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Against Convergence: Mounting a Legal Challenge to FASB's Adoption of International Accounting Standards

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By the close of 2011, the Securities and Exchange Commission (SEC or Commission) was to have announced its decision regarding the adoption of international accounting standards for public company financial recordkeeping and reporting. But in December, it punted; SEC staff needed "a few additional months."[1] Someday, maybe soon, we'll find out if the nearly decade-long experiment toward *international convergence*, the joint project by private U.S. and European standard-setters to develop "high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting"[2] is actually going to happen.

If it does, the *nouvelle vague* reporting equivalent of a one-world, principles-based system of accounting will be upon us. Currently, U.S. companies by and large account for and report their financials under U.S. generally accepted accounting principles (GAAP); many European companies use International Financial Reporting Standards (IFRS); still others follow local accounting rules. Convergence would subject financial reporting to the same standards.

For those unhappy with that prospect or who believe so momentous a change requires something more than just Commission fiat to satisfy basic requirements of due process, the time for mounting a challenge to convergence is clearly approaching. What shape that challenge might take and the principle legal arguments we believe would be at its core–the unconstitutional delegation of legislative power to a private entity and almost certain violation of Article II, Section 2, Clause 2 (Appointments Clause)–should be of interest to both opposers of convergence and civil libertarians alike.

No doubt the idea of some form of accounting hegemony has appeal and its champions: one set of standards should permit more accessible cross-border comparability. Transparency should increase. And global companies should no longer need to operate within multiple accounting regimes.

Still, there are reasons to resist the move to a one-size-fits-all set of accounting standards. According to the American Insurance Association:

> [A]n accounting standard should be sufficiently flexible to reflect differences among different companies, as well as the differences that arise from the various business and legal environment in which the insurance contracts operate. Indeed, it is the differences among insurers -- many arising because of individual business strategies and cost structures unique to each insurer -- that are useful to financial statement users.[3]

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Add to those observations the view–held by, among others, former Public Company Accounting Oversight Board (PCAOB) member Charles Niemeier–that what is in fact at work is not so much *convergence* as it is *capitulation*, an abandonment of U.S. GAAP in favor of the wholesale adoption of IFRS,[4] and it is clear that not everyone welcomes international convergence.

Under a converged regime, few markets would experience more significant change than insurance, and it should come as no surprise, for example, that proposed changes to insurance contract accounting are causing many U.S. insurers to wince. Specific critiques are numerous and varied: according to prominent players on the insurer-side, the proposed standards to govern insurance contracts do not adequately differentiate between life and non-life insurance products;[5] others argue that the use of an explicit risk adjustment margin can be subjective, complex, and conservative.[6] Suffice it to say that the proposed changes have their share of detractors, despite a generally broad consensus in the insurance community that a single set of high-quality standards would be desirable,[7] at least in theory.

Concerns about convergence run deeper than the mere technical–there is more at stake than tweaks to actuarial modeling or estimating cash flows. For starters, consider the transformative effect on company balance sheets caused by the radical–and mandatory–discounting of reserves that a principles-based accounting system will require. Under current practice, insurers typically post a nominal reserve, work it off, and make a significant percentage of their revenue on the "float." With steeply discounted reserves, the existential nature of "income" is fully revealed as a major percentage of that investment income is lost. Simultaneous with that change, insurer book values balloon as their reserve base sinks due to discounting. Shareholder and bondholder confusion will be immense as all historical comparison data become useless absent almost impossible-to-do translations. Not quite accountant-induced Armageddon, but close.

"User confusion" isn't the only problem with convergence, even if it may be the biggest (one CFO we spoke to thinks it is "THE" problem with the plan). According to Deloitte, adoption by U.S. insurers of international accounting standards will require redesigns in company technology, and retooling of educational training programs for staffers; convergence might well push insurers to offer different products–and fewer, costlier products.[8] Small business owners and consumers, then, could end up suffering the most. Imagine the domino effect: U.S. insurers are required to adopt unfamiliar and untested (at least by them) international accounting standards. Fearful or uncertain of the short, medium, and long-term effects on their balance sheets under the new regime, insurers shy away from taking on as much risk as in the past and eliminate certain product lines entirely. Increased conservatism leads to less capacity leads to a hardening of markets leads to . . . . Well, you get the point. With heightened (or even steady) demand chasing less available coverage, premiums rise, and some businesses simply will be unable to afford or otherwise obtain sufficient insurance; risk-taking innovation will slow, and global economic growth will suffer.[9] On that score, Genworth Financial added this:

> [T]he insurance industry's ability to attract and retain capital is heavily dependent upon investor appetite and confidence both of which are fueled by access to decision useful information in financial statements. Certain aspects of the proposed standard have the potential to disrupt the industry's ability to obtain capital as well as impact certain markets supported heavily by insurance businesses. Companies that issue insurance contracts serve as long-term stable investors in corporate debt, support the consumer financial and housing markets, and protect individuals' financial security.[10]

No matter one's view regarding the merits and demerits of international convergence–that is, the *should-they-or-shouldn't-they* question–few seem to be asking the necessarily antecedent question: *can* they or *can't* they? And, perhaps even more interesting to the lawyers and practical-minded among us, there is the related 64 billion dollar question: *how might they be stopped*? For convergence raises serious legal questions about delegation of authority to the private sector, the Executive's appointment and removal powers, and due process. In short, the implementation of international convergence may ultimately be subject to challenge as unconstitutional.

Will the day for mounting such a challenge ever come? Perhaps sooner than you think, and it is with that possibility in mind that the rest of this article proceeds. We begin by situating the convergence project in its historical context. Next, we present a brief primer on the relevant Supreme Court jurisprudence, with emphasis on the Court's precedents regarding delegation of authority to private entities and the Appointments Clause issue, and conclude by offering some brief thoughts regarding some of the strategic and tactical hurdles facing those who would oppose the full-blown implementation of convergence as presently conceived.

Historical Overview: FASB, the IASB, and Convergence

The Financial Accounting Standards Board (FASB) is the private, not-for-profit organization responsible for developing U.S. GAAP. It was created in the early 1970s following decades of fitful efforts to craft a standard set of principles for the accounting profession. By enacting the seminal federal securities laws in 1933 and 1934, Congress had given regulators the authority to police financial disclosures, among them corporate accounting practices. To avoid politicizing accounting principles or perhaps to allay concerns regarding their own technical competence, regulators tasked nongovernmental groups composed mostly of accounting industry veterans with establishing industry-wide principles. The Committee on Accounting Procedure, extant from 1939 until 1959, tried first, with few successes. The committee was hampered by inadequate research and insufficient credibility. So the torch was passed to the Accounting Principles Board. Too often, though, the board focused on one-off questions rather than overarching principles and standards. Eventually it, too, was tossed aside.[11]

With two strikes against them, the regulators turned to FASB. They were convinced then–and presumably continue to believe now–that the best course is to leave standard-setting to the private sector and retain for themselves an oversight role,[12] albeit arguably illusory (more on that later). FASB would succeed where those before it had failed, the thinking went, because accounting professionals supported it and agreed to accept its edicts. Plus, the SEC was willing to accept corporate disclosure documents prepared in accordance with FASB's pronouncements–tacit recognition that those pronouncements squared with the agency's charge to protect investors. If either of those supports faltered, though, FASB likely would suffer the same fate as its predecessors.[13]

Instead, for the past 40 years, FASB has proved its staying power. With seven full-time members appointed by the Board of Trustees of the Financial Accounting Foundation–an umbrella organization that oversees FASB and the Governmental Accounting Standards Board–and a staff of more than sixty, FASB is *the* standard-setter for U.S. GAAP; unless and until the SEC says otherwise, U.S. public companies must report financial information prepared using U.S. GAAP, as set by FASB.[14]

Had the globalization of commerce not so rapidly accelerated toward the end of the twentieth century, the story might have ended there. After all, U.S. businesses are, by and large, familiar with and largely satisfied with U.S. GAAP. They have the talent, technology, and track records to report accurately and consistently. But the demands of an increasingly interconnected global economy have raised challenges for cross-border comparisons of reported financial data. Where, for example, U.S. companies report using U.S. GAAP and non-U.S. companies report using international standards or even local standards (the SEC eliminated the reconciliation requirement in March 2008), meaningful comparisons of financial data are difficult to create and sometimes nearly impossible to come by.

Today, none of this is news, really. To be sure, FASB's predecessors tinkered with the idea of harmonizing international accounting standards as far back as the 1950s. It wasn't until 2002 that FASB began in earnest a scheme with the International Accounting Standards Board (IASB) to design singular global accounting standards–what we've been speaking about here as convergence. The IASB, organized in its current form in 2001, functions much like FASB. Just as FASB sets accounting standards by issuing U.S. GAAP, so too does the IASB set standards: IFRS. The IASB is overseen by the IFRS Foundation's Trustees who, in turn, are overseen externally by the Monitoring Board of external public capital market authorities. Just as the SEC is to ensure that FASB's work is carried out in the best interests of investors, the Monitoring Board is to ensure that the IASB fulfills its mandates regarding investor protection, market integrity, and capital formation. To the extent that it is completed successfully, convergence likely will be FASB's and the IASB's most enduring legacy.

Delegating Legislative Authority to a Private Entity such as FASB Raises Serious Constitutional Concerns

In 2003, following the enactment of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), the SEC issued a "policy statement" in which it effectively delegated standard-setting authority *to FASB*. The SEC concluded that FASB "is capable of improving both the accuracy and effectiveness of financial reporting and the protection of investors under the securities laws."[15] By virtue of that policy statement, FASB standards are authoritatively considered to be U.S. GAAP *without the SEC taking any affirmative action*.

And so, finally, we get to the rub. Either (1) *the SEC* should be the one to issue rules and regulations in oversight of FASB, thereby ensuring some measure of democratic accountability and the availability of federal strictures such as the Administrative Procedure Act (APA); or (2) FASB is a private entity engaged in lawmaking without clear accountability to any branch of government–its pronouncements have the prospective and authoritative force of law that companies must obey or face government sanction–and in this regard is constitutionally suspect. There is a strong argument that the SEC's policy of *prospectively* granting blanket recognition to future FASB accounting rule changes violates Article I of the Constitution and the private non-delegation doctrine by impermissibly delegating rulemaking authority to a private, unaccountable body without sufficient oversight by either the SEC or Congress.

The SEC's Failure to Exercise Effective Control over FASB Standards Suggests that Legislative Authority Has Been Improperly Delegated

In two seminal opinions from the 1930s, the Supreme Court articulated the principle that legislative authority cannot be delegated to private entities. In *A.L.A. Schechter Poultry Corp. v. United States*,[16] the Supreme Court considered a statute that permitted trade groups to create "codes of fair competition" and then authorized the President to approve those codes upon application. The Court made clear that a private entity, unaccountable to democratic processes, could not be delegated "legislative authority."[17] The government defended enforcement of the codes on the ground that they "consist[ed] of rules of competition deemed fair for each industry by representative members of that industry–by the persons most vitally concerned and most familiar with its problems," but the Court rejected that argument. The Court stated that such "a delegation of legislative power is unknown to our law, and is utterly inconsistent with the constitutional prerogatives and duties of Congress."[18] Rather, the codes could have binding effect, if at all, only because the President had approved them. The Court went on to hold that the President's role could not save the statute's constitutionality because Congress had specified no standards to govern the President's decision regarding which codes to enforce.[19]

A year later, in *Carter v. Carter Coal Co.*,[20] the Supreme Court held invalid a provision of the Bituminous Coal Conservation Act that allowed a majority of coal miners and producers to establish wage and hour standards for the entire industry. The Court concluded that the arrangement was "legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to *private persons* whose interests may be and often are adverse to the interests of others in the same business."[21]

Other decisions similarly stress the need for oversight of any private standard-setting body by a governmental entity that is ultimately responsible for making policy. For example, courts have upheld the SEC's delegation of the registration of broker-dealers to the National Association of Securities Dealers (NASD) as a valid exercise of power on the ground that the NASD's rules and disciplinary actions were "subject to full review by the S.E.C., a wholly public body, which must base its decision on its own findings."[22]

The SEC's regulatory oversight of self-regulatory organizations (SROs) like the NASD, and now the Financial Industry Regulatory Authority, stand in marked contrast to its present relationship with FASB. The SROs' rules must be submitted to the SEC, which undertakes notice-and-comment rulemaking, ultimately publishing a final rule in the Federal Register before any new rule can take effect.[23] Notably, in Sarbanes-Oxley itself, Congress stated that "[n]o rule of the [PCAOB] shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 7213(a)(3)(B) of this title with respect to initial or transitional standards."[24] By contrast, the SEC has construed Sarbanes-Oxley to permit it to adopt even future FASB standards wholesale, not on a standard-by-standard basis after analyzing each FASB pronouncement on its merits. In practice, what this effectively means is that the SEC fails to exercise any "apparent discrimination" with respect to FASB standards—at least until the point that the SEC makes enforcement decisions. Rather, all FASB standards are accorded "authoritative" status and have the effect of legal requirements to which public companies are compelled to comply. And lest we forget, it's not just accounting rules that flow through and out of FASB, but criminal law as well. And while no one has been locked up for disobeying the rules of a private think tank, at least not yet, company CFOs are by no means the only ones who should be concerned.

Throughout the years, the Supreme Court has bristled at the prospect of private-entity rulemaking, in part fearing private insulation from public accountability.[25] Accordingly, there is strong support for an argument that the SEC's prospective endorsement (and ultimately enforcement) of new accounting standards adopted by FASB is unconstitutional. Unlike *Sunshine Anthracite*[26] and other cases upholding the delegation of power to private organizations, the SEC's control and oversight over FASB is slight at best. The SEC does not control the appointment or removal of members of FASB, does not clearly control the FASB agenda, and as currently practiced, does not approve FASB standards through notice-and-comment rulemaking or otherwise act to make the final decisions itself. As one appellate judge boiled it down: "[A] federal agency may turn to an outside entity for advice and policy recommendation, *provided the agency makes the final decisions itself* . . . . An agency may not, however, merely 'rubber stamp' decisions made by others under the guise of seeking their 'advice,' nor will vague or inadequate assertions of final reviewing authority save an unlawful subdelegation."[27] Because an agency may not merely "rubber stamp" decisions made by private entities under the guise of seeking their "advice," the SEC's anticipatory blessing of all FASB actions raises considerable structural and constitutional concerns.

Of course, as in any minefield, one must tread carefully, and contrary arguments abound. Specifically with respect to international convergence, Sarbanes-Oxley itself requires FASB to "consider[] . . . the need to keep standards current in order to reflect changes in the business environment [and] the extent to which *international convergence on high quality accounting standards is necessary or appropriate* . . . ."[28] The SEC has issued concept releases and statements endorsing convergence and setting forth various work streams and timelines. And because FASB has "Rules of Procedure" that are based on the APA and require open meetings and opportunity for public comment, among other things, supporters of convergence undoubtedly will argue that there is no issue of unaccountability.[29] They might also argue that there is sufficient government oversight because the SEC can act to disapprove specifically any FASB standard,[30] with ultimate and final recourse to Congress.

In practice, the SEC's "oversight" is a paper tiger. To date, the SEC has yet to disapprove explicitly of any FASB pronouncement. The closest it has come was when FASB sought, in FAS 123R, to require companies to record stock options as an expense based on their fair market value from the day they were granted.[31] FAS 123R caused significant backlash in the business community,[32] and it took time for FAS 123R to be implemented; but even then, the SEC did not act to overturn the standard; rather, it merely delayed the date of compliance.[33] More fundamentally, as described below, the Constitution demands more active government ownership of, and accountability for, the rules that govern our lives (including under threat of criminal prosecution) than is offered by an agency's failure simply to "disapprove" some private initiative.

If FASB Is Exercising Legislative Authority, Its Members Must Be Executive Officers Subject to Presidential Appointment and Removal

Another constitutional flaw in the FASB structure is that, to the extent it is exercising rulemaking power delegated by Congress, its members are neither appointed nor removable by any part of the government. Rather, the seven members constituting a full FASB are appointed by the Financial Accounting Foundation's Board of Trustees for up to two five-year terms.

The Appointments Clause provides that:

> [The President] shall nominate, and, by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme

> Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law; but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

The purpose of this provision is to permit the President to control his subordinates who execute Congress's laws. "By vesting the President with the exclusive power to select the principal (noninferior) officers of the United States, the Appointments Clause prevents congressional encroachment upon the Executive and Judicial Branches."[34]

The Appointments Clause is triggered if the members of FASB–in establishing GAAP–are exercising core administrative/regulatory functions such that they are considered "officers" of the United States. According to the Department of Justice's Office of Legal Counsel, a position is an office for Appointments Clause purposes if "(1) it is invested by legal authority with a portion of the sovereign powers of the federal Government, and (2) it is 'continuing.'"[35]

The members of FASB would meet this standard to the extent that their pronouncements have the independent force of law, as they do under the SEC's current practice. There is no doubt that FASB's role is continuing, as there is no temporal condition attached to it or its members' duties. Moreover, the SEC's current practice invests FASB's members with a portion of sovereign power, namely the rulemaking function of the SEC to create legally binding GAAP standards. In *Buckley*, the Federal Election Commission (FEC) was granted recordkeeping, disclosure, and investigative functions, but was also "given extensive rulemaking and adjudicative powers."[36] The Supreme Court held that such functions rendered the FEC members "officers" and thus their method of appointment was constrained by the Constitution.[37] Similarly here, the rulemaking function of FASB derives from Congress's delegation of power to the SEC to execute Congress's "intelligible principle" set forth in the federal securities laws. The sub-delegation of power to FASB to issue pronouncements that have the force of law thus seems clearly to invest FASB with a "portion" of the sovereign authority.

Moreover, in addition to the fact that FASB members are not appointed by the President, if FASB members are officers, then the structure also suffers from a "removal problem." As the Supreme Court recently reiterated in *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*,[38] "the Constitution has been understood to empower the President to keep [executive] officers accountable–by removing them from office, if necessary." In *Free Enterprise Fund*, the Court struck down the "double for cause" removal[39] of PCAOB members, reasoning that the "President cannot 'take Care that the Laws be faithfully executed' if he cannot over*see* the faithfulness of the officers who execute them."[40] FASB suffers from an even more fundamental defect: the members of FASB are not removable at all by either the President or the SEC. In addition, unlike in *Free Enterprise Fund*, where the Supreme Court could simply sever the "for cause" restriction on removability by the Commission–making the PCAOB members removable at will–there is no similar "easy fix" here. FASB members are not removable at all by the SEC.

Indeed, the constitutional defects in the SEC's present treatment of FASB are self-evident in light of the Supreme Court's analysis of the PCAOB. Even though Sarbanes-Oxley expressly required that the SEC approve any PCAOB rule before it became effective, the Supreme Court still held that it was constitutionally required that the PCAOB's members, who were conceded to be governmental officers, be removable by the President. The FASB members are neither appointed nor removable by the President, yet the SEC treats FASB as wielding greater sovereign authority than the PCAOB, with FASB's pronouncements having automatic legal effect. This cavalier arrangement likely is impermissible.

Post-Hoc "Control" Does Not Satisfy Due Process

As discussed above, the SEC may contend that it exercises sufficient ultimate "control" over FASB because it may decide not to enforce one or another FASB standard. This argument, however, potentially raises an issue of "fair notice." To the extent that the SEC attempts to defend the adequacy of its control of FASB on the basis of post-hoc determinations that the Commission will *not* enforce a FASB standard, such a defense would raise significant due process concerns. Public companies must, in such circumstances, comply with FASB standards or subject themselves to potential enforcement action (including criminal enforcement action). Companies cannot rely on the prospect that, after the fact, the SEC *may, in its discretion*, choose not to enforce a particular standard. The *sine qua non* of due process is advance warning of the standards to which a party must conform its conduct. That is possible only if the SEC specifically endorses a FASB standard *before* companies are required to comply.

Alternatively, the APA Should Apply Directly to FASB

If, contrary to the arguments above, FASB is permissibly exercising rulemaking authority, opponents of convergence would have an alternative ground for attacking FASB rules–that they have not been adopted in accordance with the APA. By its terms, the APA applies only to an "agency" of the government.[41] Although it isn't clear at all that FASB would qualify as an agency (after all, it is a private body whose members are neither appointed by nor subject to the authority of any governmental body), if a court *were* to hold that FASB may permissibly exercise sovereign authority to make binding regulations, then there could be an argument that FASB should itself be required to comply with the APA. The Supreme Court has held that, in certain contexts, actions of private entities can sometimes be regarded as governmental action.[42] In general, the criteria courts look to when making a determination of whether "agency" action has taken place is: whether the entity (1) has authority to act with the sanction of government support, or (2) any authority in law to make decisions, or (3) substantial authority in the exercise of specific functions.[43]

To the extent that FASB may promulgate accounting standards with the force of law, then there is a reasonable argument that FASB should be deemed a governmental "agency." Sarbanes-Oxley explicitly recognizes FASB, and though it does not specifically name FASB, the Senate Judiciary Committee report on the bill that became Sarbanes-Oxley makes clear that Congress intended to formalize the SEC's reliance on FASB.[44] Moreover, not only does the SEC prospectively recognize the authoritative force of future FASB pronouncements, but post-Sarbanes-Oxley, FASB is publicly funded through a special tax assessment. Thus, FASB acts with some imprimatur of government support such that it could be treated as an agency. Although FASB already applies Rules of Procedure that are modeled upon the APA, were FASB an agency, its rules would be subject to "judicial review," including compliance with APA procedures.

Challenging the Proposed FASB Standards Going Forward

Whether and how interested parties may coalesce in opposition to convergence remains to be seen. If they do, the remedies potentially available to them could include various forms of injunctive relief, ranging from the relatively narrow–for example, a straightforward directive requiring the SEC to undertake its own rule making process before taking any action to "incorporate" new FASB standards into law–to a multi-pronged legal/policy-based attack on the implementation of any international convergence-based scheme absent Supreme Court review. If the former, and assuming that the rule making process would itself be subject to review, then presumably much of the non-democratic and messy controversy we've been talking about could be avoided. And, if the latter, a continuing and prolonged period of uncertainty and debate–political, financial, and legal–will likely ensue over the pros and cons of convergence and how to address what some would argue is the basic disregard of fundamental principles of the rule of law in the process as it currently stands. Either way–and these are by no means the only alternatives available–a further hurdle will be to identify the appropriate moment in time when bringing such an action makes sense, in other words, when convergence's implementation is sufficiently imminent to establish the threat of immediate and irreparable harm such that a justiciable controversy exists.

After years of work, FASB and the IASB are inching closer to the finish line; convergence is almost upon us. Whether one views that development as cause for celebration or alarm, it is clear that adoption of the new convergence standards under the present scheme raises serious constitutional concerns that would-be opponents may well consider pressing in legal challenges. How fruitful those challenges may be, only time will tell.

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[1] Michael Rapoport, *SEC Delays Call on Accounting Rules*, Wall St. J. Online, Dec. 6, 2011, available at http://online.wsj.com/article/SB10001424052970204083204577080262739620688.html.

[2] FASB & IASB, Memorandum of Understanding: "The Norwalk Agreement" (Sept. 18, 2002).

[3] Letter from American Insurance Association to FASB, File Reference No. 1870-100, Comment Letter No. 26, at addendum (Nov. 30, 2010).

[4] PCAOB Speech, Charles D. Niemeier, Keynote Address at the New York State Society of CPAs/FAE Conference: Recent International Initiatives, 2008 Sarbanes-Oxley, SEC and PCAOB Conference at 4 (Sept. 10, 2008).

[5] *See, e.g.*, Letter from Liberty Mutual to FASB, File Reference No. 1870-100, Comment Letter No. 24, at 2 (Nov. 30, 2010); Letter from The Travelers Companies, Inc. to FASB, File Reference No. 1870-100, Comment Letter No. 15, at 1 (Nov. 30, 2010); Letter from The Chubb Corporation to FASB, File Reference No. 1870-100, Comment Letter No. 70, at 2 (Dec. 15, 2010).

[6] *See, e.g.*, Letter from The Hartford Financial Services Group to FASB, File Reference No. 1870-100, Comment Letter No. 17, at 2 (Nov. 30, 2010); Letter from New York Life Insurance Company to FASB, File Reference No. 1870-100, Comment Letter No. 7, at 1 (Nov. 29, 2010); Letter from Northwestern Mutual to FASB, File Reference No. 1870-100, Comment Letter No. 61, at 7-8 (Dec. 15, 2010).

[7] Comments to the IASB's July 2010 Exposure Draft and FASB's December 2010 Discussion Paper regarding insurance contracts tend to show broad support–its pronouncements have the prospective and authoritative force of law, and companies must obey or face government sanction–among both accountants and insurers.

[8] Priti S. Rajagopalan, Deloitte, The IFRS Journey in Insurance: A Look Beyond the Accounting Changes 6-7 (2008).

[9] This sequence tends to play out following external shocks to the insurance industry writ large. For example, following the terrorist attacks of 9/11, "[t]he industry reacted by exiting the market for terrorism risk, resulting in capacity (supply) reduction and premium (price) increases. The costs of these market distortions trickled down to the economy, which saw increased costs of goods, increased financing costs, delayed or cancelled real estate projects, and lost jobs." Robert J. Rhee, *Terrorism Risk in a Post-9/11 Economy: The Convergence of Capital Markets, Insurance, and Government Action*, 37 Ariz. St. L.J. 435, 438 (2005).

Some have suggested that the proposed accounting changes–which largely are designed to capture "fair value"–"promote a downward spiral, as write-downs force companies to liquidate assets to meet regulatory capital requirements (called 'procyclicality')." *See, e.g.*, Guy Carpenter & Co., LLC, *Accounting and Accountability: Fair Value and Convergence*, GCCapitalIdeas.com (Dec. 31, 2008, 1:00 AM), available at http://www.gccapitalideas.com/2008/12/31/accounting-and-accountability-fair-value-and-convergence.

[10] Letter from Genworth Financial to FASB, File Reference No. 1870-100, Comment Letter No. 6, at 3 (Nov. 29, 2010).

[11] SEC Speech, A.A. Sommer, Jr., The SEC and the FASB: Their Roles (Jan. 21, 1974).

[12] FASB posts the following note on its website: "The SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest." FASB Facts about FASB, available at http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176154526495. *See also* SEC Release Nos. 33-8221, 34-47743, IC-26028 (Apr. 25, 2003).

[13] *See* A.A. Sommer, Jr., *supra*.

[14] Under Rule 4-01(a)(1) of the SEC's Regulation S-X, subject to certain exemptions, "[f]inancial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate."

[15] SEC Release No. 33-8221, *supra*. In this "Commission Statement of Policy Reaffirming the Status of FASB as a Designated Private-Sector Standard

Setter," the SEC determined that because it was issuing a "policy statement," there was no need to give notice or opportunities for public participation; nor was there a need for prior publication. *Id.*

[16] 295 U.S. 495 (1935).

[17] *Id.* at 537.

[18] *Id.*

[19] *Id.* at 537-39.

[20] 298 U.S. 238 (1936).

[21] *Id.* at 311 (emphasis added).To be sure, there is no absolute prohibition against the involvement of a private organization in fashioning standards that are incorporated into law. In *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381 (1940), for example, the Supreme Court upheld an amended version of the Coal Act under which district code boards could "propose minimum prices pursuant to prescribed statutory standards," which could "be approved, disapproved, or modified by the [Coal] Commission as the basis for the coordination of minimum prices." *Id.* at 388. But, in upholding the Coal Act, the Court stressed that the private bodies "function subordinately to the [Coal] Commission. [The Coal Commission], not the code authorities, determines the prices. And it has authority and surveillance over the activities of these authorities. Since law-making is not entrusted to the industry, this statutory scheme is unquestionably valid." *Id.* at 399.

[22] *Todd & Co. v. SEC*, 557 F.2d 1008, 1012-14 (3d Cir. 1977). *See also United States v. NASD*, 422 U.S. 694, 700 n.6 (1975) (noting that the SEC exercises "a significant oversight function over the rules and activities of the registered associations"); *R.H. Johnson & Co. v. SEC*, 198 F.2d 690, 695 (2d Cir. 1952) (upholding the delegation of power by the SEC to the NASD "[i]n the light of the statutory provisions concerning (a) the Commission's power, according to reasonably fixed statutory standards, to approve or disapprove of the [NASD]'s Rules, and (b) the Commission's review of any disciplinary action"). Likewise, in *Noblecraft Industries, Inc. v. Secretary of Labor*, 614 F.2d 199 (9th Cir. 1980), the Ninth Circuit upheld the delegation of power under the Occupational Health & Safety Act to follow a "nationally recognized standards-producing organization's" identification of a "national consensus standard," as long as the private standard was formulated in a manner which afforded an opportunity for diverse views to be considered and was adopted by the Secretary of Labor. In upholding the delegation, however, the Ninth Circuit stressed that "[the Occupational Safety and Health Administration] in practice did not surrender to [the American National Standards Institute (ANSI)] all its standard-making function," but had instead "*selected* among the ANSI standards *with apparent discrimination*." *Id.* at 203 (emphasis added).

[23] Under Section 19 of the Securities Exchange Act of 1934, "[e]ach self-regulatory organization shall file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization (hereinafter in this subsection collectively referred to as a 'proposed rule change') accompanied by a concise general statement of the basis and purpose of such proposed rule change. The Commission shall, as soon as practicable after the date of the filing of any proposed rule change, publish notice thereof together with the terms of substance of the proposed rule change or a description of the subjects and issues involved. The Commission shall give interested persons an opportunity to submit written data, views, and arguments concerning such proposed rule change. No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection." 15 U.S.C. § 78s(b)(1).

[24] 15 U.S.C. § 7217(b)(2).

[25] *See, e.g.*, *Mistretta v. United States*, 488 U.S. 361, 422 (1989) (Scalia, J., dissenting) ("If rulemaking can be entirely unrelated to the exercise of judicial or executive powers, I foresee all manner of 'expert' bodies, insulated from the political process, to which Congress will delegate various portions of its lawmaking responsibility. How tempting to create an expert Medical Commission (mostly M.D.'s, with perhaps a few Ph.D.'s in moral philosophy) to dispose of such thorny, 'no-win' political issues as the withholding of life-support systems in federally funded hospitals, or the use of fetal tissue for research."); *see also* Jody Freeman, *Collaborative Governance in the Administrative State*, 45 UCLA L. Rev. 1, 83-84 (1997) ("Institutional arrangements that empower private groups to make public policy might be unconstitutional at worst, and corrode legitimacy at best."); Jim Rossi, *Antitrust Process and Vertical Deference: Judicial Review of State Regulatory Inaction*, 93 Iowa L. Rev. 185, 223 (2007) ("Administrative law has long recognized . . . that delegations of authority to private entities also present a unique set of problems–bordering, at some level, on the unconstitutional.").

[26] *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381 (1940).

[27] *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554, 568 (D.C. Cir. 2004) (emphasis added) (citations omitted).

[28] 15 U.S.C. § 77s(b)(1)(A)(v) (emphasis added).

[29] Of course, this fact only highlights the problem with FASB. Although FASB has voluntarily adopted procedures like that of the APA, its adherence to such standards is not reviewable in the same manner as agencies acting under the APA. Moreover, if FASB were to argue that it is akin to an agency, and that it follows the APA, it would highlight other constitutional concerns–in particular, the fact that its officials are not appointed or removable by the President.

[30] *See* 15 U.S.C. § 7218(c) ("Nothing in this Act, including this section and the amendment made by this section, shall be construed to impair or limit the authority of the Commission to establish accounting principles or standards for purposes of enforcement of the securities laws.").

[31] *See* FASB Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment.

[32] When the concept of expensing stock options was first introduced by FASB in 1993, Congress introduced a number of bills to order the SEC to refuse to implement the new standard. One bill introduced by Senator Joseph Lieberman, would have required the SEC to act specifically to adopt each FASB proposal. *See* Equity Expansion Act of 1993, S. 1175, H.R. 2759, 103d Cong. (1993). In the face of this opposition, FASB tabled the standard, though in 2004 it eventually pushed it through.

[33] *See* SEC Press Release No. PR-2005-57 (Apr. 14, 2005).

[34] *Edmond v. United States*, 520 U.S. 651, 659 (1997), citing *Buckley v. Valeo*, 424 U.S. 1, 125 (1975). *See also Freytag v. CIR*, 501 U.S. 868, 885 (1991) ("The Appointments Clause prevents Congress from distributing power too widely by limiting the actors in whom Congress may vest the power to appoint. The Clause reflects our Framers' conclusion that widely distributed appointment power subverts democratic government.").

[35] Office of Legal Counsel, Officers of the United States within the Meaning of the Appointments Clause (Apr. 16, 2007).

[36] 424 U.S. at 110; *see also id.* at 137 (discussing agency's "functions with respect to . . . fleshing out the statute" and its "functions necessary to ensure compliance with the statute and rules").

[37] *Id.* at 138-40.

[38] 130 S. Ct. 3138 (2010).

[39] SEC commissioners were removable only "for cause" and PCAOB members were, in turn, removable only by the SEC "for cause," doubly insulating them from executive control.

[40] 130 S. Ct. at 3147.

[41] 5 U.S.C. § 551.

[42] *S.F. Arts & Athletics, Inc. v. U.S. Olympic Comm.*, 483 U.S. 522, 546 (1987); *Burton v. Wilmington Parking Auth.*, 365 U.S. 715 (1961).

[43] *Byers v. Intuit, Inc.*, 564 F. Supp. 2d 385 (E.D. Pa. 2008).

[44] S. Rep. No. 107-146 (2002).