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**FINANCIAL ACCOUNTING FOUNDATION
FINANCIAL ACCOUNTING STANDARDS BOARD**

STATEMENT OF POSITION

ON

**STUDY ENTITLED, "THE ACCOUNTING ESTABLISHMENT",
DATED DECEMBER 1976, PREPARED BY THE STAFF OF THE
SUBCOMMITTEE ON REPORTS, ACCOUNTING AND
MANAGEMENT, COMMITTEE ON GOVERNMENT OPERATIONS
(NOW COMMITTEE ON GOVERNMENTAL AFFAIRS)
UNITED STATES SENATE**

April 14, 1977

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(THE "STUDY")**

AN OVERVIEW IN PERSPECTIVE

The Financial Accounting Foundation ("FAF" or the "Foundation") and the Financial Accounting Standards Board ("FASB" or the "Board") welcome the opportunity to cooperate with the Subcommittee on Reports, Accounting and Management in the exercise of its Congressional oversight responsibilities, and to submit this Statement of Position to state their views with respect to certain of the Study's recommendations and to correct and supplement the Study and to balance the record.

The FASB is the authoritative professional body designated by the American Institute of Certified Public Accountants ("AICPA") and recognized by the Securities and Exchange Commission (the "SEC" or the "Commission") to establish and improve financial accounting and reporting standards—i.e., those standards concerned with recording meaningful information about economic events and transactions in a useful manner in financial statements. The FASB does not set auditing standards or regulate auditing, which involves examining financial statements for the purpose of expressing an opinion as to whether they are presented fairly in conformity with generally accepted accounting standards. The formation of the FASB in 1972, as the independent, full-time accounting standard-setting body within the FAF, was widely endorsed by the accounting profession, the SEC, the financial and business community, accounting educators, and other commentators. As such, the FASB is primarily concerned with, and specially competent to comment on and take issue with, the Study's assertions with respect to the establishment of financial accounting standards and its recommendations for action by the Federal Government in that area. We understand that the AICPA, other professional and financial associations, individual accounting firms and others will be commenting on auditing and the other major areas of the Study.

In particular, the FAF and FASB strongly disagree with the recommendation of the Study that the Federal Government directly establish financial accounting standards for publicly-owned corporations.

The FAF and FASB strongly oppose this Study recommendation because in their opinion the present system of setting financial accounting standards, as it has evolved and is evolving, has successfully served the public interest, and affords the greatest promise of further developing accounting standards which are meaningful and useful to the investing public and other users of financial statements.

There is also no evidence in the Study or elsewhere, and indeed substantial doubt, that a Federal Government agency or agencies could do as well.

In the first place, a take-over by the Federal Government, or any action reducing the FASB from a standard-setting to a consulting or advisory body, would seriously disrupt the progress being made and would inevitably result in significant delays while an untried system is developed and launched. We believe, moreover, there would be a substantial reduction in the significant voluntary efforts which have characterized the commitment of the accounting profession, academicians, financial analysts and other users of financial statements, and others within the business and financial community in contributing generously of their time and effort to improve financial accounting standards.

Second, the Study fails to document its claim that standard-setting by the Federal Government—which has concentrated in special, limited areas such as regulated industries, or on a particular aspect of accounting, such as cost determination for government contracts—would be feasible or effective in the broader area of general purpose financial statements. We are clear that it would not be. Public investors, creditors and other users concerned with capital formation and deployment and the resources and operations of business enterprises rely on general purpose financial statements prepared in conformity with generally accepted accounting principles. These generally accepted principles provide an objective framework within which literally thousands upon thousands of transactions and events are evaluated, classified and reduced to meaningful numbers and then presented in financial statements useful for decision-making. The FASB's task of establishing and improving the accounting standards on which these financial statements are based is infinitely more pervasive and complex, the constituency significantly larger and more diverse, and the subject matter not limited to a specific function of Government. When understood in these terms, it is clear why the SEC, the accounting profession, users of financial statements, the business and financial community, accounting educators, and responsible public commentators alike have supported the FASB, operating within a framework of SEC review and participation. Congress has long been aware of and inquired before about this structure, but has not disturbed it. As documented in this Statement of Position, this structure has assured development of meaningful financial accounting standards in the public interest and financial statements useful for economic and investment decisions.

Third, the present system of setting accounting standards promotes the coming together of varying points of view in order to assist the FASB in determining what is most in the public interest. This is not to say that consensus satisfactory to all is necessarily desirable or can always be reached, or that progress is always as fast as some would have it. Some FASB accounting standards have been criticized by a number of those participating in the

process, but this criticism is positive and constructive and assures general support and continuing participation. On the other hand, were the Government to take over, the process would in our judgment tend to become more adversary in nature, and constructive criticism and willingness to cooperate would diminish, and with it accounting standards most responsive to the needs of investors and the general public. We are concerned that Government accounting standard-setting would become legalistic and mechanical in both formulation and application, with problems frequently resolved in the courts.

Finally, we are concerned that displacement by Government of the present process of setting accounting standards could adversely affect the status of the United States as the world's largest and most open capital market. That status was achieved in part because the existing framework for establishing accounting standards provides financial information recognized and relied on throughout the world for its integrity and utility in reaching capital and investing decisions. If, on the other hand, accounting standards come to be formulated primarily to direct or implement specific, and changing, policy goals, this objective could seriously undermine confidence in financial statements and hamper the promising efforts in recent years towards developing the international capital markets.

We say this only after carefully considering the points advanced in the Study. We also say this as professionals who have given years of study, thought and effort to the most effective mechanism for setting accounting standards that best serve investors in particular and the public in general.

Our objective in submitting this Statement of Position is to provide a complete, accurate and balanced portrayal of the corporate financial accounting matters dealt with in the Study. We are confident that our presentation will demonstrate to the satisfaction of the Subcommittee that no fundamental change is required in the standard-setting process which, in cooperation with the SEC, has worked successfully to give the United States the most advanced accounting and corporate disclosure standards in the world.

In particular, we emphasize, and will document in this Statement of Position, that:

1. The accounting profession and the FASB, with the support, cooperation and participation of the private sector and the SEC, has been responsive to and acted in the public interest in establishing accounting standards. Contrary to the Study's assertions, the FASB's public due process procedures result in broad public participation in the standard-setting process. The analysis of the record demonstrates conclusively that the FASB meets its responsibilities with integrity, independence and objectivity and is not "dominated" (whether in terms of money, personnel or organizational support) by any of its sponsoring organizations, the large accounting firms or any "special interest group". There is a significant and steady record of progress in this cooperative effort with Government in establishing meaningful accounting standards, responsive both to newly emerging problems as well as the more intractable problems of the past. In its less than four years of operations, the FASB has issued 14 Statements of Financial Accounting Standards, 18 Interpretations, 20 Exposure Drafts, 13 Discussion Memoranda and held 15 public hearings on a range of significant accounting matters, and is currently engaged in a project to establish a comprehensive conceptual framework, including objectives of financial statements, to guide further improvements in financial accounting and reporting. (Parts I, II and III and Exhibits A, B, C and D)

2. The record is clear that the SEC has continuously exercised effective review of the FASB, its predecessor accounting standard-setting bodies and the accounting profession, and has not hesitated to exercise its authority promptly and in the public interest to supplement, supersede or to suggest standards, whenever it has perceived a need to do so. Contrary to the Study's assertions, the SEC has not "delegated" its authority or responsibility by its recognition of the FASB and its acceptance of accounting standards established by the FASB and its predecessors as presumptively binding and necessary for fair financial presentations. (Parts III, IV and V)

3. As discussed above, the Study presents no evidence that a Federal take-over of financial accounting standard-setting either could or would improve financial accounting standards, and there are substantial reasons for concluding it would not. The FASB and its predecessors have made significant progress in eliminating accounting alternatives and in some cases achieving that "uniformity" in accounting standards which the Study conceives, incorrectly, as the ultimate goal of the standard-setting process. The Government's Cost Accounting Standards Board, also a panel of extensively experienced experts, has recognized the impossibility of defining and attaining absolute uniformity, even in the comparatively limited area of cost accounting for government contracts. The FASB, like the CASB, has required a single accounting treatment when it has determined that circumstances are substantially the same for all those affected and this treatment will result in the most meaningful and useful financial presentation. (Parts III and V and Exhibits D and E)

4. Contrary to the Study's assertions, the record shows that neither preparers of financial statements nor accountants have an unrestricted ability to pick and choose, or to change, accounting standards to present matters in the most favorable light. Both the profession and the SEC have acted so that the FASB's and its predecessors' pronouncements are authoritative and presumptively binding to the exclusion of contrary principles. Changes in accounting standards are permitted if they improve financial accounting and reporting. The Study's assertions that there are too many accounting alternatives cannot be relied on, for the data the Study cites were developed in 1965 and have not been updated to reflect 12 years of progress, including steps by the FASB and its predecessor, the Accounting Principles Board, to reduce and in some cases eliminate alternatives. The Study, moreover, makes no effort to distinguish alternative practices which are necessary to reflect different circumstances or wholly different transactions. The Cost Accounting Standards Board has recognized the need for alternative accounting standards to meet differing circumstances and conditions in a number of its pronouncements. (Parts III and V and Exhibits D and E)

5. Contrary to the Study's assertions, the adequacy of accounting standards is not the issue in connection with the Study's cited instances of corporate accountability failures and financial difficulties, or public revelations of "questionable" or "improper" corporate payments. Virtually all of these cases involved fraud, dishonesty, falsification of books and records, inadequate or circumvented internal controls, estimates and judgments proved wrong by subsequent events, or simply poor or inadequate management—but not the inadequacy of accounting standards. We do not minimize the significance of these problems, or suggest they are not proper subjects for Congressional concern. We do believe it important, however, to place the factors contributing to these problems in proper perspective. (Part III)

6. The success and great value of the present cooperative effort between the FASB and the SEC with support and participation within the private and public sectors is apparent when one considers a complete, accurate and balanced record—and when one assesses the real and significant risks in switching to a new and untried system. There is no evidence in the Study or elsewhere that the FASB is not dedicated to the public interest or unequal to the task, or that Government could do better or even as well. Of equal importance, there is substantial evidence of continuing and willing support, both within Government and the private sector, for the FASB and the existing framework for establishing and improving financial accounting standards. (Parts I, II, III, IV, V and Exhibits A, B and D)

The principal question before the Subcommittee on this issue is:

Should financial accounting standards continue to be set by an experienced body responsive to the needs of public investors and others using financial information, and which draws on the substantial knowledge, experience and expertise of those who prepare, attest to and use financial statements, all as continuously reviewed and from time to time supplemented and revised by the SEC—Or should the Federal Government, directly or through an agency or agencies, replace this process with a new, untried system and assume full responsibility for, and set, accounting standards underlying general purpose financial statements?

In considering this issue, it is important to bear in mind that virtually every aspect of industry and commerce, from heavy construction and housing starts to employment levels, consumer credit, and pension, welfare and other social programs—indeed all activity involving formation or deployment of capital—is based on financial information. The primary objective of the existing structure for setting accounting standards—to provide meaningful financial information useful to the public in making decisions—will eventually cease to be reflected in public financial information if the primary objective of accounting is changed, as the Study's recommendation entails, to support specific, and changing, policy goals.

If the Federal Government perceives a need for specialized financial data in the formulation of national policy, that data can be obtained without altering or replacing the existing accounting standard-setting framework. A recent example is Public Law 94-163, "Energy Policy and Conservation Act", in which Congress directed the SEC, with the assistance of the FASB, to develop accounting practices sufficient to generate a special energy data base for oil and natural gas producers to assist Congress in formulating energy policy. The FASB is currently working on accounting standards for the extractive industries pursuant to this Congressional mandate. The FASB's development of a comprehensive Discussion Memorandum in cooperation with a task force of knowledgeable and experienced members, and observed by representatives of the SEC, the General Accounting Office, the Cost Accounting Standards Board, the Federal Power Commission, the Federal Energy Administration, and a Congressional committee, is testimony to the feasibility and advantages of maintaining financial accounting and reporting where it now is, rather than having the Federal Government assume direct control, and the corresponding sole responsibility for the work and the result.

In considering this issue, it is also important to bear in mind that the Study's principal recommendation regarding accounting standard-setting is based on fundamental and pervasive misconceptions of the purpose and goal of financial accounting and reporting, the

process for establishing financial accounting standards, the nature and basis for selecting and applying these standards, and the financial presentations to which they apply. This Statement of Position will correct these misconceptions and balance the record with respect to

1. The independence and objectivity of the FASB in performing its standard-setting responsibilities in the public interest (Part I and Exhibits A, B, C and D);
2. The broad public participation in this process (Part II and Exhibits A, B and D);
3. The responsiveness and success of the FASB and the private sector, with SEC review and participation, in establishing meaningful financial accounting standards in the public interest (Parts II and III and Exhibits A, B, D and E);
4. The nature, selection and application of financial accounting standards, the financial presentations to which they apply, and their binding and authoritative character (Part III and Exhibit D);
5. SEC review and participation in the accounting standard-setting process (Parts IV and V); and
6. Federal standard-setting, and the support and recognition Government agencies are accorded the FASB and its accounting standards (Part V).

The FAF and FASB do not claim that the existing structure for establishing accounting standards is perfect, for they recognize that the present system, like accounting itself, is a dynamic and evolving process of continuing improvement. An essential characteristic of a vital organization or profession is its willingness and ability to challenge itself, with thoroughness and objectivity, and promptly to implement improvements where desirable. The FASB and the accounting profession are not exceptions.

The profession's recent history has been marked by a number of significant efforts to improve financial accounting. In 1972, the AICPA commissioned a seven-man study group, the majority of whom were outside the accounting profession, under the chairmanship of Francis M. Wheat, a lawyer and former SEC Commissioner, to conduct a comprehensive review of the FASB's predecessor, the Accounting Principles Board. The result was the "Wheat Report", "Establishing Financial Accounting Standards", which, following wide acceptance within the profession, the interested public and endorsement by the SEC, led to the formation of the FASB. In October 1973, another AICPA-commissioned study group, under the leadership of the late Robert M. Trueblood, issued a comprehensive report entitled "Objectives of Financial Statements", which became a basis for the FASB's current major project on "A Conceptual Framework for Financial Accounting and Reporting". In another area, the AICPA commissioned former SEC Chairman Manuel F. Cohen and a group of other experts in 1974 to study and to report on the role and responsibilities of independent auditors. The Cohen Commission's tentative conclusions and recommendations for improvement have recently been announced, and a further report is expected later this spring.

The FAF and the FASB have similarly been active with regard to the structure for establishing accounting standards. The FAF's By-Laws expressly require its Trustees to "review periodically . . . the basic structure of establishing and improving standards of financial accounting and reporting." Since the FASB's formation, the FAF's Trustees have

designated a Structure Committee from among their number, and charged that Committee with the responsibility of "making recommendations to the Board of Trustees regarding any changes in the basic structure of the Financial Accounting Standards Board and Financial Accounting Standards Advisory Council. . . ."

The FAF's and FASB's internal evaluations have resulted in improvements. In early 1975, the FASB established a technical division to deal specifically with an increasing volume of emerging problems involving narrow but significant accounting questions of some urgency, and appointed a continuing 15-member Screening Committee on Emerging Problems to assist it. In mid-1976, the FAF's Structure Committee recommended that the Securities Industry Association, representing investment bankers charged by Federal statute with significant duties to the public, be added as a sponsoring organization to broaden still further public support and involvement in establishing accounting standards. The Securities Industry Association became a sponsor effective October 1, 1976.

In December 1976, the third anniversary of the FASB's first accounting pronouncement, the FAF's Trustees directed the Structure Committee to conduct a comprehensive oversight study of all aspects of the FASB's organization and operations. After an extensive process of interviewing over 100 persons of various disciplines, including persons in the Federal Government, and a two-week field review in Stamford, Connecticut of all aspects of the FASB's technical and administrative operations and procedures, the Structure Committee has recommended and recently made public specific proposals designed to increase still further public participation in the FASB's processes and to improve its effectiveness and efficiency in meeting its responsibilities. The FAF's Trustees have agreed in principle with this report and intend to consider expeditiously the Committee's recommendations. As discussed below, and perhaps of particular interest, the Structure Committee has recommended that the Trustees consider further representation of financial statement users on the FAF's Board of Trustees, and that the AICPA's Board of Directors be replaced as sole elector of FAF Trustees by representatives of the Foundation's six sponsoring organizations with each having an equal voice in the Trustee selection process.

In a similar vein, and in anticipation of the expiration of the FAF's five-year start-up financing plan in December 1977, the FAF Finance Committee is currently proceeding with a new plan for 1978 and subsequent years predicated on further increasing the breadth and depth of public support. This plan is based on the principle that no one person, firm or corporation will be solicited to contribute, or will contribute, annually more than the lesser of \$50,000 or 1% of the FASB's annual operating expenses. This plan will have the practical effect of reducing the annual contributions of the eight major accounting firms from the \$200,000 contributed annually by each since 1972—a practical necessity when the FASB was launched—to no more than \$50,000 per firm each year, and reducing other contributions as well through the AICPA's Accounting Research Association.

The FAF's Trustees are also reviewing another aspect of the FASB's process. The Trustees have directed its Committee on Personnel Policies to review the FASB's existing conflict of interest policies, and to make such recommendations as the Committee may deem appropriate. In particular, the Trustees have charged the Committee to consider reporting of all investments, even immaterial ones, by FASB members and staff directors; specific limitations on certain securities transactions and on receipt of gifts from non-family members; and adoption of a more general rule with respect to potential conflicts of interest. The Committee is expected to make its recommendations at a meeting of the FAF Trustees later this spring. While the FAF and FASB disagree with the Study's assertions as to the

effectiveness of existing personnel policies and emphasize there has been no instance of detrimental conduct since the Board's formation, they accept the principle articulated in existing policies that perceptions of potential conflict, however unfounded, can be as troublesome as conflict in fact, and should be investigated, not ignored.

The FAF and FASB are consistently on record as welcoming a fair and objective study of the structure and the public procedures for establishing and improving financial accounting and reporting standards. We are confident that when an objective analysis, based on a complete, accurate and balanced record, is made, the conclusion will be that the existing structure with the FASB is most effective in establishing financial accounting standards in the public interest. This structure has evolved and is evolving in response to Congress' recognition in the first Federal Securities Laws of the unique responsibilities of the accounting profession and the significance of financial statements to public investors.

As the balance of this Statement of Position demonstrates from varying perspectives, this structure has worked and is working effectively in the public interest through the FASB, as the designated standard-setting body, with support within the private and public sectors and review and participation by the SEC.

I. INDEPENDENCE AND OBJECTIVITY OF THE FASB IN THE STANDARD-SETTING PROCESS

A. Formation of the FAF and FASB

The FAF and FASB were created in 1972, the result of the recommendations of a seven-man study group appointed by the AICPA's Board of Directors to study the process of establishing accounting principles and to make recommendations for improving the process.

Chaired by Francis M. Wheat, a lawyer and a former SEC Commissioner, the Wheat Study Group,* after public hearings, numerous interviews and review of position papers, concluded that a "continuing dynamic relationship between a private standard-setting board and the SEC offers the greatest potential for future progress in financial accounting". The Wheat Study Group also concluded that "continuation of the framework and the process of developing accounting standards originating in the 1930's would result in acceptance of a private body's accounting standards by the accounting profession, government and the public at large", if

1. the standard-setting body were independent and objective in fact and appearance;
2. there were significant participation by the financial reporting community in the standard-setting process;
3. standards were issued only after public procedures insuring that all who wished to be heard would be heard and their views considered;
4. the quality of the body's pronouncements were high in terms of logic and supporting reasoning, consistent with objectives, amenable to the exercise of professional judgment where appropriate, and useful to investors and the public at large; and
5. the accounting profession supported these standards in attesting to the fair presentation of financial information.

To accomplish these goals, the Wheat Study Group recommended that

1. A Financial Accounting Foundation be established separate from all existing professional bodies, with a Board of Trustees nominated by organizations** having

* Other members of the Wheat Study Group and their affiliations at the time were John C. Biegler (senior partner of Price Waterhouse & Co.), Arnold I. Levine (national executive partner-management of J. K. Lasser & Company), Wallace E. Olson (executive partner of Alexander Grant & Company), Thomas C. Pryor (Senior Vice President of White, Weld & Co.), Roger B. Smith (Vice President-Finance of General Motors Corporation), and David Solomons (Professor and Chairman of the Accounting Department, Wharton School of the University of Pennsylvania).

**American Accounting Association (AAA) (12,000 accounting educators, academicians and practicing accountants), American Institute of Certified Public Accountants (130,000 certified public accountants), Financial Analysts Federation (Analysts Federation) (14,000 analysts, investment advisers and portfolio managers), Financial Executives Institute (FEI) (9,250 financial and accounting executives representing 5,000 companies), and National Association of Accountants (NAA) (70,000 financial and accounting executives and accountants). In September 1976 the Foundation's Certificate of Incorporation was amended to add the Securities Industry Association (SIA) (600 investment banking and other securities firms) as a sponsoring organization and to expand the Board of Trustees to include an additional financial executive and an investment banker. The current Trustees and their principal occupations are listed in Exhibit A hereto.

special expertise and continuing interest in financial accounting and reporting matters and consisting of five certified public accountants in public practice (including, *ex officio*, the Chairman of the AICPA), two financial executives, one accounting educator and one financial analyst. The principal duties of the Trustees would be to appoint members to the Financial Accounting Standards Board and to a public advisory body, the Financial Accounting Standards Advisory Council; to raise funds to support these organizations; and to review periodically the basic structure of the standard-setting organization;

2. The FASB be given all authority, functions and power of the AICPA and Foundation's Trustees for establishing and improving standards of financial accounting and reporting and the conduct of all activities relating thereto. The FASB would have seven full-time, salaried members independent of all other professional and business affiliations, four of whom would be certified public accountants drawn from, or principally experienced in, public practice, while the remaining three, who might but need not be certified public accountants, would be well versed in problems of financial accounting and reporting*; and

3. A Financial Accounting Standards Advisory Council be appointed from the public to work closely with the FASB in an advisory capacity as to accounting and reporting matters, with its members drawn from a variety of disciplines with no particular occupation predominating.**

These recommendations were widely endorsed at public hearings and in interviews and comment letters by the accounting profession, the SEC, the financial and business community, accounting educators, and the interested public. The Internal Revenue Service ruled in 1972 (and reaffirmed in 1976) that the Foundation was an educational charitable institution exempt from taxation under Section 501(c)(3) of the Internal Revenue Code. Of special significance, the accounting profession and the SEC each took prompt steps in 1973 to endorse the FASB as the official accounting standard-setting body and to designate its pronouncements as authoritative and presumptively binding for financial statements.

The AICPA designated the FASB, effective July 1, 1973, as the successor to the Accounting Principles Board (the "APB") in establishing accounting principles for purposes of Rule 203 of the AICPA's Code of Professional Ethics. Rule 203 provides that no accountant who is a member of the AICPA may opine that financial statements are fairly presented in conformity with generally accepted accounting principles if such statements depart from an FASB pronouncement or an effective pronouncement of its predecessor standard-setting bodies, the Accounting Principles Board and the Committee on Accounting Procedures, unless the accountant can demonstrate that due to unusual circumstances the financial statements would otherwise be misleading.

In December 1973, the SEC reaffirmed its administrative practice and policy of looking to the accounting profession's authoritative standard-setting body for initiative in establishing and improving accounting principles and standards, and stated that principles, standards and practices issued by the FASB and its predecessors were presumptively required to be applied in financial statements filed with the SEC and that financial

* Currently these three include a former accounting educator, the former Chief, Office of Accounting and Finance of the Federal Power Commission, and a former corporate financial executive. See Exhibit A hereto for a listing of the seven current FASB members and their former affiliations.

**The current members and their affiliations are listed in Exhibit A hereto.

statements applying contrary accounting principles would be unacceptable in the absence of an SEC determination to the contrary.

B. Independence Through Corporate Structure

The corporate structure of the FAF and the FASB, recommended by the Wheat Study Group and adopted only after review and public hearings called specifically for the purpose, is designed to assure the integrity, independence and objectivity of the FASB as the official accounting standard-setting body.

Under the Foundation's Certificate of Incorporation, the electors of the Foundation (i.e., its members, or stockholders if the FAF were a business corporation, and currently the AICPA's Board of Directors) have no powers, authority or functions other than electing and, in limited specific circumstances, removing the FAF's Trustees*. Similarly, the FAF's Certificate of Incorporation provides that all powers, authority and functions of the Foundation and the Trustees in respect of financial accounting and reporting standards, including all activities relating thereto, are delegated to the FASB. In furtherance of this delegation, the Foundation's By-Laws provide that the Trustees may not, directly or in connection with their approval of annual budgets, cause the FASB to undertake or to omit to undertake any particular technical project or activity, or otherwise affect the FASB in the exercise of its powers and responsibilities over financial accounting and reporting. Apart from their authority to appoint and, in limited specific circumstances, to remove members of the FASB** and the Advisory Council, the Trustees' only remaining authority is limited to periodic review of the basic structure for establishing financial accounting standards. Structural changes affecting the FASB and the Advisory Council can be made only with the affirmative vote of nine of the eleven Trustees.

Similarly, there can be no personal participation by the Foundation's Trustees in the technical work of the FASB or any of its other activities. The Trustees are prohibited from serving simultaneously as FASB members or staff members, or from serving on the Advisory Council, the FASB's Screening Committee on Emerging Problems, or any FASB task forces. Correspondingly, no appointed member of the Advisory Council may serve as a Trustee or as an FASB member or staff member, and no member of the Board of Directors of the AICPA (the Foundation's present elector) may serve as an FASB member or staff member.

The effect of these prohibitions, and the personnel policies discussed below applicable to FASB members and staff members, ensures at all times that the FASB will be free from pressures and influences which might be perceived as affecting the integrity, independence or objectivity of the FASB as a standard-setting body. This structural independence has proven as effective in practice as it was when first recommended by the Wheat Study Group and endorsed by the SEC and the accounting profession, and there has been no instance

* These circumstances are the same as for removal of FASB members, as discussed below. No Trustee has been removed or considered for removal.

** An FASB member can be removed only on the vote of eight of the FAF's eleven Trustees and only then in limited specific circumstances for reasons of disability, malfeasance or alleged malfeasance, or conduct otherwise detrimental to the Foundation or the FASB. No FASB member has been removed or considered for removal for any reason, and, contrary to the Study's assertion, these standards do not permit removal except in extreme and necessary cases. The power of removal is not a means of assuring that the FASB acts in a manner responsive to the desires of the Trustees, and certainly cannot be invoked "for anything that might offend the sensitivities of the FAF Trustees".

where anyone has sought to impose improper pressure or influence on the FASB or its activities, or where the FASB has acted other than with integrity, complete independence and objectivity.

As mentioned in the introductory overview to this Statement of Position, the FAF's Trustees directed its Structure Committee in December 1976 to conduct a comprehensive oversight study of this structure and all aspects of the FASB's organization and operations. The Structure Committee has finished its review and very recently published its report proposing recommendations designed to improve the structure of the Foundation, the FASB, and the Advisory Council to encourage still broader public participation in the standard-setting process and to improve the operating efficiency and effectiveness of the FASB and the Advisory Council.

Very briefly, the Committee's report concludes that the FASB is firmly established beyond reproach as an independent body and has added significantly to the quality and depth of accounting knowledge. The Committee also concluded that certain changes could be made to further improve the standard-setting process. Among the Committee's recommendations are that the Trustees consider further representation of users of financial statements on the FAF's Board of Trustees and that the AICPA's Board of Directors be replaced as sole elector of the FAF's Trustees by representatives of all six sponsoring organizations, each having an equal voice in the Trustee selection process. In view of its conclusion that the FASB had firmly established itself as an effective and independent standard-setting body, the Committee has also recommended that the Foundation's Certificate of Incorporation and By-Laws be amended to eliminate the requirement that four of the FASB's seven members be practicing public accountants or primarily experienced as accounting practitioners, and that FASB members be selected from the best available people solely on the basis of ability, experience and knowledge and their understanding of the needs of financial statement users. The FAF's Trustees have agreed in principle with the Committee's report and intend to consider expeditiously the Committee's recommendations.

C. Diversity of Responses to FASB Proposals

Notwithstanding, however, the careful structuring of the FAF and FASB to assure the integrity, independence and objectivity of the FASB, the Study asserts that the AICPA, the major accounting firms and the FAF's other sponsoring organizations "dominate" the FAF and through it the FASB, in order to serve the "special interests" of the major accounting firms' large corporate clients. The record proves the contrary, and clearly reflects the FASB's independence and objectivity and the breadth and depth of public participation in its processes.

Dramatic evidence of this independence and objectivity and public participation is provided by an analysis of the comments received from those alleged by the Study to dominate the FASB in response to the Exposure Drafts for FASB Statements No. 2, 5, 7, 8, 9, 12, 13 and 14, eight of the Board's most significant Statements to date.

This analysis, set forth in Exhibit B, was undertaken by the FASB's technical staff, who selected the accounting proposals, and the major issues within each proposal, before commencing the analysis and without regard to possible outcome. The staff reviewed

responses on these proposals and issues from public respondents in the following categories: the FAF's six sponsoring organizations, the 15 largest accounting firms, all academicians, and *Fortune's* 1975 listing of the 500 largest industrial companies and each of the 50 largest commercial banking, life insurance, diversified financial, retailing, transportation, and utilities enterprises. These responses are contained in the FASB's public record and are available for public inspection at its offices in Stamford, Connecticut.

This analysis shows in detail how incorrect it is to speculate, as the Study does, that professional organizations, accounting firms and business enterprises act in concert when commenting to the FASB on accounting proposals.

As Exhibit B shows, sponsoring organizations frequently disagree among themselves; major accounting firms disagree with each other, their clients and the AICPA; and the FASB's most consistent support in terms of positions taken seems to come from users of financial statements. If one were to generalize, or "keep score", the following could be viewed as representative of the entire analysis.

Taking the 19 issues* analyzed in Exhibit B on which it is possible to say that a given response on the Exposure Draft was equivalent to a given attitude on the Board's final position in the Statement, one sees that the least supportive of FASB decisions were business enterprises. Views expressed by a majority of business enterprises were rejected by the Board on 12 of 19 issues. Those sponsoring organizations representing the views of corporate financial and accounting executives also had little apparent influence on the FASB, for the FEI disagreed with the Board on 6 of the 10 issues it addressed and the NAA disagreed on all 5 on which it took a position.

The record of rejection of the views of business enterprises and corporate financial and accounting executives, conveniently classified as preparers of financial information, stands in sharp contrast to the record of users of financial information, to the extent represented by the Analysts Federation. The Analysts Federation supported the Board on all 15 issues on which it took a position.** The major accounting firms and the AICPA were somewhere between preparers and users on these proposals; the AICPA supported the FASB on 8 issues and disagreed on 4, while major accounting firms were in accord on 9 and in disagreement on 6.

The analysis also contradicts the Study's unsupported charge that accounting firms are "dominated" or "controlled" by their clients: the number of issues on which major accounting firms were consistent with a majority of their responding clients was roughly equivalent to the number of issues on which they disagreed (43 to 42).

* The questions used in these aggregate figures are Statement No. 2, issue 1; Statement No. 5, issues 1, 2 and 3; Statement No. 7, issues 1, 2 and 3; Statement No. 8, issues 1, 2 and 3; Statement No. 9, issues 1 and 2 (Exposure Draft and Public Hearing); Statement No. 12, issue 1; and Statement No. 14, issues 1-5. On Statement No. 8, issue 1, qualified agreement was classified as disagreement.

** The Study states: "Of the five private groups sponsoring the FASB, only the Financial Analysts Federation and its members have an apparent interest in developing accounting standards, which clearly convey the results of corporate activities to the public. . . . The Financial Analysts Federation appears to have the least influence as a sponsor of the FASB, and the FASB has yet to establish the type of meaningful accounting standards which would be most beneficial to investors and other users of financial statements."

In analyzing the public record of responses on specific issues, Exhibit B also demonstrates, in sharp contrast to the Study's speculation, the full range of diverse views on major FASB positions. The following examples illustrate such diversity.

In Statement No. 5, the FASB established financial accounting and reporting for loss contingencies. Support for the provisions subsequently adopted in the Statement was expressed by the Analysts Federation and the AICPA, while the FEI and the NAA opposed them. Six major accounting firms generally agreed with those provisions; five generally disagreed. The seven academicians who took positions unanimously were in support.

This pattern was generally followed on the specific issues. The FASB decided that accrual would not be permitted for self-insured risks. Business firms overwhelmingly opposed this view; fifty firms disagreed with the FASB position and only two supported it. Again, the FEI and the NAA opposed, and again the AICPA and the Analysts Federation supported the FASB position. Five accounting firms supported the FASB; only one disagreed. Four of the five firms agreeing took a view opposed by the overwhelming majority (20 to 2) of their clients. Again, the academicians unanimously supported the FASB.

Similarly, the FASB proposed and subsequently concluded in Statement No. 5 that accrual not be permitted for catastrophe loss contingencies for casualty insurers. Nineteen business firms disagreed with the FASB position; six supported it. The FEI disagreed again; the Analysts Federation and the AICPA supported the FASB. The three accounting firms disagreeing with the FASB took positions consistent with those of the majority of their clients. Once again the academic commentators responded unanimously in support of the FASB position.

In Statement No. 12, the FASB determined how certain equity marketable securities would be carried on the balance sheet and how declines in market value below cost would be treated. The Exposure Draft's proposal that those securities be carried at the lower of cost or market value was followed in the Statement. But the Exposure Draft's proposal that declines be charged to net income was modified to apply only to securities classified as current assets, with declines in other securities being charged to stockholders' equity.

The Analysts Federation, the AICPA, and the AAA committee members all supported the Exposure Draft's overall approach; the FEI disagreed. Five accounting firms disagreed; four agreed, and three had no clear overall position. Academicians split evenly. Business firms generally disagreed (38 to 13). Four of the five accounting firms disagreeing with the position of the Statement took positions consistent with those of their clients; the four accounting firms agreeing with the position of the Statement all were in disagreement with a majority of their clients.

On the issue of how securities would be carried on the balance sheet, the final FASB position was supported by the Analysts Federation, the AICPA, and the AAA committee members; the FEI disagreed. The major accounting firms were evenly divided on this issue (5 to 5). Business firms again strongly opposed the FASB approach (38 to 2). Two academicians supported the FASB position, and one opposed it. Of the five accounting firms supporting the Board's position, all took positions inconsistent with those of the majority of their clients.

On the second issue in the Exposure Draft, which the FASB modified in its final Statement, the Analysts Federation, the AICPA and the AAA committee members again supported the FASB's Exposure Draft, while the FEI disagreed. The major accounting firms opposed the position in the Exposure Draft by a narrow margin (5 to 4). The two academicians who took a position agreed with the Exposure Draft. Business firms again strongly opposed the Exposure Draft by a margin of 29 to 2.

Reaction to the Exposure Draft's proposal subsequently adopted in Statement No. 8, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", to include in determining income foreign currency exchange gains or losses was divergent between users and preparers of financial statements. The Analysts Federation supported the proposal; the NAA disagreed. Three major accounting firms supported the proposal and three disagreed. Business firms overwhelmingly opposed the proposal (54-5).

An interesting picture also emerges from the comments on the Exposure Draft preceding Statement No. 7, "Accounting and Reporting by Development Stage Enterprises", a Statement which the Study characterizes as benefiting "big business." The FASB decided that development stage enterprises should be subject to the same accounting standards as established enterprises, and the Analysts Federation, the FEI and the AICPA supported this view. The major accounting firms split (4 to 4), and nearly half (15 of 34) of *Fortune's* responding corporations disagreed with the FASB.

As mentioned above, Exhibit B contains further analyses of responses on several additional issues in these and other significant accounting standards. While comments analysis is not a precise science and, as Exhibit B points out, necessarily involves judgments in analyzing and classifying responses, the FAF and FASB believe that the results of this analysis demonstrate conclusively that no one "dominates" or "controls" the FASB, and that FASB determinations are made independently and objectively and only after receiving and considering a myriad of conflicting points of view.

D. Funding

The Study asserts that funding of the FASB through the Foundation, and the salaries paid to FASB members and staff, is one means "to insure that financial accounting standards remain compatible with the interests of the 'Big Eight' and their clients." The Study offers nothing beyond speculation in support of this assertion, and indeed nothing else exists.

In addition to revenues from the sale of FASB publications, reprint royalties and interest income (nearly one-third of total revenues in 1976), the FAF is funded by contributions from a wide range of sources, principally from the accounting profession and business, commercial and financial enterprises, including dues through its program of associate membership. Associate members receive automatically copies of Discussion Memoranda, Exposure Drafts, Statements and Interpretations and the FASB's newsletter "Status Report." For 1976, approximately 45% of the FAF's budget was funded by contributions from the financial and business communities, with the average contribution being \$1,300, and the largest being \$40,000 or less than 1% of the FASB's operating expenses of \$4,199,000. Another \$1,766,000 was attributable to dues paid to the Accounting Research Association of the AICPA, with the 15 largest accounting firms accounting for approximately 87% of this total. Additionally, the AICPA, AAA, Analyst Federation and NAA contributed \$208,000, \$7,000, \$7,000 and \$75,000, respectively.

While this breadth of financial support is significant, the Trustees' announced and continuing goal is to expand the base of support further and to rely to a lesser degree on large contributions.

Funding of the FAF has been an evolving process. When the FAF and FASB were created in 1972, the most obvious problem confronting the FAF's Trustees was to insure

adequate financing. The Wheat Study Group had estimated an annual budget of up to \$3 million per year and had recognized that voluntary contributions would necessarily constitute the bulk of financial support, at least during the start-up phase. The Wheat Study Group mentioned several possible approaches to the contribution question, but concluded that the matter was best left to the Foundation's Trustees.

It was clear to the FAF's first Board of Trustees that, as a matter of practical necessity, the success of the FASB depended upon significant financial commitments from within the accounting profession. Accordingly, the Trustees initially concentrated on establishing this necessary base and, as a result of their efforts, the Accounting Research Association of the AICPA committed to use its best efforts to raise sufficient funds from within the accounting profession to insure that the Foundation would receive at least \$2,000,000 in each of its first five years through 1977. As a part of this commitment, the eight largest accounting firms pledged \$200,000 in each year of the five-year start-up period and the ARA's suggested contributions for other accounting firms were set proportionately based on their size. As a result of the ARA's efforts, the Foundation has received approximately \$2,000,000 each year from the accounting profession, and at December 31, 1976 the ARA held approximately \$1,780,000 in excess of its commitment. Membership dues received by the ARA are its source of funds.

The Trustees also sought contributions in the FASB's start-up period from whatever other sources they could find. Contribution campaigns were undertaken by other sponsoring organizations, particularly the Financial Executives Institute. Beginning in 1974 the FAF also commenced direct annual solicitations to further broaden support. Last year the Foundation mailed nearly 9,000 requests for contributions and commenced and implemented a plan of associate membership by which those contributing a specified amount would be assured of receiving automatically the FASB's technical and other publications. This plan has been successful and there are now more than 2,500 associate members.

The FAF Board of Trustees has authorized its Finance Committee to proceed with a new financing plan for 1978 and subsequent years based on further increasing the breadth and depth of public support. Specifically, this plan is based on the principle that no one person, firm or corporation will be solicited to contribute, or will contribute, annually more than the lesser of \$50,000 or 1% of the FASB's annual operating expenses. As a part of this plan, the Finance Committee has suggested to the AICPA that the original five-year commitment on the part of the accounting profession through the ARA be reduced from \$2,000,000 to \$1,000,000 annually by means of contributions through the ARA, with this amount being supplemented by up to an additional \$500,000 annually from the \$1,780,000 currently held by the ARA in excess of its five-year commitment in 1972. This plan will have the practical effect of reducing the annual contributions of the eight largest accounting firms from \$200,000 annually to no more than \$50,000 annually, with other contributions through the ARA being reduced as well. The Trustees and the Finance Committee believe that additional public support, including support within the membership of the Securities Industries Association, and increasing publication revenues and royalties from reprint rights will prove sufficient to support the Board's operations at levels commensurate with its increasing technical activities.

The Study speculates that the seven members of the FASB may compromise their professional integrity and issue standards satisfactory to the FAF's major contributors so as not to jeopardize funding, particularly of their salaries. As demonstrated in the next section, all Board members are men with outstanding qualifications and records of service who have

made financial, career or personal sacrifices to serve on the Board. The FAF's By-Laws specifically disallow the use of the Trustees' budget authority to interfere with or influence the work of the FASB. The Study does not, and cannot, offer evidence of any attempt to influence FASB action through financial means.

E. Personnel

1. *Training, Experience and Professional Associations.*

The Study decries the extensive participation in the FASB's processes of persons within the professional, business and financial community—defined by the Study to include all persons associated with the AICPA, "big business", members of the sponsoring organizations, lawyers, investment and commercial bankers and others.

The Study's stated concern is that participation of those belonging to the AICPA and other sponsoring organizations mutes potential criticism of the FASB and assures compatibility of the FASB's accounting standards with the views of the major accounting firms and their large corporate clients. This is without basis in fact, as the Summary and Exhibit B's analysis of responses to FASB technical proposals prove. In practical terms, it is principally from among the membership of these organizations that persons best qualified to set accounting standards are to be found. If there is one essential characteristic of accounting, it is its technical complexity and the need to rely on the judgment and willingness of knowledgeable, experienced and dedicated people from a range of disciplines and with varying points of view. No one is excluded from the FASB's processes, however, for the fundamental qualification is only the capacity and willingness to contribute to the work of the Board.

Each FASB member meets this standard, and has brought a certain dimension and an individual point of view to the FASB's standard-setting process.

Marshall S. Armstrong, the FASB's first and only Chairman, was never associated with a "Big Eight" firm, having formerly been managing partner of a regional accounting firm headquartered in Indianapolis with several smaller offices elsewhere in Indiana. Prior to his appointment, Mr. Armstrong had been a member of the Accounting Principles Board and the AICPA's Committee on Auditing Procedure, and was the President of the AICPA when the Wheat and Trueblood Study Groups were commissioned to study and report on establishing accounting standards and the objectives of financial statements.

Arthur L. Litke, former Chief of the Federal Power Commission's Office of Accounting and Finance, joined the FASB in 1973 after many years of Government service, including service as Associate Director, Civil Accounting and Auditing Division, of the General Accounting Office. Mr. Litke also served as President of the Association of Government Accountants and as a member of the Committee on Auditing Procedure.

Robert T. Sprouse joined the Board in 1973 after eight years as Professor of Accounting at the Stanford University Graduate School of Business. Prior to joining Stanford, Mr. Sprouse had taught for 13 years at the Schools of Business Administration of the University of Minnesota, the University of California at Berkeley and Harvard University. Though not a member of the AICPA, Mr. Sprouse is a past President of the American Accounting Association, and is the author of several books and many articles on accounting.

Oscar S. Gellein was a retired former partner of Haskins & Sells when he joined the Board in 1974. During his years in practice, Mr. Gellein was National Director of

Accounting and Auditing and Director of Research Activities for his firm. Prior to joining Haskins & Sells, Mr. Gellein had been a Professor of Accounting at Kansas State University and the University of Denver. Mr. Gellein was also a member of the Accounting Principles Board and the Committee on Auditing Procedure, and served on the Trueblood Study Group.

Robert E. Mays joined the Board in 1973 following his retirement as Controller of Exxon Corporation. Prior to his association with Exxon, Mr. Mays had served in various financial and accounting positions in the petroleum and retailing industries.

The remaining two FASB members, Donald J. Kirk and Ralph E. Walters, severed their respective partnerships in Price Waterhouse & Co. and Touche Ross & Co. before joining the FASB. Both men brought extensive experience as audit and practice partners to the FASB, and Mr. Walters was a member of the Committee on Auditing Procedure for four years.

The Study criticizes membership in the AICPA and other sponsoring organizations, but the FAF and the FASB are aware of no requirement that restricts or prohibits federal judges, for example, from belonging to bar associations or professional organizations advancing the development of the law. Members of Congress belong to professional and other associations, yet no one has suggested that their memberships raise conflicts of interest. We are also unaware of any suggestion that judges or members of Congress reflect the views of their professional or other associations at the expense of their public responsibilities.

If sound accounting standards are to be developed, those persons best equipped by knowledge, experience and expertise will have to bear the brunt of the responsibility for researching, considering alternatives, deliberating the issues, and deciding on the standards to be adopted. The public will not be well served by turning the ultimate responsibility over to individuals with no interest or capacity to contribute to the effort. This is certainly not to suggest the public does not have a significant interest or role in the standard-setting process; as listed in Exhibit A, the breadth of disciplines, points of view and experience represented on the FASB's Advisory Council, its task forces and its Screening Committee on Emerging Problems speaks for itself. While technicians and others with extensive knowledge or experience may do most of the actual defining of issues and deliberating and accepting some proposed solutions while rejecting others, the process is open to all for their review and comment and the FASB considers the views of all. Nor is the lay public unrepresented by its own expert; continuing review and participation of the SEC, charged by Congress with responsibility to assure full and fair disclosure, assures a most qualified spokesman in a position of authority and responsibility.

The FASB is currently developing accounting standards for the extractive industries pursuant to Public Law 94-163, "Energy Policy and Conservation Act", in which Congress directed the SEC, with the assistance of the FASB, to develop accounting practices sufficient to generate a special energy data base for oil and gas producing companies to assist Congress in formulating energy policy. The Study's criticism that 17 of the 19 members of the FASB's task force have actual or potential financial interests in the outcome seems to imply that the public interest is not being protected or served. This criticism lacks any substance, for the FASB's Discussion Memorandum in December 1976 was developed as a neutral document in cooperation with the task force under the observation of representatives of the SEC, the Federal Power Commission, the Federal Energy Administration, the General Accounting Office, the Cost Accounting Standards Board, and a Congressional committee.

2. *Personnel Policies.*

In recognition that the appearance of independence is as important as its fact, the Board of Trustees has adopted personnel policies to govern the activities of FASB members, and FASB staff directors and deputy directors. The Chairman of the Board has adopted similar policies governing the activities of the remaining FASB staff. These policies are strict, and with respect to outside earned income, receipt of honoraria, obligations owing to or payable from former employers, and understandings and arrangements for future employment, are stricter than standards applicable to members of Congress and compare favorably with standards applicable to Government agencies. Each FASB member, director and deputy director is required to sign an annual acknowledgment that he has not violated these policies.*

Pursuant to these policies, FASB members, directors and deputy directors

(a) may not be owed any financial or other obligation, directly or indirectly, by any former employer or client, other than fixed and vested pension, retirement or separation benefits and other than may arise in normal banking relations, ownership of governmental securities or publicly traded securities, and certain other limited investments;

(b) prior to advising the Trustees of intent to resign or not to stand for reappointment, may not have any formal or informal arrangement or understanding with any person to the effect that he can or will return to, or become affiliated with, an employer or business partnership, or resume or enter into consulting or other similar arrangements after termination of his relationship with the FASB or the Foundation.**

* See Exhibit C for a comparison of these policies to those applicable to members of Congress, the SEC, CASB and GAO and the Federal Judiciary.

** An exception is made for academic leaves of absence for staff (but not FASB) members.

The Study suggests that Walter Schuetze's resignation and his rejoining Peat, Marwick, Mitchell & Co. violated personnel policies applicable to FASB members. This is speculation and incorrect.

The FASB understands that Mr. Schuetze first brought up the possibility of returning to his former firm, Peat, Marwick, Mitchell & Co., with that firm's senior partner shortly before April 9, 1976. On that date, Peat, Marwick's senior partner advised Mr. Schuetze that his readmission to the firm would be recommended to Peat, Marwick's partners and principals, but that there were no assurances that Mr. Schuetze could or would be readmitted since readmission was conditioned, in accordance with Peat, Marwick's established practice, on the unanimous affirmative vote of all of the firm's more than 850 partners and principals. That same day, April 9, Mr. Schuetze notified the FAF's President and the FASB's Chairman of this and that he would resign from the FASB, effective June 30, 1976, which Mr. Schuetze confirmed by letter on April 12, 1976. It was not until May 13, 1976 that Mr. Schuetze was notified by Peat, Marwick that the vote on his readmission was favorable and that he could return as a partner, effective July 1, 1976.

During the period from April 9, 1976 through June 30, 1976, the Board took no votes on the issuance of any Exposure Drafts, final Statements or final Interpretations, and Mr. Schuetze disqualified himself from voting on the four Interpretations proposed for submission to the Advisory Council for comments. During this period, the Board also considered a Discussion Memorandum as the basis for a public hearing, and requests that it reconsider Statement Nos. 5, 8 and 12 issued in 1975. Mr. Schuetze participated in these matters, since none involved the issuance of a new accounting pronouncement or issuance of an amendment or proposed amendment of an existing pronouncement. Under the personnel policies, the question of disqualification on a vote is left to each FASB member.

(c) may not have or owe any financial or other obligation to any former employer, business relationship or client, other than normal banking relationships, covenants not to compete and obligations of a comparable character;

(d) must devote their full business time to the activities of the FASB and not engage in any outside activity which interferes with the performance of their duties, and may not be affiliated as a partner, director, trustee, officer, employee, agent or consultant with respect to any organization, other than a non-profit organization (with limited exceptions involving essentially family matters), and no affiliations with non-profit organizations or family matters may exist which interfere to any material degree with devoting their full business time to the performance of their duties, or which affect their independence or objectivity;

(e) may not, directly or indirectly, use or otherwise place themselves in a position to benefit personally from, or to disclose or make available to others, any information which might be regarded as material relating to the functions or activities of the FAF or the FASB which has not been made available publicly;

(f) must pay any fees, honoraria or other like payments over to the FAF;

(g) must report by written questionnaire all material investments*; and

(h) must take great care to conduct themselves and all their activities in such a manner that investments and personal activities will not affect their independence or objectivity or be detrimental to the interests or repute of the FAF or the FASB.

The staff personnel policies, issued by the Chairman of the FASB, are similar to the personnel policies applicable to FASB members, directors and deputy directors. Certain differences in terms of permissible activities and investments are largely practical and recognize the lesser degree of involvement and sensitivity of staff positions in the standard-setting process—in particular, the fact that only FASB members decide technical issues and vote on the issuance of FASB pronouncements.

Both personnel policies provide that violations of these policies and rules of conduct may be deemed conduct detrimental to the purposes and repute of the FASB and constitute grounds for removal or involuntary termination. The Study cites no example, nor do the Chairman of the FASB nor the FAF's Trustees know of any instance, where independence

* The Study cites as an example of self-interest that immaterial investments do not have to be reported by Board members and senior staff directors and deputy directors.

At the time of the creation of the FAF and the FASB, the question of investments was considered thoroughly before the existing policies were adopted. Unlike the SEC, which has limitations in respect of the securities of particular companies which are or recently were in registration, a comparable restriction on securityholdings by Board members and directors would involve restricting investments in every possible vehicle because of the scope of the Board's mandate to establish any and all financial accounting and reporting standards affecting all companies. It was concluded that if no investments were permitted, it would be virtually impossible to find people willing to liquidate their securityholdings and possibly incur extreme tax penalties as a condition to service. Disclosure was the alternative, and it was decided, for purely practical reasons, that little could be gained by requiring a person to list every investment if immaterial in amount or immaterial in relation to his net worth. The question of a blind trust was also considered, but as the Study concedes, its usefulness is questionable in practical terms.

As discussed above, the question of scheduling investments is currently under review by the Trustees' Committee on Personnel Policies.

or objectivity, in fact or appearance, has been or might be compromised by anyone. While the FAF and the FASB believe that existing personnel policies have proven effective, the FAF's Trustees are mindful of the Study's criticisms and, as discussed above, have directed its Committee on Personnel Policies to conduct a review and to make such recommendations for improvement as may be appropriate.

3. Employment After Leaving FASB.

The record provides no support for the Study's speculation, based on one FASB member's rejoining his former accounting firm, that a "revolving door" arrangement between the FASB and the "big accounting firms" has begun.

In the FASB's nearly four years of operations, four FASB members have resigned or announced their intention to resign or to retire at the expiration of their terms. Of these four, only one, Walter Schuetze, rejoined his former accounting firm. Of the others, John W. Queenan went into retirement on his resignation in 1974; Marshall S. Armstrong will step down at the end of 1977 after five years as the FASB's first Chairman to devote his full time to the Foundation for approximately two more years as Chairman Emeritus; and Robert E. Mays, who retired as Controller of Exxon Corporation prior to joining the Board, has advised the Foundation's Trustees that he does not wish reappointment upon expiration of his term at year-end. Similarly, and looking ahead, the careers of the five other present FASB members do not suggest any foreseeable possibility of a "revolving door arrangement". Oscar S. Gellein came out of retirement to join the Board in 1974, and Robert T. Sprouse and Arthur L. Litke spent their entire professional careers as, respectively, an accounting educator and an official in the Federal Government before becoming FASB members. Donald J. Kirk was reappointed in 1976 to a five-year FASB term expiring in 1981 and Ralph E. Walters just joined the Board effective April 1, 1977.

The same pattern also emerges when the FASB's technical staff is considered.* Of the sixteen technical staff members who have left to date, only three are known to have rejoined their former accounting firms and of the four others who went into public practice, three had joined the FASB directly upon leaving school. Of the other nine former technical staff members, six went to academic institutions (of whom two did not return to accounting practice), one went with a Federal Government agency, one joined an investment banking firm, and the position of one is unknown.

II. PUBLIC PARTICIPATION IN THE STANDARD-SETTING PROCESS

A. Standard-Setting

Notwithstanding the extensive procedures for encouraging public participation and obtaining public comment specified in the FAF's Certificate of Incorporation and By-Laws and the FASB's Rules of Procedure, the Study concludes "these forms of public participation, however, do not alter the fact that the actual decisions on accounting standards are made behind closed doors by private parties with a vested interest in the outcome." In effect, the Study seems to assert that the FASB's public procedures are useless. The fact is, however, that the FASB's public participation procedures were modeled on the Adminis-

* The Board supplements its permanent technical staff through its FASB Fellow Program. These technical staff members are hired on the understanding that it is expected they will return to their former employers after an approximate two-year period of concentrated technical training on the FASB's staff. The FASB Fellow Program is comparable to the SEC's Accounting Fellow Program.

trative Procedure Act and in several respects are more demanding, and were adopted only after considerable study, public exposure for comment, public hearings and widespread support within the private and public sectors.

As described in detail in Exhibit A, no Statement of Financial Accounting Standards can be issued without public exposure for at least 30 days, and Statements more frequently are exposed for at least 60 days. No Interpretation may be issued without prior general exposure, or exposure to members of the Advisory Council for comment for at least 15 days. Public hearings on projects are required for all Statements, except those where the Board specifically finds that, on the basis of existing data, it can make an informed decision without a public hearing. Fifteen public hearings, preceded by the circulation of Discussion Memoranda or Exposure Drafts, have been held to date.* Anyone may request to appear and be heard at FASB hearings, and everyone requesting to do so has been granted time to appear and to be heard on the record. In fact, the FASB has even extended hearing dates in order to permit everyone wishing to appear to do so.

The FASB presently distributes over 27,000 copies of each Discussion Memorandum, over 37,000 copies of each Exposure Draft, over 100,000 copies of each Statement, and over 90,000 copies of each Interpretation. Anyone can get on the Board's mailing list, and, depending upon the size of the document, at least one and frequently more copies of each Discussion Memorandum and Exposure Draft are free to anyone (including non-contributors) for the asking. There are no limitations on who can ask for and receive free copies, or who can subscribe to the FASB's publications or become an FAF associate member, nor is there any restriction on ordering specific publications directly from the Board. Each FASB member considers comments and position papers submitted by anyone who is willing to take the trouble to write. In addition, all comments and position papers are analyzed by the FASB's staff and copies of analyses are given to each FASB member in connection with his review.

The evolution of Statement of Financial Accounting Standards No. 8, "The Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", is illustrative of the degree of public exposure and public participation in the FASB's standard-setting process. The FASB commenced the development of Statement No. 8 by appointing a task force of 14 knowledgeable and interested persons in 1973. A Discussion Memorandum was published on February 21, 1974, and 21,000 copies were distributed. Fifteen presentations were made during two days of public hearings held in New York City in June 1974. After considering the 90 comment letters and position papers received, the FASB issued an Exposure Draft on December 31, 1974, of which 39,000 copies were distributed. The FASB received an additional 191 comment letters on the Exposure Draft. The FASB issued Statement No. 8 in October 1975.

The public's participation in the development of Statement No. 8 is not unique. Since the FASB's formation, 2,200 comment letters and position papers have been received on 13 Discussion Memoranda; 322 oral presentations have been made at 15 public hearings; 3,160

* Hearings were not held for Statements No. 1, "Disclosure of Foreign Currency Translation"; No. 3, "Reporting Accounting Changes in Interim Financial Statements"; No. 4, "Reporting Gains and Losses from Extinguishment of Debt"; No. 6, "Classification of Short-Term Obligations Expected to be Refinanced"; and No. 10, "Extensions of 'Grandfather' Provisions for Business Combinations." In each case, the FASB concluded it had sufficient data upon which to reach an informed decision, and judged public exposure of the proposed statement to be all that was necessary.

comment letters and position papers have been received on 20 Exposure Drafts; and 179 different individuals have served on 14 task forces.

The Board's Statements are not dictated as unsupported decrees. In addition to stating the accounting standard, each Statement sets forth, among other things, (i) those FASB members dissenting and their comments in support of their dissent, (ii) the various alternative solutions considered by the Board and the reasons leading to their rejection or acceptance, (iii) a summary of the more significant views expressed in comment letters and position papers received by the Board, and (iv) relevant background information, including results of research undertaken on the project. The FASB's Interpretations must also contain the comments of dissenting FASB members. There is no provision in the FASB's Rules of Procedure for private or informal ex parte "interpretations" and, as a matter of policy, the FASB does not issue them. Arbitrary or self-interested standard-setting could not stand up under these requirements of self-analysis and the FASB's procedures for public comment and participation.

The Study criticizes the FASB for reaching substantive technical determinations on standards in meetings not open to the public. In so doing, however, the Study notes that the Government's Cost Accounting Standards Board is exempt under the "Government in the Sunshine Act" when reaching its decisions. The Sunshine Act's exemptions also permit the SEC to hold private meetings if it determines that premature disclosure is likely to result in significant speculation in securities or currency. The FASB considers its technical actions equally sensitive and subject to abuse if disclosed piecemeal or prematurely. In these circumstances, and because the FASB's processes are open to the public at every stage up to decision and the public is provided ample opportunity to consider and comment on the issues and alternatives and the FASB's Exposure Drafts, the FASB has felt it preferable for everyone to become informed of the same information at the same time.

B. Public Notice and Public Record

In order to maximize public participation and to keep the public informed promptly of significant developments, the FASB's Rules of Procedure require it to make prompt public announcements of projects added to its agenda; assignment of priorities to agenda projects; completion of each significant phase of a project; the availability of Discussion Memoranda and background and other materials; notices of public hearings; the issuance and availability of Exposure Drafts; the availability of transcripts of public hearings; and the issuance and availability of Statements and Interpretations. In addition to press releases, matters of significance are also reported in the Board's newsletter "Status Report", of which over 38,000 copies are regularly distributed. The Board's present regular mailing list includes 23,000 names.

Further, the FASB's Rules of Procedure require that the Board maintain a complete public record available for public inspection at its offices in Stamford, Connecticut. Among the materials required to be maintained in this public record are all written research data and background and other material for public hearings; all written comments and position papers submitted at all stages of the FASB's procedures (other than statistical data of a confidential character and related explanatory text); written comments of Advisory Council members on proposed Statements and Interpretations; the minutes of all meetings of the FAF, FASB and the Advisory Council; transcripts of public hearings; and the votes of FASB members, including dissents, on the issuance of Statements and Interpretations.

C. Meetings and Public Communications

The FASB meets with interested parties on its own motion or at the request of others as a means of obtaining information as to the impact of implementation of proposed standards and as a means of learning of the concerns of the public. While the Board necessarily has to budget its time and is unable, as a practical matter, to accede to every meeting request, it or its staff regularly participates in meetings when the subject is likely to result in new or additional relevant information which otherwise may not be obtainable. Although the Study has criticized these informal meetings, the FAF's Structure Committee has recommended in its recent report that the FASB and its staff hold more informal meetings as a means of further encouraging and increasing public participation in the standard-setting process.

It is interesting to note that the Government's Cost Accounting Standards Board also views meetings as an important means of getting additional information. At every stage of the CASB's deliberations, its staff consults informally with industry representatives and other affected groups in order to discuss and evaluate the need for a cost accounting standard, possible alternatives, the expected costs and benefits, and foreseeable practical difficulties in implementation.

On occasion the Board has issued public invitations requesting information relevant to its work. For example, promptly upon commencing operations in 1973, the FASB issued an "open letter" to accounting firms, the financial and business community, analysts, and all interested persons requesting information on the experiences of preparers, auditors and users of financial statements "which would indicate that existing pronouncements need interpretation, amendment or replacement." The Board received over 100 replies, some more than 30 pages, advising as to these matters for consideration by the Board. More recently, the Board issued an open invitation to all interested persons to submit research papers on the economic effects of accounting standards, with particular reference to existing standards and to projects on the FASB's agenda. In issuing this invitation, the FASB stated that all papers submitted would be reviewed and some selected for presentation at its planned conference on economic consequences of accounting standards in early 1978.

III. PROGRESS AND SUCCESS OF THE FASB AND ITS PREDECESSORS

Review of a complete and balanced record shows that the FASB and its accounting standard-setting predecessors have been successful in establishing meaningful financial accounting standards, responsive both to pervasive and persistent problems of the past and to newly emerging problems in need of prompt solution.

A. Significant Accounting Pronouncements

In its less than four years of operations, the FASB has issued 14 Statements of Financial Accounting Standards, 18 Interpretations, 20 Exposure Drafts and 13 Discussion Memoranda and has held 15 public hearings, as enumerated in Exhibit D. The FASB's pronouncements, the more significant of which are also summarized in Exhibit D, demonstrate the dedication and attention of the FASB to its objective of establishing and improving financial accounting standards. When considered in conjunction with Exhibit B's analysis of responses on FASB proposals, Exhibit D also demonstrates that the FASB is not "dominated" or "controlled" by "special interest groups", and is willing and able to reduce or eliminate accounting alternatives when reasonable to do so.