

# Financial Accounting Standards Board

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | 203-847-0700  
Ext. 312  
Fax: 203-849-9714



DENNIS R. BERESFORD  
Chairman

November 10, 1993

Mr. Walter P. Schuetze  
Chief Accountant  
Securities and Exchange Commission  
450 5th Street, N.W.  
Washington, D.C. 20549

Dear Walter:

You asked that we respond to matters raised in the September 28, 1993 letter from John S. Reed to Congressmen John D. Dingell and Edward J. Markey. This letter focuses on four areas germane to Mr. Reed's concerns--oversight of the Board's activities, how the Board sets its agenda, the extent to which the Board attempts to develop consensus, and the structure of the Board's staff. We would be pleased to provide additional information should you need it.

The concerns mentioned in Mr. Reed's letter are not new to discussions of how the Board operates. Still, the issues are important, and they deserve a fresh look from time to time. We last reviewed those issues with the Commission shortly after the appointment of Richard Breiden as SEC Chairman. I also recall a similar effort shortly after the appointment of David Ruder.

## **TRUSTEE OVERSIGHT OF THE FASB'S ACTIVITIES**

As you of course know, the FASB is subject to oversight by the SEC, and through it, committees of the U.S. Congress. The SEC reports regularly to the Congress on its oversight role. From time to time, Congressional committees have conducted hearings into the Board and its operations. Oversight by our Trustees is independent of, and unrelated to, that public-sector oversight.

Though independent as to technical matters, the Board operates in a policy framework established and monitored by the Financial Accounting Foundation. The Foundation's Board of Trustees is composed predominantly of senior executives from business and accounting firms. The Trustees have two standing committees that are pertinent to your inquiry--a Structure Review Committee and an Oversight Committee. Indeed, the structure and operation of the FASB have been under almost continuous review by the Trustees since its founding. The issues

Mr. Walter P. Schuetze  
November 10, 1993  
Page 2

raised in Mr. Reed's letter have been raised previously and addressed in reviews of the FASB process. Major reports produced or commissioned by the Trustees include:

- April 1977, The Structure of Establishing Financial Accounting Standards, Report of the Structure Committee of the Financial Accounting Foundation
- April 1980, A study of the attitudes toward and an assessment of the Financial Accounting Standards Board, Prepared for the Financial Accounting Foundation by Louis Harris Associates, Inc.
- August 1982, Operating Efficiency of the FASB, Report of the Structure Committee to the Financial Accounting Foundation
- 1985, A study of the attitudes toward and an assessment of the Financial Accounting Standards Board, Prepared for the Financial Accounting Foundation by Louis Harris Associates, Inc.
- July 1985, December 1985, and December 1986, Reports of the Special Review Committee to the Board of Trustees of the Financial Accounting Foundation
- January 1989, The Structure for Establishing Financial Accounting Standards, Report of the Committee to Review Structure for Financial Accounting Standards
- March 1989, Report of the Special Advisory Group to the Board of Trustees of the Financial Accounting Foundation
- October 1991, Report of the Oversight Committee of the Financial Accounting Foundation

These efforts led to many improvements in the Board's operating procedures. Most recently, in 1991, the Trustees changed the number of votes needed to issue an FASB pronouncement from 4 to 5. At about the same time, the Trustees established their own Oversight Committee, which monitors FASB activities.

The Trustees' Oversight Committee bears special mention. This committee follows the Board's standard-setting activities on a continuous basis. Consistent with the overall responsibility of the Trustees, the Oversight Committee is charged with evaluating whether the Board's actions are consistent with the precepts of the Board's *Mission Statement*. In addition to ongoing monitoring of all current agenda topics, the Oversight Committee has conducted in-depth post-issuance reviews of two pronouncements, FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, and FASB Statement No. 109, *Accounting for Income Taxes*.

## **THE FASB'S AGENDA-SETTING PROCESS**

Agenda setting is one of the most important aspects of the Board's activities. The issues on our agenda dictate the course of our efforts. The Board's agenda includes two types of projects.

Mr. Walter P. Schuetze

November 10, 1993

Page 3

Major projects, like accounting for income taxes or pensions, involve issues of concern to a broad cross section of the Board's constituents. Narrower projects, like the accounting for reinsurance transactions, address problems of limited scope and often involve a single industry. The number of projects on our agenda and the balance between major and narrow projects have remained fairly constant throughout the history of the Board.

### **The Source of Projects on the FASB Agenda**

Nearly all potential projects are brought to us by others. For example, in 1984 the Board formally voted to undertake the stock compensation project after receiving a lengthy Issues Paper from the American Institute of Certified Public Accountants (AICPA) urging us to reconsider Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. We also received letters from most of the major accounting firms urging us to deal with this issue. Many others also supported our consideration of the topic.

The Board receives more requests than we can handle with our limited resources, so we turn down most requests. Adding a project to our agenda, even a narrow project that deals with a specific industry, is a significant commitment. Before the Board votes on whether to add a project, our staff has usually spent many months developing materials and consulting with constituents to help us decide if there is enough reason to take on the new challenge. All new-project decisions are made at open Board meetings following public announcement.

### **The Role of Constituents in Agenda Setting**

We recognize the importance that constituents place on our agenda, and we actively seek their views. We conducted a review of potential projects in 1988 (the last time we added major projects to the agenda). Our staff prepared a detailed summary of potential projects and solicited comments from constituent groups including (but not limited to) the AICPA, the Financial Executives Institute, the Institute of Management Accountants, and the staff of the SEC. That process led to two projects now on our agenda--impairment of long-lived assets and present-value-based measurements.

During the past year, we used "prospectuses" to solicit views on whether we should add projects on accounting for mortgage servicing rights and earnings per share. The idea for using a prospectus grew out of discussions between Board members and the major CPA firms and the Business Roundtable's Accounting Principles Task Force.

We continuously challenge the progress and relative priority of projects on our agenda, and the Financial Accounting Standards Advisory Council (FASAC) is a key source of information and counsel. FASAC was organized at the formation of the Board and is charged with the responsibility for consulting with the Board on both technical and policy issues. Members of

Mr. Walter P. Schuetze

November 10, 1993

Page 4

FASAC (who are appointed by our Trustees) are expected to communicate their individual perceptions of potential economic effects of proposed or final pronouncements and are encouraged to consult with one another and others in order to communicate to the Board more effectively. FASAC presently has 32 members who are broadly representative of business, investors, creditors, academia, and government. Fourteen of the members are corporate financial executives.

FASAC conducts an annual review of potential projects and projects currently on the agenda. The current review was completed in October and discussed at the October 28, 1993 FASAC meeting. FASAC members were asked about the relative priorities of the 11 projects now on the Board's agenda and 23 potential projects. Those rankings and the members' extensive comments were compiled and shared with the Board and its staff.

Just as the Board and its Trustees regularly review and reengineer FASB operations, FASAC periodically reviews its role and how it might perform that role more effectively. FASAC recently convened a committee to make such a review.

### **Constituents' Views on the FASB Agenda**

Most of our projects enjoy significant support when we begin the effort. After all, nearly all of our projects grow out of a request for action. No matter how careful we are in adding projects, however, two things commonly happen later in a project's life. First, many people forget what caused us to add a project to the agenda. Our projects may take several years from the time the project first appears on the agenda to the issuance of an Exposure Draft. Second, support for working on a project often ebbs as people realize we might reach an answer that does not square with their view.

The 1990 SEC informal review of the FASB's agenda-setting procedures is a good example of the first phenomenon. (Then-Commissioner Lochner was in charge of that effort.) Then-SEC Chief Accountant Coulson asked us to prepare explanations of why several projects were on our agenda. We submitted lengthy summaries of our projects on income taxes, pensions and other postemployment benefits, consolidations, and financial instruments. We also prepared this kind of analysis for the Oversight Committee of our Trustees in connection with the review of two projects mentioned earlier. After studying our explanations, neither the SEC staff nor the Oversight Committee voiced any significant objection to our agenda-setting procedures.

The second phenomenon--that attitudes change about the need for a project--is more difficult to address. Our dilemma is best illustrated by two examples.

In 1988, the Board was considering adding one or two projects to our agenda and had developed a long list of possibilities. At a meeting of the AICPA's Accounting Standards Executive Committee, one of the members expressed the difficulty in deciding which project he favored.

Mr. Walter P. Schuetze  
November 10, 1993  
Page 5

He said, "I can't really say what project you should work on until you tell me what your answer will be." That was a very direct and honest statement, but it is also contrary to our unbiased approach to setting standards. We must avoid starting any project with a preconceived idea of the outcome.

A few years ago the SEC expressed concern about the accounting for marketable securities, particularly debt securities held by banks, S & Ls, and insurers. The AICPA tried to deal with the problem but was unable to follow through on a proposed Statement of Position in the face of strong opposition from business groups. The AICPA then urged us to take on the project and deal with it as a high priority. An AICPA official said at that time, "There is a need for a more objective standard such as one based on mark to market." In an unprecedented action, the Big Six accounting firms jointly signed a letter that endorsed the AICPA recommendation to us, referring to the SEC's call for market-based measures of valuation. Yet three of the Big Six firms later urged us to back off from our Exposure Draft on this issue.

### **Proposals to Change the Agenda-Setting Process**

From time to time, constituents offer proposals for changes to the way the Board decides the makeup of its agenda. Some of those suggestions involve ways to obtain more information from the various groups that are interested in financial reporting. We welcome those suggestions and have implemented some, like the prospectus, in our recent consideration of potential projects.

As he did in 1988, Mr. Reed again proposes adding some other group to the process of setting the Board's agenda. That group would consider broader public policy and economic considerations in the selection of projects. It is not clear how a new group would be more representative or thoughtful than FASAC or the many other constituents with whom we consult. The underlying objective appears to be a transfer of the Board's control over its agenda to a different authority. While, the Board would still be independent in deciding accounting issues, it could only address topics selected by this new group. The Board might be allowed to consider financial instruments, for example, but not stock-based compensation.

To be really effective, though, this outside group would have to involve itself in the scope of individual projects as well. For example, some of the issues considered in our project on stock-based compensation also arise in our project on financial instruments. If the objective is to control the Board's agenda, the outside group would have to dictate also that the Board not consider similar issues in any other project.

Such an outside group is clearly contrary to the goal of independent and unbiased standard setting. A standard-setting process that is precluded from investigating certain issues because of supposed political or economic consequences cannot be said to be independent. Allowing economic and public policy interests to dictate the agenda almost guarantees that the resulting pronouncements would lack the neutrality that we consider so important.

Mr. Walter P. Schuetze  
November 10, 1993  
Page 6

The Board has always opposed attempts to impose social or political conditions on accounting standards. The Board understands that its actions have real-world economic consequences. If financial reporting had no consequences, if it did not affect behavior, it would have no reason to exist. Any attempt to develop standards that further particular social or political goals, no matter how noble, would destroy the neutrality and credibility of financial reporting. Imposing those goals on the agenda, rather than the individual standards, could be just as destructive. It would create a false impression of independence and neutrality, while limiting the Board's ability to address certain issues.

## **BUILDING CONSENSUS**

Constituents often criticize the Board for promulgating standards contrary to what they perceive to be the "consensus view." Some of those criticisms seem to equate the speaker's individual view with the "consensus," but it is fair to say that FASB pronouncements almost always generate vociferous opposition from at least someone. We do not find that opposition surprising because we deal with contentious and difficult issues. That is why we follow an extensive due process that involves constituent input at every step along the way from the agenda decision to issues identification to proposal to final pronouncement.

We recognize the need for a balance between acceptability and leadership in improving financial reporting. Any organization that sets rules or standards must be cognizant of the need for consensus, or, failing that, acceptability. Our agenda criteria include consideration of whether "an improved accounting solution is likely to be acceptable generally." The Board's *Mission Statement* observes, "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." Several of the Trustees cited the need for enhancing the acceptability of FASB pronouncements in reaching the decision to change the Board's voting requirements mentioned earlier in this letter.

The Board has, on occasion, revisited its pronouncements when there is a demonstrated need to do so. For example:

- FASB Statement No. 52, *Foreign Currency Translation*, replaced FASB Statement No. 8, *Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements*.
- FASB Statement No. 82, *Financial Reporting and Changing Prices*, rescinded the required disclosures of information about the effects of inflation that were imposed by FASB Statement No. 33 of the same title.
- FASB Statement No. 109, *Accounting for Income Taxes*, replaced FASB Statement No. 96 of the same title.

In addition to those major reconsiderations, the Board frequently amends or interprets pronouncements to address changing needs and circumstances.

On the other hand, we maintain that the establishment of accounting standards must be more than an exercise in vote counting. The Board's mission, its reason for being, 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" (emphasis added). It is unlikely that all, or even most, of the Board's constituents will necessarily agree with a particular proposal. Many of our constituents have vested interests in the existing accounting treatment of particular transactions. The Board's *Mission Statement* charges it to weigh carefully the views of its constituents. However, the *Mission Statement* also states, "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."

Financial statement issuers provide the vast majority of comments on proposed FASB pronouncements. Issuers bear most of the compliance costs and have concerns about effects on their companies' financial statements. Issuers predictably are most likely to dislike a standard and to make their views known. It should come as no surprise, then, that the majority of comment letters on most major proposals are critical.

We believe that consensus seeking should focus on the long-term acceptability of the body of standards, not the immediate popularity of a particular standard. An accounting pronouncement cannot be fully judged until it is widely applied. Acceptability should be judged by the usefulness of standards to economic decision makers.

### **The Evolution of Consensus**

We have observed that comments about the need for consensus vary over the life of a project. Most projects suffer from a "lack of consensus" at some time in their development.

As mentioned earlier, most (but not all) projects enjoy support when they are added to the agenda. That support often ebbs as the Board reaches tentative conclusions and issues an Exposure Draft of a Proposed Statement. However, support may grow as constituents study the Board's rationale and participate in due process. Over time, pronouncements that were strongly opposed by many constituents can come to be well supported. FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, provides a recent example.

- The Board first raised the question of other postretirement benefits, principally postretirement health care benefits, in a 1981 Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits*. No more than a handful of respondents to that

Discussion Memorandum accepted the view that an employer's promise of health care benefits after retirement constituted a liability of the employer.

- The Board received similar responses to its 1982 Preliminary Views and a 1983 Discussion Memorandum (both of the same title). Opposition continued as the Board began active deliberation of this issue in 1987. Powerful groups, including the Business Roundtable, complained that there was no "consensus" supporting the Board's position. They sought various means to block FASB action.
- In February 1989, the Board issued an Exposure Draft, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. While many of the more than 475 respondents continued to oppose the Board's conclusions, a majority (including the Financial Executives Institute) agreed that the promise of benefits constituted a liability that should be recognized in the financial statements.

Today, Statement 106 enjoys substantial, although not universal, support. Many employees have expressed concern when employers, faced with the need to report their obligations, have cut or changed their promises. However, we receive few comments suggesting that the Board reached the wrong accounting conclusion. If the Board had responded to the clear lack of consensus in earlier years, accounting for postretirement health care would still be on the cash basis. Companies and the users of their financial statements would still be largely ignorant of the extent of their obligations. Information that today informs public policy would simply not exist.

## **THE STRUCTURE OF THE FASB STAFF**

Occasionally, constituents suggest restructuring the FASB professional staff. Mr. Reed's proposal involves a reassignment of staff to individual Board members. You probably recall that the Board and staff were originally structured along those lines. That approach proved unsuccessful, and the 1977 Report of the Trustees' Structure Committee recommended a change to a centralized staff organized under a Director of Research and Technical Activities. In our current structure, staff members are assigned to individual projects and responsibilities and serve the Board, rather than any individual member. The current structure has proven efficient and has contributed to development of a highly motivated, professional, and independent-minded staff. Board members are generally pleased by this approach, and it was endorsed in the 1989 report by the Structure Review Committee of our Trustees.

Our current approach has never deprived a Board member of staff support. All a member need do is ask and he receives all the support he requests. Nor does this approach work against Board members who disagree with the majority on a particular issue. Indeed, the staff frequently assists dissenting Board members in the preparation of their dissents.



Mr. Walter P. Schuetze  
November 10, 1993  
Page 9

The objectives of proposals for changes in staff structure have never been clear to us. Mr. Reed's proposal mentions increased efficiency and enhanced acceptability of FASB pronouncements. We do not see how the proposal would achieve either of those goals. Assigning staff to individual Board members would require each member's staff to gain the same depth of understanding that a project team develops in the service of the entire Board. That would hardly contribute to efficiency. Nor is it clear how the structure of our staff has anything to do with the acceptability of our pronouncements. The Board, not the staff, deliberates and votes on Exposure Drafts and final Statements.

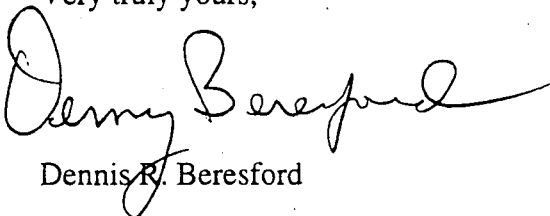
Perhaps the best argument in favor of our current organization comes from standard setters in other countries. The United Kingdom, Canada, and Australia all use a centralized staff model similar to the FASB. The United Kingdom is especially notable, because they recently reorganized their standard-setting process. We understand that their decision on a staff model resulted, in large part, from their study of the Board's operating procedures.

## CONCLUSION

I would observe that constituents often raise process issues whenever the Board is involved in a particularly contentious issue like income taxes, other postretirement benefits, or stock-based compensation. The several efforts by the Trustees and Board to study and refine the FASB's procedures testify to the importance we place on maintaining an open and objective process, and we will continue to carefully consider all suggestions to improve our process.

Please let me know if we can provide further information about any of the matters discussed in this letter.

Very truly yours,



Dennis R. Beresford