Tilburg University

Pressure and politics in financial accounting regulation

van Lent, L.A.G.M.

Published in:
Abacus

Publication date:
1997

[Link to publication in Tilburg University Research Portal](#)

Citation for published version (APA):

van Lent, L. A. G. M. (1997). Pressure and politics in financial accounting regulation: The case of the financial conglomerates in the Netherlands. *Abacus*, 33(1), 88-114.

General rights

Copyright and moral rights for the publications made accessible in the public portal are retained by the authors and/or other copyright owners and it is a condition of accessing publications that users recognise and abide by the legal requirements associated with these rights.

- Users may download and print one copy of any publication from the public portal for the purpose of private study or research.
- You may not further distribute the material or use it for any profit-making activity or commercial gain
- You may freely distribute the URL identifying the publication in the public portal

Take down policy

If you believe that this document breaches copyright please contact us providing details, and we will remove access to the work immediately and investigate your claim.

LAURENCE VAN LENT

Pressure and Politics in Financial Accounting Regulation: The Case of the Financial Conglomerates in The Netherlands

This article examines the political process of promulgating two controversial laws which pertain to the reporting of Dutch financial conglomerates. Central to the study is the exploration of the lobbying efforts observed during the process, and the interaction between the government, the supervisors of banks and insurance companies, the industry and its associations, and the users and auditors of annual reports of financial conglomerates. Previous studies in accounting-rule development have often ignored influences that do not fall within the formal regulatory procedures. By adopting an inductive research approach, this study explores in some detail the behaviour of participants, including their use of informal lobbying methods. Pluralist theory is used to explain the nature of the political process and the behaviour of interested parties. The findings indicate that the Dutch political process in accounting matters is indeed pluralistic. Although auditors and producers of accounts seem to have greater possibilities to participate, the users of corporate reports are able to effectively voice their opinion. Overall, the users' preferences were acknowledged in the final rules governing the reporting by financial conglomerates.

Key words: Accounting; Conglomerates; Financial; Regulation.

This article reports the findings of an investigation into the financial reporting regulation of financial conglomerates in the Netherlands, which was a fiercely debated issue involving several government agencies and other interest groups during 1990–4. Financial conglomerates are firms that are engaged in banking as well as insurance activities. Among the companies were some of the most powerful firms in the Dutch financial market: Internationale Nederlanden Groep (ING), Rabobank (RABO), ABN-AMRO and Fortis. The controversial accounting question that had to be addressed when promulgating the requirements for financial conglomerate reporting pertained to the consolidation of the bank and insurance activities into a single annual report. An additional question was whether additional information

LAURENCE VAN LENT is a member of the CentER Accounting Research Group, Tilburg University, the Netherlands.

Helpful comments from Gijs Bak, Jan Bouwens, Douglas DeJong, George Hendrikse, Steven Maijoor, Stephen Zeff, Ian Zimmer, Jerry Zimmerman, participants at the Nineteenth Annual EAA Congress in Bergen, Norway, and three anonymous referees are gratefully acknowledged.

concerning the individual activities would have had to be provided if consolidation was going to be allowed.

In this study, a detailed description of an accounting standard setting process in the Netherlands is provided, to illustrate the typical interaction between Dutch government and interested parties. A case study research design is then adopted to incorporate events and lobby efforts that do not fall within the formal procedures of the regulatory process. Extant accounting literature on lobbying has relied heavily on observable comment letters submitted to the standard setter. However, the success of lobbying is likely to depend on the unobservability of the lobbying agents' activities (Sutton, 1984). Hence, analysis of the publicly available comment letters is unlikely to be the most effective lobbying research method (Lindahl, 1987). The Sutton–Lindahl critique on accounting lobbying research suggests that a research design that aims at incorporating all lobbying methods used, and thereby tries to give a full description of the political process, is desired. Walker and Robinson (1993) argued that a case study might buttress the understanding of the influence of interested parties on the regulatory process and might reveal what happens behind the regulatory scenes. The claim for case-study research is further strengthened by Amershi *et al.*'s (1982) observation that lobbying is likely to be a multi-issue, multi-period process, especially for professional lobby organizations such as industry associations or unions. To restrict the investigation to one issue may present methodological problems because the behaviour of certain lobbying agents can only be understood by taking a long-term view and considering multiple issues. A case approach can address these considerations, hence its adoption here. A few recent studies on regulatory processes have adopted a similar strategy: Klumpes (1994), Walker and Robinson (1994a, 1994b), Rahman *et al.* (1994). This is the first English-language paper known to the author to have used a case study design to look at regulatory processes in the Netherlands. Data for the study was collected from documents, archival records and interviews with six key participants in the rule development process.¹

The case-study report narrates in some detail the history of the promulgation of two draft laws that laid down the reporting requirements of financial conglomerates. Throughout the narrative special attention should be paid to the following interested parties: corporate managers, auditors, the Ministry of Justice, parliament, the Council on Annual Reporting, the Dutch Central Bank (*De Nederlandsche Bank*), the users of accounts (especially, the financial press), and the industry associations.²

¹ These key informants were Mr Noordzij (Federation of Dutch Industries, VNO); Mr Vreugdenhil, MP; Ms Wortmann (Ministry of Justice); Mr Badon Ghijben and Mr Kuijper (ING); and Mr Boezer (Dutch Central Bank, DNB). The key informants were suggested by articles on the topic in the financial press. Also, the interviewees were asked to mention other key players in the field.

² In the case study, agents will be referred to by the organization they represent. This may avoid confusion caused by unfamiliar names. To be complete in the presentation of the facts, all relevant agents are identified by their names and organizations in this note. The ministers: Mr Aad Kosto and Mr Wim Kok; the Justice Ministry: Ms Sylvia Wortmann; Dutch Central Bank (*De Nederlandsche Bank*): Mr Boezer; ING financial officer: Mr Badon Ghijben; Moret, Ernst & Young vice-chairman: Dr Bindenga; Moret Ernst & Young's ING assignment partner: Mr Van der Brande; Christian Democrat Party (CDA) spokesman: Mr Thomas Vreugdenhil, MP; Labour Party (PvdA) spokesman: Dr Willem Vermeend MP; large investment firm: ROBECO.

BACKGROUND

Company Legislation

The legislation of annual reporting is vested foremost in company law (more specifically, in the Dutch Civil Code). It should be noted that, consciously, only the most important aspects of annual reporting have been regulated. Firms have considerable flexibility in comprising their annual report, thus allowing them to choose reporting methods and formats that fit their needs best. Company law in the European Community is subject to harmonization, which implies that countries in the EC have to adjust their national rules to comply with the supranational EC directives. For example, the fourth EC directive pertaining to annual reports of companies stipulates requirements for the format, disclosure, and audit of the annual report. Furthermore, the seventh EC directive is of importance. It stipulates requirements for the consolidated annual report. Dutch company law was adjusted to the requirements of both the fourth and seventh EC Directive in the 1980s.

Since all EC countries are subject to these directives, they are all characterized by having annual reporting regulation vested in company law. However, there are some differences in the degree of detail in which reporting practices have been regulated. The U.K. and the Netherlands on the one hand allow considerable freedom. France and Germany, most notably, have adopted far stricter, and more detailed, rules. In contrast to this position, it should be noted, that reporting regulation is not vested in company law in the U.S.

The comparability of annual reports is not a governing consideration in the regulation of Dutch financial reporting (Zeff *et al.*, 1992). Indeed, a different criterion, the 'insight requirement', is the guiding principle. Financial statements should furnish the *insight* required to enable the formation of a sound judgment as to the company's financial position and the result of operations, and, to the extent possible, should provide insight into solvency and liquidity. This insight requirement plays an important role in the case of the financial conglomerates, as will be shown.

Tax Laws

Tax laws are virtually irrelevant for annual reporting in the Netherlands, a feature which is comparable to U.S. and U.K. practice. Many other EC countries, including France and Belgium, have closer ties between the annual reporting regulation and tax reporting, since in these countries the annual report is used to levy corporation taxes.

Judicial Proceedings and Jurisprudence

As a consequence of the lack of detailed prescription in Dutch annual reporting regulation, jurisprudence is an important source of the rules governing annual reporting, as it is in the U.K. and the U.S. The Dutch judicial proceeding is unique owing to its Enterprise Chamber (*Ondernemings-kamer*), to which all interested parties may complain if they consider corporate financial statements do not comply with the law (Klaassen, 1980).

FIGURE 1

THE DUTCH REGULATORY FRAME WORK

Securities Committee

At the time of the research, there was no securities committee overseeing the annual reporting of publicly owned companies. However, the official listing rules of the Stock Exchange Association and the Foundation to Oversee Securities Trading provide these monitoring bodies the opportunity to demand additional accounting information from listed companies. This is notably different from the institutional arrangement in the U.S., where the Securities and Exchange Committee (SEC) is responsible for accounting rule development. In contrast to Dutch rules, the SEC demands separate filing of the required reports.

Representative Organizations

Private-sector regulation with a public-sector framework does occur. The Council on Annual Reporting (*Raad voor de Jaaverslaggeving, RJ*), in which various interest groups are represented, issues guidelines. The Council contains representatives of preparers (employers), users (employees/unions/financial analysts) and auditors. The guidelines of the Council elaborate on the stipulations of the legislative framework. The guidelines themselves do not, however, have the force of law. Efforts to promote compliance with the private-sector guidelines are limited to confidential discussions with the auditors of companies that apparently are departing from the guidelines.

When comparing the Dutch and the Anglo-American systems, a feature to be noted is the relatively weak enforcement status of the guidelines issued by the

Council on Annual Reporting. The Accounting Standards Board in the U.K., for example, has a similar composition and task as the Dutch Council on Annual Reporting. However, the Dutch auditing profession did not commit itself to mention departures from the Council's guidelines in the audit report, while both Australian and British audit reports require remark about non-compliance with accounting standards. This indicates that the pronouncements of the Council on Annual Reporting are less influential. The U.S. Financial Accounting Standards Board (FASB) also has considerably more power than the Dutch Council. The FASB, a private-sector body of a similar composition to the Dutch Council, derives its influence largely from the SEC which enforces the application of the accounting standards the FASB proclaims. Moreover, U.S. auditors will issue qualified or adverse opinions if a company's annual reports diverge from GAAP.

Regulatory Arrangements Regarding Financial Institutions

Finally, a further point of introduction is provided regarding the institutional and regulatory arrangements that were faced by financial conglomerates. Dutch banks and insurance firms are monitored by the Central Bank and *Verzekeringkamer* (Insurance Chamber), respectively. The Dutch Central Bank, which has considerable power in setting the country's monetary policy, is an independent non-governmental institution. Apart from its tasks in setting the monetary policy, it also is required by law to ensure the stability and 'healthiness' of the Dutch financial system. The Insurance Chamber is a similarly non-governmental monitoring agency, which oversees the insurance industry, and has extensive authority to achieve this. The Dutch Central Bank was committed to a 'general separation' policy in which banks and insurance companies were not allowed to merge. This policy was designed to facilitate sound banking practices and to enhance healthy competition in the industry. However, from 1 January 1990 this general separation was abolished. Subsequently, a wave of takeovers took place in the Dutch financial market. In parallel was the implementation of two EC directives covering the annual reports of banks and insurance companies. Apparently establishment of financial conglomerates was not anticipated when the EC directives were drafted, as there were no references in the directives to the annual reports of these conglomerates. The national legislature now had the opportunity to stipulate reporting requirements for these firms. Financial conglomerates are subjected neither to the legislation of banks nor to the legislation of insurance firms (Explanatory Memorandum, *Memorie van Toelichting*, 22169 A:1). Since there are no special rules in the Civil Code that apply to financial conglomerates, these companies are simply subjected to the fourth and seventh EC Directive, and the general requirements of the Dutch Civil Code. One such general requirement of the code deals with the obligation to consolidate the financial statements of all subsidiaries in a group and of all group members (Article 406, para. 1). The exception to this rule, however, is when consolidation violates the *insight* required to enable the formation of a sound judgment as to the company's financial position. Then, consolidation might be prevented, and the annual report of such a group member needs to be disclosed in the notes on the financial statement of the group (separate reporting). Potential violations of this 'insight requirement' are

caused by differences in activities between the group member and the group (Article 406, para. 3). In the legal literature pertaining to para. 3 of Article 406, the case of banks and insurance companies is explicitly mentioned as an example in which differences in activities may prevent consolidation (see, Burgert *et al.*, 1990, p. 596; Proceedings, Second Chamber, 19813, no. 3). Two technical accounting questions were raised in the promulgation process of the reporting rules governing financial conglomerates, namely, whether these companies should consolidate both banking and insurance activities. And furthermore, in case consolidation was allowed, whether anything would have to be done about the reduction of information concerning the individual activities.

THE CASE: FINANCIAL CONGLOMERATES IN THE NETHERLANDS

The case-study report comprises two distinct parts of the legislative process affecting financial conglomerates—(a) the banking directive and (b) the insurance directive. The first two sections narrate the events of the regulatory process of financial conglomerate reporting. The following section discusses some possible explanations of the case findings based upon pluralist theory. These sections are followed by a brief outline of the findings of pluralist theory. Table 1 sets out a chronology of main events.

The Legislative Process, Part 1: The Incorporation of the Banking Directive

In the background section of this paper, it was stated that Dutch financial reported regulation encompasses the effects of the fourth and seventh EC directives. Article 1 para. 2 of the fourth directive (PbEG L222, 14 August 1978) stipulates that members of the EC are not compelled to subject banks, other financial institutions, and insurance companies to the requirements of the directive.³ Despite this option in the EC directive, banks and insurance companies were not excluded from its operating range when both directives were incorporated into Dutch companies law.

On 8 December 1986 the council of the European Community accepted the proposed directive on annual reporting by banks (hereafter, the banking directive; PbEG L372, 31 December 1986). It is interesting to note that the Central Bank was the spokesman for the Dutch delegation at the EC's meetings regarding the banking directive.⁴ The Central Bank carried the point that consolidation of bank and insurance activities should not be allowed, which was also the general opinion in the EC (*Memorie van Toelichting*, 22169 A: 1). It should be noted that this issue was barely even a point of discussion at the EC meetings on the banking Directive. The Central Bank held that it was appropriate to allow only limited flexibility in reporting practices within a particular industry. Consequently, the Central Bank stressed the comparability argument for reports of firms within an industry. Thus, in the EC discussion the Central Bank agreed with the *communis opinio* that insurance

³ The exemption of banks and insurance companies from the fourth Directive was temporary. Pending further coordination of these companies, the fourth Directive was not necessarily applicable to them.

⁴ The reason for this was that financial reporting by banks is a responsibility of the Ministry of Finance. There are close ties between the DNB and the Ministry of Finance.

TABLE 1

MAIN EVENTS

Date	Event
1978	Fourth directive annual reports EC
March 1981	Draft EC bank directive
April 1984	Second draft EC bank directive
1984	Seventh directive annual reports EC: consolidation
1985	Revision draft directive coordination banks
8 December 1986	Approval bank directive by European Council of Ministers
1 January 1990	General separation of banks and insurance companies comes to an end
27 June 1991	Draft law 22169 and Explanatory Memorandum to Second Chamber
19 December 1991	Approval insurance directive by European Council of Ministers
31 January 1992	Publication of joint NVB/VvV advisory paper
25 March 1992	MEY announces its preference for separate reporting by financial conglomerates
2 April 1992	Provisional report 22169 Second Chamber
11 May 1992	Memorandum of Reply 22169 Second Chamber and Memorandum of Alterations 22169
8 July 1992	Final report 22169 Second Chamber
17 July 1992	Memorandum on account of Final report 22169 and Second Memorandum of Alterations 22169
July 1992	Justice minister requests advice of Council on Annual Reporting regarding 22169
30 September 1992	Third Memorandum of Alterations
5 November 1992	Draft law 22896 and Explanatory Memorandum to Second Chamber
10 November 1992	Plenary discussion in Second Chamber of 22169
19 November 1992	Draft law 22169 to First Chamber
29 January 1993	Report 22896 Second Chamber
2 February 1993	Provisional report 22169 First Chamber
3 February 1993	Memorandum of Reply 22169 First Chamber
24 February 1993	Memorandum to Report 22896 Second Chamber
April 1993	Conversation between Mr Vreugdenhil and Mr Badon Ghijben (ING)
17 May 1993	Report on written deliberations 22896 Second Chamber
27 May 1993	Publication in Staatsblad 1993-258 of Law 22169
24 June 1993	Amendments Vreugdenhil/Vermeend to 22896
28 June 1993	Second Memorandum of Alterations 22896
1 July 1993	Plenary discussion of 22896 in Second Chamber
12 July 1993	Draft law 22896 and Explanatory Memorandum to First Chamber
31 August 1993	Report 22896 First Chamber
14 September 1993	Plenary discussion 22896 in First Chamber
14 October 1993	Publication in Staatblad 1993-517 of Law 22896

Source: Kamerstukken and Handelingen (see references), NVB/VvV (1992) and FD (25 March 1992).

and bank activities could not be consolidated. It should be noted that the Central Bank also had not foreseen, at the time of the EC meetings, that financial conglomerates were to become an issue.

Later in the process, after a number of major financial companies had formed into conglomerates and the banking directive was transformed into a draft law by the Dutch Justice Ministry, the Central Bank lifted its objections to the consolidation issue. Pressure rose towards the Central Bank to be more lenient regarding consolidated reporting by financial conglomerates. As a supervisory agent, the Central Bank had more important issues to consider than reporting requirements. To disturb the delicate relationship between the Central Bank and the Dutch financial institutions over this minor point seemed futile (interview with Ms Wortmann). Also, there was some understanding within the Central Bank that the new financial institutions would like to show their over-all financial strength. However, since the financial conglomerates were likely to have an important impact on the public, they would have to disclose sufficient information, including separate reports on both the banking and insurance segments. In addition to the Central Bank's wish for separate reporting, there was another point that should be taken into consideration. The Central Bank strives for congruity between the annual reports of banks and the *maandstaten*, monthly reports, which banks have to submit to the Central Bank. This congruity implies that financial institutions incur fewer costs in complying with reporting requirements (interview with Mr Boezer).⁵ One could also contend that the Central Bank had an interest in controlling the knowledge gap between the general public as a user of annual reports and itself, for it has additional information from the monthly reports. Should this gap become too wide, the general public could point to the Central Bank in the case of a bank failure, accusing it of adequate supervision and of failure to inform the public in time. However, if the gap is narrow, such accusations will have less effect. Consequently, the Central Bank favoured adequate disclosure by financial institutions.

Thus, although the Central Bank relented on the consolidation issue, it maintained its position that additional separate information would have to be provided. Moreover, the Central Bank advised against laying down any further requirements in law until the EC had formulated its own requirements. The Justice Ministry did not consider this advice to be in the interest of financial conglomerates, since such EC requirements would probably take a great deal of time to formulate and the outcome of the EC regulatory processes is not readily predictable (interview with Ms Wortmann). Therefore, it strived to have the whole matter prescribed in law, before the EC formulated its own requirements.

The opinions and actions of the Central Bank are important, not only because it supervises financial conglomerates and has substantial power in the Dutch financial market, but also because, in the initial draft law, it was given substantial authority in setting reporting requirements for banks. The Second Chamber,⁶ however, opposed

⁵ Mr Boezer did not agree with Ms Wortmann's opinion that the DNB made a trade-off on the issues of reporting and supervisory tasks. He made the point that the DNB deals with these issues separately with financial institutions.

⁶ Parliament consists of two chambers, of which the Second Chamber is the politically more important.

the delegation of rule-making power to a 'private' institution such as the Central Bank. This was a surprise to the Central Bank, since it was not informed by the Justice Ministry of the pending rejection by the Chamber of the proposed draft (interview with Mr Boezer). It is likely that this experience influenced the further involvement of Central Bank on this issue. In particular, it should be considered that the spokesman of the then largest political party (Christian Democrats [CDA]) in the Second Chamber had received inside information from the banking industry stating they objected to a more pronounced role for the Central Bank in the standard setting process (interview with Mr Vreugdenhil). According to the Central Bank, reporting requirements were issued in order to comply with an explicit request made by the banks. This reveals a conflict between the official statements of banks regarding the Central Bank's standard setting efforts and their 'hidden agenda'. As the Christian Democrats' spokesman pointed out, part of this conflict can be explained by the power the Central Bank embodies in the Dutch financial system. The banks may have feared that their position *vis a vis* the Central Bank would deteriorate by increasing the Central Bank's tasks further.

The banking directive should have been incorporated into national law on 31 December 1990. However, the rewriting of the directive into a draft law took until June 1991 owing, in the explanation of the ministers of Justice and Finance, to the complexity of the matter and the *intensive deliberations* with the parties involved (Explanatory Memorandum, 22169, no. 3, p. 3).⁷ According to the Justice Ministry, it is policy to encourage involvement by the companies which a draft law will affect if the proposed legislation deals with highly complex and technical matters such as financial reporting. Indeed, the ministry took the initiative to contact *inter alia* AMEV, one of the constituting companies of Fortis to discuss reporting by financial conglomerates. In their Explanatory Memorandum, the ministers stated that further study was necessary with regard to the consolidation of banks and insurance companies which are members of the same group. This is because it was not foreseen on completing the banking directive that banks and insurance companies would be able to form financial conglomerates. Therefore, it had not been foreseen that consolidation of both activities would become an issue. No rules were laid down pertaining to organizations with equally important banking and insurance activities. The ministers also planned to take the forthcoming insurance directive into account when formulating, at a later stage, their views on the consolidation of activities within a financial conglomerate.

Despite these qualifications, the ministers voiced some preliminary opinions which were also part of the Explanatory Memorandum. The ministers argued that consolidation should not be too readily judged as conflicting with the insight requirement. In their opinion, the only rules which applied to the financial

⁷ When a minister submits a draft law to parliament, he adds an Explanatory Memorandum which contains the history of the draft, the advice offered by representative organizations and an explanation of the purpose and content of the law. The number after 'Explanatory Memorandum' refers to the number of the draft law involved, in this case, 22169. The following number, preceded by the abbreviation 'no.' refers to the number of the document pertaining to a draft law, in this case, document 3 which is the Explanatory Memorandum.

conglomerates with equal shares of banking and insurance activities were those formulated in the fourth and seventh EC directives. The ministers announced that a workgroup had been formed, consisting of industry members, which was to offer advice on the reporting requirements of financial conglomerates.

Contiguously, the Council of the European Community accepted the directive on (consolidated) annual reporting by insurance companies (hereafter, the insurance directive) on 19 December 1991 (PbEG L374, 31 December 1991). During the formulation of this insurance directive, the insurance industry maintained intensive contacts with the Dutch Justice Ministry. These contacts were used later by the Ministry to discuss the reporting requirements of financial conglomerates with industry members. In particular, the contacts with Nationale Nederlanden, one of the constituting companies of ING, proved important when the Ministry formulated its opinion on the reporting issue (interview with Mr Badon Gijben and Mr Kuijper).

On 31 January 1992, the joint workgroup of industry members, representing both the *Nederlandse Vereniging van Banken* (Dutch Association of Banks [NVB]) and the *Verbond van verzekeraars* (Alliance of Insurance Companies [VvV]) presents its advisory paper, *Verslaggeving financiële concerns* (Financial Conglomerate Reporting). Two items were of importance to the current study, namely the proposals on consolidation and segmentation. First, the principal argument of the NVB/VvV workgroup was that financial conglomerates had to and wished to present themselves as single units (NVB/VvV, 1992, p. 2). It was, therefore, not desirable to require separate reporting by the subsidiaries. The wish to be seen as one indivisible unit was also taken emphatically by ING mainly for strategic reasons. In the NVB/VvV proposal on segment reporting, the workgroup stated that more detail should be provided in the notes to the consolidated balance sheet and profit and loss statement to satisfy the insight requirement and also to comply with the requirements of the banking and insurance directives. Insight into segment (activity) would have to be given by splitting the consolidated data up to the level of earnings before taxes. However, there should be no division of shareholder equity between the segments. Such a division was argued not to be in agreement with the *bedrijfseconomische* (business economic) characteristics of consolidated reporting. In the opinion of ING, these business economic problems arise because group equity is the only important figure for shareholders of the group. Shareholders should not be concerned with the allocation of equity over the activities. Re-allocation of shareholder equity between the banking or insurance part of the company does not necessarily have to have special consequences, since this was said to be a fairly arbitrary matter. Importantly, it was recognised that clients of a particular bank or insurance company within the group should refer to the annual reports of that bank or insurance company to be assured of its solvency. Moreover, in the segmentation of group equity, units which are legally part of the insurance company could be allocated to the bank activities because of their specific character. However, this does not imply that the liabilities of these units are guaranteed by the equity of the bank (interview with Mr Badon Gijben and Mr Kuijper). This statement by ING requires some qualification. By the time of the publication of the ING 1991 annual report, it was not clear whether separate reports would be issued by the NMB-Postbank or other subsidiaries of ING.

Indeed, spokesmen at ING at the time of publication contradicted each other on this matter (FD, 2 May 1992). Consequently, ING's comment on the business-economic argument is not valid, as this argument was used in 1991, at which time ING did not know whether it was going to publish separate reports on the subsidiaries.

The workgroup presented a model for financial conglomerate reporting. This model was new. In the discussion of the reaction of the companies involved, it will be analyzed which companies reflected this model in their annual report. It is important to note that the Justice Ministry initiated and stimulated the joint NVB/VvV advisory activities, and agreed with its general terms. During the writing process, there was contact between the Justice Ministry and the workgroup. However, within the Justice Ministry it was felt that there was some disagreement between the members of the workgroup on the segmentation issue, in particular between Fortis and ING. Therefore, the Justice Ministry began to formulate some stipulations regarding this segmentation issue before the paper was published. It was in the interest of the Ministry of Justice and the industry to have a shared line of conduct in financial reporting. If controversies on the reporting issue led to completely incomparable annual reports, the EC would have more reason to speed up its regulatory process and impose a standard. Moreover, a shared line of conduct would make a favourable outcome of parliamentary deliberations more likely.

Parliament, that is, the Second Chamber waited until the publication of the industry advisory paper before starting its 'preparatory investigation' of the draft law in a legislative committee in the first quarter of 1992. In their Provisional Report, the members of the Christian Democratic Party stated that they were somewhat disappointed by the industry advice, which they considered a compromise. The Christian Democrats implied that there surely must have been significant controversy on this issue between the members of the workgroup. Log-rolling had probably taken place, leading to ING's opinion being given priority on this issue. Consequently, the advice was not considered very important by the Christian Democrats (interview with Mr Vreugdenhil). In the Christian Democrats' opinion, one of the driving forces behind the banking directive was the comparability concept. Leaving out the segmentation of group equity as irrelevant was typical of the lack of comparability between financial conglomerates, banks and insurance companies that would result from implementing this advice. The Christian Democrats' demand was that separate consolidated annual reports of both the banking and insurance groups would be provided in addition to the over-all annual report of the conglomerate (Provisional Report, 22169, no. 4, pp. 1–2). Notable was the Christian Democrats' stress on the comparability argument, which conflicts with the leading principle of Dutch financial reporting regulation, 'insight'. However, the Christian Democrats' seemed to attach a great deal of value to the interests of investors, which would allegedly be served by comparability. Indeed, a large investment firm called the Christian Democrats' attention to the need for the comparability of annual reports. Although their spokesman on the issue visited several financial conglomerates,⁸ it was the investor's interests which appear to have had the most influence.

⁸ Vreugdenhil visited ABN-AMRO, ING, RABO, and Credit Lyonnaise Bank Nederland.

At this stage of the regulatory process, only the Christian Democrats made remarks regarding financial conglomerates. The ministers answered the legislative committee in a Memorandum of Reply (22169, no. 5, pp. 2–3). They again expressed their opinion that financial conglomerate reporting was not subject to the rules pertaining to banks or insurance companies. In the present situation, without the example of existing rules abroad or in the Netherlands, the initiative of the NVB/VvV should be appreciated as a first attempt to map out the problems and furnish some solutions. With regard to the irrelevance of the segmentation of equity, the ministers stated that the existence of financial conglomerates was a relatively new development. The special characteristics of financial conglomerates, that is, the entanglement of both banking and insurance activities, would have to be expressed in their annual report. In particular, the consolidated annual report of the whole economic entity, the financial conglomerate, was viewed as the vital element. In view of the special properties of banks and insurance companies and their prominent position in society, financial conglomerates cannot suffice with this consolidated information. Owing to the separation of banks and insurance firms in the past it is possible, at present, to provide information about the separate activities. The question, according to the ministers, is in which fashion the additional information should be offered and which level of insight is sufficient. The ministers suggested that insight should be offered into both activities in accordance with the two directives. This proposal was formalized in a Memorandum of Alterations (*Nota van wijziging*, 22169, no. 6, p. 1) pertaining to Article 406, to which three new paragraphs were added of which paras 4 and 5 are relevant to the issue at hand. The ministers argued that their proposal was in line with the NVB/VvV advice. It should be noted that the Minister of Justice initially did not intend to set down these requirements in law. The initial plan was to let the NVB/VvV suggestions be the (informal) standard, without any legislative backing. However, the new paragraphs of Article 406 were implemented owing to political pressures (Christian Democrats) and the explicit wish of the Central Bank for legislative requirements on this issue (interview with Ms Wortmann and Mr Boezer).⁹ In hindsight, both the Ministry of Justice and ING, as a major contributor to the NVB/VvV advisory paper, concluded that the advice was of little relevance to the resulting regulation, in contrast to *ex-ante* expectations. One of the most important statements in their Memorandum of Reply was that the ministers did not wish to commit themselves to *the method* by which insight in both activities would be provided. They insisted that there would be an ongoing entanglement of both activities. The requirement of separate consolidated annual reports could lead, in time, to statements which did not offer a reliable picture of the financial situation per segment, owing to the large number of arbitrary allocations and the dissection of what is, in fact, an indivisible economic entity. However, if financial conglomerates felt that the insight demanded was best provided by separate annual reports, they would be permitted to issue such reports.

⁹ The DNB did not only favour legal reporting requirements, it also preferred limiting the reporting options. Limiting freedom in reporting would facilitate comparability, one of the prime goals of the DNB.

In summary, the increasing possibility of distinguishing between banking and insurance products and activities had led the ministers to propose that insight, as a general and broad requirement, should be provided into the entity as well as both separate activities. Managerial discretion would determine the most adequate accounting method of offering such insight. This ministerial proposal was in line with the joint-industry advice. At this stage of the policy process, there was consensus concerning the consolidation of banking and insurance activities into one annual report. Differences of opinion between the ministers and industry on the one hand, and the Christian Democrats and Central Bank on the other, existed on the segmentation issue, and more specifically on the subject of the accounting format by which insight into the discerned activities should be offered.

The final report of the legislative committee emphasized this difference of opinion. The Christian Democrats' reaction to the ministers' Memorandum of Reply was that, although the entanglement of banking and insurance activities might theoretically prevent the adequate separation of both activities in separate reports, in practice, the management of financial conglomerates would still want to know whether a certain activity is profitable or efficient. In other words, it was unlikely that the separation of both activities would prove to be impossible, owing to the need for managerial control within the company. The Christian Democrats also mentioned the position of the supervising institutions: the Central Bank and the Insurance Chamber. The supervisors would also require segmented equity information. The Christian Democrats argued that the ministers' noncommittal position to the accounting method in which insight in both activities should be provided, conflicted with the EC directive and with the proposed changes of Article 406 which, from this perspective, implied that disclosure of the equity of the banking segment was necessary. Interestingly, the Christian Democrats referred to the Fortis annual report as an example of the possibility of disclosing the banking segment's equity. The Fortis report convinced the Christian Democrats that it was possible to provide insight into both activities separately (interview with Mr Vreugdenhil). ING likewise contended that there were only a few technical obstacles to separate reporting (interview with Mr Badon Ghijben and Mr Kuijper). Thus, although the ministers stressed the accounting problems involved with separate reporting, the companies involved readily admitted that these problems were not the major issue.

The ministers subsequently responded to the final report in a Memorandum (*Nota naar aanleiding van het Eindverslag*, 22169, no. 8). They stated that, in their opinion, it was not possible to act in conflict with the EC directives since neither the banking nor the insurance directive made any provisions regarding financial conglomerates. The ministers argued, furthermore, that although it was uncertain whether banking and insurance activities would become so entwined that reporting on separate activities would become arbitrary, both management and supervising institutions would have sufficient instruments for obtaining the necessary insight into the financial condition.¹⁰ Moreover, the ministers agreed with the Christian Democrats'

¹⁰ The Justice Ministry itself regarded the entanglement argument as weak. Nonetheless, it was considered convenient in parliamentary discussions.

view that, as a result of Article 406, paras 4 and 5, would be that the equity of both banking and insurance activities would have to be disclosed in some fashion in the segmentation. Furthermore, the ministers announced that the Council on Annual Reporting was going to be consulted regarding the way in which insight should be provided (i.e., the concrete elaboration of paras 4 and 5 of Article 406).¹¹ This request for advice was a diversionary manoeuvre, the intention of which was to get the proposed Article 406 implemented without further changes (interview with Ms Wortmann). It should be noted that Article 406 retained considerable reporting flexibility to the financial conglomerates. Indeed, it was formulated in such a way that it suited both ING and Fortis, the parties which had the most divergent opinions.

This reply by the ministers formed the somewhat sudden (provisional) end to the problem. The proposed Article 406 was enacted without further changes and the matter was no longer a point of discussion on the floor of the Second Chamber (Proceedings, *Handelingen*, TK 20-1481). The First Chamber likewise had no comments on the issue of financial conglomerates.

The Legislative Process, Part 2: The Incorporation of the Insurance Directive

This was not the end of the story. On 19 December 1991, the Council of the European Community accepted the proposed Directive regarding the (consolidated) annual reports of insurance companies (PbEG L374 31 December 1991). The draft law to incorporate the Directive into the Dutch Civil Code was submitted to parliament on 5 November 1992. In the Explanatory Memorandum (22896, no. 3, p. 23) the ministers stated that financial conglomerates should report in accordance with paras 4 and 5 of Article 406. In its report (Report, 22896, no. 5, p. 1), the Christian Democrats at the legislative committee once again stressed the comparability issue. Moreover, the Christian Democrats favoured an organizational structure for financial conglomerates with a topholding and two subholdings which supervised the banking and insurance activities, respectively. All three holdings should disclose a consolidated annual report, and in this fashion the financial position of the whole conglomerate, as well as its constituting parts, would become visible. The Christian Democrats indicated that they were willing to lay down such a structure in law. The idea behind this proposal was that this type of organizational structure would enhance investors' ability to form sound judgements on corporate financial affairs. Moreover, the supervising institutions would be provided with a clear distinction between banks and insurance companies (interview with Mr Vreugdenhil). The Labour Party (PydA) (Report, 22896, no. 5, p. 2) joined the Christian Democrats in their opinion that insight into financial conglomerates should be enlarged by setting requirements on the disclosure of banking and insurance activities.

¹¹ The Council on Annual Reporting subsequently established a workgroup, whose members were Mr J. van der Plas (Moret, Ernst & Young, auditor of ING), Mr J. Buitendijk (ING), A. F. M. van Klaren (CNV/FNV—union), Mr O. L. A. M. Spaan (ABN/AMRO), Mr M. H. Th. Steunebrink (NIVRA—auditor), Professor F. van der Wel (Touche Ross Nederland/academic) (RJ, 1993:4).

The minister replied (Memorandum to Report, 22896, no. 6, p. 2) that, in accordance with Article 406, financial conglomerates would already have to disclose in their notes on the consolidated annual report, *behoorlijk wat*, that is, substantial information pertaining to the separate activities. These stipulations had been incorporated into the law because it was feared that, without such requirements, a top holding company could disclose just one consolidated annual report without providing any insight into the separate activities.

Apparently, the committee's Christian Democrat members were not satisfied with this solution. They did not consider the disclosure of substantial amount of data in the notes on the consolidation of the top-holding to be sufficient. They once again proposed two additional consolidated annual reports, one for each activity (*Verslag van een schriftelijk overleg*, Report on written deliberations, 22896, no. 8, p. 2). In his reply, the minister maintained that although Article 406 allowed consolidation, separate information about bank and insurance activities was required, in accordance with the EC directives regarding both activities. This answer was still not satisfactory to the Labour and Christian Democrat Parties, and the MPS Mr Vreugdenhil (CDA) and Mr Vermeend (PvdA) submitted an amendment to Article 406 in which the separate reporting on banking and insurance activities was specified. Formally, a new para. 6 was added to Article 406, which demanded the separation of balance sheet information, *in accordance with the format requirements* of the EC directives. The separation would have to include the equity of the separate bank and insurance activities. Through this amendment, the indecision of the ministers regarding the accounting method in which insight should be given was put aside. Instead of the relative flexibility in accounting method choice that the ministers (and industry) advocated, the framework and requirements of both EC directives were imposed. The draft law was subsequently accepted by parliament. The First Chamber did not comment on the proposal. One question that remains to be answered is: what triggered Mr Vreugdenhil and Mr Vermeend's amendment in which the choice of format was specified based on insight, including the requirement pertaining to the segmentation of shareholder equity. Two factors seem to have been influential. A high ranking financial officer at ING voiced the opinion in a conversation with the Christian Democrats' spokesman that Article 406 did not compel financial conglomerates to report separately on banking and insurance activities in accordance with the format requirements of the EC directive, nor did it compel these companies to segment shareholder equity. In fact, the 1992 ING annual report did not disclose segmental information about shareholder equity. Second, the minister announced in the parliamentary treatment of the bank draft, that he would consult the Council on Annual Reporting on the matter of the application of Article 406 in the case of annual reporting by financial conglomerates. A source from within the Council entrusted to the Christian Democrats' spokesman that the Council was unable to reach an agreement. The Council's workgroup advised that the disclosure of segmentation information on shareholder equity, in line with ING's position (interview with Mr Badon Ghijben and Mr Kuijper). The advice of the Council's workgroup met with resistance within the Council. In particular, the auditors' and users' delegation objected to the implications of the advice. They were in favour of disclosure. The

Christian Democrats concluded that ING was again the obstructing party in the failure to reach an agreement.¹² According to the Christian Democrats, ING had considerable influence on the employers' delegation in the Council on Annual Reporting, as it was a large contributor to the funds of the Employers Association, the Federation of Dutch Industries (VNO). In conclusion, the obstruction of the implementation of Article 406 by ING led to the Vreugdenhil/ Vermeend-amendment.

Why was ING the foremost opponent to the requirements of (the draft) law? The CDA felt that of the companies constituting ING, NMB-Postbank and Nationale Nederlanden, it was the former which had the weaker shareholder equity position (interview with Mr Vreugdenhil).¹³ In the merger process, significant transfers of equity funds had taken place to strengthen the NMB-Postbank's equity position. NMB-Postbank itself was established as a result of a merger between NMB and Postbank. It was NMB which had previously committed itself to an aggressive market policy which inherently entailed high risk. This high risk had had its effects on NMB's shareholder equity. Table 2 provides the reported equity of ING and NMB-Postbank in the relevant years. ING denied that equity transfers were the reason for their rejection of separate reporting. Instead, they stated that they had wished to present themselves as a single indivisible unit. This wish had a strategic origin. Some (financial) analysts had doubted the feasibility of financial conglomerates (Borkema *et al.*, 1992; Keiser, 1993; FD, 6-08-1993). ING, therefore, did not wish to emphasize that it was the result of a merger between two fields which were previously thought to be impossible to unite. In a way, separate reporting would signal to investors that the critics were right and that even ING was not certain of its own success (interview with Mr Badon Ghijben and Mr Kuijper).

While ING did not favour the segmentation proposal, in the end it acknowledged that it was very likely that this proposal would become law. At that time, ING changed its strategy. As was noted before, ING's financial officer had a conversation with the Christian Democrats spokesman in April 1993. In this discussion, ING tried

TABLE 2

CONSOLIDATED EQUITY DEVELOPMENT: ING GROUP AND NMB-POSTBANK

	1989	1990	1991	1992	1993
ING Group	14,150*	13,874*	13,859	15,597	21,481
NMB-Postbank	4,944	5,346	5,902		

Source: Annual Reports of ING-Group (1992) and NMB-Postbank (1990 and 1991). *pro forma combined amounts according to ING-Group annual report 1992

¹² Another high-ranking INH officer, Mr J. Buitendijk, was a member of the workgroup which prepared the advisory paper.

¹³ Mr Vreugdenhil based this observation on information that was conveyed to him by an employee of ING.

to convince the Christian Democrats that segmentation of shareholder equity would not provide useful information to the users. When this argument failed, ING put forward another aspect of the insurance draft which was considered undesirable by the insurance industry. Under the draft law (22896), real estate which was used by the company itself had to be depreciated (Explanatory Memorandum, 22896, nos 1–2, p. 9). Although there had been intensive discussions between the Justice Ministry and industry on this point, the ministry had not given in. In a letter to the Chamber's legislative committee, the Verbond van Verzekeraars had already asked the committee to amend this point. ING now suggested to the Christian Democrats spokesman amending the draft in accordance with the wishes of industry. This could be viewed as a trade-off on the segmentation and the depreciation issues (interview with Mr Badon Ghijben and Mr Vreugdenhil).

A Brief Note on the Explanatory Framework: Pluralism

The detailed description of the behaviour of the participants and the events of the regulatory process enables an attempt to explain the empirical findings. It should be noted that the exploration of the case was conducted independently from the explanatory effort. Essentially, then, pluralism presents a view of the political process in which power is fragmented and diffused, although some individuals or groups have more power than others. The outcome of the political process is said to be dependent on the relative strength of the interest groups involved (Dahl, 1961; Hirschleifer, 1976; Becker, 1983). Sources of power are distributed non-cumulatively, and no one source is dominant (Ham and Hill, 1988). Dahl (1957) argued that the behaviour of agents pursuing different preferences in concrete decisions should be studied to describe the relative influence of interested parties. The pluralist tenet underlies the economic literature of the political process, more commonly known as public-choice theory (Mueller, 1989). Many researchers in accounting have adopted economic theories of regulation (Puro, 1984), or of democracy of Downs (1957) and Olson (1965) (Sutton, 1984; Lindahl, 1987), or of the firm (Watts and Zimmerman, 1978; Holthausen and Leftwich, 1983; Kelly, 1983). In this line of work the incentives and preferences of interested parties are outlined and an equilibrium prediction is generated based upon the resources agents commit to their purpose. Government is seen as an interest group itself, the political process is depicted as a marketplace in which politicians compete for votes (Downs, 1967). Regulations are demanded and supplied (by government) in order to fulfil the self-interest of the actors in the process (Peltzman, 1976; McCormick and Tollison, 1981; Tollison, 1982). Accounting standards can thus be seen as products of a process in which regulations are set on the strength of the demands of effectively participating interest groups to fulfil the needs of the standard-setters (Rahman *et al.*, 1994). Regulation implies that certain agents are restricted in their implementation of *ex-ante* plans; therefore, regulation results in wealth transfers (McCormick and Tollison, 1981). Choosing between two alternative reporting requirements, then, is similar to the choice between two wealth distributions (May and Sundem, 1976; Bryant and Thornton, 1983). Since agents are affected in their wealth by regulation, they have an interest in the regulatory process. In public choice theory, all agents are potential wealth suppliers as well as deman-

ders. Attempts by agents to induce government to grant favours are costly (Tollison, 1982). If agents consider the costs of individual campaigning too high, they may combine their interests and undertake collective action. Then, organization costs will be incurred (Ohlson, 1965). Finally, the costs of employing a certain lobby instrument must be considered (Berry, 1977). In public choice theory, lobbying is, in the end, a cost/benefit trade-off. The entrance of an issue in the political process is often the result of a perceived crisis (Watts, 1977). Nobes (1991) argued that a wave of takeovers can provide the energy to start a regulatory process.

Pluralism has been criticized on two levels. First, political scientists have argued that power can be used to limit the scope of actual decision making to 'safe' issues. In such a fashion, the emergence of new demands for regulation is deterred. The analysis of decision making is then biased since it only incorporates (overt) influence attempts in innocuous issues, instead of the covert conflict in shaping the political agenda (Bachrach and Baratz, 1962). Moreover, Lukes (1974) argued that there is a third dimension of power, latent conflict, in which power is used to shape people's preferences so that no conflicts at all arise. Second, pluralism has been attacked because its assumptions might not be consistent with the political processes in the development of accounting standards (Walker and Robinson, 1993). Regulatory arrangements in accounting often involve complex and dynamic interactions between agencies. Pluralism does not explicitly address the intricacies of interorganizational relationships.

With regard to the political science critique on pluralism it should be noted that examining covert and latent conflict encounters ample empirical problems. Even the study of decision making in a pluralist context is often incomplete for the very reason that lobby success depends on secrecy. However, the case study design allows the collection of evidence of possible power exertion beyond that in overt decision making. Thus, although pluralist theory may not be able to explain this phenomenon, the research design that was adopted facilitated the collection of data that indicate whether there is evidence of covert or latent conflict. Whether the pluralist notion is applicable to explain political processes in accounting is an empirical question which is addressed in the discussion sections below.

Discussion of Field Reactions: The Position and Lobby Efforts of Users

Most users did not lobby intensively. User involvement in the formal regulatory process was largely restricted to participation in the Council on Annual Reporting. This is not unexpected since there is prior empirical evidence of the lack of user involvement in regulatory processes (e.g., Nobes, 1992). Moreover, lobbying is costly, and lobby efforts are said to be dependent on the resources at an agent's disposal (Blake, 1973; Becker, 1983). It should be remembered that the pluralist's notion of political processes asserts that resources are widely but unequally distributed, and consequently lobbying will be undertaken by certain groups only. Users, arguably, are not the wealthiest group. In this case, two user groups, however, did have substantial resources. First, the large investment firm that called the Christian Democrats' attention to the position of the users of financial conglomerates' reports. And second, the financial press, that is, FEM (a financial biweekly) and FD (a financial daily), which are widely read in the financial community, seemed to be critical and sometimes

even hostile to the prevailing practice of financial conglomerate reporting. Editorial comments on the rule development of 'bancassurance' reporting stressed that vitally important companies should provide sufficiently detailed information in their annual reports. In particular, the concentration of power in financial conglomerates concerned the financial press. It was stated that more disclosure and better annual reports could contribute to the insight into the affairs of financial conglomerates. The relatively large number of articles that appeared on the subject indicates that considerable resources were devoted to this cause (FD, 2 May 1992, 13 November 1992; FEM, 13 June 1992; Hers, 1993a, 1993b; Keiser 1993). Moreover, the Christian Democrats used the articles in FEM and the FD in forming an opinion on the matter. Hence, these two users had an important influence on the resulting segmental reporting standard. The users in the Council had similar preferences for segmental reporting as the financial press and the investment firm. The preferences of the users are in line with prior findings in the literature. Users of financial statements are found to prefer as much disclosure of information as possible as long as it is provided freely (Mian and Smith, 1990). With regard to the question at hand, it should be noted that unconsolidated reports are generally more informative than consolidated financial statements in the sense that the information in a set of unconsolidated statements generally allows a user to perform a 'homemade' consolidation, particularly if the magnitude of the within-group contracting is reported or is small; the reverse, however, is not true (Mian and Smith, 1990). In the course of time, it is expected that the interdependencies between the banking and insurance part of financial conglomerates will grow. This will frustrate home-made consolidations by users. Then, a consolidated report will be valuable for this interest group, in addition to segmental information. Thus, the users' preferences are understandable in view of this analysis.

Discussion of Field Reactions: The Companies Involved

The companies involved in this bancassurance case are relatively new in their present form. The 1991 annual reports became the centre of attention because no regulation had yet been implemented. Therefore, these reports were the most likely to reflect the preferences of the companies involved. In the 1991 annual report of all seven¹⁴ relevant companies, both banking and insurance activities were consolidated. Van der Tas (1993) showed that ING and Reaal copied the proposals (model) of the NVB/VvV workgroup for both the balance sheet and the profit and loss. ING adhered more closely to the proposal than Reaal. Table 3 reflects the segmental information provided by the companies. This table supports the conclusion that Fortis disclosed the most information.¹⁵

¹⁴ These companies are: ABN-AMRO, Aegon, Fortis, ING, Levob, Reaal and RABO (Van der Tas, 1993).

¹⁵ Fortis held a somewhat special position in this case as it was a transnational merger, being the result of the merger between the Dutch VSB/AMEV and the Belgian AG. The choice for separate reporting of bank and insurance activities may be attributed to the special structure of Fortis as it had two parents, AG Group and N.V. AMEV, neither of which is a part of Fortis. Both parents have a 50 per cent interest in Fortis, through a 50 per cent interest in AG 1824 and AMEV/VSB 1990. The AG Group participates in AMEV/VSB 1990 through its 94 per cent subsidiary AG 1990 N.V. and the 100 per cent subsidiary of the latter, AG 1990 (Netherlands), in which they perform their operational activities.

TABLE 3

SEPARATE REPORTING BY FINANCIAL CONGLOMERATES IN 1991

Segmentation	Balance sheet	Profit and Loss statement
ING	investments in nominal values	consolidated result per activity
Reaal	investments, placings, and loans	consolidated result per activity except other gains and losses
Fortis	separate consolidated statements for insurance, banking and general activities	separate consolidated statements for insurance, banking, and general activities
Levob	separation of equity in financial services, other activities, and insurance	no separate reporting
Aegon	no separate reporting	amount and composition of turnover and earnings before interest and taxes of non-insurance activities
ABN-AMRO	no separate reporting	no separate reporting
RABO	segmentation of all relevant items in both activities	segmentation of all relevant items in both activities

Source: Annual Reports and Van der Tas (1993).

The economics perspective on accounting method choice may be used to explain the preparers' preferences. Based on Mian and Smith's (1990) findings, it is argued that 'interdependence' is a major factor in explaining consolidation and disclosure preferences. Increased interdependence strengthens the preference for consolidation. Mian and Smith (1990) drew on transaction cost economics to argue that the more firm-specific an activity, the more likely it will be performed within a department or division and the less likely it will be subcontracted to an independent firm. The accounting decision on consolidation will then reflect the firm's choice of organizational structure (make or buy), which, in turn, is determined by the degree of interdependence between the parent and the subsidiary activities. The findings of the case suggest that these predictions are substantially accurate. All seven firms preferred consolidated reporting. And although the financial conglomerates disclosed substantial information, there was a clear borderline: the segmentation of shareholder equity was strongly opposed.

According to pluralism, preparers will have greater incentives and better prospects to lobby. In theory an agent will lobby to the point where the marginal benefits of lobbying equal the marginal costs. Preparers bear greater benefits of lobbying than users because the potential costs of regulation will generally be larger (see also, Sutton, 1984, p. 85). Indeed, empirical evidence substantiated the theoretical predictions in this case. It was primarily the preparers who lobbied. They had intensive contacts with the Justice Ministry in the drafting phase of both laws, and prior to that they were involved in European discussions pertaining to the two directives. Likewise, they also contacted the Christian Democratic Party presumably in an attempt to convince its representatives of their point of view.

A large agent's expected total benefits are more likely to exceed lobbying costs than a small agent's. Thus, large agents can be expected to lobby most ardently (Ohlson, 1965). The group of companies involved in the financial conglomerate case was not of homogeneous size. ING was by far the most important mixed financial firm. Fortis was likewise of considerable importance. Indeed, ING appeared to be the most active lobbying party. Even Fortis did not seem to play as important a part as ING, although it was certainly involved, for example, in its contacts with the Justice Ministry and in the preparation of the NVB/VvV advice. The contacts with the Justice Ministry were, however, the result of initiatives on the side of the ministry itself. Therefore, the prediction is corroborated to the extent that only very large companies with significant interests in the regulatory process would attempt individually to influence the outcome. An important part of the lobbying was performed collectively by the joint initiative of the two industry associations involved, the NVB and VvV. It should be noted that since accounting regulation exhibits the characteristics of a public good, no agent can be excluded from its benefits after implementation. Therefore, little incentive exists to contribute to the costs of lobbying. Unless a cost-sharing rule is agreed upon, free riding is likely to occur. Industry associations are then likely candidates to represent the views of preparers of financial statements. In contrast to *ad hoc* lobby groups, industry associations have established cost-sharing rules, and other measures for facilitating effective collective action. Moreover, they do not encounter start-up costs which ensue from initiating an organization which unifies agents with similar interests. The joint NVB/VvV workgroup was supplied secretarial support by NVB. Moreover, the workgroup was formed by members of both industry associations. As such, this workgroup participated intensively in the process at relatively low costs.

Some companies appeared to dominate the collective actions, although all of the important companies provided some input. When intensities of preferences over a certain item differ between members of a lobbying group, log-rolling may occur, that is, the agent who feels the strongest on an issue will be supported by other agents (with marginal interests) on the condition that such a support be reciprocated in due time. Lobbying seemed to be aimed at the Council on Annual Reporting. In the workgroup formed by this Council, there was support for ING's position. Subsequently, the representatives of the employers' organizations readily supported ING's position in deliberations on the floor of the Council. Comparing the 1991 annual reports of the financial conglomerates with the NVB/VvV proposal, it appeared that ING's annual report was the most in line with this proposal. Therefore, and in light of the results of the interviews, it seems reasonable to suggest that log-rolling took place in favour of ING's preferences when drafting the NVB/VvV advice, and in the employers' delegation of the Council. The conclusion seems all the more legitimate because Fortis, the other major player in the field, had a completely different disclosure preference.

One of the respondents pointed out that it was unlikely that captains of industry would participate in demonstrations.¹⁶ Indeed, most lobbying occurred through some

¹⁶ In the recent intense controversy in the U.S.A. over recognizing the compensation expense implicit in stock option plans, however, companies that objected to the FASB's proposal hired a band and demonstrated loudly outside the FASB's hearing room.

form of information transfer. It is interesting to note that the government itself explicitly solicited the transfer of information (e.g., NVB/VvV advice). Not only did the industry transfer information by publishing an advisory statement, it also participated in the exchange of views while the new legislation was being debated. The lobby method of information transfer from agents to the standard-setter, and especially subsidizing 'independent' or 'expert' information that supports the position of an agent, has long been recognized in the literature (Bartlett, 1973; Watts and Zimmerman, 1979). Information transfer is not the only way agents put their views on the stage. Private conversations and informal meetings with members of parliament, and representatives of government (politicians as well as civil servants) are among the most effective lobbying instruments, and were used by the producers of financial accounts.

With regard to the timing of the lobbying, the prediction is that effective lobbying would occur as early in the process as possible. Lobbying is likely to be most successful if it takes place before a civil servant sets pencil to paper for the first time to write a proposal. Once a certain regulation is enacted, the possibilities of changing its implications are limited (Sutton, 1984; Van Schendelen, 1988). One of the most successful lobbying efforts was undertaken by the large investment firm which contacted the Christian Democrats Party at an early stage of the process. Although industry representatives engaged in talks with the Justice Ministry regarding the draft laws, the most intense lobbying occurred relatively late in the process, when ING's financial officer talked to the Christian Democrats' spokesman in April 1993. Apparently, the Christian Democrats had already made up their mind on this issue and the efforts of industry proved to be futile.

Discussion of Field Reactions: Auditor Involvement

The market for audit services for financial conglomerates is characterized by a duopoly. The market is almost completely dominated by two audit firms: Moret, Ernst & Young (MEY) and KPMG. There are only a few contemporary statements of the opinion of auditors regarding the financial conglomerates issue. One of the most interesting was made by the MEY vice-chairman of the board while presenting the MEY annual report 1991. He declared that it was the opinion of MEY that separate reporting should be required for those financial conglomerates which had equally large banking and insurance activities (FD, 25 March 1992). This opinion diametrically opposed the interests of MEY's (large) clients, who were only willing to implement separate reporting to a limited degree. Moreover, it should be noted that the vice-chairman's ideas conflicted with the proposals made by NVB/VvV. The vice-chairman made his statement after the joint NVB/VvV advice was published, but before parliament discussed the draft law. Although remarkable, this statement did not seem to have had an important impact on the political process, as the Christian Democrats Party was unaware of it. However, the Justice Ministry was somewhat disconcerted that one of the largest auditing firms in the country appeared to be taking a position which clearly diverged from the Ministry's policy. Hence, MEY was contacted by the Justice Ministry to find out whether this was indeed an official position taken by the firm regarding this issue. MEY made it clear that there

was no such position and that the vice-chairman's statement reflected only his personal views (interview with Ms Wortmann). One of the large clients of MEY was ING. The ING assignment partner at MEY held quite a different opinion on the issue than his vice-chairman; he supported the idea that ING should present itself as a single indivisible unit. ING's top financial officer was rather annoyed with the statements by MEY's vice-chairman (interview with Mr Badon Ghijben). In an attempt to convince ING of their good intentions, MEY officials referred to their vice-chairman's comments as 'an internal communications error'.

With regard to the position of auditors, the literature suggests that they face a number of incentives, which are not mutually exclusive. Watts and Zimmerman (1986) argued that audit firms have incentives to lobby for standards that increase their value; an increase in value will be expected if audit fees rise due to increased audit services which originate, for example, in the examination of previously separated reported activities. Consequently, auditors will favour consolidation. Furthermore, when separate statements on activities have to be provided to prevent information loss, additional audit services can be expected, and auditors can be expected to favour separate statements. Auditors have, in addition, an incentive to support their clients' positions (Haring, 1979; Puro, 1984, 1985). Puro showed that, although in lobbying the FASB audit firms did not support their clients in disclosure matters, they did support their client's position on measurement issues. In this case, it is then expected that auditors and their clients will disagree on the disclosure of segmental information. The prediction is that auditors will lobby for segmental reports while preparers are expected to lobby against it. The empirical findings in this case suggest that auditors did *support* their clients, even in disclosure matters. Thus, Puro's (1985) findings were not corroborated, but evidence was found in support of Watts and Zimmerman (1986) 'audit fee hypothesis'. The pluralist notion that only large audit firms will be involved in lobbying the standard-setter was also corroborated. Indeed, only Big-6 firms (KPMG; Moret, Ernst & Young; Touche Ross) played a part in the political process.

CONCLUSION

Pluralism states that the agent that commits the most resources to lobbying is more likely to see his preferences reflected in the standard (Becker, 1983). The standard that was implemented by parliament (Article 406) mirrored mostly the preferences of users, that is, consolidation of both bank and insurance activities, and substantial segmental information including information about the allocation of shareholder equity. Although prior beliefs might indicate that preparers, as the most wealthy party, would have the most influence, the financial conglomerate case showed that the combined lobby efforts (resource dedication) of users were substantial. Especially, the input of a large investment firm and the financial press played an important role. The regulatory effort was the result of a 'crisis', namely, the unanticipated merger of banks and insurance firms. The analysis showed that there were several interested parties in the forging of Article 406. From the outline of their preferences it can be implied that the producers of accounts were not a cohesive block. However, they lobbied for a

standard that accommodated each of their views. Auditors did adhere closely to the preferences of the companies to which they were affiliated. In contrast to some earlier findings (Puro, 1985; Rahman *et al.*, 1994), producers and auditors clustered when presenting their views. Users and the Dutch Central Bank opposed the producers and auditors with regard to their disclosure preferences. Government was involved in the process, mainly through two 'agencies': parliament and the Justice Ministry. The interested parties differed in the opportunities they had to participate in the formal promulgation process. Moreover, they differed in the degree they had access to decision makers at key governmental positions. Preparers and the Dutch Central Bank, for example, had ample opportunities to engage in the preparatory phase of the regulation process because they were involved with the EC discussions on the banking and insurance directive, and because the Justice Ministry sought to incorporate the preparers' views in the draft law and, therefore, asked for contributions to the process. The preparers and the large investment firm also had direct access to the Christian Democrats Party. Other users were confined to indirect means like newspapers to convey their views. Although companies, in general, seem to have institutionalized their involvement in accounting standard setting, and thus might be better capable to present their views, in line with the pluralist tenet, other interested parties were able to effectively voice their opinion in the process and have some influence in the political process.

REFERENCES

- Amershi, A. H., J. S. Demski and M. A. Wolfson, 'Strategic Behaviour and Regulation Research in Accounting', *Journal of Accounting and Public Policy*, Vol 1, 1982.
- Bachrach, P., and M. S. Baratz, 'Two Faces of Power', *American Political Science Review*, Vol. 56, 1962.
- Barkema, H. G., S. W. Douma and B. T. M. Steins Bisschop, *Analyse van een Fusie. Strategische. Financieel-Economische en Juridische Aspecten van de Fusie Tussen Nationale-Nederlandse en de NMB-Postbank Group*, Academic Service, 1992.
- Bartlett, R., *Economic Foundations of Political Power*, The Free Press, 1973.
- Becker, G., 'A Theory of Competition Among Pressure Groups for Political Influence', *Quarterly Journal of Economics*, XCVIII, 1983.
- Berry, J. M., *Lobbying for the People: The Political Behavior of Public Interest Groups*. Princeton University Press, 1977.
- Blake, H., 'Conglomerate Mergers and Antitrust Laws', *Columbia Law Review*, Vol. 73, 1973.
- Bryant, M. J. and D. B. Thornton, 'Public Choice of Corporate Accounting Standards', in R. Mattessich (ed.), *Modern Accounting Research*, Research Monograph 7, Canadian Certified General Accountants' Research Foundation, 1984.
- De Haan, H. P., 'De Nieuwe Jaarrekening van Nederlandse Banken', *Bank-en Effectenbedrijf*, Vol. 42, 1993a+b.
- De Nederlandsche Bank (DNB), *Jaarverslag 1989, 1990, 1991*. De Nederlandsche Bank, 1990, 1991, 1992.
- Dahl, R. A., 'The Concept of Power', *Behavioural Science*, Vol. 2, 1957.
- , *Who Governs?*, Yale University Press, 1961.
- Downs, A., *Inside Bureaucracy*, Little Brown, 1967.
- FD, 'Advies Jaarrekening Bankverzekeraars', 4 February 1992.
- , 'Banken en Verzekeraars Zitten op Elkaars Lip', 25 February 1992.
- , 'Moret: Separate Rapportage Nodig bij Banken', 25 March 1992.

- , 'Jaarverslag ING Biedt Nog Minder Dan ABN-AMRO', 2 May 1992.
- , 'Loflied op Verzekebanken Verstilt', 13 November 1992.
- , 'ING Brengt Met Eigen CAO 'Bancassurance' in het Spel', 3 December 1993.
- FEM, 'Financiele Concerns Maken Ratjetoe', *FEM*, 23, 1992.
- Francis, J. R., 'Lobbying Against Proposed Accounting Standards: The Case of Employers' Pension Accounting', *Journal of Accounting and Public Policy*, Vol. 6, 1987.
- Ham, C., and M. Hill, 'The Policy Process in the Modern Capitalist State', Wheatsheaf, 1988.
- Haring, J. R., 'Accounting Rules and the Accounting Establishment', *Journal of Business*, Vol. 52, 1979.
- Hers, F., 'Verzekeringslobby Scoort', *FEM*, 24, 1993a.
- , 'Verzekeraars, Meer Realism Graag!', *FEM*, 24, 1993b.
- Hirschleifer, J., 'Comment', *Journal of Law and Economics*, Vol. 6, 1976.
- Holthausen, R. W. and R. W. Leftwich, 'The Economic Consequences of Accounting Choice', *Journal of Accounting and Economics*, Vol. 5, 1983.
- Keiser, H., 'Weg Met All Finanz!', *FEM*, 24, 1993.
- Kelly, L., 'The Development of a Positive Theory of Corporate Management's Role in External Financial Reporting', *Journal of Accounting Literature*, Vol. 2, 1983.
- Klassen, J., 'An Accounting Court: The Impact of the Enterprise Chamber on Financial Reporting in the Netherlands', *The Accounting Review*, Vol. 55, 1980.
- Klumpes, P. J. M., 'The Politics of Rule Development: A Case Study of Australian Pension Fund Accounting Rule-Making', *Abacus*, September 1994.
- KPMG, *Bepalingen voor de Jaarrekening van Banken*, KPMG Klynveld, 1993a.
- , 'Pro Forma Annual Accounts for Banks for the Financial Year 1993', KPMG, Klynveld, 1993b.
- Leftwich, R. W., R. L. Watts and J. L. Zimmerman, 'Voluntary Corporate Disclosure: The Case of Interim Reporting', *Journal of Accounting Research*, Vol. 19, 1981.
- Lindahl, F. W., 'Accounting Standards and Olson's Theory of Collective Action', *Journal of Accounting and Public Policy*, Vol. 6, 1987.
- Lukes, S., *Power: A Radical View*, Macmillan, 1974.
- May, R. G. and G. L. Sundem, 'Research for Accounting Policy: An Overview', *The Accounting Review*, Vol. 51, 1976.
- McCormick, R. E., and R. D. Tollison, *Politicians, Legislation, and the Economy: An Inquiry into the Interest-Group Theory of Government*, Martinus-Nijhoff, 1981.
- Mian, S. L., and C. W. Smith, 'Incentives for Unconsolidated Financial Reporting', *Journal of Accounting and Economics*, Vol. 12, 1990.
- Moret, Ernst & Young (Reijrink, J. G. L. M.). *Banken en Effecteninstellingen in 1993*, (2nd edn), MEY, 1990.
- Mueller, D. C., *Public Choice II*, Cambridge University Press, 1989.
- Nederlandse Vereniging van Banken and Verbond van Verzekeraars (NVB/VvV), *Verslaggeving Financiele Concerns*, NVB/VvV, 1992.
- Nobes, C., 'Cycles in U.K. Standard Setting', *Accounting and Business Research*, Vol. 21, 1991.
- , 'A Political History of Goodwill in the U.K.: An Illustration of Cyclical Standard Setting', *Abacus*, September 1992.
- Nobes, C. and R. Parker (ed.). *Comparative International Accounting*, (4th edn), Prentice Hall, 1995.
- Olson, M., *The Logic of Collective Action*, Harvard University Press, 1965.
- Peltzman, S., 'Toward a More General Theory of Regulation', *Journal of Law and Economics*, Vol. 6, 1976.
- Puro, M., 'Audit Firm Lobbying Before the Financial Accounting Standards Board: An Empirical Study', *Journal of Accounting Research*, Vol. 22, 1984.
- , 'Do Large Accounting Firms Collude in the Standard-Setting Process?' *Journal of Accounting, Auditing and Finance*, Vol. 8, 1985.
- Rahman, A. R., L. W. Ng and G. D. Tower, 'Public Choice and Accounting Standard Setting in New Zealand: An Exploratory Study', *Abacus*, March 1994.

- Sutton, T. G., 'Lobbying of Accounting Standard-Setting Bodies in the U.K. and the U.S.A.: A Downsian Analysis', *Accounting, Organizations and Society*, Vol. 9, 1984.
- Tollison, R. D., 'Rent Seeking: A Survey', *KYKLOS*, Vol. 35, 1982.
- Van der Tas, L. G., 'Verslaggeving door Gemengde Financiële Instellingen', in M. N. Hoogendoorn and R. Van der Wal. (eds), *Jaar-In-Jaar-Uit 7*, Wolters-Noordhoff, 1993.
- Van der Wel, F., 'Jaarverslaggeving van Nederlandse Banken', *Maandblad voor Accountancy en Bedrijfseconomie*, Vol. 65, 1991a.
- , 'De betekenis van de IASC-en de EG-Richtlijn voor de Jaarverslaggeving van Banken', *De Naamloze Vennootschap*, Vol. 69, 1991b.
- , 'Nieuwe wetgeving voor de jaarverslaggeving van banken', *Bank-en Effectenbedrijf*, Vol. 41, 1992.
- Van Schendelen, M. P. C. M., 'Omgaan met de Politiek: Lobbyen', *Namens*, Vol. 3, 1988.
- Walker, R. G., and S. P. Robinson, 'A Critical Assessment of the Literature on Political Activity and Accounting Regulations', *Research in Accounting Regulation*, 1993.
- , 'Related Party Transactions: A Case Study of Inter-Organizational Conflict Over the "Development" of Disclosure Rules', *Abacus*, March 1994.
- , 'Competing Regulatory Agencies with Conflicting Agendas: Setting Standards for Cash Flow Reporting in Australia', *Abacus*, September 1994.
- Watts, R. L., 'Corporate Financial Statements, a Product of the Market and Political Processes', *Australian Journal of Management*, Vol. 2, 1977.
- Watts, R. L. and J. L. Zimmerman, 'Towards a Positive Theory of the Determination of Accounting Standards', *The Accounting Review*, Vol. 53, 1978.
- , 'The Demand for and Supply of Accounting Theories: The Market for Excuses', *The Accounting Review*, Vol. 54, 1979.
- , *Positive Accounting Theory*, Prentice Hall, 1986.
- , 'Positive Accounting Theory: A Ten Year Perspective', *The Accounting Review*, Vol. 65, 1990
- Yin, R. K., *Case study Research: Design and Methods*, (rev. edn), Sage, 1989.
- Zeff, S. A., F. Van der Wel and K. Camfferman, *Company Financial Reporting*, North-Holland, 1992.
- Zeff, S. A., 'Some Reflections on Company Financial Reporting: An American in the Netherlands', *The European Accounting Review*, Vol. 3, 1993.

Other Sources

Below, an overview is presented of the parliamentary documents used in this study. The Dutch terminology is used.

Kamerstukken	Tweede Kamer	vergaderjaar 1990-1991	22169	A-B, 1-3
		vergaderjaar 1991-1992	22169	4-9
		vergaderjaar 1992-1993	22169	10-15
Handelingen	Tweede Kamer	10 November 1992	22169	TK20
				TK22
Kamerstukken	Eerste Kamer	vergaderjaar 1992-1993	22169	84
				84Herdruk
				84a-c
Handelingen	Eerste Kamer	16 March 1993	22169	EK21
Staatsblad		1993	258	
Kamerstukken	Tweede Kamer	vergaderjaar 1992-1993	22896	A-B, 1-11
Handelingen	Tweede Kamer	1 July 1993	22896	TK86
Kamerstukken	Eerste Kamer	vergaderjaar 1992-1993	22896	323, 323a
Handelingen	Eerste Kamer	14 September 1993	22896	EK37
Staatsblad		1993	517	