeing] with the Steering Committee's views are expressed with the intention of making the Committee establish [change/flex] such views, the emphasis is not on the degree by which comments conform with [deviate from] the tentative views, as Weetman *et al* 1996 evaluation scale would suggest, but rather on the extent to which registering such views represent a "vote" in support of [against] the Steering Committee's position. Therefore, L was partitioned into a dichotomous variable with value of either [0] for "support" or [1]⁷ for "objection" to the proposals. This partitioning enabled an analysis to be undertaken based on the treatment of the responses as a "voting" scenario (see Sutton's (1984) extension of Downsian single-period voting model to lobbying considerations (Downs, 1957)). Using O'Keefe and Soloman's (1985) 'meaning-oriented' content analysis, responses of the 23 firms to questions asked in relation to the issues 4, 5, 6, 7, 8, and 9⁸ were analyzed and categorized as either supporting

⁷ Since intensive lobbying is seen as an objection to the proposals, the reference category is coded to have value "1" for the instances to be observed (in this case objection).

⁸ Issues 4, 6, 7, 8, and 9 have already been introduced above. Issue 5 relates to the question about the relative desirability of historical costs methods and value-based concepts of accounting for preproduction activities. These issues appear in the chapters of the issues paper with the corresponding numbers respectively.

or objecting to the Steering Committee's position. For this purpose, Weetman *et al.*'s (1996) scale items 3-5 are taken to mean an objection to the proposal item concerned. Arguably, this approach reduces the level of subjectivity in the analysis by making it easier to segregate responses on this basis.

Discussion and Interpretation of Results

Sample Descriptive

The broad summaries of the responses are presented in Tables 1–3. Table 1 presents the distribution of respondents by geographical location of respondent firms or organizations. Table 2 categorizes respondents as firms, accounting boards/institutes, or representative organizations. Table 3 classifies respondents according to whether they are purely mining, petroleum industry firms/affiliates, or both.

Table 1
Geographical Distribution of Respondents

Continent	Frequency	Percent
North America	8*	15.4
Europe	19	36.5
Africa	8	15.4
Australia	12	23.1
South America	1	1.9
Asia	4	7.7
Total	52	100.0

**Includes two submissions from the same entity*

Table 2
Affiliations of Respondents

Respondent's affiliation	Frequency	Percent
Industry – extractive activities	23*	42.3
Public practice accountants	4	7.7
Industry – analysts and affiliates	3	7.7
Individuals – Academics and non-	2	3.8
Representative bodies – accounting	13	25.0
Representative bodies – non-	7	13.5
Total	52	100.0

**See note to Table 1*

Table 3
Extractive Industry Sector Addressed by Respondents

Sub-sector	Frequency	Percent
Mining	13	25.0
Petroleum	14*	26.9
Combined	25	48.1
Total	52	100.0

**See note to Table 1*

From Table 1 it can be seen that the greatest participation in the process is by American and European entities, which may reflect the developed nature of their accounting regulatory activities/processes and their long history of openness in standard-setting processes. The participation by African entities can be explained by the high importance attached to mineral resources and the politics of resource control in these countries (especially South Africa and Zimbabwe) where solid minerals form the greatest contributor to gross domestic product of their economies. Table 2 shows the diversity in affiliations of responding bodies, confirming that various stakeholders take part in the accounting standard-setting process with a view to safeguarding their interests. Table 3 also confirms an adequate representation of the sub-industries subsumed by the proposals of the issues paper.

Lobbying Intensity and Income Management Intent

Table 4 summarizes the “voting” pattern in respect of the issues reviewed for which the Steering Committee had a tentative view. Based on the dichotomous (“support” versus “objection”) classification of responses, the indicated means represent the percentage of firms that objected (“objection” = 1) to the indicated Steering Committee’s tentative views in each case. There is a high correlation⁹ between the two pairs of statistics for the entire population of respondents (N=52) and the subgroup of firm respondents (N=23) respectively. In each case, the number of votes does not equal the population (or subpopulation) numbers because not all respondents provided an opinion about every issue. The issues with firm objection percentages greater than a third of the sample are shown in **bold** font, together with the relevant firm-sample mean.

From Table 4 it can be seen that respondents objected most to the recommendations relating to the treatment of costs incurred in the exploration and evaluation (E&E) phase of the exploitation of mineral reserves. E&E costs can be substantial, and their treatment can impact dramatically on reported performance in particular accounting periods. Consequently, the opposition¹⁰ to the proposed restriction of choice in this area is consistent with a desire to maintain an earnings management capability.

⁹ $r = 0.936$, t -statistic = -2.712 , both significant at 5% level.

¹⁰ The most significant objections (from the perspective of responding firms – the descriptive statistics block on the right side of Table 4) relate to the costs of (middle stage) post-acquisition or preproduction costs (issues 6.4 – 6.7, highlighted in Table 4).

Table 4: Descriptive Statistics of Individual Issues' Lobbying Intensity Constructs

No.	Issues Paper question/subject	Steering Committee's View	All responses (N=52)			Responses from firms (N=23)		
			n	Mean	SD	n	Mean	SD
4.1 or 4.2	Historical cost concepts for petroleum/mining enterprises	Successful efforts concept.	48	0.33	0.48	23	0.26	0.45
4.1.1 or 4.2.1	Allow more than one concept for petroleum/mining enterprises	A single concept for all enterprises.	48	0.15	0.36	23	0.09	0.29
5.1 or 5.2	Basis of primary financial statements: petroleum/mining enterprises	A historical cost concept.	48	0.06	0.24	22	0.05	0.21
6.1	Preacquisition prospecting and exploration costs	Expense all in the period in which they are incurred, no reinstatement.	44	0.32	0.47	21	0.33	0.48
6.2	Mineral property direct acquisition costs	Capitalize all as an asset.	44	0.20	0.41	21	0.14	0.36
6.3	Incidental property acquisition costs	Treat all in the same way as direct property acquisition costs.	44	0.23	0.42	21	0.33	0.48

Table 4, continued			All responses (N=52)			Responses from firms (N=23)		
No.	Issues Paper question/subject	Steering Committee's View	n	Mean	SD	n	Mean	SD
6.4	Post-acquisition geological and geophysical (G&G) exploration costs	Defer all as an asset pending determination of whether commercially recoverable reserves are discovered. If reserves are not found, charge the costs to expense. If reserves are found, capitalize related costs.	44	0.55	0.50	21	0.71	0.46
6.5	Post-acquisition drilling, trenching, and sampling exploration costs	"	44	0.45	0.50	21	0.62	0.50
6.6	Post-acquisition evaluation or appraisal costs	"	43	0.44	0.50	21	0.57	0.51
6.7	Time limit on deferrals	Some type of time limit if preproduction costs are deferred.	40	0.45	0.50	17	0.41	0.51
6.8	Development costs	Capitalize all as an asset.	43	0.21	0.41	21	0.24	0.44
6.9	Construction costs	Construction costs that relate to a single [more than one cost center] should be capitalized as part of that cost center [accounted for as other property, plant and equipment under IAS 16].	42	0.29	0.46	21	0.29	0.46
6.10	Exploration and development costs after production	Treat as any other exploration or development cost.	41	0.10	0.30	21	0.10	0.30

Table 4, continued

No.	Issues Paper question/subject	Steering Committee's View	All responses (N=52)			Responses from firms (N=23)		
			n	Mean	SD	n	Mean	SD
6.11	Capitalization of borrowing costs	Allow both the benchmark (expense) and allowed alternative (capitalize) treatments under IAS 23	41	0.22	0.42	21	0.38	0.50
6.12	Overhead costs	Capitalize overhead attributable to activities whose costs are capitalized.	40	0.05	0.22	21	-	-
6.14	Choice of cost center	Accumulate costs by area of interest or geological units smaller than an area of interest.	42	0.19	0.40	21	0.14	0.36
7.1	Method of calculating depreciation	Use unit-of-production for all of the categories of costs except capitalized single mineral cost center construction costs (straight-line depreciation) and construction costs that serve two or more cost centers (follow IAS 16)	43	0.28	0.45	21	0.33	0.48
7.1.2	Method of depreciation of assets that serve or are capable of serving multiple cost centers	Use unit-of-production for all costs with the exception of assets whose life is shorter than the mineral reserves, for which IAS 16 should apply.	40	0.43	0.50	18	0.56	0.51

Table 4, continued			All responses (N=52)			Responses from firms (N=23)		
No.	Issues Paper question/subject	Steering Committee's View	n	Mean	SD	n	Mean	SD
7.6	Change in reserve estimates	Changes in reserve estimates should be included prospectively in period of change or future periods, consistent with IAS 8.	41	-	-	21	-	-
8.1	Applicability of IAS 37 in recognizing and measuring future removal and restoration provisions	IAS 37 should be applied.	42	0.12	0.33	20	0.10	0.31
8.2	Provision arising when asset is installed	The amount of the provision is part of the cost of acquiring the asset, and is depreciated, as illustrated in IAS 37.	40	0.23	0.42	20	0.40	0.50
8.5	Changes in provisions other than for changes in the discount rate	Changes (other than from changes in discount rate) in estimated provision for removal and restoration should be recognized in subsequent periods.	39	0.05	0.22	20	0.05	0.22
8.6	Changes in discount rate	Use current market assessment of the discount rate when rate changes for provision for removal and restoration in subsequent periods.	40	0.15	0.36	20	0.25	0.44
8.7	Treatment of the effect of a change in a provision	Adjust the carrying amount of the asset only where borrowing costs are capitalized	40	0.68	0.47	20	0.75	0.44

Table 4, continued			All responses (N=52)			Responses from firms (N=23)		
No.	Issues Paper question/subject	Steering Committee's View	n	Mean	SD	n	Mean	SD
8.8	Deposits to fund dismantlement, removal, and abandonment	Deposits should be capitalized where the deposits can be relied upon to reduce the amount of the liability.	39	0.05	0.22	20	0.10	0.31
9.1	Reserve category for impairment	Proved and probable only.	43	0.35	0.48	21	0.33	0.48
9.4	Reversal of provision on recovery of asset or cash generating unit (CGU) (IAS36)	Apply the general guidance in IAS 36.	42	0.24	0.43	21	0.29	0.46
9.5	Impairment of deferred preproduction costs not attributed to CGU	Impose a time limit	41	0.61	0.49	19	0.63	0.50

Notes: N = Total number of comment letters from all respondents (52) and from firms (23). Number of valid responses to each issue. Some respondents chose to answer only questions they felt were fundamental to the overall proposal. Mean = Average of responses to each issue. Since lobbying intensity, L, is dichotomous with values '1' or '0', the means (\bar{L}) represent the percentage of respondents who objected to that issue ("objection" = 1), e.g., 63% (i.e., 12) of the 19 that responded to issue 9.5 (impairment of deferred preproduction costs) objected to imposing a time limit. SD = Standard deviation, which measures the variability (or spread) of responses. For a dichotomous variable, the range of possible values is $0 \leq SD \leq 0.5$. The slightly inflated figures represent the corrected SD, using N-1 or n-1

as denominator instead of N or n in the formula $SD = \sqrt{\frac{\sum(L - \bar{L})^2}{N}}$.

Issue 5 was included to test the likelihood or otherwise of adopting a non-historical value-based accounting concept. There appears to be a consensus (over 95% of respondents) that the historical cost concept represents the most reliable reporting basis. Issues 4.1.1 and 4.2.1 also indicate a willingness to support a single concept for all enterprises. However, only approximately one-third of respondents agreed with the Steering Committee's preferred historical cost method.

The above observation is consistent with prior research. Both the FC and SE methods have survived because of the failure to develop truly acceptable alternatives to historical cost methods. Thus, rather than making the widely acclaimed reserves recognition accounting method (RRA) the mandatory method, SFAS 69 (1982) retained the historical cost methods while specifying reserve disclosures as supplemental information. Despite all the efforts that have gone into developing RRA, newer studies that had the benefit of historical information surrounding the period of the early debates as well as more advanced tools of analysis have indicated that the market nonetheless relies on the historical cost methods and is able to distinguish between them (Harris and Ohlson, 1987). Berry and Wright (2001), by examining historical costs (FC or SE) proxies for efforts and ability of firms to discover reserves, concluded that these disclosures contained value relevant information for predicting market values.

Table 5 shows the actual historical cost method employed by the 23 firms which submitted comment letters. The table also shows the classification of these firms by the sub-industry served. It is interesting to note that the majority of the firms supported the SE method or the largely similar area-of-interest method. Since IFRS 6 permits companies to use either the FC or the SE method this outcome may indicate that the few firms employing the methods not favored by the Steering Committee were either overly successful with their lobbying effort or that the influence of non-firm respondents swayed the debate their way. It could also be the case that firms using the other methods resorted to covert or indirect forms of lobbying.

Table 5
Actual Historical Cost Method Employed by Responding Firms

Sub-industry of respondent	Historical cost method used by respondent				Total
	Successful efforts	Area-of-interest	Full cost	Variants	
Mining	4	4	-	-	8
Petroleum	8*	1	2	1	12
Combined	2	1	-	-	3
Total	14	6	2	1	23

* See note to Table 1

The analysis suggests that there was strong lobbying against other proposals in the issues paper, namely: the capitalization of borrowing costs (6.11), the method of depreciation of assets serving multiple cost centers (7.1.2), the provision arising in respect of removal and restoration costs (8.2), the treatment of the effect of changes in provision (8.7), and the modality for carrying out impairment of deferred preproduction costs not attributed to a cash generating unit (9.5, and also 6.7). These issues are highlighted in Table 4 to show they exhibited relatively higher lobbying intensity measures¹¹.

There is wide agreement that considerable discretion exists in accounting policy choice decisions relating to the capitalization/expensing of E&E expenditure and borrowing costs, calculating depreciation, estimating provisions, and performing impairment tests. Therefore, it appears logical to conclude that the observed lobbying intensity on these issues confirms the conjecture that lobbying will be more intense for matters that limit the income management strategies of managers. This again is consistent with prior research that tests for income smoothing in the specific contexts of these issues.

A single measure of lobbying intensity was constructed from the “intensely lobbied” issues identified in Table 4. For this purpose, the non-responses are taken to mean non-opposition to the tentative views of the Steering Committee. The single lobbying intensity measure and notes on its computation are presented in Table 6; the measure indicates that about 61% of responding firms lobbied against changes to the issues with a scope for income management.

¹¹ The mean figures show the proportion of firms that lobbied against individual items.

Table 6
Descriptive Statistics for a Combined Measure of Lobbying Intensity

No.	Issues Paper question/subject	Responses from firms (N=23)			Normalized* (N=n=23)		
		n	Mn	SD	n	Mn	SD
6.4	Post-acquisition geological and geophysical (G&G) exploration costs	21	0.71	0.46	23	0.65	0.49
6.5	Post-acquisition drilling, trenching, and sampling exploration costs	21	0.62	0.50	23	0.57	0.51
6.6	Post-acquisition evaluation or appraisal costs	21	0.57	0.51	23	0.52	0.51
6.7	Time limit on deferrals	17	0.41	0.51	23	0.30	0.47
6.11	Capitalization of borrowing costs	21	0.38	0.50	23	0.35	0.49
7.1.2	Method of depreciation of assets that serve or are capable of serving multiple cost centers	18	0.56	0.51	23	0.43	0.51
8.2	Provision arising when asset is installed	20	0.40	0.50	23	0.35	0.49
8.7	Treatment of the effect of a change in a provision	20	0.75	0.44	23	0.65	0.49
9.5	Impairment of deferred preproduction costs not attributed to CGU	19	0.63	0.50	23	0.52	0.51
L	Lobbying intensity				23	0.61	0.50

Notes:

*The left hand block replicates the statistics previously presented. The normalization process treated non-responses to particular issues as if the respondent supported the Steering Committee's position. The revised coding (including all 23 firms) is used for determining an average measure of lobbying intensity, which is taken to be an objection (L=1) if a firm objected to at least five of the above nine issues. Thus, 61% of firms lobbied intensely against the issues.

Conclusion

This paper has made an important contribution to the extractive industries income management practices literature by showing that a majority of extractive industry respondents appear to have used the IASC's issues paper to lobby for retention of practices that maintain the current discretionary aspects of accounting for the exploitation of mineral resources. The findings are consistent with the previous lobbying literature on responses to proposed accounting standards. In addition the paper has argued that potential income management intentions are revealed by the comments made in response to the issues paper. This perception opens potentially fruitful research options for income management researchers that may lead to useful insights in this area.

References

- Alciatore, M. L. (1993). "New evidence on SFAS No. 69 and the components of change in reserve value." *The Accounting Review*, vol. 68, no. 3: 639-656.
- Bandyopadhyay, S. P. (1994). "Market reaction to earnings announcements of successful efforts and full cost firms in the oil and gas industry." *The Accounting Review*, vol. 69, no. 4: 657-674.
- Bao, B.-H. and D.-H. Bao (2004). "Income smoothing, earnings quality and firm valuation." *Journal of Business Finance and Accounting*, vol. 32, no. 9 and 10: 1525-1557.
- Beattie, V., S. Brown, D. Ewers, B. John, S. Manson, D. Thomas, and M. Turner (1994). "Extraordinary items and income smoothing: A positive accounting approach." *Journal of Business Finance and Accounting*, vol. 21, no. 6: 791-811.
- Berelson, B. (1952). *Content Analysis in Communication Research*. Glencoe, Ill.: Free Press.
- Berry, K. T. and C. J. Wright (2001). "The value relevance of oil and gas disclosures: An assessment of the market's perception of firms' effort and ability to discover reserves," *Journal of Business Finance and Accounting*, vol. 28, no. 5 & 6: 741-769.
- Bickerton, I., M. Skapinker, and C. Hoyos (2004). "Shocks inside Shell: How one of the worlds most admired companies changed its culture and lost its way." *Financial Times*, pp. 17. 18 June 2004.
- Bryant, L. (2003). "Relative value relevance of successful efforts and full cost accounting methods in the oil and gas industry." *Review of Accounting Studies*, vol. 8, no. 1: 5-28.

- Chung, D. Y. (1999). "The informational effect of corporate lobbying against proposed accounting standards." *Review of Quantitative Finance and Accounting*, vol. 12, no. 3: 243-269.
- Clinch, G. and J. Magliolo (1992). "Market perceptions of reserve disclosures under SFAS No. 69." *The Accounting Review*, vol. 67, no. 4: 843-861.
- Collins, D. W. and W. T. Dent (1979). "The proposed elimination of full cost accounting in the extractive petroleum industry: An empirical assessment of the market consequences." *Journal of Accounting and Economics*, vol. 1, no. 1: 3-44.
- Collins, D. W., M. S. Rozeff, and W. K. Salatka (1982). "The SEC's rejection of SFAS No. 19: Tests of market price reversal." *The Accounting Review*, vol. 57, no. 1: 1-17.
- de Albornoz, B. G. and J. J. Alcarria (2003). "Analysis and diagnosis of income smoothing in Spain." *European Accounting Review*, vol. 12, no. 3: 443-464.
- Deakin, E. B. (1979). "An analysis of differences between non-major oil firms using successful efforts and full cost methods." *The Accounting Review*, vol. 54, no. 4: 722-734.
- Deakin, E. B. (1989). "Rational economic behavior and lobbying on accounting issues: Evidence from the oil and gas industry." *The Accounting Review*, vol. 64, no. 1: 137-151.
- Dechow, P. M. and D. J. Skinner (2000). "Earnings management: reconciling the views of accounting academics, practitioners, and regulators." *Accounting Horizons*, vol. 14, no. 2: 235-249.
- Doran, B. M., D. W. Collins, and D. S. Dhaliwal (1988). "The information of historical earnings relative to supplemental reserve-base accounting data in the extractive petroleum industry." *The Accounting Review*, vol. 63, no. 3: 389-413.
- Downs, A. (1957). *An Economic Theory of Democracy*. New York: Harper & Row.
- Dyckman, T. R. and A. J. Smith (1979). "Financial accounting and reporting by oil and gas producing companies: A study of information effects." *Journal of Accounting and Economics*, vol. 1, no. 1: 45-75.
- Fama, E. F. (1980). "Agency Problems and the Theory of the Firm." *The Journal of Political Economy*, vol. 88, no. 2: 288-307.
- Fudenberg, D. and J. Tirole (1995). "A theory of income and dividend smoothing based on incumbency rents." *Journal of Political Economy*, vol. 103, no. 1: 75-93.
- Georgiou, G. (2004). "Corporate lobbying on accounting standards: methods, timing and perceived effectiveness." *Abacus*, vol. 40, no. 2: 219-237.

- Harris, T. S. and J. A. Ohlson (1987). "Accounting disclosures and the market's valuation of oil and gas properties." *The Accounting Review*, vol. 62, no. 4: 651-670.
- Healy, P. M. and K. G. Palepu (2003). "The fall of Enron." *The Journal of Economic Perspectives*, vol. 17, no. 2: 3-26.
- Healy, P. M. and J. M. Wahlen (1999). "A review of earnings management literature and its implications for standard setting." *Accounting Horizons*, vol. 13, no. 4: 365-383.
- Holsti, O. R. (1969). *Content Analysis for the Social Sciences and Humanities*. Reading, Mass.: Addison-Wesley.
- Hoyos, C., V. Marsh, and M. Peel (2004). "Unsure of Shell: Shareholders call for change after almost 4bn barrels of oil and gas are cut from proved reserves." *Financial Times*, pp. 21. 23 January 2004.
- IASB (2004). *International Financial Reporting Standard 6: Exploration for and Evaluation of Mineral Resources*. International Accounting Standards Board, London, UK (December 2004).
- IASC (2000). "*Issues Paper: Accounting by Extractive Industries*," and "*Summary of issues: Extractive industries*." International Accounting Standards Committee, London, UK (November 2000).
- Jensen, M. C. and W. H. Meckling (1976). "Theory of the firm: Managerial behavior, agency costs and ownership structure." *Journal of Financial Economics*, vol. 3, no. 4: 305-360.
- Klein, L. R. (1946). "Macroeconomics and the Theory of Rational Behavior." *Econometrica*, vol. 14, no. 2: 93-108.
- Largay, J. A. III (2002). "Lessons from Enron." *Accounting Horizons*, vol. 16, no. 2: 153-156.
- Larson, R. K. (1997). "Corporate lobbying of the International Accounting Standards Committee." *Journal of International Financial Management and Accounting*, vol. 8, no. 3: 175-203.
- Lev, B. (1979). "The impact of accounting regulation on the stock market: The case of oil and gas companies." *The Accounting Review*, vol. 54, no. 3: 485-503.
- MacArthur, J. B. (1988). "An analysis of the content of corporate submissions on proposed accounting standards in the UK." *Accounting and Business Research*, vol. 18, no. 71: 213-226.
- McNichols, M. (2000). "Research design issues in earnings management studies." *Journal of Accounting and Public Policy*, vol. 19, no. 4&5: 313-345.
- O'Keefe, T. B. and S. Y. Soloman (1985). "Do managers believe the efficient market hypothesis? Additional evidence." *Accounting and Business Research*, Spring: 67-79.

- Ronen, J. and S. Sadan (1981). *Smoothing Income Numbers: Objectives, Means, and Implications*. Reading, Mass.: Addison-Wesley.
- Schipper, K. (1989). "Commentary on earnings management." *Accounting Horizons*, vol. 3, no. 4: 91-102.
- SFAS 69 (1982). "Statement of Financial Accounting Standards No. 69: Disclosures About Oil and Gas Producing Activities: An Amendment of FASB Statements 19, 25, 33, and 39 (November 1982)." Financial Accounting Standards Board, USA.
- Sutton, T. G. (1984). "Lobbying of accounting standards-setting bodies in the U.K. and the U.S.A.: A Downsian analysis." *Accounting, Organizations and Society*, vol. 9, no. 1: 81-95.
- Tutticci, I., K. Dunstan, and S. Holmes (1994). "Respondent lobbying in the Australian accounting standard-setting process: ED49—A case study." *Accounting, Auditing and Accountability Journal*, vol. 7, no. 2: 86-104
- Watts, R. L. and J. L. Zimmerman (1978). "Towards a positive theory of the determination of accounting standards." *The Accounting Review*, vol. 53, no. 1: 112-134.
- Weetman, P., E. S. Davie, and W. Collins (1996). "Lobbying on accounting issues: preparer/user imbalance in the case of the Operating and Financial Review." *Accounting, Auditing and Accountability Journal*, vol. 9, no. 1: 59-76.