

J. T. Ball



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Financial Accounting Standards Board

HIGH RIDGE PARK, STAMFORD, CONNECTICUT 06905, 203-329-8401

April 24, 1978

The Honorable Harold M. Williams
Chairman
Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Dear Chairman Williams:

We are enclosing materials relating to improving accounting standards to assist the Commission in preparing its annual report to Congress on progress in achieving accounting reforms.

Sincerely,

FINANCIAL ACCOUNTING STANDARDS BOARD

A handwritten signature in cursive script that reads "Donald J. Kirk".

Donald J. Kirk, Chairman

FINANCIAL ACCOUNTING FOUNDATION

A handwritten signature in cursive script that reads "Alva O. Way".

Alva O. Way, President

DJK/AOW:kjp
Enclosures



April 24, 1978

MATERIALS TO ASSIST
THE SECURITIES AND EXCHANGE COMMISSION
IN REPORTING TO CONGRESS
ON PROGRESS OF THE
FINANCIAL ACCOUNTING STANDARDS BOARD
IN ESTABLISHING ACCOUNTING STANDARDS
DURING THE YEAR ENDED JUNE 30, 1978

This looseleaf binder contains the response of the Financial Accounting Standards Board (FASB) and Financial Accounting Foundation (FAF) to a recent inquiry from Senator Thomas F. Eagleton, Chairman, Senate Subcommittee on Governmental Efficiency and the District of Columbia. The answers provided by the FASB/FAF to the seventeen questions included in Senator Eagleton's inquiry, and the twenty Exhibits supporting those answers, should provide the Commission with most, if not all, of the information it needs for its oversight report to Congress.

In addition to the responses to the seventeen questions, the Exhibits that will probably be most useful to the Commission in preparing its report are:

- Exhibit 5, which is the joint 1977 annual report of the FAF and FASB.
- Exhibit 6, which is a list of FASB technical activities since April 1977.
- Exhibit 8, which is the detailed (unpublished) plan for FASB technical projects and other technical activities as of March 31, 1978. This plan indicates the estimated timing, where reasonably determinable, of major phases of projects now on the Board's agenda and the timing of decisions as to whether to place on the agenda certain topics now under study by the staff. Schedule D to the plan contains brief descriptions of each of the projects and topics.

Attached to this page are some additional materials that may be of use to the Commission in preparing its report:

- A brief description of FASB Statements and Interpretations issued since June 1, 1977.
- A description of the FASB's conceptual framework project.

The FASB and FAF would be pleased to provide additional information to the Commission in connection with its oversight report to Congress. Please contact Paul A. Pacter of the FASB staff.

BRIEF DESCRIPTION
FASB STATEMENTS AND INTERPRETATIONS
ISSUED AFTER JUNE 1, 1977

FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," June 1977.

A troubled debt restructuring is a change in outstanding debt necessitated by financial difficulties of the borrower--a settlement or concession that the lender has granted for economic or legal reasons that would not have been granted if the debtor were financially sound.

Under Statement 15, both debtor and creditor are required to account for the fair value of receivables, real estate, or other assets transferred and equity interests granted to the debtor in a troubled debt restructuring, with gain or loss recognized on the difference between those fair values and the recorded amount of the debt satisfied. Gain or loss is also recognized on assets transferred if their fair values differ from their carrying amounts.

However, if no assets or equity interests are transferred, but rather the old debt is continued with modified terms to defer or reduce cash payments that the debtor is required to make to the creditor, no gain or loss is recognized at the time of the restructuring. Instead, the effects of modifications of terms are accounted for prospectively as reduced interest expense (debtor) or interest income (creditor)--with one exception: If the total future cash payments under the revised terms are less than the recorded amount of the debt at the time of the restructuring, the difference is immediately recognized as a gain by the debtor and a loss by the creditor.

Statement 15 is effective for restructurings consummated after December 31, 1977, with certain disclosures required in financial statements for fiscal 1977.

FASB Statement No. 16, "Prior Period Adjustments," June 1977.

Statement 16 requires that all items of profit or loss recognized during a period be included in the determination of net income for that period rather than be reported as adjustments to prior periods' net income or to retained earnings--except for corrections of errors made in the financial statements of prior periods and for adjustments that result from realization of income tax benefits of pre-acquisition operating loss carryforwards of purchased subsidiaries.

The Statement also allows certain adjustments related to prior interim periods of the current fiscal year to be treated as adjustments of those earlier interim periods. The four types of adjustments that are accorded this treatment are settlement of litigation, of income taxes, of renegotiation proceedings, and of utility rate cases.

Statement 16 is effective for fiscal years beginning after October 15, 1977, with early application encouraged.

FASB Statement No. 17, "Accounting for Leases--Initial Direct Costs: an amendment of FASB Statement No. 13, November 1977.

This amendment to FASB Statement No. 13, "Accounting for Leases," elaborates on the definition of the term "initial direct costs" as used in that Statement. Under Statement 13, a lessor is permitted to recognize income at the inception of a direct financing lease to the extent of the amount of initial direct costs (commissions, legal fees, costs of credit investigations, and the like).

FASB Statement No. 18, "Financial Reporting for Segments of a Business Enterprise--Interim Financial Statements: an amendment of FASB Statement No. 14," November 1977.

This Statement exempts all interim financial statements from the segment reporting requirements of FASB Statement No. 14, pending completion of the Board's comprehensive interim financial reporting project.

FASB Statement No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies," December 1977.

Statement 19 prescribes a form of the successful efforts method of accounting for oil and gas producing activities and proscribes full costing. In general, under the Statement, costs of acquiring oil and gas properties are capitalized when incurred. Geological and geophysical costs and the costs of carrying unproved properties are expensed when incurred. Exploratory drilling costs are temporarily deferred--and retained as an asset if reserves are discovered or written off to expense if the exploratory well is a dry hole. Once reserves are found, development costs incurred to drill wells and construct other facilities are capitalized. Capitalized costs of producing properties, wells, and equipment are amortized on a unit-of-production basis as the oil and gas are produced. Costs of properties held for future exploratory drilling are amortized or otherwise written down if their value diminishes.

Statement 19 requires extensive financial statement disclosures, including disclosures of quantities of various categories of reserves and changes in them during the year, subdivided by geographic area, and disclosure of capitalized costs and types and amounts of costs incurred.

The Statement will be effective for fiscal years beginning after December 15, 1978.

FASB Statement No. 20, "Accounting for Forward Exchange Contracts: an amendment of FASB Statement No. 8," December 1977.

Under Statement 8, which was issued in October 1975 and established standards of accounting for the translation of foreign currency transactions and foreign currency financial statements, gain or loss on a forward exchange contract may be deferred if the contract hedges a foreign currency commitment. Statement 20 elaborates on that rule (a) by providing a grandfather clause to enter into forward exchange contracts to hedge foreign currency commitments entered into before the effective date of Statement 8 and (b) by permitting the deferral of a gain or loss on a portion of a forward contract in excess of the amount of the foreign currency commitment to the extent that the portion is intended to provide a hedge on an after-tax basis. Statement 20 is effective January 1, 1978.

FASB Interpretation No. 19, "Lessee Guarantee of the Residual Value of Leased Property: an interpretation of FASB Statement No. 13," October 1977.

This Interpretation resolves questions that were raised with respect to the determination of the amount of the lessee's guarantee of the residual value of leased property that should be included in minimum lease payments in applying Statement No. 13. The Interpretation was effective January 1, 1978.

FASB Interpretation No. 20, "Reporting Accounting Changes under AICPA Statements of Position: an interpretation of APB Opinion No. 20," November 1977.

This Interpretation specifies that for purposes of applying APB Opinion No. 20 an enterprise making a change in accounting principle to conform to the recommendations of an American Institute of CPAs Statement of Position must report the change as specified in the AICPA Statement. If an AICPA Statement of Position does not specify the manner of reporting such a change, an enterprise must report the change as specified by APB Opinion No. 20. The Interpretation was effective December 1, 1977.

FASB Interpretation No. 21, "Accounting for Leases in a Business Combination: an interpretation of FASB Statement No. 13," April 1978.

This Interpretation specifies that the leases of the combining companies in a business combination shall not be treated as new leases to be classified according to the criteria in Statement 13 as of the date of the combination unless the provisions of the lease are changed. The Interpretation will be effective May 1, 1978.

FASB Interpretation No. 22, "Applicability of Indefinite Reversal Criteria to Timing Differences: an interpretation of APB Opinions No. 11 and 23," April 1978.

This Interpretation resolves the question of whether the indefinite reversal criteria of APB Opinion No. 23 (which specifies conditions under which tax allocation is not required for certain timing differences) are applicable to timing differences other than those specified in Opinion 23 by concluding that the criteria apply only to the four special areas identified in the Opinion. Some persons had proposed to extend the applicability of the indefinite reversal criteria to timing differences relating to amortization and depreciation of railroad gradings and tunnel bores. The Interpretation is effective for fiscal years beginning after June 15, 1978.

DESCRIPTION OF THE
FASB'S CONCEPTUAL FRAMEWORK PROJECT

APRIL 24, 1978

The conceptual framework for financial accounting and reporting is one of the Board's most important and most far-reaching projects. It was added to the Board's agenda in April 1973 and is expected to continue for several years. It is concerned with the conceptual basis underlying financial accounting and reporting and is expected to result in statements of both financial accounting concepts and financial accounting standards. As the conceptual framework is developed, it will become the basis for all future Board pronouncements.

From the early stages of the project, the Board recognized that a conceptual framework could not be successfully developed in a single giant step but must be approached in a series of related steps or phases. The obvious place to begin was the objectives of financial accounting and reporting, and the identity of other major phases also soon became reasonably clear. The project has for some time been conceived of as comprising six major phases -- (a) objectives, (b) elements of financial statements (assets, liabilities, revenues, expenses, etc.), (c) measurement, usually described as the attributes of the elements to be measured and the unit of measure, (d) qualitative characteristics or qualities of useful financial information, (e) recognition matters, and (f) presentation. Others may, of course, yet be added.

The Board has issued five documents as part of the conceptual framework project:

June 6, 1974 --

Discussion Memorandum, "Consideration of the Report of the Study Group on the Objectives of Financial Statements."

December 2, 1976 --

"Tentative Conclusions on Objectives of Financial Statements of Business Enterprises."

Discussion Memorandum, "Elements of Financial Statements and Their Measurement."

"Scope and Implications of the Conceptual Framework Project."

December 29, 1977 --

Exposure Draft, "Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises."

The Board has held three public hearings on the conceptual framework:

September 23-24, 1974 on the first discussion memorandum.

August 1-2, 1977 on the "Tentative Conclusions..." and Part I (elements) of the second discussion memorandum.

January 16-18, 1978 on Part II (qualitative characteristics) and Part III (attributes to be measured, along with capital maintenance concepts from Part I) of the second discussion memorandum.

The Board now has five parts of the conceptual framework on its technical agenda, and one part is on the staff agenda being prepared for consideration by the Board for addition to its technical agenda. The status of those projects is briefly as follows:

Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises - The December 1977 exposure draft covered both of these parts. Comments on the exposure draft were to be received by April 14, 1978. The Board expects to issue a final statement of financial accounting concepts in the fourth quarter of 1978.

Measurement of the Elements of Financial Statements - This aspect of the conceptual framework project includes determining the circumstances, if any, in which attributes that are now measured only in restricted instances should be more extensively measured for various elements and presented in financial statements or in related disclosures to meet the objectives of financial reporting. The project includes consideration of presenting information measured in units of the same general purchasing power instead of or in addition to information in units of money.

The staff has analyzed the comments received on this topic and in the public hearing of January 16-18, 1978. Except for a significant minority of respondents who favored mandating LIFO and current cost depreciation in the income statement, the responses overwhelmingly suggested that the Board should approach the measurement questions of the conceptual framework through experimentation with supplementary disclosures rather than changes in financial statements.

Consequently, on consideration of those comments the Board announced on March 31, 1978 that any major changes in measurement concepts needed to show the effects of inflation on business enterprises should be introduced as supplemental disclosures rather than by changing the basic financial statements. To implement that decision, the Board authorized its staff to undertake work on both measurement concepts and possible types of supplemental disclosures of inflation effects consistent with those concepts.

By introducing new measurement concepts on a supplemental disclosure basis, preparers, auditors, and users of financial statements can gain experience under less rigid guidance than would be required if the changes were to be made immediately in the basic financial statements themselves. That experience may provide a basis for a subsequent Board decision to change the measurements in the basic statements, or it could suggest that no such change should be made.

Qualitative Characteristics of Financial Information - This aspect of the conceptual framework is concerned with identifying and clarifying the qualitative characteristics to be used by the Board in its future deliberations on accounting standards and by those who provide, audit, or use financial statements in understanding and applying the Board's standards and in resolving accounting questions for which no standards have been promulgated. Examples of possible characteristics include relevance, reliability, verifiability, comparability, timeliness, completeness, freedom from bias, and understandability.

This topic was also included in the September 1974 and January 1978 public hearings, and the staff is analyzing written and oral comments received. A consultant has been engaged to direct the project. The Board plans to issue an exposure draft in 1979.

Earnings Report - This aspect of the conceptual framework involves developing concepts or standards for reporting changes in net assets other than from transactions with owners. At the core of this project are the functions of the income or earnings statement and methods of classifying and aggregating and disaggregating inflows and outflows and presenting relations between them in ways that fulfill those functions.

This project was added to the Board's technical agenda in December 1977. The Board's technical plan tentatively indicates that a discussion memorandum will be issued late this year.

Accounting Recognition Criteria - The Board plans to decide in the second half of 1978 whether a project on accounting recognition criteria should be added to its technical agenda. That project would be concerned with criteria for recognizing elements in financial statements as well as for recognizing changes in attributes measured. Thus, it would involve, for example, criteria to identify when assets and liabilities representing the rights and obligations under executory contracts should be recognized in financial statements and when revenues from earning activities should be recognized. This project is closely related to the elements of financial statements, as described in the exposure draft of December 29, 1977, and is also closely related to the measurement project.