

CONFIDENTIAL MEMORANDUM

To: Marshall S. Armstrong  
From: J. T. Ball  
Subject: Notes on January 5 Meeting at SEC

The following are my notes on our meeting at the SEC in Washington, D. C., On Friday, January fifth. The conference started about 10:00 A.M. and lasted slightly over two hours. It was attended by:

John C. ("Sandy") Burton - Chief Accountant, SEC  
A. Clarence Sampson - Associate Chief Accountant, SEC  
Marshall S. Armstrong - Chairman, FASB  
J. T. Ball - Staff, FASB

MSA opened the discussion by stating his interest in keeping the lines of communication open but at the same time making it clear that he would have to await the functioning of the full FASB before being able to talk in other than general terms on any particular topic. Burton asked when the other members would be named and MSA indicated a press release naming some members could be expected on or about January fifteenth with the remaining members named by January thirty-first. MSA indicated that a banker had extended a \$1 million line of credit to the FASB with a willingness to grant more and Burton suggested that the banker had probably insisted on a compensating balance (a jest in reference to a currently proposed SEC disclosure requirement).

Burton stated the SEC doesn't want the job of setting accounting standards but can't avoid its statutory responsibility. He pointed out that the SEC doesn't have the staff or resources that the FASB will have. He personally wished the FASB every success and thought the SEC could be helpful in pointing out problem areas.

MSA suggested that most of the problems of accounting that have been in the public spotlight have in reality been auditing problems rather than accounting problems per se, also noting that the tremendous number of "good" cases are never mentioned. Burton agreed and said that he and his staff have to guard against the feeling that all cases are "bad" because only the cases with problems are brought to the attention of the Chief Accountant's Office.

Burton stated he felt companies and their accountants too often tried to meet only the words of the rules and knowingly violated the spirit; because of this he had been working on an ASR on "form vs. substance" but had found this to be a very difficult topic

to come to grips with - his only success so far had been in using specific cases as examples. He illustrated by referring to ASR 130 to deal with the "bailout" problem in poolings and ASR 132 to deal with an attempt to keep liabilities off the balance sheet through leasing. There was some discussion of these two examples, especially the latter where Burton explained that a "sham" dummy corporation had been established for \$1,000 and had used its parent's credit to sell commercial paper which it planned to "roll over" in the future to finance a purchase which was in turn leased to the parent with the intent that the parent would reflect only a \$1,000 investment in its balance sheet.

Burton also gave an example of a company that expensed R&D but set up a research subsidiary to improve earnings by effectively capitalizing R&D. Advances to the sub to undertake research projects were proposed to be carried as additional investments rather than being expensed as R&D as incurred.

The subject shifted to land sales and the considerable publicity and controversy that had surrounded this topic. Burton acknowledged that this was a case of a breakdown in communications but thought the SEC had not been kept adequately informed. MSA noted the WSJ that morning had reported Phil DeFliese as estimating a 15 to 3 vote in favor of the APB position (of accepting accrual accounting in some cases rather than installment accounting only). MSA asked for Burton's reaction. Burton replied that he would not recommend to the Commission to go counter to a firm APB stand on accrual accounting but thought the APB was wrong in this case. He stated: "The APB used up a hell of a lot of its goodwill with the Commission over this one!" He thought a long time might be needed to repair the damage.

After some discussion covering several of the topics previously mentioned, Burton asked MSA to discuss the matters the FASB might consider in its first year. At this point Burton was called from the room to an unexpected meeting of the Commission and he gave a list of topics in front of him to Clarence Sampson. MSA said he thought four topics very likely were: (1) leases, (2) marketable securities, (3) full costing, and (4) the accounting objectives study. While Sampson, MSA and JTB were discussing the research and consideration that might be needed for the question of capitalizing leases, Burton returned. He immediately ventured that the FASB should "move on this one in short order." JTB stated that the research to date was somewhat superficial and he felt using it as a basis for action would cause an immediate loss of public confidence in the FASB. Burton agreed that some research on the impact of alternatives might be needed but thought this should not require too much time.

MSA asked Burton what topics Burton thought the FASB needed to consider. Burton suggested leases, marketable securities, full costing, interim financial statements, extraordinary items, and business combinations. There was also some discussion of catastrophe reserves by insurance companies, with the matter to be undertaken by an AICPA Committee but perhaps coming under the FASB. Under prodding, Burton said the APB exposure draft on lease disclosure was not enough and the question of capitalization had to be resolved soon. He was not greatly concerned about leveraged leases at this discussion. He also thought the APB exposure draft on interim financial statements was inadequate but didn't see how the APB could do more. He felt much the same about the question of extraordinary items. As to business combinations, he thought the question of pooling should be reopened, indicating that he thought as a minimum that a size test was required to allow pooling to continue. He said this was not a critical question, however, and didn't just want to see some patchwork on the APB opinion No. 16.

MSA agreed to try but said there was no way to complete leases, marketable securities and full costing in 1973.

Although all remarks to this point were perhaps somewhat guarded, the tone of the meeting had been generally cordial on both sides. However, as the meeting closed, Burton appeared to give MSA an ultimatum that all future contact between the FASB and the SEC should be through Burton. He indicated his displeasure at being "shunned" at an earlier meeting by MSA and Ralph Kent. MSA explained that the Commission had not seen fit to bring Burton into the earlier meeting and that he and Kent did not want to go counter to the Commission by making a point of meeting with Burton later since the Commission didn't seem to be encouraging this. MSA promised to keep the lines of communication open with Burton and to be sure that he was informed regarding FASB activities and asked that Burton also keep the FASB informed.

JTB:jt