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THE FASB AFTER TEN YEARS: AN INSIDE VIEW

A PAPER BY

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Expressions of individual views by members of the FASB and its staff are encouraged. The views expressed in this text are those of Mr. Kirk. Official positions of the FASB on accounting matters are determined only after extensive due process and deliberation.

The FASB After Ten Years: An Inside View

I am pleased to have this opportunity for what the program describes as a self-evaluation. While I have been a member of the Board since it was organized and Chairman since January 1, 1978, I would not presume to equate an evaluation of myself with an analysis of the FASB. As the participants in this program know, I am just one member of a collegial decision-making body.

Do not confuse longevity with influence. My longevity as a member is testimony to my relative youth at the time of my appointment, the quirks of the by-laws of the Foundation, and the low market value of an accounting standard-setter. My dissents to FASB Statements are ample evidence that my longevity is in no way attributable to persuasive powers.

The chairmanship has many special responsibilities but few special powers. The Chairman occasionally blows his referee's whistle from the middle seat of a loosely organized seven-member debating society that meets regularly to resume ongoing debates on subjects that have been examined and reexamined since 1918. The man-in-the-street, if he listened, would think the debates rivaled in importance the scholastic debates of the middle ages. However, outside the shelter at High Ridge Park, the perceived realities of our theoretical debates descend upon an FASB member like the "slings and arrows of outrageous fortune." While usually willing to "take arms against a sea of troubles," there are times when Hamlet's dilemma is faced by the FASB. Personally, I have faced the temptations, when asked where I work, to mumble, and when at conventions, to request a name tag that says, "name withheld upon request". So far, I have not succumbed to those temptations.

While I will try, during this program, to alter the course of any misdirected arrows, I will also try to avoid taking up arms against justified criticism. If vanity or self-deception enter into this evaluation, I know I can count on the participants in this program to point out the error of my ways.

Several of the participants in the roundtable are responsible for my being here as the Chairman of the FASB. Certainly the encouragement of Marshall Armstrong in these early years of the Board was a major factor. The most recent past President of the Foundation, Russ Palmer, is the latest to share the blame. He convinced me to accept my present and last term on the Board. I regret that Al Way and Ralph Kent cannot be with us. Al was President in my first two years as Chairman. Ralph was the first President of the Foundation and, therefore, he hired me and was also instrumental in my first reappointment in 1976. That reappointment had repercussions on the Board that you may have forgotten. They were promptly reported in a "Status Report" headline, as follows: "Kirk Accepts Reappointment to Board. Schuetze Plans to Return to Public Accounting Practice."[2]

John Biegler, the second President of the Foundation, warrants special mention, not just for his service as a member of the APB and the Wheat study group, but for bringing the name of an obscure partner of his--me--to the attention of the first group of Trustees charged with the responsibility of forming the Board. You might think that when the senior partner of a firm inquires of a junior partner about his interest in employment elsewhere, a less than subtle message was being sent. Well, I never worried about whether there was a subtle message, because I wanted to be considered for membership on the FASB.

THE ORIGINS OF THE FASB

The environment that preceded the birth of the FASB was vividly described in a book entitled The Go-Go Years: When Prices Went Topless.[3] It was the time, in the author's words, of corporate chutzpah, creative accounting, and public offerings at 118 times earnings. It was the time when what a more recent observer, Robert Reich, has labeled "paper entrepreneurialism" reached its zenith. To Reich, "paper entrepreneurialism," which he believes continues as a fundamental social problem of this country, means the obsession with symbols and appearances rather than economic realities.[4]

It was in those times that John Biegler served on the APB, and the AICPA struggled with the authority of APB opinions. It was in those times, the 1960's, that I became a CPA and then a partner in a gentlemanly firm with a long, proud tradition of the independence of individual partners and reliance on their professional judgment. George O. May and Paul Grady were no longer active partners in that firm, but their thoughts and philosophies were certainly present. Herman Bevis was the senior partner of the firm during most of the 1960's and his philosophy was well known from his membership on the APB and his numerous writings. Bevis' philosophy was reflective of the tradition of the firm and, while strongly criticized by some in the profession, it had its supporters outside his firm as well. In brief, the philosophy was one of assigning responsibility for the corporate financial report to management and their certifying CPAs, rather than to a centralized authority that could issue mandatory standards. Centralized consensus building was acceptable to Bevis only if it established preferred practice and rested on persuasion, not compulsion.[5]

Contrast that philosophy with the more recent words of then-Chairman of the SEC, Harold Williams, who said the need is not for consensus building, but for aggressive leadership and enlightened followership, and that a meaningful framework for financial reporting will never be a product of consensus.[6] Contrast the Bevis philosophy with the words of the Chairman of the FASB - a central authority issuing compulsory standards. While calling for consensus building in support of private sector standard setting and the Board's view on the nature of standard setting, I have referred to "generally accepted accounting principles," which by name imply consensus, as false labelling.[7]

I do not contrast these views to make the point that later views are superior, only that they are in vogue. And while the views of the participants in this roundtable program might not differ much as to which will prevail in the short run, they probably differ as to which will or should prevail in the long run. Our democratic society is an arena for the tug-of-war between personal freedom and responsibility and centralized authority. That tug-of-war underlies many people's assessment and predictions about the FASB. For example, Thomas A. Murphy, retired chairman of General Motors Corporation, former Trustee of the Financial Accounting Foundation, and consistent supporter of private sector standard setting, has expressed his concern about what he perceives as the risk of a shifting toward centralized authority, as follows:

> A large part of my concern is that the worship of false idols--in this case, the idol of comparability--inevitably leads to the zealous acceptance of equally false doctrines. Because it is not accounting standards alone that cause disparity in the results reported by different businesses, those who make a god of comparability will inevitably take additional steps. . . . It is conceivable that they will decide to make each business apply the same depreciation rates and the same maintenance and

> replacement standards for fixed assets. . . . And they will justify such radical behavior by arguing that, if all businesses aren't following the same practices in these and a whole host of other areas, how can meaningful comparisons be made? How can this shiny new god of comparability be properly served?[8]

To summarize what has gone before, my point is that the role, performance, and outlook for an institution like the FASB needs to be judged within the context of a larger social and political scene.[9] Also, it helps to understand the major players, the standard-setters and their private and public overseers. They do not arrive with clean slates; they are a composite of prior business or professional experience and attitudes that sometimes defy easy analysis. I have no intention of subjecting you to a psychological analysis of my attitudes (or of those of Harold Williams or John Shad), but rather, will limit the self-analysis to brief mention of my professional experience. It started at the same time as the APB. I embraced my then firm's philosophy based upon the integrity and judgment of the individual practitioner, both in auditing and in the application of generally accepted accounting principles. In the early sixties I witnessed the clash of differing philosophies and rapidly learned of the difficulties and, at times, inadequacies of the individual practitioner's judgment to deal with the corporate chutzpah and creative accounting of the go-go years. I had been brought up professionally to believe Paul Grady when he said, ". . . the scrub brush of good accrual accounting holds the solution to most of the dingy areas of accounting practice."[10] I still believe that, but at the time, "bad" accrual accounting was driving out "good" accrual accounting. That resulted in part, in my judgment, because the tools of the auditors to know income when they saw it were no match for the creative accounting of the times.[11]

In the early 1970's I was ready to join the bold new experiment recommended by Frank Wheat and his fellow members of the Study Group on Establishment of Accounting Principles.

The FASB started with a structure almost identical to that recommended by the Wheat study group. With seven Board members and a small staff, we took on seven major projects and awaited the completion of the work of the Trueblood study group on the Objectives of Financial Statements. We were guided by the Wheat group and our own assessments of the strengths and weaknesses of the approach of the APB and by a scant few words in the by-laws of the Foundation that charged us to establish and improve standards for financial accounting and reporting.

We started with wide support and high hopes. Reginald Jones noted those high hopes at an inaugural dinner. He also noted that challenge to the private sector effort would come when someone's ox was gored.[12] Walter Wriston voiced a similar theme in our early days:

> The accounting profession still has time but if you don't want to see a future of bookkeepers filling out government forms, it is absolutely essential that the FASB move rapidly. . . . If you have any influence with the FASB, you'll tell them to get busy and issue 30 regulations, most of which you'll disagree with violently. That's fine. As long as you follow them, you'll have a profession. If you don't, you could wind up being an organization of bookkeepers.[13]

A few years later, when it appeared that the banking industry's ox might be gored, he proclaimed that accounting standards were too important to be the responsibility of accountants.[14]

Obviously the Board had demonstrated its independence, and independence was certainly among the prime objectives of the bold new experiment envisioned by the Wheat group. Looking at the objectives of those who established and those who have since reviewed the operation and the structure of the Board, I have, for purposes of analysis, approached the subject in two parts: first, the process for setting standards and, second, the objectives of standard setting. This approach is similar to the one adopted by Marshall Armstrong in 1971 when, as President of the AICPA, he assigned the responsibility for the study of how accounting principles should be established to one group and the study of the objectives of financial statements to another. The Wheat study group completed its work first and recommended a process that has lasted for ten years with only slight modifications. The second study was more difficult to complete and its impact on standard setting more controversial and difficult to implement.

THE PROCESS OF SETTING STANDARDS

John Biegler has been asked to revisit and comment on the structure and process for standard setting. Therefore, I will be brief on the background but will offer my own assessment and outlook in order to add a perspective from inside the Board. In sequence I will address the subjects of a nongovernmental and independent structure, and then a participatory and open process.

A nongovernmental and independent structure

In recommending a nongovernmental structure, the Wheat study group enumerated the familiar arguments against a governmental structure, i.e., political pressures, inflexibility, and the sapping of the vitality of the accounting profession. The oversight reports carried out by or commissioned by the Trustees of the Foundation have consistently shown the continued strong support for a nongovernmental standard-setting activity.

The reasons for that support are well-cataloged by Louis Harris and Associates, Inc. and include a pervasive "general distrust of government".[15] I would suspect that distrust in the business community has not subsided since that 1980 survey.

My own experience tells me that some of that support is not in recognition of the private sector's ability to do a better job of standard setting, but rather expresses a hope that the FASB will keep government (and standards) off their back. My own experience has also convinced me that the greater availability of resources and greater freedom from political pressures are valid reasons, not just shibboleths, for private sector standard-setting.

Being one step removed from direct involvement in the Washington scene, we can try to lessen the peaks and valleys of political oscillations between more regulation and less regulation, between hating oil companies and tolerating banks, and hating banks and tolerating oil companies, between Main Street and Wall Street, between liberals and conservatives, between Democrats and Republicans, etc., etc. The FASB's project on oil and gas accounting is an excellent example of political influence on a seemingly technical subject. One incident during that project will help explain why I am convinced that private sector standard-setting is at least partially sheltered from political pressures. It was the statement of a representative of the Department of Justice's Antitrust Division to me that the Department knew how to stop another government department or agency, but they did not know how to stop the FASB from issuing Statement No. 19.

Political insulation (via the SEC) also has its drawbacks; it subjects the FASB to criticism by its insulator. In that respect the insulatee (the FASB) may, at times, end up being the insulator of the SEC, or even at times the scapegoat of its overseer. I do not describe the relationship to be critical of it, it just goes with the territory. It is part of the public-private partnership that has evolved over the last fifty years. The Wheat Study referred to the partnership as a "continuing dynamic relationship."

To keep standard-setting in the private sector requires special attention to this relationship. By its nature it has and will have its ups and downs. We at the FASB have worked hard at this relationship (an "E" for effort), trying to uphold our half of what Sandy Burton called a policy of "mutual non-surprise."

To keep the relationship working in the future requires three things: first, understanding and respect by each for the other's role; second, timely response by the FASB to the valid concerns of the SEC; and third, restraint on the part of the SEC, to avoid the temptation to impose its preferences. The first requires frequent communication between the two organizations. That has been the routine in the past and will, I am sure, continue to be in the future. The second, i.e. timely response, will be discussed later in this paper. Hopefully, the third, i.e., restraint, will result from successful accomplishment of the first two. However, realistically, political pressures may make it impossible at times for all the efforts of the FASB to achieve the third ingredient. I believe, however, that the SEC's need for some "insulation" will reinforce the need for restraint. Unrestrained action on the part of the SEC will destroy the Board's effectiveness, just as the Board's implementing the preferences of the SEC will destroy the FASB's credibility. Maintaining the "dynamic relationship" will be an ongoing challenge.

Independence, as noted earlier, was a prime objective the Wheat group had in mind for the FASB. Independence is essential to bolster the Board's credibility with the press (whose importance should not be overlooked) and the federal government. Signals from Washington since the Metcalf hearings have generally been positive in this respect. More and more legislators know what the FASB is and recognize it as an independent, believable organization. Turnover in Congress and in committee assignments requires that continuous words and deeds reinforce the current belief in the Board's independence.

The Wheat study group was particularly sensitive to the Board's need for support from the AICPA and, therefore, noted the need for a special relationship with that organization. Later events, for example the Metcalf inquiries, have emphasized the need for an arm's-length relationship between the two organizations. Both have "public" responsibilities, but the interests of the two can and do diverge. Explaining and demonstrating that arm's-length relationship between the two is another continuing challenge to insure independence of the FASB.

A concern about independent regulatory agencies is that they can be captured by those who are regulated. Populists such as former Representative Moss and the late Senator Metcalf were concerned that the FASB was or might be nothing more than a front for the special interests of the accounting establishment. In that instance the capture theory was disproved, but the theory has some basis in fact and populism in politics is not dead. I believe, however, that the diverse backgrounds of the Trustees of the Foundation who appoint FASB members, and their recognition that a "captured" FASB will be a short-lived interlude between private sector standard-setting and government regulation, will keep the capture theory a vision of populists' imaginations.

<u>A participatory and open process</u>

The Wheat study group emphasized the need for a participatory and open process. It was shortcomings in this regard that resulted in severe but justifiable criticism of the FASB in the early years by its overseers. This aspect of the bold new experiment - participation and openness - was foreign to the old way of doing business, and there inevitably was some carryover from the old way. It is difficult to recall the exact reasons for meetings of the Board being closed to the public and for the avoidance of public discussion of tentative decisions, but I do believe it was the experience of the APB that was a crucial factor. Disclosure of tentative positions of the APB resulted in pressure being exerted on that Board. We at the FASB concluded that the best way to avoid that pressure was to deliberate and develop standards behind closed doors. Our decision to do our public job in private was a mistake. We were, however, a new, insecure organization groping for a way to carry out its responsibility. Judges did not and do not deliberate in public; sunshine in government was a new phenomenon certainly not considered, in 1973, applicable to the FASB. In fact, even when deliberations in the sunshine were recommended to the Board by the Trustees and the Metcalf subcommittee four years later, a majority of the Board opposed it. (Marshall Armstrong, Arthur Litke, and I were in the minority.)

I continue to be a strong advocate of participation and openness. I believe they add more to the credibility of the Board than they inhibit free-thinking and discussion among Board members. Without question participation and openness do add to the pressures placed on the Board and further test its independence. Keeping the right balance between openness and independence will be a challenge. Convincing special interests that you have listened and heard but then disagreed with them for good reasons will only become more difficult if our participatory approach to government in general continues to foster organized lobbying and single-issue politics.

A new challenge to the process is on the horizon - the Government Accounting Standards Board. This board, which is to be set up under the Financial Accounting Foundation, has at present no special charge other than what its name implies. The understanding approved by the Trustees in December of 1982 contains two sentences concerning the scope of activities of the FASB and the GASB:

> The jurisdictional division between GASB and FASB shall be worked out by the two chairmen. The FAF shall have responsibility for resolving jurisdictional questions.

The jurisdictional question is amplified in a "memorandum of understandings" as follows:

> The FAF shall have final authority for resolving jurisdictional questions. In that regard, the FAF will prescribe a process for resolving disputes between FASB and GASB.

The potential jurisdiction problems have been raised and discussed during the past several years, but nothing more than hopes for a good-faith resolution of the many potential problems has evolved. While that posture may have been needed in order to bring the various parties this far along, serious discussion about jurisdiction is needed prior to the beginning of work by the GASB. Agendas and work plans cannot be established without guidelines about the respective responsibilities of the two boards. The thought that a "process for resolving disputes" will be established conjures up, in my mind, the possibility of an appellate body over, or a conference committee between, the two Boards.

The former possibility was assessed by the Wheat study group and by the 1977 structure committee of the FAF. Neither were convinced of the merits then, and I doubt that many would endorse it now. I certainly do not.

The conference committee approach, while integral to a bicameral legislative process, is certainly foreign to the process of the FASB. While some have said standard-setting is a legislative process, the analogy to law-making is weak, at best.[16] (However, there are times when I am ready to add accounting standards to sausages and law as things that you should never see being made.) The conference committee approach just does not fit into the process as presently designed, and the design should not be changed to accommodate it.

THE OBJECTIVES OF STANDARD SETTING

Both human nature and logic have resulted in my addressing the more difficult part of my analysis last. Procrastination requires no explanation. The logic is that the structure for standard-setting is relatively static; the objectives of standard-setting are controversial and are still undergoing development. The later I address objectives, the more current my remarks will be. With subjects such as whether the Board is contributing to standards overload or failing to furnish timely guidance, being debated currently, what I write today may be overtaken by events tomorrow.

Key questions in assessing the Board are: What progress has the FASB made in articulating its purposes? Has it done so in a convincing, generally accepted way that will prove useful in the future?

As previously mentioned, the FASB started with a few words in the by-laws charging the Board with responsibility to establish and improve standards of financial accounting and reporting and some helpful ideas in the Wheat study group report. As was the case when the APB was formed, there was an expectation that we would develop objectives and concepts to guide our work. We were more than willing to wait for the Trueblood study group to complete its assignment, for we had little idea how we might use it. We did know what the problems of the 1960's had been and we had a long list of problems that needed solving. The problems selected were pervasive ones. Our limited staff resources suggested that we concentrate on those projects and try to avoid dealing with emerging practice problems.[17] Those would be left for resolution by corporations and their independent auditors.

Those early projects involved significant concepts and created controversy, not only with regard to the particular solutions in, say, Statements 2, 5, 7 and 8, but about the process and the objectives of standard-setting, as well. The public discomfort with the Board's early Statements was accentuated by the less than open door policy of the Board. It was also probably brought to the boiling point by a December 1976 document entitled, "Scope and Implications of the Conceptual Framework Project".

That document was the formal beginning of the Board's attempt to explain itself. While much of what is written in that document is not as incendiary as it was at the time, it still contains embers that flare up in Board discussions at High Ridge Park. It contained the beginnings of an articulation of a mission statement:

> To add credence to financial reporting--to minimize skepticism about financial statements--is a major purpose of a conceptual framework and, indeed, can be said to be an important aspect of the mission of the Financial Accounting Standards Board. The concepts provide the discipline to assure triumph of substance over form and consistency of treatment of similar matters, while allowing for the judgments inherently required in the determination and display of financial results.[18]

It also suggested a new way was needed to differentiate "good" accrual accounting from "bad" accrual accounting:

> Without a conceptual underpinning, periodic earnings and financial position are essentially matters of judgment and personal opinion. Preciseness of definition of fundamentals narrows subjectivity, circumscribes the areas for applying judgments, and provides a frame of reference for those judgments. A conceptual framework should foster consistency of treatment of like things, provide the means for identifying unlike things, and leave open for judgment the estimates inherent in the accounting process. Without the discipline that a sharpened conceptual framework can provide it is doubtful whether financial reporting generally can attain an optimal level of credibility. . .[19]

To explain how definition and discipline might be attained it stated:

> . . . . .acceptance of the asset and liability view would likely bring more rigor or discipline to accounting in the sense that some of the latitude presently permitted by the twin concepts of <u>proper matching</u> and <u>nondistortion of periodic net income</u> would be limited. (Opponents of the asset and liability view would probably say rigidity and inflexibility instead of rigor and discipline.) How would that latitude be limited? Under the revenue and expense view, which has generally been the basis for accounting practice and for most of the authoritative accounting pronouncements during the past three or four decades, earnings measurement depends on matching expenses with revenues properly to minimize distortion of reported earnings. Even those who support the revenue and expense view tend to agree that matching and nondistortion have not been sharply defined concepts. Therefore, they have been subject to considerable individual interpretation or collective opinion.[20]

These two subjects, communication of role or mission and definition of "good" accrual accounting, have been major activities of the Board, particularly since December 1976.

Mission of the FASB

Attached to this paper as an appendix is a draft statement of mission that has been discussed by the Financial Accounting Standards Advisory Council and the Trustees. Internal discussions beginning in 1976 were the seeds for the mission statement. It was clear by that time that early standards had rekindled old arguments about the need for and purpose of standards. The old arguments of the 1960's of uniformity versus flexibility and centralized authority versus decentralized professional responsibility were resurfacing.

The 1977 Structure Committee Report captured the concerns and uncertainties in the minds of the Board's constituents. In response to what they heard, the Trustees urged the Board to develop general agreement on the nature of the standard setting process, to address the economic impact of its standards, to develop and articulate, a rationale for permitting or prohibiting alternative accounting principles, and to educate the public about the standard-setting process and the reasons for its standards.

Progress has been steady but slow in responding to those recommendations. The attached mission statement is tangible evidence of progress. Explanation of the slowness, however, is needed.

In spite of good intentions on the part of the FASB, attempts to articulate an institutional response to the recommendations of the Trustees required agreement on the objectives of financial reporting and on the qualitative characteristics that make financial information useful. Concepts Statement No. 1, which expressed the agreement on objectives, was issued in November of 1978; Concepts Statement No. 2, which expressed the agreement on the qualitative characteristics, was issued in May, 1980. Variations on a mission statement, first published as an appendix to a 1980 speech, have been undergoing occasional internal discussion and external review by FASAC since that time. The 1980 Harris survey and 1982 Structure Committee review confirmed that concerns and uncertainties similar to those found by the 1977 structure review still existed and that the Board had to accelerate its communication and educational activites. A great deal more needs to be done; planning is under way for ways to improve those activities. The mission statement is a partial response.

The draft mission statement states that the FASB acts to "keep standards current" and to "consider promptly any significant areas of deficiency in financial reporting." Earlier I mentioned the need for timely response to the valid concerns of the SEC. In theory, the financial reporting concerns of the SEC and FASB should be the same. However, the registration process and enforcement activities of the SEC do sometimes result in problems first coming to the attention of that agency. Also, two groups operating in different environments can reach different conclusions on which financial reporting problems require a standard solution. However, I qualified SEC "concerns" with "valid" to limit this analysis to those problems that both groups agree warrant standardized solutions. Other organizations or companies can also have valid concerns that require prompt action by the FASB

Deciding which issues require prompt action by the FASB and how to respond to those issues have been difficult problems for the Board from the beginning. (In fact, the question of whether or not the Board should be in the business of giving prompt answers to implementation and emerging problems has been debated over the years, within and outside the Board.) My personal views on this subject have been reported.[21] In summary, I believe the Board has in recent years been furnishing adequate timely guidance and in the future needs to be alert and aggressive in this area.

If we are not, a future congressional committee will have the necessary evidence to convert the endangered species of private sector standard-setters to an extinct one.

The subject of whether or not the Board is furnishing adequate timely guidance is presently under study by a blue-ribbon FASB task force. Following that study, the Board is expected to develop a plan for dealing with implementation and emerging problems. Striking the best possible balance between the conflicting demands on the Board to furnish timely guidance and to reduce standards overload will be another challenge in the future.

The mission statement's mention of comparability, credibility and neutrality is, I believe, particularly important. Comparability adds to the understandability and, therefore, to the credibility of financial reporting (and of the financial reporter); neutrality of information keeps financial reporting standards as a part of a measurement process, rather than a purposeful resource allocation process and, therefore, also adds to the credibility of financial reporting. The mission statement also makes mention of the importance of standards to "the efficient functioning of the economy" and of the importance of concepts for resolving accounting issues. I cannot pass up the opportunity to address the former, and no review of the FASB can avoid the latter.

I have discovered in my years at the FASB that opinions vary significantly on what effect the choice of disclosures or methods has on allocation of resources.

First let me emphasize that timely and reliable financial reports add to the efficiency of our economy's pricing of capital and that credible financial reporting is important for reasons beyond just efficient pricing of capital. However, I am of the belief that the importance for resource allocation attached by many to the selection, particularly by standard setters, of one accounting method over another is greatly exaggerated. At worst, the importance attached to accounting choices is symptomatic of the social problem described by Reich as "paper entrepreneurialism" and mentioned earlier in this paper. At best, it is an educational lag in the business world and in the courts in an understanding of how financial disclosures and accounting method selection impact on security prices.[22] Unfortunately, many corporate controllers and investment bankers do not agree with me. Disbelief in the theory, or concern about the disbelief of others, encourages standard-setters and regulators to act in the same way and address what may well be trivial matters, thereby contributing to standards overload. Disbelief can also drive standard-setters and regulators to incur or cause excessive costs in the search for more disclosures and different measurement schemes in the hope of perfecting the capital pricing mechanism or protecting the naive investor.

Adding to the confusion about the effect of accounting standards on stock prices are views about the feedback effect on management behavior of financial reporting methods or disclosures. If repeated representations to the FASB are to be believed, that changes in methods or disclosures will affect behavior (usually in a net adverse way), then certainly existing methods and disclosures must also be affecting behavior. The FASB's views on neutrality of information are helpful in addressing those representations.[23] However, it is clear to me that more needs to be done to insure that standard-setters understand as much as possible about the impact of accounting and disclosure choices on stock prices and management behavior. Understanding is essential in order to make a convincing case about the relevance (or irrelevance) of those impacts on standard setting. Assertions about the adverse impact of FASB proposals show no sign of diminishing. The best defense is to be knowledgable and convincing in addressing those assetions.

The Board has said that purposeful direction of behavior should not be a standard-setter's objective -- relevant and reliable (i.e. decision useful) information should be the standard-setter's goal. And that brings me to the conceptual framework.

The Conceptual Framework

Robert Sterling has said that "decision usefulness is the conceptual framework - the rest is commentary." That is a brief but accurate description of where we presently stand in the development of the framework. It is just about where we stood in 1980 when I said that a decision-usefulness model still leaves plenty of room for controversy among seven dedicated standard-setters in deciding which accounting alternative is most useful.[24] Subsequent to those remarks the Board completed Concepts Statement No. 3; no Statements have been issued since.

I believe that Statements 1-3 have and will have a significant impact on FASB decisions. They go a long way in helping to distinguish "good" accrual accounting from "bad" accrual accounting. But they don't go far enough. The Board would be well served if agreement could be reached on the distinction between capital and income and on the circumstances under which current values are candidates for inclusion in financial statements or as disclosures.

Deductive reasoning seems to have taken us as far as it can in defining the decision model of financial statement users. To date we have found that our individual attitudes about the role that financial statements play in decision making and our beliefs about what constitutes relevant information to be included in those financial statements seem to differ enough that we lack the necessary overlap of our individual conceptual frameworks to resolve these important issues.[25] We are going to give it one more good try in 1983 to see if we can progress on the recognition and measurement issues in a meaningful way. If we cannot, I will urge that we set them aside and continue with our other projects. Completion of projects like pensions, income taxes and consolidation, and maybe even changeover in Board membership, might furnish the impetus for resolving recognition and measurement conceptual issues. At the moment it seems that ten years of the FASB has not brought us any closer than the Trueblood study group to resolution of these intractable problems. Here is what that group said ten years ago:

> (For some time there has been consistent demand for a single earnings figure. Members of the Study Group disagree on whether value changes that meet the qualitative criteria discussed in this report should be included in earnings. Some believe the objective should be to reflect current value changes in earnings. Others believe that inclusion of unrealized value changes in earnings may be desirable but is not now practicable. Still others believe that their inclusion is neither desirable nor practicable.)[26]

While my assessment of the outlook for further progress on the framework depends on the results of a renewed effort in the next few months, I must conclude with a consistent theme of mine. What we have completed to date has been and will be useful to the Board. Completion of the remaining phases of the project will be even more beneficial to the understanding of financial reporting and standard setting. The framework project was never intended to automatically solve practice problems and in that respect there are false expectations. On the other hand, if there is any hope of solving what the AICPA has labelled "standards overload," general acceptance of a framework that includes recognition and measurement does offer the possibility of simpler and less controversial standards.

Conclusion

The structure and process for standard setting are sound, but working out the jurisdictional boundaries with the GASB will put them to a test. Progress has been slow in developing explanations of the purposes of financial reporting and standard setting and the impact of both on prices, behavior, and decision making. More needs to be done to explain the purposes and impacts.

Standards overload might be reduced by further development and use of the conceptual framework. A little humility about the importance of accounting also would help. Standards overload, however, is not just a financial reporting problem. It is a social problem identified by Reich as "paper entrepreneurialism" and identified in the legal profession as "hyperlexis," a national disease caused by an overactive law-making gland.[27]

A solution to the problem would seem to require (a) producers to focus less on e.p.s., tax benefits, and subsidies and more on quality products and high productivity and, (b) accountants and lawyers to rely less on rules and laws and more on professional judgment. However, that solution requires assumptions of risks that most who can effect the solution have been unwilling to assume in these uncertain times.

THE MISSION OF THE FINANCIAL ACCOUNTING STANDARDS BOARD

The mission of the Financial Accounting Standards Board is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise, and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:

1. Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;

2. Keep standards current to reflect changes in methods of doing business and changes in the economic environment;

3. Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process; and

4. Improve the common understanding of the nature and purposes of information contained in financial reports.

The FASB develops broad accounting concepts as well as standards for financial reporting. It also provides guidance on implementation of standards.

Concepts are useful in guiding the Board in establishing standards and in providing a frame of reference, or conceptual framework, for resolving accounting issues. The framework will help to establish reasonable bounds for judgment in preparing financial information and to increase understanding of, and confidence in, financial information on the part of users of financial reports. It also will help the public to understand the nature and limitations of information supplied by financial reporting.

The Board's work on both concepts and standards is based on research conducted by the FASB staff and by others. The Board's activities are open to public participation and observation under the "due process" mandated by formal Rules of Procedure. The FASB actively solicits the views of its various constituencies on accounting issues.

The Board follows certain precepts in the conduct of its activities. They are:

- <u>To be objective in its decision making</u> and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.

- To weigh carefully the views of its constituents in developing concepts and standards. The ultimate determinant of concepts and standards, however, must be the Board's judgment, based on research, public input, and careful deliberation, about the usefulness of the resulting information.

- To promulgate standards only when the expected benefits exceed the perceived costs. While reliable quantitative cost-benefit calculations are seldom possible, the Board strives to determine that a proposed standard will fill a significant need and that the costs it imposes, compared with possible alternatives, are justified in relation to the overall benefits.

- To bring about needed changes in ways that minimize disruption to the continuity of reporting practice. Reasonable effective dates and transition provisions are established when new standards are introduced. The Board considers it desirable that change be evolutionary to the extent that can be accommodated by the need for relevance, reliability, comparability, and consistency.

- To review the effects of past decisions and interpret, amend, or replace standards in a timely fashion when such action is indicated.

The FASB is committed to following an open, orderly process for standard setting that precludes placing any particular interest above the interests of the many who rely on financial information. The Board believes that this broad public interest is best served by developing neutral standards that result in accounting for similar transactions and circumstances similarly and for different transactions and circumstances differently.

FOOTNOTES

1. At the annual meeting of the American Institute of Accountants (later to become the AICPA) in 1918 the following was adopted by a vote of the members present: "Inclusion in production cost of interest on investment is unsound in theory and wrong, not to say absurd, in practice". Robert N. Anthony, Accounting for the Cost of Interest (Lexington MA: D.C. Heath and Company, Lexington Books, 1975), p. 23; AICPA, 1918 Yearbook "Report of the Special Committee on Interest in Relation to Cost", pp. 110-112.

2. FASB, Status Report No. 36 April 28, 1976, p.1.

3. John Brooks, The Go-Go Years: When Prices Went Topless (New York: Ballantine Books Div. of Random House, Inc., 1974).

4. Robert B. Reich, "The Next American Frontier", The Atlantic 251, no. 3 (March 1983), p. 50.

5. Herman W. Bevis, Corporate Financial Reporting in a Competitive Economy, Columbia University Graduate School of Business Studies of the Modern Corporation (New York: Macmillan Company, Arkville Press, 1965), pp. 198, 200.

6. Harold M. Williams, Proceedings: Financial reporting and changing prices: the conference, Paul A. Griffin, ed. (Stamford CT: FASB, 1979), pp. 69-70.

7. Donald J. Kirk, "The Role of Concepts, Consensus, Compromise and Consequences in Standard Setting" (Address delivered at the Annual Meeting of the American Accounting Association, Boston MA, August 13, 1980), "Statements in Quotes: Concepts, consensus, compromise and consequences: their roles in standards setting", Journal of Accountancy 151, no. 4 (April 1981), p. 85.

8. Thomas A. Murphy, "Statements in Quotes: A businessman's views on uniform standards", Journal of Accountancy 147, no. 5 (March 1983), pp. 86-7.

9. For similar themes see, Donald J. Kirk, "Corporate Accounting and Accountability in Turbulent Times" (Paper delivered at Fourth John M. Olin Fellow Lecture, Fairfield University School of Business, Fairfield CT, April 30, 1981), FASB Viewpoints June 1, 1981, and "Self Regulation in a Deregulatory Environment" (Address delivered at the Fiftieth International Conference of the Financial Executives Institute, New York City, October 13, 1981), FASB Viewpoints February 25, 1982.

10. Paul Grady, "The Quest for Accounting Principles", Journal of Accountancy 113, no. 5 (May 1962), p. 50.

11. See, for example, Bevis' warning about the possible misuse of the "non-distortion guideline" for measuring periodic net income, Corporate Financial Reporting, pp. 104-7.

12. Reginald H. Jones, "The Challenge of Capital Attraction" (Address to Financial Accounting Foundation, New York, March 28, 1973), p. 17.

13. Walter B. Wriston, "A banker views professional self-regulation, lenders' information needs, audit committees", Peat, Marwick, Mitchell & Co. World 8, no. 2 (Spring 1974), p. 49

14. Walter B. Wriston, "Accounting to whom for what?" (Adaptation of a speech before the National Association of Accountants, Miami, June 21, 1976), Journal of Accountancy 142, no. 3 (September 1976), p. 99.

15. Louis Harris and Associates, Inc., A Study of the Attitudes Toward and an Assessment of the Financial Accounting Standards Board (Stamford CT: Financial Accounting Foundation, 1980), p. 2.

16. I have addressed the nature of standard-setting on a number of occasions, the latest being in "The Role of Concepts. . ."

17. The Board's experiences with emerging practice problems are described by Paul A. Pacter, "The FASB after Ten Years: History and Emerging Trends", FASB Viewpoints April 7, 1983.

18. FASB, Scope and Implications of the Conceptual Framework Project (Stamford CT: December 1976), pp. 8-9.

19. Ibid., p. 9.

20. Ibid., p. 19.

21. Kirk, "Statements in Quotes: FASB standards: too many or too few?" (Adaptation of address before Financial Executives Institute Conference on Current Financial Issues in New York City, November 15, 1982), Journal of Accountancy 155, no. 2 (February 1983), pp. 75-80.

22. A recent analysis of the impact of modern finance theory is contained in: Daniel R. Fischel, "Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities", Business Lawyer 38, no. 1 (November 1982), pp. 1-20.

23. FASB, Statement of Financial Accounting Concepts No. 2: Qualitative Characteristics of Accounting Information (Stamford CT: May 1980), paragraphs 98-110.

24. Kirk, "The Role of Concepts..."

25. See the excellent discussion of moving from individual Members' values to Board values in Charles T. Horngren, "Statements in Quotes: Uses and limitations of a conceptual framework" (Adaptation of presentation at American Accounting Association Annual Meeting, Boston, August 1980), Journal of Accountancy 151, no. 4 (April 1981), pp. 87-95.

26. AICPA, Objectives of Financial Statements: Report of the Study Group (New York City: October 1973), p. 64.

27. Bayless Manning, "Hyperlexis: Our National Disease" (Article based on speech before Chicago Law Club, November 4, 1976), Northwestern University Law Review 71, no. 6 (1977), pp. 767-782. See also "Too Much Law: Our National Disease", Business Lawyer 33, no. 1 (November 1977), pp. 435-440 and "Hyperlexis and the Law of Conservation of Ambiguity: Thoughts on Section 385", Tax Lawyer 36, no. 1 (1983) pp. 9-15.